IFRS

STAFF PAPER

13-14 November 2012

IFRS Interpretations Committee Meeting

Project	**Disclosure requirements about an assessment of going concern**		
Paper topic	Background and defining the issue		
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Purpose of this paper

1. In June 2012, the IFRS Interpretations Committee (the Interpretations Committee) received a request for clarification about IAS 1 *Presentation of Financial Statements*. This standard includes guidance on when financial statements should be prepared on a going concern basis. It also requires that when management are aware of material uncertainties about the entity's ability to continue as a going concern, those uncertainties shall be disclosed. The submitter, the International Audit and Assurance Standards Board (IAASB), thinks that the guidance about the disclosure of these uncertainties is not clear.

Background to 'going concern'

2. The financial crisis has made concerns about the going concern assessment more common. In 2008 the reduction in liquidity caused auditors and regulators to focus on going concern. The concern was heightened by a number of high-profile collapses that had not been identified in going concern-related disclosures beforehand.

3. Regulators and auditors have produced a wealth of guidance in response to these concerns, including:

   (a) Financial Reporting Council in the UK (UK FRC) *Going Concern and Liquidity Risk* 2008

   (b) European Commission Green Paper *Audit Policy: Lessons from the Crisis* 2010

   (c) Public Company Accounting Oversight Board's Investor Advisory Group *Agenda papers March 2012*

   (d) Compagnie Nationale des Commissaires aux Comptes (France) *Reports on the consequences of the financial crisis on the audit of accounts* 2008

   (e) Bank of Italy, Commissione Nazionale per le Società e la Borsa and Instituto per la Vigilanza sulle Assicurazioni Private February 2009 *Disclosure in financial reports on the going concern assumption, financial risks, tests of assets for impairment and uncertainties in the use of estimates*

4. The UK FRC also commissioned the Sharman Inquiry *Going Concern and Liquidity Risks: Lessons for Companies and Auditor* (Preliminary report issued November 2011; Final report issued June 2012). This report recommends that the current corporate governance, financial reporting and auditing going concern requirements should be moulded into a more integrated framework and suggests that the IASB and the IAASB should work closely together to achieve this.

5. Auditing guidance about the going concern assumption has developed in recent years. The International Standard of Auditing 570 *Going Concern* was effective from 15 Dec 2009. In addition, in June 2012 the submitter, the IAASB, initiated public consultation on improving the audit report *Invitation to Comment: Improving the Auditor's Report*. Two significant aspects of these proposals are:

   (a) to require the auditor to give a conclusion on the appropriateness of management's use of the going concern assumption in preparing the financial statements and an explicit statement as to whether material uncertainties in relation to going concern have been identified; and

(b) to require auditors to provide a commentary on matters that are, in the auditor's judgement, likely to be most important to investors' understanding of the financial statements

6. This has, in part, prompted the submitter's query.

Paper structure

7. The paper is organised as follows:

(a) the issue submitted;

(b) requirements of IAS 1;

(c) summary of outreach conducted;

(d) preliminary findings from outreach;

(e) scope of the issues to be addressed and possible solutions;

(f) discussions at the June IFRS Advisory Council (Advisory Council);

(g) staff analysis and recommendations; and

(h) assessment against the Interpretation Committee's agenda criteria.

The issue submitted

8. In the submission to the Interpretations Committee, the IAASB ask:

> In considering how to clearly convey the outcome of the auditor's work on going concern in the auditor's report, the IAASB has identified three areas where it believes further guidance may be beneficial:
>
> Are the criteria (or "threshold") for management's use of the going concern assumption the same as those for

> deeming the entity as being able to continue as a going concern?
>
> How should the term “significant doubt” be interpreted in relation to the concept of material uncertainty?
>
> What is management expected to disclose in relation to a material uncertainty?

9. The full submission is included as Appendix A. With the agreement of representatives of the submitter, this wording is simplified in the development of this paper.

Requirements of IAS 1

10. Going concern is addressed in paragraph 25 of IAS 1:

> 25 When preparing financial statements, management shall make an assessment of an 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 trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity shall disclose those uncertainties. 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.

11. It is also addressed in the Conceptual Framework:

> 4.1 The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it

is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

12. At issue are the narrow criteria for assessing going concern in IAS 1.25. The threshold for not preparing the financial statements on a going concern basis is a high one—intention to cease trading or liquidate or no reasonable way to avoid such a fate. That assessment about the basis of preparation of the financial statements is made at the date of preparation.

