STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**Disclosure requirements about an assessment of going concern**
Paper topic	When to disclose material uncertainties

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Purpose of this paper

1. IAS 1 *Presentation of Financial Statements* 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. This paper discusses when these uncertainties should be disclosed. It should be read with paper 12A, which discusses the wider aspects of the topic.

The 'going concern' assessment

2. As discussed in paper 12A, the threshold in IAS1 for not preparing the financial statements on a going concern basis is a high one—management's intention to cease trading or liquidate or no realistic alternative but to do so—and that threshold is accepted as appropriate by most respondents to our outreach.

3. Many continue reading the same paragraph in IAS 1, however, 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, 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 any disclosure requirement meaningless where this narrow disclosure threshold is used.

4. As noted in paper 12A, the staff recommendation is to answer the question: 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?

Paper structure

5. The paper is organised as follows:

   (a) summary of outreach conducted;

   (b) other topics raised in the outreach;

   (c) summary of preliminary messages received from outreach;

   (d) suggested revisions to IAS 1;

   (e) assessment against the Interpretations Committee's agenda criteria; and

   (f) staff recommendation.

Summary of outreach conducted

6. We received 24 responses to this request, which are analysed in paper 12A. The request for information is set out in Appendix B to that paper.

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

7. The key messages analysed in paper 12 A are noted below for convenience:

   (a) All respondents thought that the criteria in IAS 1 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—intends to cease trading or liquidate or has no realistic alternative but to do so.

(b) Some respondents stated that some jurisdictions have specific requirements that define insolvency or provide guidance about local conditions that determine 'going concern'.

(c) Many respondents cautioned against changing the definition of when an entity is not a going concern.

(d) Most consider that judgements about the appropriateness of going concern as a basis for preparation of the financial statements are made consistently by using the criteria in IAS 1.

8. For this reason we conclude that any anticipated changes to IAS 1.25, made in order to clarify *when* material uncertainties should be disclosed, should leave unchanged the guidance about *assessing* going concern as an appropriate basis for the preparation of the financial statements.

Trigger for disclosure of material uncertainties

9. There was, however, significant diversity noted in the outreach responses about when disclosure of material uncertainties should be made.

10. A minority of respondents report that the criteria used for disclosure are the same as those used for an assessment of whether going concern is an appropriate basis of preparation (unless liquidate, cease or no alternative). This interpretation would mean that disclosure would only be made when the entity is no longer a going concern and it is very likely that the entity will be forced into liquidation.

11. Most respondents take a view that disclosure about uncertainties is required at an earlier stage in order to forewarn users about those uncertainties and about the effect those uncertainties may have on the future activities of the entity. Even in cases, however, in which the broader threshold is acknowledged, many respondents note that a commonly-held view is that if management have a plan to remedy these uncertainties, that is sufficient to support the going concern

assumption for the preparation of the financial statements: the uncertainties have been 'resolved' and disclosure of the uncertainties is not required.

Degree of diversity in practice

12. The conclusion from outreach conducted is that:

    (a) judgements about the appropriateness of going concern as a basis for preparation of the financial statements are made consistently by using the criteria in IAS 1; but

    (b) there is significant diversity about when disclosure of material uncertainties should be made.

Other topics raised in outreach

13. Our outreach was designed principally to establish whether diversity in applying IAS1.25 exists in practice.

14. In addition to answering this question, many respondents identified a number of topics related to the question of when disclosures about material uncertainties about an entity's ability to continue as a going concern should be disclosed. These further considerations related to:

    (a) harmonisation of auditing and financial reporting requirements;

    (b) jurisdictional differences and harmonising corporate governance;

    (c) the expectation gap;

    (d) identifying uncertainties that require disclosure;

    (e) the use of judgement;

    (f) the importance of the disclosure to investors and others;

    (g) the significance of 'the normal course of business';

    (h) time scale of the resolution of the uncertainty;

    (i) use of subjective wording; and

(j) going concern disclosures as a self-fulfilling prophecy.

