The Ball is in Your Court: Management to Assess Going Concern Issues
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The Financial Accounting Standards Board (FASB) recently issued Accounting Standards Update No. (ASU) 2014-15, Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. Now management, not auditors, will be responsible for assessing if there's a going concern issue. Disclosure will be required when there’s substantial doubt about business continuity or substantial doubt has been alleviated by management’s mitigating plans.

The new standard will apply to public and private companies that prepare financial statements under U.S. Generally Accepted Accounting Principles (GAAP) — not just those that are audited.

The going concern assumption

The going concern assumption underlies all GAAP financial reporting. It presumes that a company will continue normal business operations into the future. When liquidation is imminent, the liquidation basis of accounting is used to report financial results instead.

Even when liquidation isn’t imminent, current standards require external auditors to decide when to cast doubts about a business’s ability to continue as a going concern. Critics say auditors often make this call too late — when a business is well on its way to collapse.

The new standard gives a company’s management the final responsibilities to decide whether there’s substantial doubt about the company’s ability to continue as a going concern and to provide related footnote disclosures. The standard provides guidance to management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that companies commonly provide in their footnotes.
Identifying going concern risks

Under the new standard, management must decide whether there are conditions or events that raise substantial doubt about the company's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, to prevent auditors from holding financial statements for several months after year end to see if the company survives).

Substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it's probable that the company won't be able to meet its current obligations as they become due. Examples of adverse conditions or events that might cause management to doubt the going concern assumption include:

- Negative financial trends, such as recurring operating losses or working capital deficiencies,
- Loan defaults and debt restructuring,
- Denial of credit from suppliers,
- Dividend arrearages,
- Disposals of substantial assets,
- Work stoppages and other labor difficulties,
- Legal proceedings or legislation that jeopardizes ongoing operations,
- Loss of a key franchise, license or patent,
- Loss of a principal customer or supplier, and
- An uninsured or underinsured catastrophe, such as a hurricane, tornado, earthquake or flood.

The existence of one or more of these conditions or events doesn’t automatically mean that there’s a going concern issue. Similarly, the absence of these conditions or events isn’t a guarantee that the company will meet its obligations over the next year.

Instead, management should base its assessment on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or available to be issued). Management should consider the timing, likelihood and magnitude of the potential effects of these conditions and events when making its determination.

Mitigating management's concerns

After management identifies that a going concern issue exists, it should consider whether any mitigating plans will alleviate the substantial doubt. In other words, management should ask, “Can we fix it?” The mitigating effect of management’s plans should be considered only if it’s probable that the plans will be implemented and
will alleviate the adverse conditions or events.

Examples of corrective actions include plans to raise equity, borrow money, restructure debt, cut costs or dispose of an asset or business line. Management should also evaluate the feasibility of its plans. For instance, if it plans to sell an interest in a failing joint venture, management might consider transfer restrictions, the interest’s marketability and indirect effects that the divestiture may have on the rest of the business.

**Disclosing going concern issues**

FASB’s new going concern standard puts pressure on management to assess business continuity. If you’re unsure how to proceed, your financial advisors can help explain the “substantial doubt” threshold, discuss how adverse conditions and events might impact future operations, brainstorm corrective actions, and draft disclosures that comply with the new standard.

Although management will be responsible for making going concern disclosures under GAAP, the new standard doesn’t eliminate an auditor’s responsibility to review management’s going concern evaluation. The Public Company Accounting Oversight Board issued Staff Audit Practice Alert No. 13, *Matters Related to the Auditor’s Consideration of a Company’s Ability to Continue as a Going Concern*, on Sept. 22, in response to FASB’s new going-concern standard. So, auditors will still look over management’s shoulder to ensure timely, relevant disclosure of potential uncertainty.

Compliance with the new FASB standard starts with annual periods ending after Dec. 15, 2016. Management will also be required to make going concern assessments during interim reporting after the effective date. Early application is permitted.

To further discuss when going concern issues might arise and evaluate the effectiveness of any mitigating plans, contact Dan Ward, Manager, Audit Services, at 314.983.1237 or dward@bswllc.com.