

## Supplement to Agenda Item 2-B

### Highlights of Relevant Developments of Accounting Standard Setters Relating to Going Concern

**Note:** The following is intended to provide highlights from the recent discussions of the International Financial Reporting Interpretations Committee (IFRIC) and the International Accounting Standards Board (IASB), as well as the US Financial Accounting Standards Board (FASB) relating to going concern.

#### IASB and IFRIC Update

The IAASB submitted a request for clarification on the disclosure requirements about the assessment of going concern in IAS 1.<sup>1</sup> IAS 1 requires that when management is aware of material uncertainties about the entity's ability to continue as a going concern, those uncertainties shall be disclosed. The IAASB suggested further guidance on these disclosures would be helpful, in particular in relation to:

- (a) When an entity should be required to disclose this information;
- (b) What the objective of that disclosure is; and
- (c) What disclosures should be required.

At its November 2012 meeting, IFRIC requested that proposals for a narrow scope amendment to IAS 1 should be prepared to provide further guidance on this topic. At its January 2013 meeting, IFRIC was presented with proposed amendments to IAS 1 that:

- (a) Retain, substantially unchanged, the guidance relating to going concern as a basis for the preparation of the financial statements;
- (b) Provide guidance on how to identify material uncertainties; and
- (c) Contain requirements about what to disclose about material uncertainties.

The proposed amendments considered by IFRIC are included as an Appendix to this paper.

IFRIC discussed the proposed amendments and what level of detail should be included within the amendments. It agreed that the proposed amendments should be exposed with examples of both the types of conditions that indicate when material uncertainties arise and the types of disclosures that an entity should give, but that a question should be included in its Exposure Draft (ED) to ask respondents whether or not that level of detail was helpful.

At its January 2013 meeting, IFRIC also decided to propose that a question be included in its ED about whether the proposed amendments should include an alignment of the going concern assessment time frame in IAS 1 with the time frame set out in many local auditing requirements. While IAS 1 and ISA 570<sup>2</sup> are aligned, some national auditing standards require consideration of a different period, for example 12 months from the date of the auditor's opinion or date of approval of the financial statements.

IFRIC recommended these revised proposals be presented to the IASB for consideration at a future meeting; IASB Staff has indicated this is planned for discussion at the March 2013 IASB meeting. If agreed by IASB, the proposals will be issued for public comment and discussions will continue through late 2013.

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<sup>1</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

<sup>2</sup> International Standard on Auditing (ISA) 570, *Going Concern*

## FASB Update

Current US accounting standards do not require management to make an assessment of the entity's ability to continue as a going concern.

In May 2012, FASB decided that it would revisit the question of whether management should be required to assess an entity's ability to continue as a going concern in light of its recent decision not to pursue going-concern-type disclosures in the project about liquidity and interest rate risk disclosures. FASB directed the staff to consider this question in the context of a second phase of the project on the Liquidation Basis of Accounting.

In November 2012, FASB decided to adopt a new financial reporting model for management's assessment of going concern, and related disclosures. The following represents FASB's decisions pertaining to the new financial reporting model:

- At each reporting period, management would assess an entity's potential inability to continue as a going concern and the need for related disclosures. In doing so, management would consider the likelihood of an entity's potential inability to meet its obligations as they become due for a *reasonable period of time*.
- Management would start providing disclosures in its financial statements when existing events or conditions indicate it is near *more likely than not* that the entity may be unable to meet its obligations *in the ordinary course of business*, within a *reasonable period of time* from the balance sheet date. In assessing the need for disclosures, the mitigating effect of management's plans would be considered unless such plans involve actions that are *outside the ordinary course of business*.
- Management would assert in the financial statements that there is *substantial doubt* about an entity's ability to continue as a going concern when the likelihood of the entity's inability to meet its obligations within a reasonable period of time reaches *probable*. In evaluating the need for this assertion, management would consider the effect of *all* management plans.
- In performing the assessment, management would consider existing events or conditions that may result in an entity's inability to meet its obligations within a *reasonable period of time*. *Reasonable period of time* would represent 12 months from the financial statement (period end) date. In addition, the assessment would consider the effect of existing events or conditions that are *probable* of resulting in an entity's inability to meet its obligations beyond the initial 12 months. *Reasonable period of time* would be limited to a practical amount of time in which the future impact of existing events or conditions can be identified, *not to exceed a period of 24 months* from the period end date.

In February 2013, FASB further refined its proposed approach to reporting on going concern as follows:

### *Disclosure Threshold*

FASB decided that management should provide disclosures when existing events or conditions indicate that it is *more likely than not* that the entity may be unable to meet its obligations within a reasonable period of time from the financial statement date. The assessment would not consider the mitigating effect of management plans that are outside the ordinary course of business. Because the assessment is inherently judgmental, FASB intends more likely than not to be viewed as an approximate benchmark for

starting disclosures and not as a bright-line threshold. The proposed standard will include example indicators to help management in assessing the need for disclosures.