13. Many continue reading the same paragraph, IAS 1.25, as though the same high threshold applies to the disclosure of material uncertainties in the going concern assessment. If that is how the paragraph is interpreted, this interpretation leads to the conclusion that disclosure of material uncertainties will only occur when the going concern basis is no longer appropriate and the entity is about to cease operations or go into liquidation. This is obviously too late to provide useful information—and makes the disclosure requirement meaningless.

Summary of outreach conducted

14. We sent requests to the International Forum of Accounting Standard-setters (IFASS), the European Securities and Markets Authority (ESMA), the International Organization of Securities Commissions (IOSCO) and the technical departments of the major accounting firms on whether the issues raised by the submitter are widespread and have practical relevance and whether there are significant divergent interpretations.

15. Detailed discussion of the topic with the submitter led us to include some specific questions in our outreach, including:

    (a) Is the phrase 'ability to continue as a going concern' intended to mean that the entity will not be liquidated or cease operations, or does it mean (more broadly) that the entity will be able to discharge its obligations as they become due in the normal course of business?

(b) Would it assist if the words "and therefore meet its obligations as they become due in the normal course of business" were added at the end of "ability to continue as a going concern".

16. The outreach request itself is included as Appendix B.

Responses received

17. We received 24 responses to this informal outreach:

Global firms		6
Regulators		4
IFASS:		
Europe	5	
Asia–Oceania	5	
Latin America	2	
North America	1	
Africa	1	14
Total		24

Preliminary findings from outreach

Going concern as a basis for the preparation of the financial statements

18. All respondents thought that the criteria in IAS 1.25 for assessing going concern as a suitable basis for the preparation of the financial statements are clear and that the rebuttal of the going concern presumption was set at a suitably high level—ie, intends to cease trading or liquidate or no realistic alternative but to do so. Some noted that the Conceptual Framework extends this to include the material curtailment of the scale of the entity's operations. Some respondents noted that

many jurisdictions have specific requirements that define insolvency or provide guidance about local conditions that determine 'going concern'. In these jurisdictions, judgements about going concern as a basis for the preparation of financial statements arise mainly from local auditing standards and regulatory requirements rather than from financial reporting standards.

Threshold for disclosure of material uncertainties about the going concern assessment

19. There was, however, significant diversity about when disclosure of material uncertainties should be made.

20. The relevant guidance is interpreted in two different ways:

> IAS 1.25 …When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. ..

21. A minority of respondents think that the criteria used for the assessment of the need for disclosure are the same as those used for an assessment of whether going concern is an appropriate basis of preparation, that is unless management intends to liquidate, cease trading or has no realistic alternative but to do so. This interpretation would mean that disclosure would only be made when the entity is no longer a going concern and management is about to cease operations.

22. Most respondents take the view that disclosure is required at an earlier stage in order to forewarn investors about the uncertainties and their possible effect on the entity's future activities. Some go on to link 'the entity's ability to continue as a going concern' with its ability to discharge obligations in the ordinary course of business.

Nature of the disclosures

23. Many respondents discussed the nature of disclosures about material uncertainties about the going concern assessment.

24. Some respondents cautioned against trying to provide prescriptive requirements about what should be disclosed about material uncertainties relating to an entity's going concern assessment. They were concerned that such disclosures could become boilerplate. Others suggested detailed requirements about this disclosure, often drawn from their local guidance.

25. Some suggested that this disclosure was already covered by the requirements of IAS 1.22 (disclosure of critical assumptions made in the preparation of the financial statements) or IAS 1.15 (fair presentation) or the requirements of other Standards, such as IFRS 7 *Financial Instruments: Disclosure* 39(c) (disclosure on how an entity manages liquidity risk).

Previous submission to the Interpretations Committee

26. Some respondents referred to an earlier submission on this topic.

27. In March 2010, the Interpretations Committee received a request to clarify disclosures about uncertainties related to the going concern assessment. The submitter asked that disclosures about material uncertainties arising during management's assessment of going concern should be specifically identified as uncertainties that cast doubt on the entity's ability to continue as a going concern. This topic was not added to the Interpretation Committee's agenda because the Interpretations Committee concluded that IAS 1 provides sufficient guidance on these disclosure requirements and that the Interpretations Committee did not expect diversity to arise in practice. The agenda decision made in July 2010 is recorded in Appendix C.

