STANDARDS AND EMERGING ISSUES ADVISORY GROUP MEETING

DISCUSSION – GOING CONCERN

MARCH 30, 2023

I. INTRODUCTION

The PCAOB's standard-setting agenda includes a project to consider how the requirements in AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, should be revised in response to changes in financial reporting, the auditing environment, and stakeholder needs.[1]

At the March 2023 meeting, members of the PCAOB's Standards and Emerging Issues Advisory Group (SEIAG) will discuss their views and experiences regarding the auditor's consideration of a company's ability to continue as a going concern. In addition, the Board is interested in whether SEIAG members are aware of academic research papers, external reports, or other information sources for evaluating relevant economic impacts or providing additional perspectives on this topic that should be taken into consideration.

The auditor's evaluation of a company's ability to continue as a going concern is a topic of interest to investors and other users of financial statements. Some other financial regulators and standard setters have revised their requirements related to the auditor's evaluation and reporting of going concern matters or are in the process of considering additional changes. This briefing paper is intended to facilitate a focused SEIAG discussion of these matters by providing background information and describing: (i) auditor responsibilities under U.S. securities laws and AS 2415; (ii) relevant changes to the requirements of financial reporting frameworks; (iii) input from previous PCAOB advisory group meetings; and (iv) the activities of other regulators and standard setters. This briefing paper also includes questions related to SEIAG members' views regarding: (i) the current state of auditor going

[1] AS 2415 addresses the auditor's responsibilities to evaluate a company's ability to continue as a going concern.

concern reporting; (ii) auditor procedures to evaluate going concern matters; and (iii) auditor reporting of going concern matters.

II. AUDITOR RESPONSIBILITIES UNDER U.S. SECURITIES LAWS AND AS 2415

An important consideration in the audit of a company's financial statements is the evaluation of the company's ability to continue as a going concern for a reasonable period of time. Under U.S. and international financial reporting frameworks, the continuation of a company as a going concern is presumed as the basis for preparing financial statements unless and until the company no longer reports under this basis, such as by changing to the liquidation basis of accounting. Preparation of financial statements under this presumption is commonly referred to as the going concern basis of accounting.

Requirements for the auditor's evaluation of a company's ability to continue as a going concern have increased in rigor since the issue was first addressed in U.S. auditing standards. In 1988 the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) issued SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, in response to public questions about companies' financial failures and whether auditors had "assumed sufficient responsibility for evaluating the continued existence of an entity." The new standard (codified as AU sec. 341, and currently codified in PCAOB auditing standards as AS 2415)[2] augmented an auditor's responsibilities with respect to a going concern assessment. That standard requires the auditor to: (i) evaluate in every audit whether there is substantial doubt about the company's ability to continue as a going concern; and (ii) include in the auditor's report an explanatory paragraph when substantial doubt exists.

In 1995, Congress incorporated certain aspects of the auditing standard into the securities laws through the enactment of the Private Securities Litigation Reform Act of 1995, which included the addition of Section 10A(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act").[3] That section requires that each audit of financial statements include, in accordance with auditing standards, "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."[4]

AS 2415 describes auditor responsibilities under PCAOB standards for evaluating a company's ability to continue as a going concern. Briefly, the standard requires the evaluation to be performed in the following manner:

- The auditor considers, in the course of performing audit procedures required by other standards, whether conditions and events have been identified that, considered in the aggregate, indicate there could be substantial doubt about a company's ability to continue

[2] Shortly after the Board's inception, the Board adopted the AICPA's standards, as in existence on April 16, 2003, as the Board's interim auditing standards. *See Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). AU sec. 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, was one of these auditing standards. As of December 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system, at which time AU sec. 341 was designated as AS 2415. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015).

[3] 15 U.S.C. § 78j-1(a)(3).

[4] *Id.*

as a going concern for a reasonable period of time, no more than one year beyond the date of the financial statements;

- If the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor: (i) obtains information about management's plans that are intended to mitigate the effect of such conditions or events, and (ii) assesses the likelihood that such plans can be effectively implemented; and
- After evaluating management's plans, if the auditor concludes that substantial doubt is not alleviated, the auditor: (i) considers the possible effects on the financial statements and adequacy of the related disclosure, and (ii) includes a going concern paragraph (following the opinion paragraph) in the audit report. If the auditor concludes that substantial doubt is alleviated, no paragraph is required, but the auditor should consider the need for financial statement disclosure.

