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Report from the Working Group on the Auditor's Evaluation of Going Concern

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Auditor's Evaluation of Going Concern

Issues Presented

- ❑ Going Concern reporting by auditors has its basis in statute.
- ❑ IAG considered Going Concern Issue in 2012.
- ❑ Going Concern reporting structure has not been a good “early warning” system for major bankruptcies - should it?
- ❑ FASB ASU 2014 – 15 requires management Going Concern determinations but may use an inconsistent threshold to that used by auditors.

Auditor's Evaluation of Going Concern

Statutory Audit Requirement

- Exchange Act Sec. 10A. AUDIT REQUIREMENTS
 - (a) IN GENERAL.—Each audit required pursuant to this title of the financial statements of an issuer by a registered public accounting firm shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission—
 - (3) an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.

Auditor's Evaluation of Going Concern

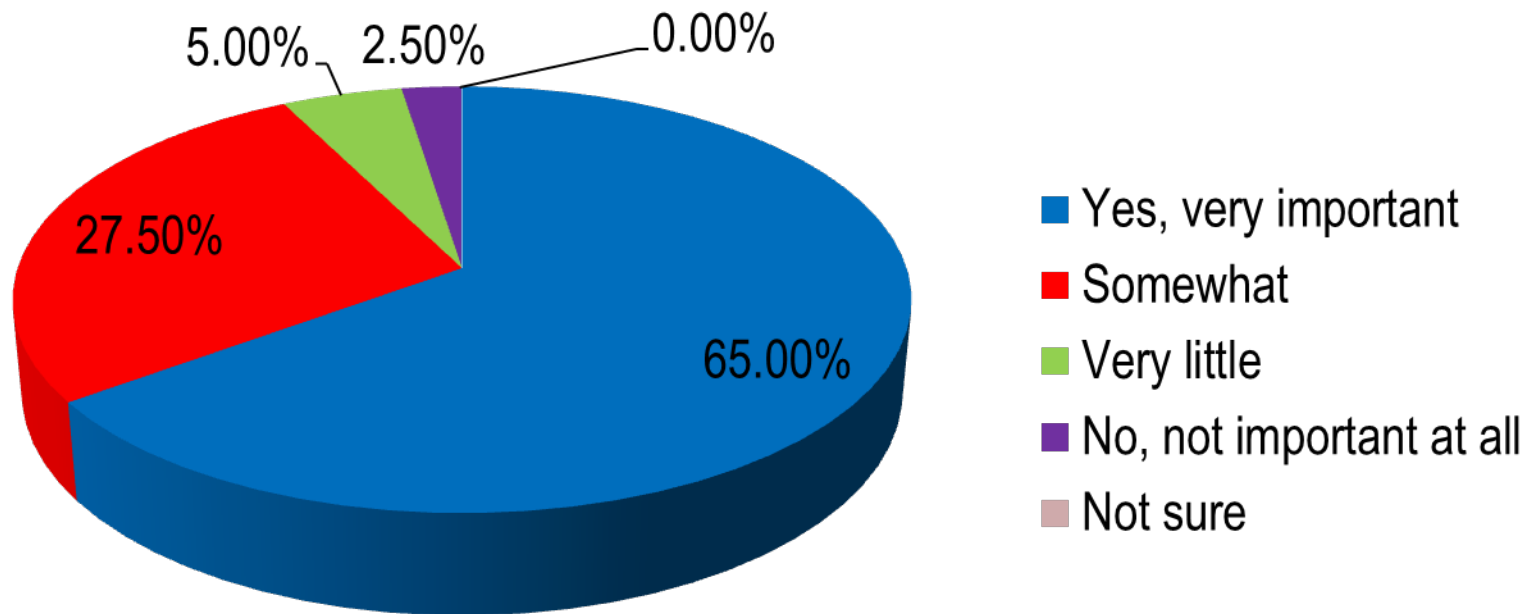
Prior IAG Review

- IAG considered Going Concern Issues in March of 2012
 - Conducted Investor Survey
 - Submitted Detailed Report
 - see IAG March 28, 2012 Meeting webpage:
http://pcaobus.org/News/Events/Pages/03282012_IAGMeeting.aspx
 - Made numerous recommendations including:
 - Move auditing standard from Substantial Doubt to More Likely than Not
 - Require disclosure when Reasonable Possibility exists that the company is no longer a going concern
 - Extend the period of evaluation to 12 months plus foreseeable events beyond 12 months
 - Management to disclose in SEC filings