Scope of the issues to be addressed and possible solutions

28. Comments received from respondents ranged over a number of additional aspects of the going concern assessment in addition to the questions asked about the disclosure of material uncertainties affecting the going concern assessment:

    (a) Some respondents think that we should specify who is responsible for the going concern assessment (auditors or management) and where this assessment should be presented (management commentary, audit report or financial statements) although most would consider that to be outside our remit.

    (b) Other respondents think that we should harmonise the requirements about going concern in IAS 1, for the presentation of financial statements, with the IAASB's work on improving the audit report in relation to going concern. This also echoes the recommendations of the Sharman Inquiry that the UK FRC, the IASB and the IAASB should work together to provide an integrated framework for the assessment and reporting of the going concern status, based on existing guidance from corporate governance, financial reporting and auditing requirements.

    (c) Some respondents think that we should conduct a comprehensive review of those parts of IFRSs that deal with liquidity risks, curtailment of operations or disclosure of uncertainty. Related standards include:

        (i) IFRS 4 *Insurance Contracts* and IFRS 7 *Financial Instruments: Disclosures*–IFRS 4.15 and IFRS 7.39 relate to liquidity;

        (ii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*–relates to contingencies; and

        (iii) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—IFRS 5.13 relates to abandonment.

(d) A few respondents think that we should address what they see as a more fundamental issue, that we should set out requirements for the preparation of the financial statements when the going concern basis of preparation is not appropriate—although one respondent accepted that these circumstances were so unusual that it would not be a priority. In our view, we should leave these requirements to local legislation because once liquidation is in prospect, local insolvency requirements are likely to come into play.

29. Audit firms in general wanted a clearer link between audit guidance and the IASB's requirements. Standard-setters and regulators, on the other hand, warned about the difficulties in trying to achieve an international solution on a topic that affects auditing, corporate governance, financial reporting and compliance. Many think that a local level of guidance is currently adequate to reflect local regulatory concerns.

Identified solutions

30. Respondents identified a range of possible approaches to the question about disclosure of material uncertainties:

Proposal	**Pros**	**Cons**
Prepare an agenda rejection	Easy Reinforces 2010 IFRIC conclusion on a narrower submission	Does not address diversity of disclosure reported in 2012 Not seen as responsive or helpful
Converge going concern wording in IFRS with the wording of ISA 570	Makes requirements clearer for auditors Acts upon Sharman recommendation	Although the assessment threshold is similar, ISA 570 includes additional guidance that may conflict with IFRSs. This is a major topic—would require IASB redeliberation of both this part of the Framework and IAS 1
Require explicit disclosure of management's and / or auditor's basis of assessment of going concern	Ensures full disclosure in all circumstances	Onerous on both preparers and auditors Commercial and confidentiality issues Would result in excessive disclosure for many entities where the going concern assumption is not contentious
IASB to redeliberate IAS 1.25-26 in its entirety	Could be done as part of Conceptual Framework development	Long time scale Risk of unintended consequences of redeliberating 'material uncertainty' and 'significant doubt'.

Discussions at the June Advisory Council

31. At the June meeting of the Advisory Council, Roger Marshall (Chair of the Accounting Council, UK FRC) briefed members of the Advisory Council on actions being taken in response to the Sharman Inquiry and others. Lord Sharman recommended enhanced processes in three areas: management's review of the business; audit committees; and auditors' reports. The objective is to require more disclosure in financial statements, management commentary and the auditors' reports regarding material risks and uncertainties that could affect the reporting entity's ability to continue as a going concern.

32. Members of the Advisory Council expressed the view that this may be more of a governance issue; and that early warning signals to investors would be useful but must not become so commonplace or vague as to be meaningless. The suggestion was made that perhaps the IFRS Interpretations Committee or the IASB could provide guidance on disclosures relating to material uncertainties.

Staff analysis and recommendations

33. Having analysed the results of outreach conducted on this topic, and mindful of the comments made by members of the Advisory Council, the staff recommendation is to limit our work to answering two questions:

    (a) When should an entity be required to disclose information about material uncertainties related to events or circumstance that cast significant doubts upon the entity's ability to continue as a going concern?

