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NO. 1650-100 | OCTOBER 9, 2008

# Financial Accounting Series

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EXPOSURE DRAFT

## Proposed Statement of Financial Accounting Standards

**Going Concern**

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director  
File Reference No. 1650-100

Comment Deadline: December 8, 2008



Financial Accounting Standards Board  
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be **received** in writing by December 8, 2008. Interested parties should submit their comments by email to [director@fasb.org](mailto:director@fasb.org), File Reference No. 1650-100. Those without email may send their comments to the “Technical Director—File Reference No. 1650-100” at the address at the bottom of this page. Responses should **not** be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB’s website and will be included in the project’s public record.

An electronic copy of this Exposure Draft is available on the FASB’s website until the FASB issues a final document. Any individual or organization may obtain one copy of this Exposure Draft without charge until December 8, 2008, on written request only. **Please ask for our Product Code No. E201.** For information on applicable prices for additional copies and copies requested after December 8, 2008, contact:

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Financial Accounting Standards Board  
of the Financial Accounting Foundation  
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## **Notice for Recipients of This Exposure Draft**

This proposed Statement would provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also would require certain disclosures when either financial statements are not prepared on a going concern basis or when there is substantial doubt as to an entity's ability to continue as a going concern. Currently, AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, of the AICPA Codification of Statements on Auditing Standards contains the guidance about the going concern assessment. The Public Company Accounting Oversight Board (PCAOB) adopted AU Section 341 on an initial, transitional basis and has subsequently amended that interim standard.

The FASB is responsible for establishing standards that guide the overall presentation of an entity's financial statements and related disclosures. The Board believes that accounting guidance about the going concern assumption should be directed specifically to management of a reporting entity because management is responsible for preparing an entity's financial statements and evaluating its ability to continue as a going concern. Accordingly, the Board concluded that guidance about the going concern assumption also should reside in the accounting literature established by the FASB and decided to issue this proposed Statement.

The Board decided to carry forward the going concern guidance from AU Section 341, subject to several modifications to align the guidance with International Financial Reporting Standards (IFRSs). One of those modifications is to change the time horizon for the going concern assessment. AU Section 341 states that there is "a responsibility to evaluate whether there is substantial doubt about 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" (paragraph .02). International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, requires that an entity consider "all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period" (paragraph 26) when assessing whether the going concern assumption is appropriate. The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed.

The other modifications to align the going concern guidance with IFRSs include (1) using the wording in IAS 1 with respect to the type of information that should be considered in making the going concern assessment (*all available information about the future*) and (2) requiring an entity to disclose when it does not present financial statements on a going concern basis. The Board thinks there is no substantial difference between the wording in IAS 1 and the wording previously included in AU Section 341 with respect to the type of information that should be considered in making the going concern assessment. Therefore, the Board does not expect this modification to result in a change to practice.

## **Information for Respondents**

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement, particularly on the issues listed below. Respondents need not comment on each issue and are encouraged to comment on additional matters that they believe should be brought to the Board's attention. Comments are requested from those who agree with the provisions of this proposed Statement and from those who do not.

Comments are most helpful if they identify the issues or the specific paragraph(s) to which the comments relate and clearly explain the reasons for the positions taken. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning. Respondents must submit comments in writing by December 8, 2008.

The Board specifically requests comments on the issue discussed below.

### **Time Horizon over Which an Entity Should Evaluate Its Ability to Continue as a Going Concern**

As discussed above, the Board decided to adopt the time horizon in IAS 1 (*at least, but not limited to, twelve months from the end of the reporting period*), instead of the time horizon considered in AU Section 341 (*not to exceed one year beyond the date of the financial statements*). The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. It also would result in a convergent approach between U.S. generally accepted accounting principles and IFRSs.

Do you agree with the Board's decision to remove the bright-line time horizon in AU Section 341 in favor of the guidance in IAS 1? If not, why? Do you believe that this time horizon is helpful and operational? If not, why?

