FASB Issues Going Concern Standard

The FASB recently issued a new going concern standard, which describes how entities should assess their ability to meet their obligations and sets disclosure requirements about how this information should be communicated.¹ The standard provides guidance that will be used along with existing auditing standards.

Key Facts

- Entities must perform a going concern assessment by evaluating their ability to meet their obligations for a look-forward period of one year from the financial statement issuance date (or date the financial statements are available to be issued).
- Disclosures are required if it is probable an entity will be unable to meet its obligations within the look-forward period. Incremental substantial doubt disclosure is required if the probability is not mitigated by management’s plans.
- The new standard applies to all entities for the first annual period ending after December 15, 2016, and interim periods thereafter.

Key Impacts

- Management is responsible for assessing going concern uncertainties at each annual and interim reporting period.
- While the new guidance is similar to existing auditing standards, conclusions about whether substantial doubt exists and the extent of disclosures may differ from existing practice as a result of the new substantial doubt definition and the expanded disclosure requirements in the Accounting Standards Update (ASU).
- While the new substantial doubt definition and disclosure requirements may change existing practice for some entities, they are expected to reduce overall diversity in the nature, timing, and extent of going concern disclosures.

Substantial Doubt

The standard amended the Master Glossary of FASB’s Accounting Standards Codification to specifically define substantial doubt in the context of assessing going concern uncertainties.\(^2\) Substantial doubt about an entity’s ability to continue as a going concern exists if it is probable that the entity will be unable to meet its obligations as they become due within one year after the date the annual or interim financial statements are issued or available to be issued (assessment date).\(^3\) Management needs to consider known (and reasonably knowable) events and conditions at the assessment date.

KPMG Observations

During discussions the FASB decided to generally align the accounting guidance with existing auditing standards, with the exception of beginning the one-year look-forward period at the financial statement issuance date instead of the balance sheet date. The auditing literature refers to a one-year period from the balance sheet date.

This difference could result in different conclusions about an entity’s ability to continue as a going concern because management will be considering a one-year look-forward period beginning at a later date. While no changes have been proposed yet to auditing standards, we anticipate a proposal to eliminate this inconsistency. The PCAOB has a project on its agenda to evaluate potential revisions to the going concern auditing standard and to monitor the activities of the FASB and other standard setters.

\(^2\) FASB ASC Subtopic 205-40, Presentation of Financial Assets–Going Concern, which is a new codification subtopic that is available at www.fasb.org.

\(^3\) The probable threshold is consistent with its usage in FASB ASC Topic 450, Contingencies, available at www.fasb.org.
Evaluating Whether There Is Substantial Doubt

When preparing financial statements for each annual and interim period, management considers relevant conditions and events, in the aggregate, that may raise substantial doubt about an entity’s ability to continue as a going concern. Management’s consideration should include both qualitative and quantitative information. While not inclusive, the following types of conditions and events should be considered in the analysis:

- Entity’s current financial condition, including its liquidity sources at the assessment date;
- Entity’s conditional and unconditional obligations due or anticipated within one year after the assessment date (regardless of whether those obligations are recognized in the financial statements);
- Funds necessary to maintain the entity’s operations considering its current financial condition, obligations, and other expected cash flows within one year after the assessment date; and
- Other conditions or events, when considered with the conditions and events noted above, that may adversely affect the entity’s ability to meet its obligations within one year after the assessment date.4

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Considering Management’s Plans When Substantial Doubt Is Raised

In some cases, management initially may conclude it is probable the entity will be unable to meet its obligations within the look-forward period, but has a plan to mitigate that risk. In those situations, the mitigating effect of management’s plans can overcome a substantial doubt conclusion only if it is probable the plans can be effectively implemented. The ASU provides examples of management plans and the types of information management should consider in making this evaluation.

If management concludes it is probable its plans can be effectively implemented, it further assesses whether it is probable those plans will mitigate the conditions or events that raise substantial doubt. In making that assessment, management considers the expected magnitude and timing of both the relevant conditions or events and the mitigating effect of its plans.

If it is not probable that management’s plans can be both effectively implemented and mitigate the conditions or events that raise substantial doubt, those plans cannot be used to overcome substantial doubt about the entity’s ability to continue as a going concern.5

Disclosures

The standard outlines three categories of disclosures as described below. However, the auditing standards only outline information that might be disclosed when substantial doubt exists after considering management’s plans. If management has overcome that substantial doubt with its plans, the auditing standards require the auditor to consider the need for and evaluate disclosure of the initial conditions or events casting that doubt.6

When Substantial Doubt Is Overcome by Management’s Plans

If substantial doubt is overcome primarily due to management’s plans (i.e., substantial doubt was raised, but management’s plans overcome that doubt), those plans, along with the principal conditions or events that gave rise to that doubt and management’s evaluation of the significance of those conditions or events, must be disclosed.7

When Substantial Doubt Is Not Overcome

If substantial doubt has not been overcome after consideration of management’s plans, the entity must explicitly state in the financial statement notes that there is substantial doubt about its ability to continue as a going concern within one year from the assessment date. The entity also must disclose:

- The principal conditions or events that gave rise to the substantial doubt;
- Management’s evaluation of the significance of those conditions or events in relation to the entity’s ability to meet its obligations; and

6 AU-C Section 570 – The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern, and AU 341, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.
• Management’s plans that are intended to mitigate the conditions or events that gave rise to the substantial doubt.\(^8\)

**Subsequent Disclosures**

If conditions or events continue to raise substantial doubt in subsequent reporting periods, the entity should continue to disclose the relevant information described above and should increase the extent of the disclosures as additional information becomes available about the relevant conditions or events and management’s plans.

If substantial doubt no longer exists in a later period, the entity must disclose how the relevant conditions or events were resolved.\(^9\)

**Effective Date**

The guidance is effective for all entities for annual periods ending after December 15, 2016, and interim periods in fiscal years beginning after December 15, 2016. Early application is permitted.

**KPMG Observations**

While the Private Company Decision Making Framework generally calls for a one-year delay in the effective date of new guidance for private companies, the Board decided all entities should apply the going concern guidance at the same time. The Board believed the effective date (which results in a calendar year-end entity initially applying the standard, if not early adopted, in 2017 for its 2016 year-end) provides enough transition time for all entities. The extended effective date also may allow the audit standard setters to evaluate whether the existing audit standards on going concern uncertainties should be revised based on the guidance in the new accounting standard.

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