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2012 IAG Survey Results

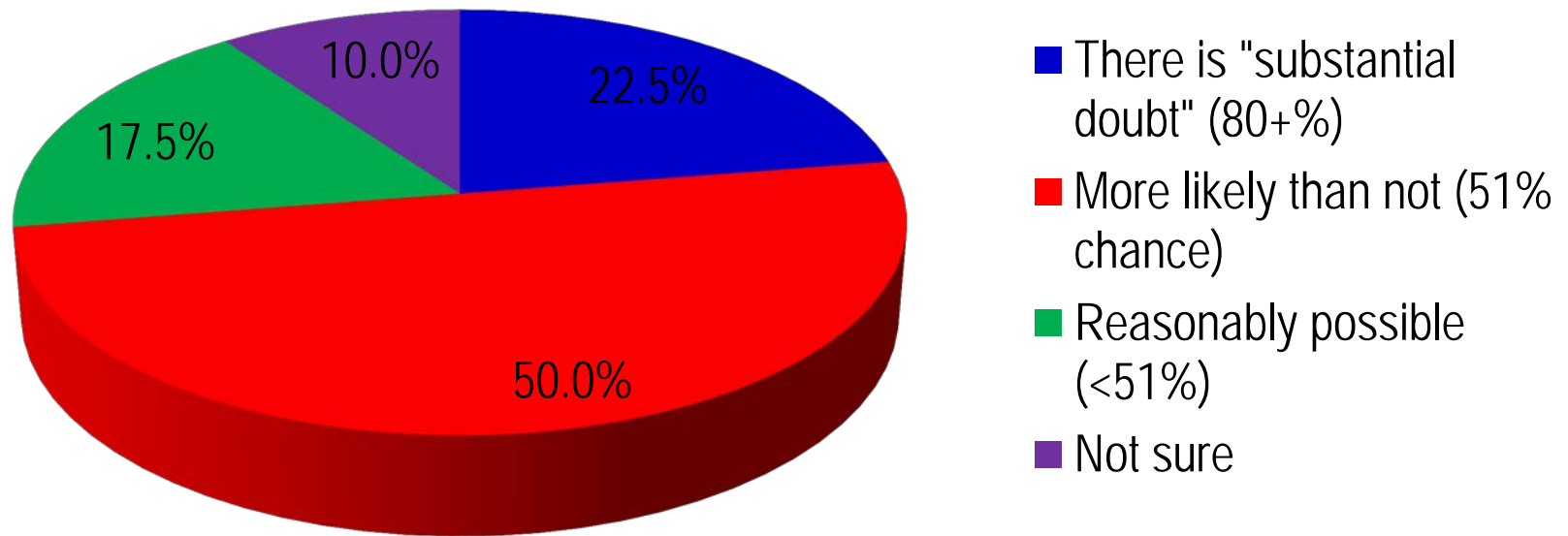
Is the Concept of Going Concern Important?