## Summary

### **Why Is the FASB Issuing This Proposed Statement and When Will It Be Effective?**

The objective of this proposed Statement is to (1) provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern and (2) require disclosures when either financial statements are not prepared on a going concern basis or there is substantial doubt as to an entity's ability to continue as a going concern. Similar guidance currently resides in the auditing literature. The Board has decided that this guidance also belongs in the accounting literature because it is management's responsibility to assess the ongoing viability of the reporting entity.

An entity would be required to apply the requirements of this proposed Statement to interim or annual financial statements issued after ratification of the FASB Accounting Standards Codification.<sup>TM</sup>

### **What Is the Scope of This Proposed Statement?**

This proposed Statement would apply to business entities and not-for-profit entities that prepare financial statements in accordance with generally accepted accounting principles (GAAP). This proposed Statement would apply to both interim and annual financial statements.

### **How Will This Proposed Statement Change Current Practice?**

This proposed Statement would require that management of a reporting entity consider all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period, when assessing whether the going concern assumption is appropriate. Prior to the issuance of this proposed Statement, the time horizon for assessment was limited to one year beyond the date of the financial statements.

The Board decided to use this time horizon because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed.

### **What Is the Effect of This Proposed Statement on Convergence with International Financial Reporting Standards?**

This proposed Statement would introduce going concern guidance into U.S. GAAP and by modifying the guidance contained in U.S. auditing literature (AU Section 341) would reduce the differences between the going concern guidance in U.S. GAAP and the going concern guidance in IAS 1. For example, the proposed Statement would require management of an entity to use the time horizon in IAS 1 when assessing whether the going concern assumption is appropriate. The proposed Statement also would (1) use the

wording in IAS 1 with respect to the type of information that should be considered in making the going concern assessment (*all available information about the future*) and (2) require an entity to disclose when it does not present financial statements on a going concern basis.

# Proposed Statement of Financial Accounting Standards

## Going Concern

October 9, 2008

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# Proposed Statement of Financial Accounting Standards

## Going Concern

October 9, 2008

### OBJECTIVE

1. The objective of this Statement is to provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also requires disclosures when either of the following conditions exists:
  - a. Financial statements are not prepared on a going concern basis.
  - b. There is substantial doubt as to an entity's ability to continue as a going concern.

<p>All paragraphs in this Statement have equal authority. Paragraphs in <b>bold</b> set out the main principles.</p>
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## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### Scope

2. This Statement applies to business entities and not-for-profit entities that prepare financial statements in accordance with generally accepted accounting principles (GAAP). This Statement applies to both interim and annual financial statements.

### Presentation

3. **When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. 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.**
4. In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management

may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

5. Management may identify information about certain conditions or events that, if considered in the aggregate, indicate there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

- a. Negative trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and adverse key financial ratios
- b. Other indications of possible financial difficulties, for example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- d. External matters that have occurred, for example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

6. If, after considering the information in the aggregate, management believes that there is substantial doubt about the reporting entity's ability to continue as a going concern, management shall consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and whether those plans can be effectively implemented. Management's considerations relating to its plans may include the following:

- a. Plans to dispose of assets:
  - (1) Restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
  - (2) Apparent marketability of assets that the entity plans to sell
  - (3) Possible direct or indirect effects of disposal of assets
- b. Plans to borrow money or restructure debt:
  - (1) Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - (2) Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity

- (3) Possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures:
  - (1) Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - (2) Possible direct or indirect effects of reduced or delayed expenditures
- d. Plans to increase ownership equity:
  - (1) Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - (2) Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors.

## Disclosure

**7. When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.** In particular, the entity shall disclose information that enables users of the financial statements to understand:

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern
- b. The possible effects of those conditions and events
- c. Management's evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations
- e. Management's plans to mitigate the effect of the uncertainties and whether management's plans alleviate the substantial doubt about its ability to continue as a going concern
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

8. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

## **EFFECTIVE DATE AND TRANSITION**

9. This Statement shall be effective for interim or annual financial statements issued after ratification of the FASB Accounting Standards Codification™ and shall be applied prospectively.