15. Respondents' comments about these topics are discussed below.

Harmonisation of auditing and financial reporting requirements

16. Many respondents, and especially the accounting firms, requested that auditing and financial reporting requirements should align, but in our view it would be very difficult to reproduce the detailed guidance in International Standard on Auditing 570 *Going Concern* (ISA 570) in a financial reporting Standard or even to ensure compatibility between the two.

17. ISA 570 begins by echoing the requirements in IAS 1:

> *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.

18. There are many cases subsequently, however, when the detailed guidance on going concern diverges. For example, ISA 570 refers to an assessment timescale of 12 months from issuing the financial statements, whereas IAS 1 refers to 12 months from the date of preparation.

19. As another example, ISA 570 states:

> 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.

20. This is not the measurement objective that is applied to assets and liabilities that are recorded in accordance with IFRS. In our view, introducing this requirement could conflict with the measurement objectives of a number of IFRSs.

21. In our view, harmonisation of financial reporting standards and ISA 570 is a larger issue than can be addressed in this paper. That harmonisation could be

considered separately by the IASB and the IAASB as part of their on-going coordination and cooperation.

Jurisdictional differences and harmonisation of corporate governance

22. Some respondents provided copies of local guidance about when disclosures about material uncertainties should be made. This guidance often specified quantifiable thresholds based on:

    (a) maintenance of capital ratios;

    (b) specific liquidity requirements; or

    (c) individual regulatory going concern statements that are required in some jurisdictions, whether made by auditors or by management. These statements may include details of what factors are included in the assessment of going concern.

23. Many respondents expressed concern about including local corporate governance or regulatory requirements about disclosure in financial reporting Standards, because of the range of jurisdictions in which IFRSs apply and the difficulties inherent in trying to converge these different requirements. In their view, this separate guidance should be specific to those jurisdictions, because most respondents in those jurisdictions think that it works well.

24. On the basis of these views, we think that it would not be feasible to identify a quantifiable threshold, based on capital maintenance or liquidity ratios, to improve disclosures about uncertainties that could apply to all jurisdictions.

The expectation gap

25. Instead, the issue that many respondents ask us to clarify is the gap between the high threshold used for assessing going concern as a basis for preparing the financial statements and the lower disclosure threshold that most respondents think needs to be used if disclosure is to provide useful information to investors and others. Some respondents think that the threshold for disclosure is the same as that used for assessment, that is liquidate, cease operations or cannot realistically avoid this. Under that view, the existence of a plan by management

to overcome the uncertainties identified when making the going concern assessment, and so avoid liquidation or cessation, removes any need for disclosure. In accordance with this view, either the uncertainties no longer exist or the existence of the plan means that they don't need to be disclosed. However, in either case, most respondents think that these views result in important disclosures being omitted.

Identifying uncertainties that require disclosure

26. Respondents think that we need to be clearer about what uncertainties require disclosure. If we are clear about 'what' uncertainties need to be disclosed that may clarify 'when' those disclosures need to be made.

27. IAS 1.26 provides guidance on how management should assess the entity's ability to continue as a going concern and what types of uncertainties should be considered in making that assessment:

> 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.

28. In performing this assessment, management will identify any material uncertainties that may cast significant doubt upon the entity's ability to continue as a going concern. Many respondents provided examples of factors that could indicate the presence of such uncertainties, including:

(a) operating losses;

(b) negative, or no, cash flow from operations;

(c) net deficit/ liability position;

(d) expiration of rights or loss of assets essential to the business;

(e) working capital deficiencies;

(f) inability to obtain new borrowings; or

(g) inability to repay debt.

29. Respondents point out that an accumulation of these uncertainties, or an extreme level of one factor, could result in there being no realistic alternative but to consider that exceptional action should be taken by the entity's management, such as:

(a) discontinue or materially curtail the entity's operations; or

(b) take actions outside the entity's normal course of business such as realising assets sooner than originally intended or obtaining alternative additional sources of funding.