III. CHANGES TO THE REQUIREMENTS OF FINANCIAL REPORTING FRAMEWORKS

When AS 2415 was issued in 1988, U.S. accounting standards (generally accepted accounting principles or U.S. GAAP) did not require management to perform a going concern assessment or provide related financial statement disclosures. After its issuance, both U.S. GAAP and International Financial Reporting Standards (IFRS) have been revised to require a company's management to evaluate the company's ability to continue as a going concern and to make certain related disclosures in the financial statements, for both annual and interim reporting periods.

Since 2016, U.S. GAAP has required a company's management to assess the company's ability to continue as a going concern for one year after the date that the financial statements are issued (or are available to be issued, when applicable) and to disclose in the financial statements when substantial doubt exists or when substantial doubt has been alleviated by management's plans.[5] Under U.S. GAAP, "substantial doubt" exists "when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued" (for issuers) or "are available to be issued" (for non-issuers). U.S. GAAP requires financial statement disclosure of "substantial doubt" using a threshold of "probable," which means "likely to occur."[6]

In April 2001, the International Accounting Standards Board adopted International Accounting Standard 1, *Presentation of Financial Statements*, (IAS 1) which had originally been issued by the International Accounting Standards Committee in September 1997. IAS 1 established requirements in IFRS for management to evaluate the company's ability to continue as a going concern, and to make

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[5] *See* FASB, *Financial Accounting Series, Accounting Standards Update No. 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* (Aug. 2014) (effective for the annual period ending after Dec. 15, 2016, and for annual periods and interim periods thereafter). *See also* SEC Codification of Financial Reporting Policies Section 607.02 (Feb. 15, 1984) (stating that "filings containing accountant's reports that are qualified as a result of questions about the entity's continued existence must contain appropriate and prominent disclosure of the registrant's financial difficulties and viable plans to overcome these difficulties. Such disclosure is required by existing rules and by the antifraud provisions of the federal securities laws.").

[6] U.S. GAAP provides that the term "probable" is used consistently with its use in ASC Topic 450, *Contingencies*. Topic 450 specifies three levels of likelihood—"probable" ("likely to occur"), "remote" (chance of occurrence is "slight"), and reasonably possible (chance of occurrence is "more than remote but less than likely").

related financial statement disclosures. IFRS requirements differ from the analogous U.S. GAAP requirements, including the threshold for financial statement disclosure and the period over which going concern is evaluated. For example, IFRS requires financial statement disclosure of "material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern." IFRS also requires that management take into account in its going concern assessment "all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period."[7]

The establishment of requirements under U.S. GAAP and IFRS for companies to perform a going concern assessment did not change the auditor's obligation under Section 10A of the Exchange Act and under AS 2415 to independently evaluate whether there is substantial doubt about the ability of the company to continue as a going concern during the ensuing fiscal year. Auditors continue to be responsible for evaluating whether the financial statements are presented fairly and in conformity with the applicable financial reporting framework,[8] which includes evaluating the company's required assessment of its ability to continue as a going concern and, when required, related financial statement disclosures. Thus, these changes to the financial reporting frameworks mean that the auditor both reviews management's going concern assessment and performs its own, independent going concern evaluation. The auditor's going concern evaluation and reporting continue to serve as an independent and objective early signal to investors of company financial distress.

IV. PCAOB ADVISORY GROUP DISCUSSIONS

The staff has discussed the auditor's going concern evaluation with PCAOB advisory groups on multiple occasions.

A number of members of the Standing Advisory Group (SAG) commented on the importance of the auditor's going concern evaluation and reporting, and they generally have expressed support for improving the auditor's going concern evaluation and reporting.[9] They have also provided a wide range of comments on how to improve such evaluation and reporting.

