Management’s Going Concern Reminder

Management Requirements

Until recently, going concern guidance only was addressed within auditing literature, and company management generally waited for the auditor to approach the topic. This changed in August 2014, when the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern, incorporating going concern into U.S. generally accepted accounting principles (GAAP). Beginning with annual periods ending on or after December 15, 2016, reporting entity management will need to perform a going concern self-assessment each annual and interim reporting period. The update applies to all nongovernmental entities.

Management is required to evaluate whether conditions or events exist that raise substantial doubt about the entity’s ability to continue as a going concern within one year after the financial statements are issued or available to be issued (look-forward period). ASU 2014-15 also mandates comprehensive note disclosures when substantial doubt exists, regardless if such doubt is ultimately alleviated.

Key Considerations

Substantial doubt exists when conditions and events—considered in the aggregate—indicate it is probable the entity will be unable to meet its obligations as they become due within the look-forward period. Management’s evaluation should be based on relevant information known and reasonably knowable at the date the financial statements are issued—or at the date the financial statements are available to be issued, as applicable.

Management is expected to make a reasonable effort to identify conditions and events not readily known, but those it can identify without undue cost and effort. Management’s documentation should include what factors, conditions and events were considered and the potential effect these items may have on the organization. The initial substantial doubt evaluation should disregard any potential mitigating plans. Consummated refinancing and unequivocal third-party commitments, however, are included in this evaluation.

For entities with a history of profitable operations and ready access to financial resources, management’s evaluation may simply entail documenting the excess of available liquid funds over significant near-term obligations. Conversely, a more detailed analysis, e.g., forecasts and projections, and documentation efforts may be required when potentially negative events or conditions exist.

If management determines substantial doubt exists, it is required to disclose the facts and circumstances in the financial statement notes and whether the conditions raising substantial doubt have been alleviated. In preparation for disclosure, management should evaluate plans probable of mitigating the conditions and events and being effectively implemented within one year of financial statement issuance.

If management determines a plan meeting the criteria alleviates the substantial doubt, it should disclose its evaluation of the conditions or events’ significance that raised the substantial doubt in relation to the company’s ability to meet its obligations, and its plans that alleviated the substantial doubt. Management’s documentation should include its assessment that the plan is probable of mitigating the relevant conditions and being effectively implemented within one year of financial statement issuance.
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Generally, to be considered probable of effective implementation, the plan, e.g., to raise capital, borrow money, restructure debt or sell assets, must be approved before the financial statement issuance date. To be considered probable of mitigating the relevant conditions, management must consider the magnitude and timing of the mitigated effect of its plans in relation to the magnitude and timing of the relevant conditions or events that those plans are intended to mitigate. Probable means “likely to occur.”

The table below summarizes management’s requirements within ASU 2014-15.

<table>
<thead>
<tr>
<th>Management’s Requirements</th>
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<tr>
<td><strong>Evaluation Period</strong></td>
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<tr>
<td>Evaluate going concern up to 12 months after financial statement issuance date or date available for issuance (look-forward period)</td>
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<tr>
<td><strong>Substantial Doubt Evaluation</strong></td>
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<tr>
<td>Identify conditions and events, considered in the aggregate, that indicate it is probable the entity will be unable to meet its obligations as they become due within the look-forward period</td>
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<td><strong>Plan Evaluation When Substantial Doubt Exists</strong></td>
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<tr>
<td>Evaluate plans considered probable, when implemented, of mitigating the relevant conditions that raised the initial substantial doubt, and probable of being effectively implemented within one year after the date of financial statement issuance</td>
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<tr>
<td><strong>Substantive Doubt Alleviated</strong></td>
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<tr>
<td>Disclose the conditions or events that raised substantial doubt, management’s evaluation of the conditions’ or events’ significance in relation to the entity’s ability to meet its obligations and management’s plans that alleviated the substantial doubt</td>
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<tr>
<td><strong>Substantial Doubt Not Alleviated</strong></td>
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<tr>
<td>Disclose a statement that there is substantial doubt about the entity’s ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued). Disclose conditions, evaluation and plans—similar to those when substantial doubt is alleviated (above)—and whether financial statements are prepared on a going concern basis</td>
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Example 1

Background

Company A is a creditworthy, highly profitable entity in an industry with positive trends. The company has positive financial trends and the funds necessary to maintain operations considering its current financial position and expected cash flows, including a history of debt refinancing. Company A management considers this information as well as conditional and unconditional obligations due within a year of financial statement issuance. The company has a significant debt obligation due within 12 months of the financial statement issuance date and liquid resources on hand are insufficient to repay the debt at maturity. Management determines it is probable that the company cannot meet the obligation without considering a third-party commitment to refinance.

Analysis & Disclosure Requirements

Company A secures—before the financial statement issuance date—a lender’s firm and unequivocal commitment to secure lending to pay the forthcoming debt obligation. Because the third-party commitment is fully implemented, management includes the mitigating effects of refinancing—along with all other company information—in its initial going concern assessment. Management concludes that substantial doubt does not exist. No disclosures within ASU 2014-15 are warranted. Management will include the refinancing in its other disclosures as applicable within U.S. GAAP, e.g., debt commitments, subsequent events.

In a second scenario, plans to restructure debt are approved by management but not consummated or an unequivocal commitment has not been obtained, i.e., the plan is not fully implemented. Considering management’s plans with information about Company A’s current financial position and trends, the upcoming debt raises substantial doubt about the company’s ability to continue as a going concern. However, substantial doubt may be alleviated if the refinancing is deemed probable of being implemented and mitigating the adverse conditions. Substantial doubt disclosure within ASU 2014-15 is required.
Example 2

Background

In subsequent years, Company A has recurring operating losses, working capital deficiencies and negative cash flows. Information in the aggregate indicates it is probable the entity will be unable to meet a significant debt obligation due within 12 months of financial statement issuance. Management concludes that substantial doubt exists about the company’s ability to continue as a going concern within 12 months of financial statement issuance.

Analysis & Disclosure Requirements

Similar to Example 1, Scenario 2, management has not obtained an unequivocal refinancing commitment and concludes that substantial doubt has been raised. In this example, it may be more challenging than Example 1 to conclude a refinancing is probable of being implemented given the negative financial conditions and trends. If substantial doubt is alleviated, disclosures are required within ASU 2014-15. Unlike situations where substantial doubt is not alleviated, however, disclosure does not require reference to “substantial doubt” or “going concern.” Instead, Company A is disclosing the conditions or events that raised substantial doubt, its evaluation of the significance of those conditions in relation to the company’s ability to meet its obligations and its plans that alleviated the substantial doubt. Company A also is disclosing the information within other applicable U.S. GAAP disclosure requirements as applicable, e.g., risks, uncertainties, contingencies.

If substantial doubt is not alleviated, similar disclosures are required as well as an explicit statement that there is substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued.

Debt Classification Considerations

FASB’s proposal on debt classification issued January 10, 2017, provides guidance on whether debt should be classified as current or noncurrent in a classified balance sheet. The proposal applies to debt arrangements that provide a lender with a contractual right to receive consideration and a borrower with a contractual obligation to pay consideration on demand or on fixed or determinable dates. These arrangements are often a going concern factor.

Although both standards cover debt, ASU 2014-15 does not distinguish between short-term and long-term debt classifications on the balance sheet. For example, debt classified as long-term may be due within 12 months after the financial statement issuance date and, thus, within the scope of a going concern evaluation.

For more information, contact your BKD advisor.

Related Resource: Management’s Going Concern Responsibilities Defined

Contributor

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