FASB In Focus

Proposed Accounting Standards Update—*Presentation of Financial Statements (Topic 205): Disclosure of Uncertainties about an Entity's Going Concern Presumption*

Background

Under U.S. generally accepted accounting principles (GAAP), financial statements are prepared under the inherent presumption that the reporting organization will be able to continue as a going concern. In other words, it is presumed that the organization will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business. This is called the going concern presumption, and it is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities.

U.S. GAAP requires financial statements to be prepared under the going concern presumption unless and until an organization's liquidation is imminent. When liquidation is imminent, the organization is required to start applying the liquidation basis of accounting.

Even before an organization's liquidation is imminent, however, there may be uncertainties about its ability to continue as a going concern and, therefore, about its going concern presumption (going concern uncertainties). Currently, there is no guidance in U.S. GAAP about management's responsibilities in evaluating or disclosing going concern uncertainties. There also is no guidance in U.S. GAAP about when and how going concern uncertainties should be disclosed in an organization's financial statement footnotes. U.S. auditing standards and federal securities law, as applicable, require that an auditor evaluate whether there is substantial doubt about an organization's ability to continue as a going concern for a reasonable period of time. Auditing standards also require auditors to assess the possible financial statement effects, including the adequacy of disclosures on uncertainties about the organization's ability to continue as a going concern for a reasonable period of time.

Why Is the FASB Issuing this Exposure Draft?

The Board received input indicating that the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed under the auditing standards result in diversity in the timing, nature, and extent of existing footnote disclosures. The proposed amendments are intended to provide preparers with guidance in U.S. GAAP on management's responsibilities for evaluating and disclosing going concern uncertainties and, thereby, reduce existing diversity in footnote disclosures. In doing so, the Board believes that the proposed amendments also would improve the timeliness and the quality of footnote disclosures about going concern uncertainties.

What Are the Main Proposals?

The proposal would provide guidance in U.S. GAAP on management's responsibilities in evaluating an organization's going concern uncertainties and on the timing, nature and extent of related footnote disclosures. An organization would determine the need for disclosures by assessing the likelihood that the organization would be unable to meet its obligations as they become due within 24 months after the financial statement date.

Going concern uncertainties would be evaluated at each interim and annual reporting period. The reporting organization would start providing footnote disclosures when it is either (1) more likely than not that the organization will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside of the ordinary course of business, or (2) known or probable that the organization will be unable to meet its obligations within 24 months after the financial statement due date without taking actions outside the ordinary course of business.

Determining Whether Disclosures Are Necessary

In determining whether disclosures are necessary, the organization would assess information about conditions and events that exist at the date the financial statements are issued (or for a private company or not-for-profit organization, the date that the financial statements are available to be issued). Mitigating conditions and events also would be considered—for example, cost cutting measures that are likely to be effective. In determining whether disclosures are necessary, however, an organization would not consider the potential mitigating effect of management's plans that are outside of the ordinary course of business. Management's plans that involve actions of a nature, magnitude, or frequency that are inconsistent with actions customary in carrying out an organization's ongoing business activities would be considered outside the ordinary course of business.

When the disclosure threshold is met, an organization would disclose in the footnotes:

1. The principal conditions and events that give rise to the organization's potential inability to meet its obligations
2. The possible effects those conditions and events could have on the organization
3. Management's evaluation of the significance of those conditions and events
4. Mitigating conditions and events, and
5. Management's plans that are intended to address the organization's potential inability to meet its obligations.

Disclosures may be less extensive in the early stages because available information may be limited. In subsequent reporting periods, if the organization continues to meet the disclosure threshold, disclosures would become more extensive as additional information becomes available about the previously disclosed conditions and events, and about management's plans.

SEC Filers and Substantial Doubt

Additionally, the proposal would require an SEC filer[1] to evaluate whether there is substantial doubt about its ability to continue as a going concern. If substantial doubt exists, the reporting organization would disclose that determination in its footnotes. Substantial doubt would exist if, after assessing existing conditions and events and all of management's plans, including those outside the course of ordinary business, the reporting organization concludes that it is known or probable that it will be unable to meet its obligations within 24 months after the financial statement date. An organization that is not an SEC filer would not be required to evaluate or disclose whether there is substantial doubt about its ability to continue as a going concern, but would be required to apply all of the other disclosure requirements within the proposal.