The PCAOB's outreach activities have included consideration of views expressed by members of the former Investor Advisory Group (IAG).[10] Members of the IAG emphasized to the PCAOB the importance to investors of the auditor's going concern evaluation and related reporting. At the same time, IAG members also expressed concerns about the effectiveness of auditor going concern reporting to provide a signal of a company's financial difficulties and have suggested strengthening the auditing standards.

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7 *See* paragraph 26 of IAS 1.

8 *See* paragraphs .30 and .31 of AS 2810, *Evaluating Audit Results*.

9 *See* April 2, 2009, November 9, 2011, May 17, 2012, and June 25, 2014 meetings of the SAG. An archive of SAG meeting agendas, briefing papers, and webcasts, is available at https://pcaobus.org/about/advisory-groups/archive-advisory/standing-advisory-group/sagmeetingarchive.

10 *See* Mar. 28, 2012 and Sept. 9, 2015 meetings of the IAG. An archive of IAG meeting agendas, briefing papers, and webcasts, is available at https://pcaobus.org/about/advisory-groups/archive-advisory/iag/iagmeetingarchive.

V. *ACTIVITIES OF OTHER REGULATORS AND STANDARD SETTERS*

Other audit standard setters and regulators have updated, or are considering updating, their standards regarding the auditor's evaluation of a company's ability to continue as a going concern. For example, in September 2019, the U.K. Financial Reporting Council (FRC) issued a revised going concern standard "in response to recent Enforcement cases and well-publicized corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after."[11] According to the FRC, the revised standard requires:

- Greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement;
- Improved transparency with a new reporting requirement for the auditor of public interest entities, and listed and large private companies, to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect; and
- A stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.

In addition, the International Auditing and Assurance Standards Board (IAASB) is currently working to revise its standard, ISA 570 (Revised), *Going Concern*. According to its website, the project focuses on making targeted rather than comprehensive revisions.[12] In revising the standard, the IAASB's stated aims are to:

- Promote consistent practice and behavior and facilitate effective responses to identified risks of material misstatement related to going concern;
- Strengthen the auditor's evaluation of management's assessment of going concern, including reinforcing the importance, throughout the audit, of the appropriate exercise of professional skepticism; and
- Enhance transparency with respect to the auditor's responsibilities and work related to going concern where appropriate, including strengthening communications and reporting requirements.

The 2022-23 Work Plan of the AICPA's Auditing Standards Board includes a similar project, with the stated objective to "consider additional guidance or actions that might be taken to address issues and challenges relating to addressing going concern in an audit of financial statements."[13]

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[11] *See* International Standard on Auditing (UK) 570 (Revised Sept. 2019), Going Concern, and "FRC strengthens Going Concern audit standard," available at https://www.frc.org.uk/news/september-2019/frc-strengthens-going-concern-audit-standard (Sept. 30, 2019).

[12] *See* IAASB's *Going Concern Project Page,* available at https://www.iaasb.org/consultations-projects/going-concern.

[13] *See* AICPA ASB 2022-23 Work Plan, available at https://www.aicpa.org/resources/landing/asb-auditing-standards-board.

VI. SEIAG MEMBERS' VIEWS ON THE STATE OF AUDITOR GOING CONCERN REPORTING

As described above, the auditor's going concern evaluation of issuers is required under federal securities law and AS 2415. Through our research and outreach, we understand that auditor responsibilities to evaluate a company's ability to continue as a going concern remain an area of interest for stakeholders. That outreach further indicates that some stakeholders, including investors, believe that current auditor going concern reporting practices may not accomplish their intended purpose—to provide early warnings of companies' inability to meet their obligations as they become due within one year. While no auditing standard could ensure an advance warning in every case (for example, company financial failures can occur suddenly, based on unforeseen events or sudden deterioration in industry or general economic conditions), the staff is seeking members' views on the current state of auditor going concern reporting and auditor procedures to evaluate and report on going concern matters.