    (b) What is the objective of those disclosures about material uncertainties about the entity's ability to continue as a going concern and what disclosures should be required?

34. If the IASB were to decide subsequently to address the larger issues relating to the interaction of the requirements in financial reporting about going concern with those of auditing and corporate governance, we think that that could be done at a

later stage as part of the IASB's work on the Conceptual Framework. In addition, we think that this is a topic that could be addressed at some stage by the International Integrated Reporting Council.

35. Representatives of the submitter, the IAASB, has agreed to the simplification of the wording of its submission as presented in paragraph 33 above.

Assessment against the Interpretations Committee's agenda criteria

36. Each of the questions to be addressed will be separately assessed against the agenda-setting criteria of the Interpretations Committee. (See papers 12B and 12C).

Question for the Interpretations Committee
Does the Interpretations Committee agree with the staff's recommendation that (a) other matters raised on this topic are too broad to be addressed by the interpretations Committee and (b) that we limit our discussions to two areas about the disclosure of material uncertainties about the going concern assessment—(i) when those uncertainties should be disclosed and (ii) what should be disclosed about those uncertainties?

Appendix A Original agenda request

A1. Below is the original request submitted by the International Auditing and Assurance Standards Board (IAASB). This request contains two appendices Appendix 1 and Appendix 2.

Briefing Paper – Clarification of the Concepts Relating to Going Concern in IFRSs

Background

1. The recent global financial crisis has highlighted the importance to financial markets of clear and timely financial reporting, and has resulted in a greater focus on the assessment of going concern and related disclosures. In the wake of the crisis, major policy debates have been initiated regarding the lessons that can be learned and the actions that can be taken with respect to going concern and liquidity risk issues that entities may be facing, including how the auditor might play a greater role in this regard.[1] The fact that going concern remains an especially critical financial reporting and auditing issue is underscored by the recent European Commission (EC) policy proposals regarding the statutory audit, a significant element of which is intended to enhance auditor reporting through the inclusion of an affirmative statement regarding going concern in the auditor's report for a public interest entity (PIE).[2] In addition, some respondents to the IAASB's May 2011 consultation[3] asked for clarification of the respective roles and responsibilities of management and the

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1 For example:

- In March 2011, the UK FRC launched an inquiry to identify lessons for companies and auditors addressing going concern and liquidity risks (the Sharman Inquiry) (see www.frc.org.uk/about/sharmaninquiry.cfm).
- In March 2012, the US PCAOB Investor Advisory Group (IAG) held discussions on the topic of going concern and related recommendations for possible actions by policy makers to enhance reporting by both companies and auditors regarding going concern (see pcaobus.org/News/Events/Pages/03282012_IAGMeeting.aspx).

2 Under Article 22 of the EC's proposed regulation concerning audit reporting for PIEs, auditors would be required to provide "a statement on the situation of the audited entity or, in case of the statutory audit of consolidated financial statements, of the parent undertaking and the group, especially an assessment of the entity's or the parent undertaking's and group's ability to meet its/their obligation in the foreseeable future and therefore continue as a going concern." The EC's proposals can be accessed at http://ec.europa.eu/internal_market/auditing/reform/index_en.htm.

3 To explore options to enhance auditor reporting globally, the IAASB issued a consultation paper *Enhancing the Value of Auditor Reporting: Exploring Options for Change* in May 2011 (see http://www.ifac.org/sites/default/files/publications/exposure-drafts/CP_Auditor_Reporting-Final.pdf). The IAASB subsequently approved a project on auditor reporting in December 2011 (see http://www.ifac.org/sites/default/files/meetings/files/20111205-IAASB-Updated%20Agenda_Item_5-A-Auditor_%20Reporting_Project_Proposal-Approved__Clean_.pdf).

auditor regarding going concern, and for auditors to report the outcome of their audit work regarding going concern. These developments provide a significant impetus for the IAASB to seek to enhance auditor reporting in this area.

2. In response to these developments, the IAASB intends to propose in its forthcoming consultation on auditor reporting[4] that all auditors' reports be required to include:
   (a) A conclusion regarding the appropriateness of management's use of the going concern assumption; and
   (b) A statement regarding whether, based on the audit work performed, material uncertainties have been identified related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

3. To support this proposal, the IAASB believes that it may be necessary to provide additional guidance in the International Standards on Auditing (ISAs) regarding the nature of going concern and material uncertainties related to it. In this regard, the IAASB believes that, in developing and finalizing such guidance, it would be highly desirable to coordinate closely with the International Accounting Standards Board (IASB), given that the guidance on going concern in the ISAs (see Appendix 1) is closely interrelated with that in International Financial Reporting Standards (IFRSs) (see Appendix 2).

