

Evaluating Whether There is Substantial Doubt About an Entity's Ability to Continue As a Going Concern

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Presentation Overview

- Office of the Chief Auditor
 - Overview of existing audit requirements
 - PCAOB going concern project
- FASB project update
- Discussion of existing academic research
- Discussion questions

Overview of Existing Requirements

- Section 10A of the Securities Exchange Act of 1934* requires that audits include "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."
 - This evaluation affects the auditor's consideration of disclosures in the financial statements.
 - If the auditor concludes that substantial doubt does exist, the auditor is required to add an explanatory paragraph to the auditor's report indicating that substantial doubt.

* As amended by the 1995 Private Securities Litigation Reform Act (PSLRA).

Overview of Existing Requirements (cont'd)

- Under PCAOB auditing standards (AU sec. 341) the auditor's evaluation of whether there is substantial doubt about an entity's ability to continue as a going concern includes:
 - Consideration of conditions and events that may indicate there could be substantial doubt about an entity's ability to continue as a going concern.
 - Consideration of management's plans for dealing with the adverse effects of the conditions and events.
 - Evaluation of the possible effects on the financial statements and the adequacy of the related disclosure.
 - Determining the effects on the auditor's report.
- AU sec. 341 does not define the term "substantial doubt."

PCAOB Going Concern Project

- The PCAOB has a project to consider revisions to the auditing standard on the auditor's evaluation of a company's ability to continue as a going concern.
- Among other things, the project team is considering:
 - How to enhance the auditor's evaluation process
 - How to align the auditing standard with the respective accounting standards
 - How to enhance the usefulness of the auditor's communication regarding going concern uncertainty

Other Relevant Literature

- ❑ FASB Accounting Standards Codification Topic 275, *Risks and Uncertainties* (SOP 94-6)
- ❑ International Accounting Standard No. 1, *Presentation of Financial Statements*
- ❑ SEC rules and regulations (e.g., Financial Reporting Release No. 16 and S-K item 303(a))



Financial Accounting Standards Board

PCAOB

SAG 11/9/11 Meeting

Lawrence Smith
Board Member

Discussion Questions

Discussion Question

1. What criteria should be used to determine whether an auditor's report should be modified to disclose a going concern uncertainty?
 - What conditions or events should be considered in determining substantial doubt?
 - AU sec 341 includes examples of the following types of conditions and events: (1) Negative trends; (2) Other indications of possible financial difficulties; (3) Internal matters and (4) External matters that have occurred.
 - Should substantial doubt be based on a single threshold of likelihood, or should other factors be considered, such as the magnitude of the going concern uncertainties?

Discussion Question

2. Should the going concern evaluation be limited to the ensuing fiscal year? For example, should the auditor also be required to consider the potential outcome of known events that will occur after the ensuing fiscal year?