"Going Concern" Gone

Here's an update on the status of the FASB's efforts to incorporate "going concern" guidance into U.S. GAAP.

One sure sign that an entity is in financial trouble is an unfavorable "going concern" opinion from its auditor. Any indication of doubt regarding the entity's ability to continue as a going concern is certain to grab the attention of investors, creditors, and other users of the entity's financial statements.

For several years, the Financial Accounting Standards Board (FASB) has been interested in the significance of going-concern assessments. Over time, the Board has explored many ideas for incorporating guidance regarding going-concern assessments and related issues into U.S. Generally Accepted Accounting Principles (U.S. GAAP). In this month's column, I'll describe how the FASB has arrived at its current thinking on these matters.

Background

Under U.S. GAAP, there are two bases of accounting: going concern and liquidation. But U.S. GAAP provides no guidance to financial-statement preparers on how to assess an entity's ability to continue as a going concern or on when it's appropriate to use one basis of accounting vs. the other.

Although U.S. GAAP lacks going-concern guidance, such guidance is contained in U.S. Generally Accepted Auditing Standards (U.S. GAAS). Specifically, going-concern guidance is found in the American Institute of Certified Public Accountants' (AICPA) codification of Statements of Auditing Standards (SAS), which largely have been adopted by the Public Company Accounting Oversight Board (PCAOB) on an interim basis. In particular, AU Section 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern," states that the auditor of an entity's financial statements is responsible for evaluating the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year beyond the date of the financial statements being audited. Furthermore, the auditor's evaluation must be based specifically on knowledge of relevant conditions and events obtained from the auditing procedures performed during a financial statement audit, effectively excluding knowledge that the auditor might obtain from other sources.

Interestingly, AU Section 341 doesn't define what a going concern is but does define what a going concern *isn't*. If the auditor has "substantial doubt about the entity's ability…to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions," then the entity ordinarily wouldn't be considered able "to continue as a going concern."

The FASB Takes Notice

Even before the recent financial crisis, the FASB's constituents expressed a need for U.S. GAAP to make an entity's management responsible for assessing the entity's ability to continue as a going concern. Constituents also expressed a need for U.S. GAAP to provide guidance on how management should perform going-concern assessments. And constituents asked for U.S. GAAP to include more guidance on when an entity should apply the liquidation basis of accounting and how costs of liquidation should be presented in the financial statements.

Responding to its constituents,

the FASB added the "Going Concern and Liquidation Basis of Accounting" project to its standards-setting agenda in May 2007. Later that year, the Board integrated the project into its "Codification and Retrieval" project. After considerable deliberation, the Board published an exposure draft (ED) of a proposed Statement of Financial Accounting Standards (SFAS), *Going Concern*, in October 2008. The proposed Statement would have applied to any business entity or not-for-profit entity that prepares financial statements in accordance with U.S. GAAP.

The FASB's proposed SFAS incorporated the going-concern guidance from AU Section 341, modified to align the guidance with International Financial Reporting Standards (IFRS). Within IFRS, International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, and IAS 10, *Events after the Balance Sheet Date*, have long provided the kind of going-concern guidance that the FASB's constituents sought to be included in U.S. GAAP.

In particular, the proposed SFAS would have required an entity's management, when preparing the entity's financial statements, to assess the entity's ability to continue as a going concern. Additionally, management would have been required to take into account all information about the future at least, but not limited to, 12 months from the end of the reporting period. The proposed SFAS also stipulated that an entity shall prepare financial statements on a going-concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so. And the proposed SFAS would have required detailed disclosures related to management's going-concern assessment.

After the Exposure Draft

Throughout 2009, the FASB redeliberated issues raised in the comments that it received in response to the *Going Concern* ED. The Board's redeliberations resulted in changes to its thinking about the kinds of information management would be required to consider when making a going-concern assessment as well as the time frame over which management would be required to consider that information. Also during 2009, the FASB decided to define "going concern" explicitly and to expand the scope of the project to include:

- New required disclosures regarding short-term and long-term risks,
- A definition of *substantial doubt* as it pertains to management's going-concern assessments, and
- Determining when it's appropriate for an entity to apply the liquidation basis of accounting.

After further redeliberations throughout 2010, the Board changed the name of the project to "Disclosures about Risks and Uncertainties and the Liquidation Basis of Accounting." In conjunction with the name change, it also revisited the fundamental questions of whether U.S. GAAP should require management to assess an entity's ability to continue as a going concern and, if so, how. The Board also increased its emphasis on prescribing how and when an entity should apply the liquidation basis of accounting.

What Now?

At its October 26, 2011, meeting, the FASB decided that improving disclosures that would serve as an early warning of an entity's potential inability to continue as a going concern would not be an objective of the "Disclosures about Risks and Uncertainties and the Liquidation Basis of Accounting" project. That decision was partly because the Board recently decided to add incremental disclosures about liquidity risk in the separate project on accounting for financial instruments.

Subsequently, during its January 11, 2012, meeting, the Board decided to not require that management of an entity assess whether there's substantial doubt about the entity's ability to continue as a going concern. Most Board members believed that such a requirement would be difficult to apply and that users of financial statements would benefit to a greater extent from ongoing disclosures about risks and uncertainties than they would from disclosures that would be made only after management concludes that there's substantial doubt about an entity's ability to continue as a going concern.

Most recently, at its February 15, 2012, meeting, the Board affirmed earlier tentative decisions about when and how an entity should apply the liquidation basis of accounting. It also affirmed that under the liquidation basis of accounting, an entity should

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prepare, at a minimum, a statement of net assets in liquidation and a statement of changes in net assets in liquidation and that it should disclose all measurement bases and significant assumptions.

As you can see from the history of this project, the FASB's thinking about "going concern" issues has changed significantly over time, and the Board scrapped many prior tentative decisions. Financial-statement preparers should watch for the FASB to issue a new ED of a proposed Accounting Standards Update in the second quarter of 2012. As always, the issuance of the ED will represent an opportunity for you to voice your opinion on the changes to U.S. GAAP that the FASB is about to propose. **SF**

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