Matters for IASB Consideration

4. In considering how to clearly convey the outcome of the auditor's work on going concern in the auditor's report, the IAASB has identified three areas where it believes further guidance may be beneficial:
   (a) Are the criteria (or "threshold") for management's use of the going concern assumption the same as those for deeming the entity as being able to continue as a going concern?
   (b) How should the term "significant doubt" be interpreted in relation to the concept of material uncertainty?
   (c) What is management expected to disclose in relation to a material uncertainty?

Criteria for Use of the Going Concern Assumption and for Regarding the Entity as a Going Concern

5. IAS 1,[5] paragraph 25, requires that when preparing the financial statements, management make an assessment of the entity's ability to continue as a going concern. It requires that the entity prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

6. From this requirement, it is clear that use of the going concern basis of accounting (i.e., the going concern assumption) is appropriate only when the entity is not already in extreme financial distress (i.e., when the entity needs to liquidate or cease operations). This is also emphasized by the requirement in IAS 10,[6] paragraph 14 (see Appendix 2). It is less clear

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[4] At its June 2012 meeting, the IAASB will be considering for approval an Invitation to Comment that will seek stakeholder input on a number of proposals to enhance the communicative value of auditor reporting (see http://www.ifac.org/sites/default/files/meetings/files/20120611-IAASB-Agenda_Item_3A-Auditor_Reporting__Draft_ITC-final.pdf).

[5] IAS 1, *Presentation of Financial Statements*

[6] IAS 10, *Events after the Reporting Period*

whether *proximity to liquidation* is, or should be, the same threshold for the disclosure of material uncertainties relating to going concern.

7. A potential for differing views on this is created by the use of the phrase “ability to continue as a going concern” in the first sentence of paragraph 25 of IAS 1 in relation to the assessment that management is required to make, and in the description of a material uncertainty (“significant doubt upon the entity’s ability to continue as a going concern”). It is unclear from the guidance in IAS 1 whether the “ability to continue as a going concern” is intended to simply mean that the entity will not need to liquidate or cease operations, or whether it more broadly means that the entity will be able to discharge its obligations as they become due in the normal course of business. There is a conceptual difference in that an entity that is facing significant difficulties in meeting its obligations as they become due may not be facing liquidation. For example, an entity that is unable to make its normal debt repayments may address this through debt rescheduling, raising additional equity capital by way of a rights issue, or selling part of its business.
8. Given that users are seeking timelier disclosures in relation to going concern, linking the disclosure of a material uncertainty to the broader concept of the entity’s ability to discharge its obligations as they become due in the normal course of business would make information about such a material uncertainty public earlier than if the disclosure were linked to the entity’s imminent liquidation.

Meaning of “Significant Doubt”

9. The disclosure of material uncertainties relating to going concern is important information for users. It is therefore very important that preparers and auditors understand the threshold for the disclosure of material uncertainties and apply it consistently.
10. IAS 1, paragraph 25, requires that when management is aware, in making its assessment, of <u>material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern</u>, the entity disclose those uncertainties. IAS 1, however, does not define the concept of material uncertainty or provide guidance to explain what it means.
11. The interaction of the terms “material,” “may,” and “significant” make this a very complex concept and can lead to confusion in practice.
12. An uncertainty about whether an entity will be able to continue as a going concern will likely always be material to users. For example, from a capital markets perspective, even a slight perception of a risk of a going concern issue can have a material impact on bond yields or the interest rate charged by other creditors (e.g., banks) to the entity. Arguably, it is the *likelihood* of the occurrence of the event or condition that will give rise to the existence of the need for disclosures.
13. In addition, the word “may” in a probabilistic sense means “possible,” which implies a very low threshold for identifying when events or conditions “may” cast significant doubt. On the other hand, the use of the word “significant” implies a high threshold.

