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Via e-mail: director@fasb.org



LETTER OF COMMENT NO. 27

Mr. Russell G. Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

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File Reference No. 1650-100—Exposure Draft, *Going Concern*

Dear Mr. Golden:

BDO Seidman, LLP is pleased to offer comments on the Exposure Draft of the Proposed Statement of Financial Accounting Standards, *Going Concern*. We agree that the guidance on going concern should be in the accounting literature, rather than the auditing literature, because it is the responsibility of management to decide whether substantial doubt exists about the reporting entity's ability to continue as a going concern.

The Board specifically requests comment on the expanded time horizon from IAS 1. We understand the Board's desire to converge with IFRS and to move away from bright lines. We also understand the Board's desire to capture events that are just beyond the 12 month period, such as a contract with a major customer that will expire 13 months after the balance sheet date and will not be renewed. However, we believe that the expanded time horizon is a very significant change that will not be operational and will expose preparers and auditors to greatly increased and unwarranted liability. In that regard, we note that the Auditing Standards Board (ASB) deliberately added the 12-month bright line upon issuance of AU Section 341. The prior auditing guidance regarding going concern did not contain this bright line. We recommend that the FASB investigate why the ASB added the bright line before discarding it.

In our view, the proposed open-ended timeframe:

- (1) creates the potential for second-guessing by plaintiffs and regulators in a legal environment that is the most hostile in the world,
- (2) may require companies (including private companies) to incur the costs of having management prepare long-term forecasts and having auditors evaluate them,
- (3) brings into the financial statements unreliable long-term information that does not meet the reliability criterion of Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*,
- (4) creates an inconsistency with the time horizon in AICPA Statement of Position (SOP) 94-6, *Disclosure of Risks and Uncertainties*, and



- (5) provides no guidance on the infinite variety of judgments as to the factors influencing a company's long-term viability and the time period considered reasonable in assessing those prospects.

*Potential for second-guessing.* Judges, arbitrators, and juries understand and can apply the one-year bright line. By contrast, with the proposed open-ended time frame, plaintiffs' counsel can reverse-engineer an event that occurs well over a year after the reporting period and argue that it should have changed the going concern analysis. In such situation, if the company has failed, many fact finders could conclude that both the company and the auditors failed to comply with professional standards by not predicting this failure. This is particularly troublesome because there is no safe harbor rule for going concern assessments made in good faith.

We understand that the open-ended standard of IAS 1 is meant to deal with a situation where a negative event occurs shortly after the 12 month date (e.g., a company's debt comes due 2 days after the 12 month date). It seems, therefore, that in practice IAS 1 is interpreted as "no more than *approximately* 12 months after the balance sheet date." However, the open-ended words of IAS 1 do not say that, and US plaintiffs' counsel are not likely to conform to the "gentlemen's agreement" that seems to be in effect abroad.

*Need for long-term forecasts.* Many entities, particularly smaller privately-held companies, do not prepare detailed budgets beyond the next year, which meshes well with the existing requirement under AU Section 341. Although they may use informal forecasts beyond that time frame for managing the business, these data are often not sufficiently reliable to form an adequate basis for a long-term going concern assessment. If the time frame for assessments of ability to continue as a going concern is extended indefinitely, entities would be required to look further into the future, which would ordinarily require them to prepare more detailed forecasts for periods beyond one year than they have heretofore found necessary. Preparing the additional forecasts could be costly. Further, the auditors likely would need to evaluate the long-term forecasts as part of auditing management's judgments, which would increase audit costs. Moreover, there is no guidance as to the appropriate length of the future period to be considered.

*Unreliable information.* Predictions of operations beyond one year are inherently unreliable. Asking entities to look forward more than one year would seem to require the gift of prophesy, meaning that they and their auditors would be attempting to evaluate information that is inherently unreliable. As such, it would not meet the reliability criterion of Concepts Statement 2.

*Inconsistency with SOP 94-6.* SOP 94-6 defines near term as a "period of time not to exceed one year from the date of the financial statements." The definition applies to disclosures about (1) estimates for which a material change *in the near term* is at least reasonably possible and (2) concentrations of risk that make "the enterprise vulnerable to



the risk of a *near-term* severe impact.” (Italics added) An open-ended period for assessing the ability to continue as a going concern while using only a one-year horizon for disclosing significant risks seems confusing for everyone—preparers, auditors, and users.

*Provides no guidance.* If the Board were to proceed with the open ended approach, we believe that it should provide additional guidance in the following areas

- *Examples.* The Exposure Draft, *Subsequent Events*, contains examples of recognized and nonrecognized subsequent events. The final Statement on Going Concern similarly should have examples of situations that do, or do not, create substantial doubt about an entity’s ability to continue as a going concern.
- *Appropriate time frame.* In view of the way in which we understand IAS 1 is applied in foreign jurisdictions, the FASB should explicitly note that the intent of the new language is to extend the time horizon only to known information about transactions or events for a reasonably short period beyond 12-months from the date of the financial statements.
- *Entity-specific information versus macroeconomic conditions.* The final Statement should clarify that management should assess known information about the reporting entity and entities with whom it does business (customers, vendors, lenders, investors, etc.). By contrast, management would not have the competence, and would not be expected, to assess future macroeconomic conditions. For example, an entity would be expected to assess its ability to refinance debt coming due in the near future under normal credit market conditions. An entity would not be expected to assess whether the current abnormal credit market conditions will continue or for how long, nor to predict a tightening of the credit market when one does not currently exist.

#### Liquidation Basis of Accounting

We agree with the proposed disclosures in paragraph 8 when an entity does not prepare financial statements on a going concern basis. However, we note that significant diversity in practice exists in the preparation of liquidation basis financial statements, particularly in the definition of a liability. For example, do the salaries of employees from the balance sheet date to the final liquidation date meet the definition of a liability at the balance sheet date if the employees’ future services are required to wind down the entity’s operations?

We recommend that the Board initiate a separate project to provide guidance on the liquidation basis of accounting as its calendar permits. Perhaps this is a topic that could be handled by the Emerging Issues Task Force.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Ben Neuhausen, National Director of Accounting, at 312-616-4661.

Very truly yours,  
BDO Seidman, LLP