Going concern

Executive summary

US GAAP

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A responsibility of management

The going concern presumption that an entity will be able to meet its obligations when they become due is foundational to financial reporting. This presumption may be challenged at any time, but especially during uncertain economic times.

Economic uncertainty has been prevalent in global markets over the last several years due to many unexpected macro events – from COVID-19 and the related supply chain disruptions to international conflicts and rising interest rates. While some companies thrive from uncertainty, others may see their financial performance, liquidity and cash flow projections negatively impacted. These vulnerabilities continue to shine a bright light on management's responsibility for a going concern assessment.

The ever-evolving complexities attributable to economic uncertainty may disrupt business as usual. When forecasting becomes less reliable and the past no longer predicts the future, the going concern assessment becomes much harder to document and update, and robust disclosures much more critical.

Amidst this uncertainty, this Executive Summary provides a glimpse into management's going concern assessment by first providing an overview and defining key concepts. Next, the discussion is organized in steps to make it easier to identify the elements factored into the analysis and the resulting required disclosures.

Our related Handbook, Going concern, provides an in-depth look into management's going concern assessment and answers many questions that have arisen in our continued practical experience with those assessments.

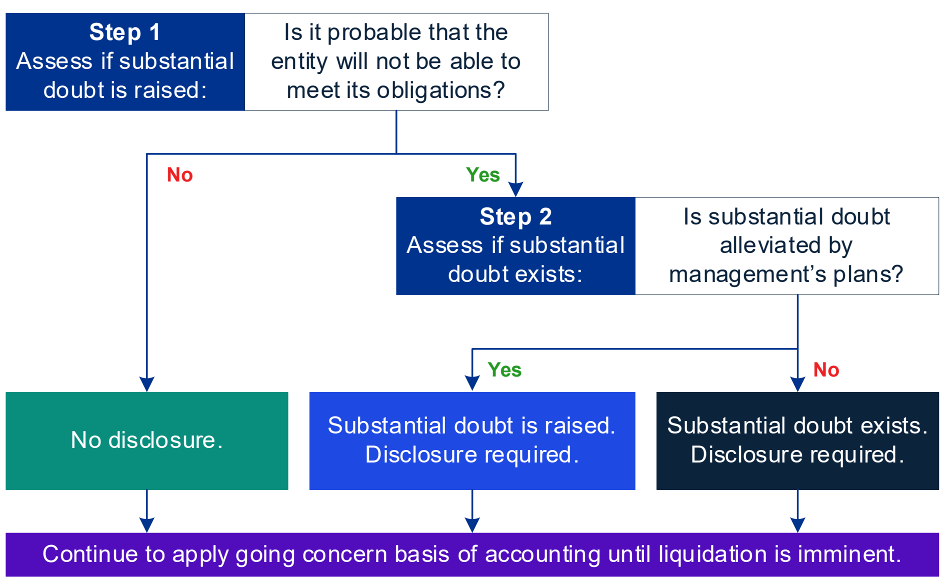
Overview

Since 2017, US GAAP has required management to assess an entity's ability to continue as a going concern. Subtopic 205-40 contains the requirements management must follow in conducting its going concern assessment and the disclosures the entity may have to make as a result. Conducting a going concern assessment requires considerable judgment.

Management's assessment is a two-step process that requires determining whether it is probable the entity will be unable to meet its obligations over a defined period. That period – referred to in this Executive Summary as the look-forward period – spans one year from the assessment date – i.e. the date the entity's financial statements are issued or available to be issued. Because management's assessment concludes on the assessment date, it reflects events or conditions that occurred after the reporting date up to the assessment date – i.e. subsequent events.

Management must perform the assessment at each reporting period, so the look-forward period is continuously rolling forward.

The assessment – summarized as follows – may lead the entity to disclose information about its ability to continue as a going concern but has no direct effect on its basis of accounting.



Key concepts

The following are some of the key concepts essential to management conducting a going concern assessment.

Substantial doubt	Substantial doubt about an entity's ability to continue as a going concern is raised when it is probable the entity will not be able to meet its obligations as they become due during the look-forward period.
Probable	Likely to occur, which is interpreted to mean there is a high likelihood that the future event will occur.
Assessment date	The date on which management concludes its going concern assessment. This is the date that the financial statements are: • issued, for SEC filers and entities that are conduit bond obligors for conduit debt securities that are traded in a public market; or • available to be issued, for all other entities.
Look-forward period	The period covered by the going concern assessment, which is the 12-month period extending from the assessment date.

To appreciate the relationship between the reporting date, the assessment date and the look-forward period, assume an entity's reporting date is December 31, Year 1, and its financial statements are issued (or available to be issued) on February 28, Year 2. In this example:

- the assessment date is February 28, Year 2; and
- the look-forward period is February 28, Year 2 through February 28, Year 3.

Step 1: Assess whether substantial doubt is raised

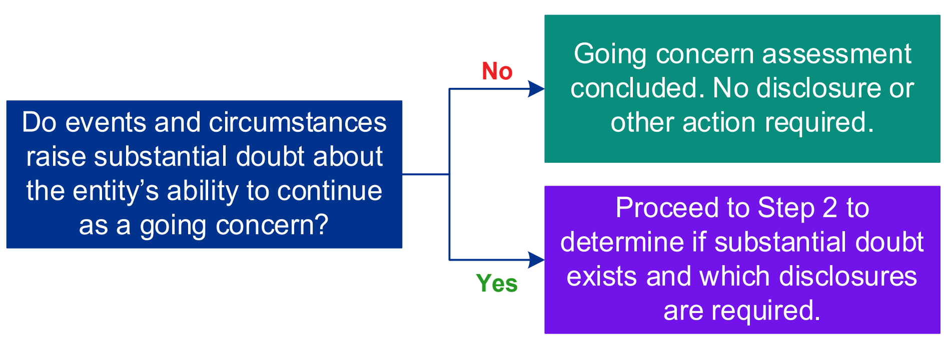
Under Step 1, management determines whether events and circumstances raise substantial doubt about the entity's ability to continue as a going concern. Management can make this determination by breaking the process into smaller steps that collectively identify what the entity *has*, *owes* and *needs* to continue to operate throughout the look-forward period.