DISCUSSION QUESTIONS:

1. In general, how do stakeholders use the paragraph on going concern in the audit report to inform investment decisions (i.e., is current auditor reporting decision-useful)?
2. In general, what are your views on the use of information external to the company and/or the use of emerging technologies as part of the auditor's evaluation of a company's ability to continue as a going concern?
3. Are there differences between how auditors and users of audit reports view auditor responsibilities regarding going concern? For example, is more transparency needed about the purpose of the auditor's work in relation to the evaluation of a company's ability to continue as a going concern? Do users of audit reports expect that going concern evaluation and reporting are designed to predict bankruptcy?

VII. AUDITOR PROCEDURES TO EVALUATE A COMPANY'S ABILITY TO CONTINUE AS A GOING CONCERN

AS 2415 is premised on the view that the audit evidence collected during the course of the audit should be sufficient to identify going concern matters. The standard states:

> It is not necessary 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 for a reasonable period of time. The results of auditing procedures designed and performed to achieve other audit objectives should be sufficient for that purpose.[14]

AS 2415 does not describe separate audit procedures to evaluate whether management's going concern assessment and related disclosures are in conformity with the applicable financial reporting framework. Auditors continue to be responsible, overall, for evaluating whether the financial statements are presented fairly in conformity with the applicable financial reporting framework,[15] which necessarily

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14 *See* AS 2415.05.

15 *See* paragraphs .30 and .31 of AS 2810, *Evaluating Audit Results*.

includes evaluating the company's required assessment of its ability to continue as a going concern and, when required, related financial statement disclosures.

PCAOB inspections have found that some auditors did not fulfill their responsibilities under AS 2415 and other standards when evaluating a company's ability to continue as a going concern. For example, staff inspectors have identified instances in which auditors did not: (i) consider whether identified conditions and events indicated there could be substantial doubt about the company's ability to continue as a going concern or (ii) evaluate the company's plans to mitigate the effects of the identified conditions and events that raised substantial doubt.

The staff is considering the need to strengthen the performance requirements of AS 2415 related to the auditor's evaluation. Therefore, the staff is seeking members' views, in particular those of auditor members, on the current practices related to evaluating the company's going concern assessment; identifying conditions and events that indicate there could be substantial doubt; and when substantial doubt exists, evaluating the company's plans to alleviate the adverse effects of the conditions or events that raise substantial doubt.

DISCUSSION QUESTIONS:

4. In your experience, what audit procedures are commonly performed to (i) identify conditions and events that indicate there could be substantial doubt about the company's ability to continue as a going concern, and (ii) evaluate the company's going concern assessment?
5. In your experience, what factors are most relevant in determining if conditions and events indicate that there could be substantial doubt about a company's ability to continue as a going concern?
6. In your experience, what audit evidence is generally necessary to conclude that a company's plans alleviate the adverse effects of conditions and events that raise substantial doubt about the company's ability to continue as a going concern?
7. How can the auditor's procedures be enhanced? Are there opportunities to improve the required audit procedures when evaluating the company's going concern assessment or when evaluating the company's plans to alleviate the adverse effects of conditions and events that raise substantial doubt about the company's ability to continue as a going concern? If so, what are those opportunities?

VIII. AUDITOR REPORTING OF GOING CONCERN MATTERS

AS 2415 requires that if, after evaluating management's plans, the auditor concludes that substantial doubt is not alleviated, the auditor: (i) considers the possible effects on the financial statements and adequacy of the related disclosure, and (ii) includes a going concern paragraph in the audit report. If the auditor concludes that substantial doubt is alleviated, a going concern paragraph is not required, but AS 2415 states that the auditor should consider the need for disclosures in the financial statements.

Under AS 2415, the going concern paragraph includes: (i) a statement that substantial doubt exists about the company's ability to continue as a going concern; (ii) a description of the conditions or events resulting in substantial doubt about the company's ability to continue as a going concern; and (iii) a reference to the financial statement disclosure in which management discusses the conditions or events resulting in substantial doubt.[16] Further, the auditor may include an emphasis of matter paragraph to emphasize certain matters, including certain matters related to the company's ability to continue as a going concern.[17]

