A CAQ COVID-19 RESOURCE

Going Concern:
Management and Auditor Responsibilities

Published April 2020

The COVID-19 pandemic and the related market conditions create many new uncertainties for auditors, audit committees, investors and management of public companies. As SEC Chair Jay Clayton recently recognized, the continuing operation of the US capital markets is an essential component of our national response to, and recovery from, COVID-19. Under US GAAP, financial statements are generally prepared under the assumption that a company will continue as a going concern for a reasonable period of time.This resource is intended to provide a high-level overview of management's accounting requirements under US GAAP and a public company auditor's requirements under PCAOB auditing standards related to going concern.

This resource is intended as general information and should not be relied upon as being definitive or all-inclusive, or a substitute for PCAOB and SEC rules, FASB accounting requirements, standards, guidance, or other resources.

TECHNICAL REQUIREMENTS

For Management

Accounting Standards Update (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* establishes the US GAAP requirements for management to evaluate a company's ability to continue as a going concern and to provide disclosures in its interim and annual financial statements when there is substantial doubt about an entity's ability to continue as a going concern.

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The following represents a summary of the requirements included in ASU 2014-15:

+ *Substantial doubt* about the entity's ability to continue as a going concern is considered to exist when aggregate conditions and events indicate that it is *probable* that the entity will be unable to meet obligations when due within one year of the date that the financial statements are issued or are available to be issued.

+ Management's evaluation is based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued.

+ The evaluation initially shall not take into consideration the potential mitigating effect of management's plans that have not been fully implemented as of the date that the financial statements are issued (for example, plans to raise capital, borrow money, restructure debt, or dispose of an asset that have been approved but that have not been fully implemented as of the date that the financial statements are issued).

+ When evaluating an entity's ability to meet its obligations, management shall consider quantitative and qualitative information about the following conditions and events, among other relevant conditions and events known and reasonably knowable at the date that the financial statements are issued:

  - The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued;

  - The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements);

  - The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued; and

  - The other conditions and events, when considered in conjunction with the bullets above, that may adversely affect the entity's ability to meet its obligations within one year after the date that the financial statements are issued.

+ ASU 2014-15 also requires management to include certain disclosures in its interim and annual financial statements when management concludes that substantial doubt about an entity's ability to continue as a going concern exists.

For Auditors

In the auditor's evaluation of whether the financial statements are presented in conformity with US GAAP, they consider whether the financial statements contain all required disclosures, including those related to going concern, if applicable. As part of this evaluation, auditors assess management's going concern evaluation.

PCAOB Auditing Standard 2415, *Consideration of an Entity's Ability to Continue as a Going Concern* (AS 2415) requires the auditor to, among other things, evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the annual financial statements being audited. The auditor's evaluation is based on his or her knowledge of conditions and events that exist or have occurred prior to the date of the auditor's report. AS 2415 does not require auditors to design audit procedures solely to identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern. Rather, the auditing standard suggests that the results of auditing procedures performed to achieve other audit objectives be leveraged to identify such conditions and events. AS 2415 provides the following examples of the types of audit procedures that could be used:

+ Analytical procedures;

+ Review of subsequent events;

+ Review of compliance with terms of debt and loan agreements;

+ Reading of minutes of meetings of stockholders, board of directors, and important committees of the board;

+ Inquiry of an entity's legal counsel about litigation, claims, and assessments; and

+ Confirmation with related and third parties of the details of arrangements to provide or maintain financial support.

If through the performance of audit procedures, conditions or events indicate there could be substantial doubt about the entity's ability to continue as a going concern, the auditor then reviews management's plans to alleviate such conditions to inform his or her conclusions. After evaluating the evidence obtained, the auditor may conclude that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, and the auditor's report would include an explanatory paragraph to reflect that conclusion.

AS 2415 also provides clarification as to the auditor's responsibility over going concern through the following statements: *"The auditor is not responsible for predicting future conditions or events. The fact that the entity may cease to exist as a going concern subsequent to receiving a report from the auditor that does not refer to substantial doubt, even within one year following the date of the financial statements, does not, in itself indicate inadequate performance by the auditor. Accordingly, the absence of reference to substantial doubt in an auditor's report should not be viewed as providing assurance as to an entity's ability to continue as a going concern."*

PCAOB Auditing Standard 4105 (AS 4105), *Reviews of Interim Financial Information* establishes standards and provides guidance on the nature, timing, and extent of the procedures to be performed by an independent auditor when conducting a review of *interim financial information*. AS 4105 states that *"A review of interim financial information is not designed to identify conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern." Through the course of the performing an interim review, the auditor may become aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern. In such cases, the auditor performing the interim review is required under AS 4105 to inquire of management as to its plans for addressing such matters and to consider the adequacy of the Company's disclosures of such matters in the interim financial statements*.

Key Differences Between Management's and The Auditor's Requirements

+ ***Definition of substantial doubt*** - ASU 2014-15 defines *substantial doubt* about the entity's ability to continue as a going concern when aggregate conditions and events indicate that it is *probable* that the entity will be unable to meet obligations when due within one year of the date that the financial statements are issued or are available to be issued. The auditor's evaluation of whether substantial doubt exists is *qualitative* and based on the relevant events and conditions outlined in AS 2415.

+ ***Time period of evaluation*** - ASU 2014-15 requires management to evaluate whether the entity will be unable to meet its obligations due within one year of the date the financial statements are issued or are available to be issued. Meanwhile, the auditors are required as part of their annual audit to evaluate whether there is substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the annual financial statements being audited. This may result in situations where the auditor's going concern evaluation is for a period of time that is less than management's evaluation period.

+ ***Interim financial statement requirements*** – ASU 2014-15 requires management to assess an entity's ability as a going concern for each interim reporting period. For interim reviews performed in accordance with AS 4105, auditors are required to inquire of management and to consider the adequacy of management's disclosures if they become aware *of conditions or events that might be indicative of the entity's possible inability to continue as a going concern. AS 4105 states that for an interim review* "It ordinarily is not necessary for the [auditor] to obtain evidence in support of the information that mitigates the effects of the conditions and events."

COVID-19 CONSIDERATIONS

As a result of the COVID-19 pandemic and the resulting economic uncertainty, several companies may face challenges that could impact their ability to continue operating as a going concern. Those challenges may include, among others, work stoppages, restrictions and/or regulations, supply chain disruptions and reduced consumer spending. To determine the effect of these challenges on the business, management may need to invest significant effort to prepare supportable future cash flow projections for the next twelve months that will be utilized in going concern evaluations. This may result in increased judgements by management and corresponding increases in skepticism from auditors with respect to going concern evaluations. In this environment, it becomes even more critical that management, the auditors and those relying on the financial statements have a clear understanding of each party’s responsibilities as it relates to going concern with respect to both the interim and annual financial statements.