Step 1 notably requires a thorough analysis of the effects of adverse conditions and events on the entity's current financial condition, debt arrangements and detailed forecasts of cash flows.

Conditions and events that are known and reasonably knowable at the assessment date are considered in the Step 1 analysis. In addition, management plans and actions considered (or not considered) in the analysis are summarized in the following table.

Management plans and actions	Considered in Step 1?
Actions taken in the normal course of managing the entity	✓
Plans fully implemented by the assessment date	✓
Plans that have not been fully implemented by the assessment date (see Step 2)	✗

Management considers the following after completing its Step 1 analysis.



Step 2: Assess whether substantial doubt exists

Substantial doubt about an entity's ability to continue as a going concern exists when such doubt is raised and is not alleviated by management's plans. Under Step 2, management determines whether it has plans to alleviate the substantial doubt that is raised in Step 1. Plans considered (or not considered) in Step 2 are summarized in the following table.

Management plans and actions	Considered in Step 2?
Unapproved plans	✗
Approved plans that have not been fully implemented by the assessment date	✓

Because the plans considered in Step 2 are not fully implemented, they only alleviate substantial doubt about the entity's ability to continue as a going concern if they meet both of the following conditions.

It is probable the plans will be implemented during the look-forward period.

+

It is probable the plans will alleviate the substantial doubt if they are properly implemented.

Considerations:
- Appropriate approval of plan
- Feasibility of plan
- Management control of plan
- History of forecasting and executing similar plans

Consideratons:
- Timeliness and magnitude of plan's mitigating effects
- Mitigation of liquidity needs throughout the look-forward period
- Indirect effects and/or costs of implementing plan

Meeting these conditions may prove challenging when key elements of the plan are beyond management's control.

Additional forecasting to that done under Step 1 is often necessary.

Disclosures

Subtopic 205-40 is a disclosure standard. Therefore, the going concern assessment informs the required disclosures. There is no direct effect on the entity's accounting.

There are three potential disclosure outcomes from the going concern assessment. First, no disclosure is required if management concludes under Step 1 that substantial doubt has not been raised. The following chart captures the other two outcomes and summarizes the disclosure requirements for each.

<table>
<tr><th>Substantial doubt is raised but alleviated</th><th>Substantial doubt exists</th></tr>
<tr><td>Disclose principal conditions or events that raise substantial doubt (before consideration of management's plans).</td><td>Disclose principal conditions or events that raise substantial doubt.</td></tr>
<tr><td colspan="2">Disclose management's assessment of the significance of those conditions or events in relation to the entity's ability to meet its obligations.</td></tr>
<tr><td>Disclose management's plans that alleviated substantial doubt.</td><td>Disclose management's plans intended to alleviate substantial doubt.</td></tr>
<tr><td>No statement is required that substantial doubt was raised about the entity's ability to continue as a going concern.</td><td>Include an explicit statement in the notes that indicates there is substantial doubt about the entity's ability to continue as a going concern.</td></tr>
</table>

The disclosures should be updated in each period as conditions and events change. When substantial doubt ceases to exist during a period, the disclosures should explain how the relevant conditions or events that raised substantial doubt were resolved.

Other considerations

Although the going concern assessment has no direct effect on an entity's accounting, it can have indirect implications. It also affects an entity's risk assessment and internal controls over financial reporting (ICFR). In addition, an entity's auditors conduct a similar independent going concern assessment that can affect the audit report.

Indirect accounting affects

Management's conclusion that substantial doubt is raised or exists can indirectly affect such accounting matters as:

- hedge accounting;
- current versus noncurrent debt classification;
- deferred tax asset valuation allowances; and
- impairment testing.

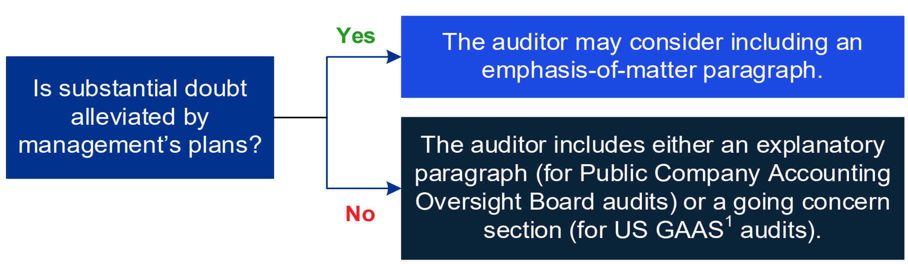
Assumptions used in the going concern assessment should be consistent with assumptions used in addressing these and other accounting matters.

ICFR

Properly conducting a going concern assessment requires a strong risk assessment process and strong ICFR. Management can take certain steps to ensure these processes adequately address the going concern assessment. For example, management can take steps to ensure proper controls exist over any forecasts used in the going concern assessment.

Auditor's assessment

When an auditor's going concern assessment raises substantial doubt, the effect on the auditor's report depends on whether that doubt is alleviated by management's plans. Assuming the financial statement disclosures are adequate, the auditor's report is affected as follows.



Note:

1. Auditing standards issued by the AICPA and followed by auditors in the preparation of audit reports of entities in the United States that are nonissuers.

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