In addition to the auditor's reporting under AS 2415, the staff is considering the auditor's reporting under AS 3101, including the existing requirements regarding critical audit matters which AS 3101 requires to be included in an audit report for audits of certain types of issuers.[18] AS 3101 states that critical audit matters are not a substitute for required explanatory language, such as a going concern explanatory paragraph. AS 3101 further states that if a matter that meets the definition of a critical audit matter also requires an explanatory paragraph, such as a matter related to going concern, the auditor may include the information required by AS 3101 in the explanatory paragraph and include a cross-reference in the critical audit matters section of the auditor's report to the explanatory paragraph. That standard also states that, alternatively, the auditor may include the explanatory paragraph and critical audit matter communication separately in the audit report and add a cross-reference between the two sections. While in certain instances the auditor's going concern evaluation could be determined to be a critical audit matter requiring discussion in the audit report, staff research suggests that audit reports do not frequently include critical audit matter disclosures related to the auditor's going concern evaluation.

Another consideration is that while AS 2415 requires that the auditor include a going concern explanatory paragraph when substantial doubt is raised and not alleviated by the company's plans, it does not require disclosure of information related to the auditor's going concern evaluation in other circumstances. AS 3101 permits the auditor to include an emphasis of matter paragraph in the audit report, and that emphasis of matter paragraph could be used to communicate additional information regarding the auditor's going concern evaluation. However, we understand that auditors seldom use this option in practice.

As described above, other regulators and standard setters have made, or are considering making, changes to their requirements regarding the auditor's evaluation of and reporting on matters related to a company's ability to continue as a going concern. Previous discussions with PCAOB advisory groups have indicated an interest from some stakeholders for the auditor's report to be more transparent and to provide additional information about the audit engagement and about the auditor's evaluation of going concern. The staff is interested in members' perspectives on the content of the auditor's current going concern paragraph and, if enhancements are needed, what changes are appropriate to make auditor going concern reporting more meaningful.

DISCUSSION QUESTIONS:

8. Is the content of the auditor's going concern paragraph useful to investors? Can the auditor's reporting of going concern matters be enhanced to be more useful to investors? If so, how?

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16 *See* AS 2415.12-.13 and paragraph 18.b of AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

17 *See* AS 3101.19.

18 *See* AS 3101.05 and .11–.17.

9. Would additional information about "close call" situations, beyond those that might already be contained in some critical audit matters, be useful to investors? For example, would additional information about the auditor's determination of whether conditions and events raise substantial doubt, or whether the company's plans alleviate substantial doubt, be useful to investors?
10. Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continues as a Going Concern,* states that management's going concern evaluation under the applicable financial reporting framework is not conclusive to the auditor's evaluation under AS 2415. What challenges do auditors have under today's model in reporting "close call" situations?

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The PCAOB is a nonprofit corporation established by Congress to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

AS 2415: Consideration of an Entity's Ability to Continue as a Going Concern

.01 This section provides guidance to the auditor in conducting an audit of financial statements in accordance with the standards of the PCAOB with respect to evaluating whether there is substantial doubt about the entity's ability to continue as a going concern.[1,2] Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Ordinarily, information that significantly contradicts the going concern assumption relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.

The Auditor's Responsibility

.02 The auditor has 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 (hereinafter referred to as *a reasonable period of time*). 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. Information about such conditions or events is obtained from the application of auditing procedures planned and performed to achieve audit objectives that are related to management's assertions embodied in the financial statements being audited, as described in AS 1105, *Audit Evidence*.

.03 The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the following manner:

a. The auditor considers whether the results of his procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit 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 for a reasonable period of time. It may be necessary to obtain additional information about such conditions and events, as well as the appropriate evidential matter to support information that mitigates the auditor's doubt.

b. If the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented.

c. After the auditor has evaluated management's plans, he concludes whether he has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, he should (1) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and (2) include an explanatory paragraph, including an appropriate title (immediately following the opinion paragraph), in his audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he should consider the need for disclosure.

.04 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.