**The provisions of this Statement need  
not be applied to immaterial items.**

## **Appendix A**

### **BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS**

#### **Introduction**

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this proposed Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

#### **Background Information**

A2. In conjunction with the Board's effort to simplify access to all authoritative U.S. GAAP by providing all the authoritative literature related to a particular topic in one place, the Board has undertaken projects to incorporate accounting guidance that originated as auditing standards into the body of authoritative literature issued by the FASB. In addition to this proposed Statement, these projects include FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and a proposed Statement on subsequent events. Including this guidance in authoritative accounting literature as well as in auditing standards further emphasizes that accounting and reporting are the primary responsibility of an entity and its management, not its auditor.

#### **Scope**

A3. The Board decided to develop a standard that would (a) provide guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern and (b) require disclosures when either financial statements are not prepared on a going concern basis or there is substantial doubt as to an entity's ability to continue as a going concern. The Board also decided that, as part of this project, it would seek to develop a standard that converges with IAS 1 and IAS 10, *Events after the Reporting Period*, supplemented by disclosure requirements in AU Section 341.

A4. The Board concluded that management of a reporting entity has the responsibility to assess the reporting entity's ability to continue as a going concern. The Board further decided that all entities should be required to disclose when their financial statements are not prepared on a going concern basis and when there is substantial doubt as to an entity's ability to continue as a going concern.

A5. The Board decided that the project would not address the liquidation basis of accounting. However, the Board did decide to require an entity to disclose when an entity does not prepare financial statements on a going concern basis together with the basis under which it prepared the statements. In addition, the Board decided to require that an entity disclose the reason why it is not regarded to be a going concern.

## **Time Horizon through Which an Entity Should Evaluate Its Ability to Continue as a Going Concern**

A6. The Board decided to adopt the time horizon in IAS 1 (at least, but not limited to, 12 months from the end of the reporting period), instead of the time horizon considered in AU Section 341 (not to exceed 1 year beyond the date of the financial statements). The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. It also would result in a convergent approach between U.S. GAAP and International Financial Reporting Standards (IFRSs).

## **Information Management Should Consider**

A7. The Board decided to conform the wording of the type of information that management should consider in its going concern assessment with IAS 1. Whereas AU Section 341 states that “the auditor’s evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor’s report” (paragraph .02), IAS 1 refers to “all available information about the future” (paragraph 26). The Board thinks there is no substantial difference between the wording in IAS 1 and the wording previously included in AU Section 341. Therefore, the Board does not expect this decision to result in a change to practice.

## **Effective Date and Transition**

A8. The Board decided that this proposed Statement should be effective for interim or annual financial statements issued after ratification of the Codification and that it should be applied prospectively. The Board concluded that a prospective transition method would avoid requiring that an entity determine whether all available information about the future had been considered during past assessments of its ability to continue as a going concern.

## **Benefits and Costs**

A9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement a new standard are borne primarily by present investors. The Board’s assessment of the costs and benefits of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an

accounting standard or to quantify the value of improved information in financial statements.

A10. The Board decided to adopt the time horizon for assessment in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. The Board believes that this change will provide more useful information to users of financial statements. The Board also believes that this proposed Statement provides the benefit of convergence with IFRSs.

A11. The Board does not believe that this proposed Statement will impose any significant costs on its constituents.

## Appendix B

# AMENDMENTS TO THE FASB ACCOUNTING STANDARDS CODIFICATION™

## Introduction

B1. This appendix outlines how this proposed Statement would affect the FASB Accounting Standards Codification™ (Codification). Because this proposed Statement would be effective for interim or annual financial statements issued after ratification of the Codification, this appendix outlines how the proposed Statement would affect the Codification rather than outlining how the proposed Statement would affect current accounting standards (that will be superseded once the Codification has been ratified).

B2. This proposed Statement would create a new Subtopic in Topic 205, *Presentation of Financial Statements*, to provide guidance on going concern.