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2012 IAG Survey Results

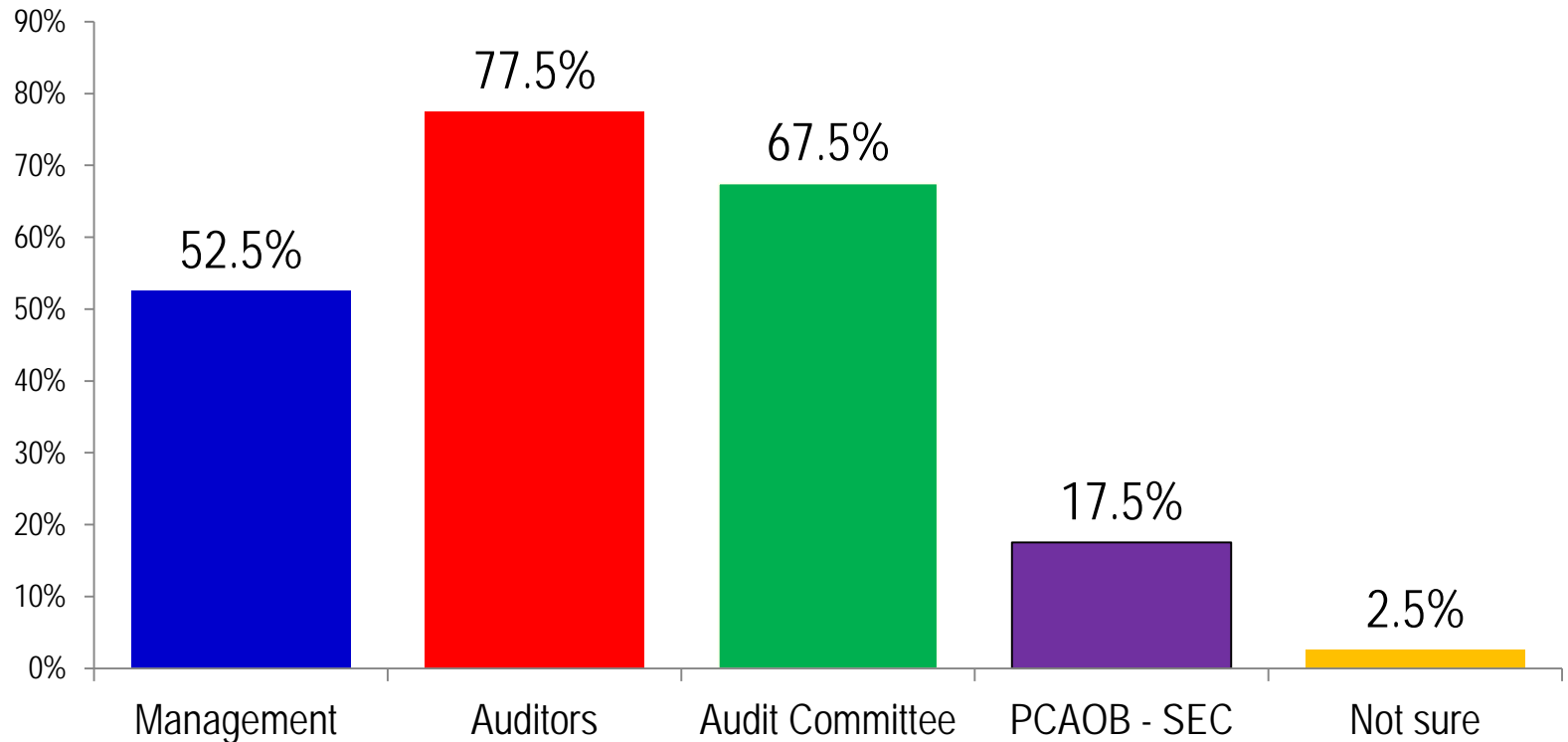
When Should a Company Be Identified As a Going Concern?



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2012 IAG Survey Results

Whose Responsibility to Report to Investors on Going Concern?



Auditor's Evaluation of Going Concern

Going Concern Reporting as "Early Warning" Mechanism

- ❑ Percentage of opinions having Going Concern statements between 2000 and 2013 have ranged from 14% to 21% with the highest percentages , as would be expected, in 2008.
- ❑ As demonstrated in the next slide the lack of a Going Concern opinion has been a poor predictor of impending insolvency.