Audit Procedures

.05 It is not necessary 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 for a reasonable period of time. The results of auditing procedures designed and performed to achieve other audit objectives should be sufficient for that purpose. The following are examples of procedures that may identify such conditions and events:

- Analytical procedures
- Review of subsequent events
- Review of compliance with the 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
- Confirmation with related and third parties of the details of arrangements to provide or maintain financial support

Consideration of Conditions and Events

.06 In performing audit procedures such as those presented in paragraph .05, the auditor may identify information about certain conditions or events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. The following are examples of such conditions and events:

- *Negative trends*—for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, adverse key financial ratios
- *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, need to seek new sources or methods of financing or to dispose of substantial assets
- *Internal matters*—for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, need to significantly revise operations
- *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; uninsured or underinsured catastrophe such as a drought, earthquake, or flood

Consideration of Management's Plans

.07 If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he should consider management's plans for dealing with the adverse effects of the conditions and events. The auditor should obtain information about the plans and consider whether it is likely the adverse effects will be mitigated for a reasonable period of time and that such plans can be effectively implemented. The auditor's considerations relating to management plans may include the following:

- Plans to dispose of assets
    - Restrictions on disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
    - Apparent marketability of assets that management plans to sell
    - Possible direct or indirect effects of disposal of assets
- Plans to borrow money or restructure debt
    - 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
    - Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
    - Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- Plans to reduce or delay expenditures
    - 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
    - Possible direct or indirect effects of reduced or delayed expenditures
- Plans to increase ownership equity
    - Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
    - Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors

.08 When evaluating management's plans, the auditor should identify those elements that are particularly significant to overcoming the adverse effects of the conditions and events and should plan and perform auditing procedures to obtain evidential matter about them. For example, the auditor should consider the adequacy of support regarding the ability to obtain additional financing or the planned disposal of assets.

.09 When prospective financial information is particularly significant to management's plans, the auditor should request management to provide that information and should consider the adequacy of support for significant assumptions underlying that information. The auditor should give particular attention to assumptions that are—

- Material to the prospective financial information.
- Especially sensitive or susceptible to change.
- Inconsistent with historical trends.

The auditor's consideration should be based on knowledge of the entity, its business, and its management and should include (*a*) reading of the prospective financial information and the underlying assumptions and (*b*) comparing prospective financial information in prior periods with actual results and comparing prospective information for the current period with results achieved to date. If the auditor becomes aware of factors, the effects of which are not reflected in such prospective financial information, he should discuss those factors with management and, if necessary, request revision of the prospective financial information.

Consideration of Financial Statement Effects

.10 When, after considering management's plans, the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should consider the possible effects on the financial statements and the adequacy of the related disclosure. Some of the information that might be disclosed includes—

- 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.
- The possible effects of such conditions and events.
- Management's evaluation of the significance of those conditions and events and any mitigating factors.
- Possible discontinuance of operations.
- Management's plans (including relevant prospective financial information).[3]
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

.11 When, primarily because of the auditor's consideration of management's plans, he concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is alleviated, he should consider the need for disclosure of the principal conditions and events that initially caused him to believe there was substantial doubt. The auditor's consideration of disclosure should include the possible effects of such conditions and events, and any mitigating factors, including management's plans.

Consideration of the Effects on the Auditor's Report

.12 If, after considering identified conditions and events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the audit report should include an explanatory paragraph, including an appropriate title (immediately following the opinion paragraph), to reflect that conclusion.[4] The auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" [or similar wording that includes the terms substantial doubt *and* going concern] as illustrated in paragraph .13.

.13 An example follows of an explanatory paragraph (immediately following the opinion paragraph) in the auditor's report describing an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time.[5]

[*Appropriate Title*]

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

.14 If the auditor concludes that the entity's disclosures with respect to the entity's ability to continue as a going concern for a reasonable period of time are inadequate, a departure from generally accepted accounting principles exists. This may result in either a qualified (except for) or an adverse opinion. Reporting guidance for such situations is provided in AS 3105.

.15 Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, should not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. When financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period, reporting guidance is provided in AS 3105.

.16 If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis, and that doubt has been removed in the current period, the explanatory paragraph included in the auditor's report (following the opinion paragraph) on the financial statements of the prior period should not be repeated.