## Amendments to the Codification

B3. Insert Subtopic 205-30 as follows: [Added text is underlined and deleted text is ~~struck out.~~]

### Presentation > 205 Presentation of Financial Statements > 30 Going Concern

#### 205-30-05 Overview and Background

05-1 This Subtopic provides guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate a reporting entity's ability to continue as a going concern. It also requires disclosures when either of the following conditions exists:

- a. Financial statements are not prepared on a going concern basis.
- b. There is substantial doubt as to an entity's ability to continue as a going concern.

#### 205-30-15 Scope and Scope Exceptions

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 205-10-15.

#### 205-30-45 Other Presentation Matters

45-1 When preparing financial statements, management shall assess the reporting entity's ability to continue as a going concern. 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.

45-2 In assessing whether the going concern assumption is appropriate, management shall take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period. The degree of consideration depends on the facts in each case. If an entity has a history of profitable operations and ready access to financial resources, management may conclude that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

45-3 Management may identify information about certain conditions or events that, if considered in the aggregate, indicate there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with other conditions or events. The following are examples of those conditions and events:

- a. Negative trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and adverse key financial ratios
- b. Other indications of possible financial difficulties, for example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- d. External matters that have occurred, for example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

45-4 If, after considering the information in the aggregate, management believes that there is substantial doubt about the reporting entity's ability to continue as a going concern, management shall consider its plans for dealing with the adverse effects of those conditions and events and whether those plans will mitigate the adverse effects and whether those plans can be effectively implemented. Management's considerations relating to its plans may include the following:

- a. Plans to dispose of assets:
  - (1) Restrictions on the disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets

- (2) Apparent marketability of assets that the entity plans to sell
- (3) Possible direct or indirect effects of disposal of assets
- b. Plans to borrow money or restructure debt:
  - (1) Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - (2) Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - (3) Possible effects on the entity's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures:
  - (1) Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - (2) Possible direct or indirect effects of reduced or delayed expenditures
- d. Plans to increase ownership equity:
  - (1) Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - (2) Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors.

## **205-30-50 Disclosure**

**50-1** When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. In particular, the entity shall disclose information that enables users of the financial statements to understand:

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern
- b. The possible effects of those conditions and events
- c. Management's evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations
- e. Management's plans to mitigate the effect of the uncertainties and whether management's plans alleviate the substantial doubt about its ability to continue as a going concern
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

**50-2** When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

B4. Subtopic 942-505 (Financial Services—Depository and Lending > Equity) is amended as follows:

a. Paragraph 942-505-50-1:

Noncompliance with regulatory capital requirements may, when considered with other factors, raise substantial doubt about a credit union's ability to continue as a going concern ~~for a reasonable period of time.~~ See paragraph 205-30-50-1 for ~~Additional information that might be disclosed in situations in which there is substantial doubt about the entity's ability to continue as a going concern,~~ for a reasonable period of time may include all of the following:

- ~~1. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time-~~
- ~~2. Possible effects of such conditions and events-~~
- ~~3. Management's evaluation of the significance of those conditions and events and any mitigating factors-~~
- ~~4. Possible discontinuance of operations-~~
- ~~5. Management's plans (including any relevant financial information)-~~
- ~~6. Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities.-~~

B5. Subtopic 948-10 (Financial Services—Mortgage Lending > Overall) is amended as follows:

a. Paragraph 948-10-50-4:

Further, noncompliance with minimum net worth requirements may, when considered with other factors, raise substantial doubt about an entity's ability to continue as a going concern ~~for a reasonable period of time.~~ See paragraph 205-30-50-1 for ~~Additional information that might be disclosed in these situations,~~ may include the following:

- ~~a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time-~~
- ~~b. Possible effects of such conditions and events-~~
- ~~c. Management's evaluation of the significance of those conditions and events and any mitigating factors-~~
- ~~d. Possible discontinuance of operations-~~
- ~~e. Management's plans (including any relevant financial information)-~~
- ~~f. Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities.-~~