*Definition of “Outside the Ordinary Course of Business”*

The Board decided to define “outside the ordinary course of business” as follows:

“Management’s plans that would require actions of a nature, magnitude, or frequency inconsistent with actions customary in carrying out an entity’s ongoing business activities shall be considered outside the ordinary course of business. Management’s plans specifically intended to mitigate concerns about an entity’s ability to meet its obligations within a reasonable period of time shall be considered outside the ordinary course of business. In addition, management’s plans that are not definitive, or are in early stages of implementation, shall be considered outside the ordinary course of business when assessing the need for disclosures.”

The proposed standard will include examples of management plans that are outside the ordinary course of business.

*Disclosure Principle*

Consistent with the disclosure considerations outlined in present auditing standards, the proposed standard would require an entity to disclose sufficient information to enable users to understand the principal events giving rise to an entity’s potential inability to meet its obligations, their possible effects, and management’s plans.

*Applicability to Nonpublic Entities*

In previous deliberations, FASB had decided that management would assert in the financial statements that there is substantial doubt about an entity’s ability to continue as a going concern when the likelihood of the entity’s inability to meet its obligations within a reasonable period of time reaches probable. The Board decided that nonpublic entities would not be required to make a substantial doubt assertion. Nonpublic entities would still be required to apply all other provisions and disclosures of the new model.

*Transition and Other Matters*

FASB tentatively decided that an entity would apply the proposed guidance prospectively. The FASB plans to release an ED for public comment by late March or early April, with a 90-day comment period.

## Proposed Amendment to IAS 1, *Financial Statement Presentation*

Paragraph 25 and 25A are amended and paragraph 26 is renumbered as 25B. Paragraphs 25C-H are inserted. New text is underlined.

### Going concern

#### **Basis of preparation of financial statements**

**25** When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern for the foreseeable future. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

25A (formerly 26) In assessing whether the going concern assumption is appropriate, management takes into account all available information about the foreseeable future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

**25B** (order changed) When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

#### **Identification of material uncertainties**

**25C** When management is aware, in making its going concern assessment, of material uncertainties ~~related to events or conditions that may cast significant doubt upon~~ about the entity's ability to continue as a going concern for the foreseeable future, the entity shall disclose those uncertainties.

**25D** Even when management determines that the going concern assumption is a suitable basis for the preparation of the financial statements, information about these material uncertainties will still provide useful information to users of the financial statements. The disclosure of material uncertainties should be a warning signal that one or more risks have been heightened to the point where knowledge of that fact would be material to users in making decisions.

**25E** Management will need to apply judgement in identifying whether these uncertainties are material. In making that judgement, management should consider the following factors:

- (a) the nature of the uncertainty;
- (b) the magnitude of the potential impact on the entity if the event or condition giving rise to the uncertainty occurs;

- (c) the likelihood of that event or condition occurring; and
- (d) the likely timing of the event or condition giving rise to the uncertainty.

25F Material uncertainties may be indicated when management can foresee possible future indicators of financial distress or operating constraints, such as:

- (a) the breach, or foreseeable breach, of borrowing or other contractual covenants;
- (b) the inability to make new investments essential to sustain the business;
- (c) reliance on obtaining or retaining one specific contract or customer;
- (d) the discontinuance or curtailment of some operations.

Such uncertainties are also signified when the entity foresees levels of financial distress that mean that management may have no realistic alternative but to take remedial action outside its intended normal course of business. This situation may be indicated by events or conditions such as:

- (a) the need to raise or renegotiate finance; and
- (b) the disposal of the entity's assets earlier than planned at the time of acquisition of the asset or otherwise than through its normal trading activities.

### **Disclosure**

**25G An entity shall disclose information that enables users of the financial statements to understand the judgements made and assumptions used in assessing whether going concern is an appropriate basis for the preparation of the financial statements. When material uncertainties are identified with respect to an entity's ability to continue as a going concern, the entity shall disclose information that enables users of financial statements to:**

- (a) **identify those uncertainties regarded as material;**
- (b) **assess the feasibility of the remedial actions or mitigating factors available to the entity; and**
- (c) **understand the effect of any significant future transactions that may be taken by management to ensure that the entity continues as a going concern.**

25H To comply with paragraph 25 G, the disclosures should:

- (a) describe the critical judgements made and assumptions used in relation to the management's assessment of the entity's ability to continue as a going concern;
- (b) describe the principal events or conditions that give rise to any material uncertainties with respect to the entity's ability to continue as a going concern;
- (c) provide information about remedial or mitigating actions available to the entity, their effectiveness and the extent to which management can control those actions ;
- (d) include details of any other facts and circumstances required to meet the objectives of paragraph 25G; and
- (e) state clearly that these circumstances were identified as part of management's assessment of the entity's ability to continue as a going concern.