Auditor's Evaluation of Going Concern

Top Ten U.S. Bankruptcies Since 2001

Top Ten Bankruptcies Issuers by Market Cap	Sector	Bankruptcy Filing Date	ICFR Effective	Going Concern	Opinion Signature Date After Bankruptcy Filing	ICFR Effective	Going Concern	Signing Auditor (Pre and Post Opinions)	Auditor Since
Lehman Brothers Holding (\$639B)	Financial	9/15/2008	Y	N	N/A	N/A	N/A	E&Y	1990
WorldCom, Inc. (\$103.9B)	Telecom	7/21/2002	N/A - though designated Max risk 1999-2001	N	N/A	N 2004	N/A	Arthur Anderson/ KPMG	1989 / engaged May 2002
General Motors (\$91.05B)	Industrials	6/1/2009	N	Y 2009	4/7/2010	N 2009	N	D&T	1918
CIT Group (\$80.45B)	Financial	11/1/2009	N 2004	N	12/10/2009	N 2010	N	PWC	2001
Enron (\$65.50B)	Energy	12/2/2001	N/A	N	N/A	N/A	N/A	Arthur Anderson	1946
Conseco Inc.(\$61.4B)	Financial/ Insurance	12/17/2002	N/A	N	2003	Y	Y 2003	PWC	1985
MF Global Holdings (\$41.05B)	Financial Derivatives Broker	10/31/2011	Y	N	N/A	N/A	N/A	PWC	2007
Chrysler (\$39.30B)	Auto	4/30/2009	Y	N	04/30/2010	Y	N	D&T*	1947*
Thornburg Mortgage(\$36.5B)	Residential Mortgage Lending	5/1/2009	Y	Y 2008	N/A	N/A	N/A	KPMG	2006
Pacific Gas and Electric (\$36.15B)	Utility	4/6/2001	N/A	Y 2000 - 2003	3/1/2002	Y	Y 2001,2002, 2003	D&T	1999

Auditor's Evaluation of Going Concern

FASB ASU 2014 – 15 Adopted August 2014

- Effective - for annual periods ending after December 15, 2016, and interim periods beginning after December 15, 2016.
 - Early application is permitted for previously unissued statements.
- The Board decided **not** to pursue the early-warning disclosures that were proposed in the 2013 Exposure Draft.

Auditor's Evaluation of Going Concern

FASB ASU 2014 – 15

- ❑ The amendments in this Update provide guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern.
- ❑ Previously, there was no guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern.

Auditor's Evaluation of Going Concern

FASB ASU 2014 – 15

- The Board decided that the definition of *substantial doubt* should incorporate a likelihood component using the term *probable*. Substantial doubt would exist when it is probable that an entity will not meet its obligations within one year from the financial statement issuance date.

Auditor's Evaluation of Going Concern

Issues for IAG Discussion

Auditor's Evaluation of Going Concern

What is Proper GC Threshold?

- ❑ Term “substantial doubt” in statute is currently undefined in auditing rules and literature.
- ❑ Commentators believe that “probable” may be construed as a lower standard resulting in fewer Going Concern reports.
- ❑ IAG discussion in 2012 recommended a standard of “more likely than not” which is a lower threshold than FASB (and possibly current audit threshold).

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Who "Goes First"?

- ❑ Is the shift of the initial burden to management appropriate (consistent with 2012 IAG recommendation).
- ❑ Is it important that management and the auditor use the same disclosure threshold?

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Recommendations for PCAOB

- Consider appropriate amendments to current audit requirements.
- Address potential differences in FASB and Audit Going Concern guidance.
 - Determine whether “probable” threshold is in investor interest.
 - Seek ,on a timeframe consistent with the effective date of FASB 2014-15, a Staff Consultation to resolve potential inconsistencies.

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Recommendations for PCAOB

- If timing of Staff Consultation cannot be completed before effective date of 2014-15 seek concurrence of FASB and SEC to defer effectiveness for the shortest period of time which will allow reasonable analysis of the potential impact of differing standards.
- What are the implications to investors if:
 - There is no modification of audit standards and the FASB provision goes into effect, or
 - PCAOB issues guidance acquiescing to the “probable” standard utilized by FASB

Auditor's Evaluation of Going Concern

Questions



Auditor's Evaluation of Going Concern

Open Discussion