Disclosure of Material Uncertainties

14. Paragraph 25 of IAS 1 requires that when management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern, the entity disclose those uncertainties. There is no guidance as to what management is in fact expected to disclose. In particular, it is unclear whether management is expected to disclose the nature

of the event or condition, the severity of the issue, the likelihood of its occurrence, or the likely effect of mitigating circumstances, including management actions to address the issue.

APPENDIX 1 to the Original Agenda Request

Relevant Requirements and Guidance in ISA 570[7]

2. Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared 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. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant (for example, the going concern basis is not relevant for some financial statements prepared on a tax basis in particular jurisdictions). When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

9. The objectives of the auditor are:

   (a) To obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements;

   (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

   …

12. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern.

13. In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements as defined in ISA 560,[8] the auditor shall request management to extend its assessment period to at least twelve months from that date.

16. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors.

17. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for:

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[7] ISA 570, *Going Concern*

[8] ISA 560, "Subsequent Events," paragraph 5(a).

(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

(b) In the case of a compliance framework, the financial statements not to be misleading.

APPENDIX 2 to the Original Agenda Request

Relevant Requirements and Guidance in IASs 1 and 10

IAS 1

25. When preparing financial statements, management shall make an assessment of an 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 trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. 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.

26. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion 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.

IAS 10

14. An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

15. Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

16. IAS 1 specifies required disclosures if:

(a) the financial statements are not prepared on a going concern basis; or

(b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

The events or conditions requiring disclosure may arise after the reporting period.

Appendix B-Questions sent for outreach

B1. We asked IOSCO, ESMA, the technical departments in accounting firms and International Forum of Standard Setters to provide us with feedback on whether the issue raised in the submission:

(a) is widespread and has practical relevance; and

(b) indicates that there are significant divergent interpretations (either emerging or existing in practice).

B2. More specifically, we sent the following request:

> The IAASB believes that clarification may be necessary regarding the need for, and nature of, disclosures especially when an entity is facing financial difficulties but can take one or more actions (e.g., rights issue, debt rescheduling, fire sale of assets, etc.) in order to avoid liquidation or ceasing to trade. The IAASB notes that the UK Sharman inquiry concluded that the description of such matters in IFRSs is open to different interpretations and is in fact interpreted differently by different people.
>
> The following questions are raised:
>
> (1) Are the criteria for management's use of the going concern assumption (i.e., liquidation or ceasing to trade) the same as those for the disclosure of material uncertainties? In particular, is the phrase "ability to continue as a going concern" intended to simply mean that the entity will not need to liquidate or cease operations, or does it mean more broadly that the entity will be able to discharge its obligations as they become due in the normal course of business?
>
> (2) What disclosures should be given about material uncertainties? In particular, what should be disclosed

when an entity is in financial difficulties but management is confident that it can take one or more actions outside the ordinary course of business, and therefore prepares financial statements on a going concern basis?

(3) Is IAS 1 sufficiently clear on this? Would it assist if the words “and therefore meet its obligations as they become due in the normal course of business” were added at the end of “ability to continue as a going concern” in (c) above?

Questions for response:

A) In your jurisdiction, how common are the issues raised in regards to item (1) above? If it occurs, could you provide us with information that the Committee could use to assess how widespread the issue is?

B) In your view, is there diversity in practice on how an entity discloses the material uncertainties “that may cast significant doubt upon the entity’s ability to continue as a going concern”? Please describe the predominant approach that you observe in your jurisdiction. If you have examples to illustrate your reasons, that would be useful.

Appendix C—Previous agenda decision in regards to going concern disclosure

C1. Below is the Interpretations Committee's agenda decision on the going concern disclosure that was made in July 2010.

IAS 1 *Financial Statement Presentation* — Going concern disclosure

The Committee received a request for guidance on the disclosure requirements in IAS 1 on uncertainties related to an entity's ability to continue as a going concern.

How an entity applies the disclosure requirements in paragraph 25 of IAS 1 requires the exercise of professional judgement. The Committee noted that paragraph 25 requires that an entity shall disclose 'material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern'. The Committee also noted that for this disclosure to be useful it must identify that the disclosed uncertainties may cast significant doubt upon the entity's ability to continue as a going concern.

The Committee noted that IAS 1 provides sufficient guidance on the disclosure requirements on uncertainties related to an entity's ability to continue as a going concern and that it does not expect diversity in practice. Therefore, the Committee decided not to add the issue to its agenda.