How Would the Board's Proposals Improve Financial Reporting?

Currently, the lack of guidance in U.S. GAAP and the varying interpretations of when and how going concern uncertainties should be disclosed under the auditing standards result in diversity in the timing, nature, and

[1]An organization that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)
b. With respect to an organization subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

extent of existing footnote disclosures. The proposed amendments are intended to provide within U.S. GAAP guidance on management's responsibilities for evaluating and disclosing going concern uncertainties, and thereby reduce existing diversity in footnote disclosures. In addition to clarifying management's responsibilities for evaluating and disclosing going concern uncertainties, the proposed amendments would improve and incorporate into U.S. GAAP many of the principles that are currently in the auditing standards by:

1. Requiring management to evaluate going concern uncertainties at each annual and interim reporting period
2. Prescribing a threshold and related guidance for starting disclosures
3. Requiring a 24-month assessment period after the financial statement date, and
4. Providing a threshold for SEC filers to determine whether there is substantial doubt about an organization's ability to continue as a going concern.

Currently, the SEC's disclosure rules require that an SEC registrant disclose in its management's discussion and analysis (MD&A) information about trends and uncertainties that are reasonably likely to have a material effect on the registrant's liquidity, capital resources, and results of operations (Regulation S-K, Item 303(a)). Additionally, the SEC's regulations mandate disclosures about a registrant's most significant risk factors (Regulation S-K, Item 503(c)). The information disclosed in the MD&A and the disclosure of risk factors can help users in their evaluation of going concern uncertainties. Therefore, the proposed amendments would not provide new or incremental information in an SEC registrant's filing as a whole. However, the proposal would provide SEC registrants with guidance in U.S. GAAP about the timing and content of footnote disclosures specific to going concern uncertainties. The FASB believes that the introduction of this guidance would reduce diversity in the timing, nature and extent of footnote disclosures, and in doing so, improve their timeliness and quality.

How Does this Proposal Fit into the Goal of Convergence?

International Financial Reporting Standards (IFRS) contain guidance that addresses the preparation of financial statements as a going concern and disclosures when there is a material uncertainty about an organization's ability to continue as a going concern. The International Accounting Standards Board (IASB) is currently in the process of clarifying the disclosure requirements of that guidance as part of a narrow implementation project.

The proposed amendments to U.S. GAAP and current IFRS both emphasize that management is responsible for evaluating uncertainties about an organization's ability to continue as a going concern and for providing disclosures of those uncertainties. However, there are important differences:

- When an organization does not prepare its financial statements on a going concern basis, IFRS requires that the organization disclose the basis of preparation used. IFRS does not provide guidance on the liquidation basis of accounting. Under U.S. GAAP, an organization uses the going concern presumption until liquidation is imminent, that is, when the liquidation basis of accounting is applied as described in Subtopic 205-30 in the FASB Codification.
- Under IFRS, there is a single threshold for disclosures of going concern uncertainties. Under the proposed amendments to U.S. GAAP, there are two thresholds: one threshold for all organizations that indicates the start of going concern uncertainties, and an additional threshold for SEC filers that indicates there is substantial doubt about an organization's ability to continue as going concern.
- Finally, under IFRS, the consideration period is at least 12 months from the financial statement date with no upper time limit. Under the FASB's proposal, the consideration period would not exceed 24 months after the financial statement date.

When Would the Proposed Amendments Be Effective?

The effective date of the proposal would be determined by the Board after it considers stakeholder feedback on the proposed Update. The proposed amendments would apply prospectively for reporting periods after the effective date.

What Are the Next Steps in the Process?

Stakeholders are encouraged to review and provide comment on the proposal by September 24, 2013. The proposal, as well as instructions on how to provide comments, is available at www.fasb.org. ■

For more information about the project, please visit the FASB's website at www.fasb.org.

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