Documentation

.17 As stated in paragraph .03 of this section, the auditor considers whether the results of the auditing procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit 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 for a reasonable period of time. If, after considering the identified conditions and events in the aggregate, the auditor believes there is substantial doubt about the ability of the entity to continue as a going concern for a reasonable period of time, he or she follows the guidance in paragraphs .07 through .16. In connection with that guidance, the auditor should document all of the following:

a. The conditions or events that led him or her to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the adverse effects of the conditions or events.

c. The auditing procedures performed and evidence obtained to evaluate the significant elements of management's plans.

d. The auditor's conclusion as to whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated. If substantial doubt remains, the auditor also should document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor also should document the conclusion as to the need for disclosure of the principal conditions and events that initially caused him or her to believe there was substantial doubt.

e. The auditor's conclusion as to whether he or she should include an explanatory paragraph in the audit report. If disclosures with respect to an entity's ability to continue as a going concern are inadequate, the auditor also should document the conclusion as to whether to express a qualified or adverse opinion for the resultant departure from generally accepted accounting principles.

Communications with Audit Committees

.17A Paragraph .17 of AS 1301, *Communications with Audit Committees*, describes matters an auditor is required to communicate to the audit committee related to the auditor's evaluation of a company's ability to continue as a going concern for a reasonable period of time.

Effective Date

.18 This section is effective for audits of financial statements for periods beginning on or after January 1, 1989. Early application of the provisions of this section is permissible.

Footnotes (AS 2415 - Consideration of an Entity's Ability to Continue as a Going Concern):

[1] This section does not apply to an audit of financial statements based on the assumption of liquidation (for example, when [*a*] an entity is in the process of liquidation, [*b*] the owners have decided to commence dissolution or liquidation, or [*c*] legal proceedings, including bankruptcy, have reached a point at which dissolution or liquidation is probable). *See* Auditing Interpretation, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting" (AI 23.33-.38).

[2] The guidance provided in this section applies to audits of financial statements prepared either in accordance with generally accepted accounting principles or in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. References in this section to generally accepted accounting principles are intended to include a comprehensive basis of accounting other than generally accepted accounting principles (excluding liquidation basis).

[3] It is not intended that such prospective financial information constitute prospective financial statements meeting the minimum presentation guidelines set forth in AT section 301, *Financial Forecasts and Projections*, nor that the inclusion of such information require any consideration beyond that normally required by PCAOB auditing standards.

[4] The inclusion of an explanatory paragraph (immediately following the opinion paragraph) in the auditor's report contemplated by this section should serve adequately to inform the users of the financial statements. Nothing in this section, however, is intended to preclude an auditor from declining to express an opinion in cases involving uncertainties. If he disclaims an opinion, the uncertainties and their possible effects on the financial statements should be disclosed in an appropriate manner (*see* paragraph .10), and the auditor's report should give all the substantive reasons for his disclaimer of opinion (*see* paragraphs .44–.47 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*).

[5] In a going-concern explanatory paragraph, the auditor should not use conditional language in expressing a conclusion concerning the existence of substantial doubt about the entity's ability to continue as a going concern. Examples of inappropriate wording in the explanatory paragraph would be, "If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern" or "The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern."

AS 4105: Reviews of Interim Financial Information

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.21 *Inquiry concerning an entity's ability to continue as a going concern.* 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. However, such conditions or events may have existed at the date of prior-period financial statements.[14] In addition, in the course of performing review procedures on the current-period interim financial information, the accountant may become aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern. In either case, the accountant should (*a*) inquire of management as to its plans for dealing with the adverse effects of the conditions and events and (*b*) consider the adequacy of the disclosure about such matters in the interim financial information. [15] It ordinarily is not necessary for the accountant to obtain evidence in support of the information that mitigates the effects of the conditions and events.

Footnotes (AS 4105 - Reviews of Interim Financial Information):

[14]For purposes of this section, "conditions or events that existed at the date of prior-period financial statements" include (*a*) substantial doubt about the entity's ability to continue as a going concern that existed at the preceding year end, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (*b*) conditions and events disclosed in the immediately preceding interim period.

[15]Information that might be disclosed is set forth in paragraph .10 of AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*. If the accountant determines that the disclosure about the entity's possible inability to continue as a going concern is inadequate, a departure from generally accepted accounting principles exists.