30. It is information about these types of uncertainties that most respondents think needs to be disclosed. Some respondents suggest that IAS 1 should include explicit requirements such that where judgement needs to be exercised to conclude that the material uncertainties no longer apply, information about the uncertainties should be disclosed. Some state that these judgements already require disclosure in accordance with IAS 1.122 as part of the general disclosure about significant judgements made.

31. Some respondents have suggested that in practice the disclosure threshold will be reached when an auditor discusses with their client whether an 'emphasis of matter' statement will be required.

The use of judgement

32. Many respondents noted that determining when to make these disclosures about uncertainties will require significant judgement. In addition, many think that

these judgements are now more difficult to make as a result of the financial crisis and that the likelihood that disclosures will need to be made has also increased because those judgements are now compounded by increased risks arising from the financial crisis in addition to entity-specific risks.

The importance of these disclosures to investors and others

33. In order to identify ‘when’ this information is disclosed we also need to ask ourselves ‘why’ this information should be disclosed. If we are clear about why these disclosures are important, that should clarify when that disclosure needs to take place.

34. Investors are interested in assessing the amount, timing and uncertainty of future cash flows. They base these assessments on the current operating circumstances of the entity, modified by communicated strategic decisions. Investors want information, therefore, about what could change their predictions and request disclosure about any future events that are not predictable and might alter underlying operating trends. Going concern disclosures are important to investors, therefore, because they provide warnings about significant risks or changes that the entity could face in the future.

35. Most respondents therefore think that disclosure about material uncertainties about an entity’s ability to continue as a going concern are useful in two respects:

    (a) It informs investors of the fact of the uncertainties and alerts them to the effect that changes in these uncertainties could have on the going concern presumption.

    (b) It should provide information about significant transactions that may need to be taken in the future to avoid the effects of those uncertainties, eg rescheduling of loans, raising capital from shareholders or others or curtailing loss-making operations. These activities are generally categorised as being outside the entity’s normal course of business.

The significance of 'the normal course of business'

36. In our outreach we asked about the significance of 'able to meet obligations as they become due in the normal course of business' in an assessment of going concern. Many responded that they do link the entity's ability to continue as a going concern with an ability to discharge obligations in the ordinary course of business.

37. These respondents were concerned, however, that this would change the guidance for assessing when the financial statements should be prepared on a going concern basis. At present in IFRS, the going concern basis of preparation will be appropriate in many cases when the entity cannot meet its obligations in the ordinary course of business because management is confident that it can take mitigating action, such as rescheduling debt, obtaining funds or guarantees from shareholders, or scaling back loss-making activities. This basis currently works well in most respondents' view and should not be changed.

38. However, investors are interested in information about significant future transactions that cannot be anticipated from the underlying operating trends of the business. In predicting future results and cash flows, significant future actions and transactions outside the normal operating trends of the underlying business, such as rescheduling finance or curtailing loss-making business lines, will be important to investors. If investors are interested in this information, perhaps the fact that these uncertain transactions might be required should form part of the threshold mechanism for disclosure?

39. One respondent suggested that the threshold for disclosure should be when the uncertainties signify levels of financial distress that mean that there is no realistic alternative but to take action outside the normal course of business, for example to:

(a) raise or renegotiate finance;

(b) materially curtail the entity's operations;

(c) realise its assets; and/ or

(d) discharge its liabilities.

Timescale of the resolution of the uncertainty

40. The timing of the event or circumstances giving rise to uncertainty is also significant in assessing when the uncertainties should be disclosed. The shorter the time period in which management must take remedial action, the more significant is the doubt about the entity's ability to continue as a going concern. The longer the period of time before the uncertainty affects the entity and its activities, the higher is the probability that negative consequences will be avoided.

Use of subjective wording

41. Many respondents also requested the clarification of subjective terms used in IAS 1.25 such as 'significant doubts' and 'material uncertainty'. In their view, use of these subjective terms had led to diversity in the application of IAS 1.25. Some referred to the prohibition by the US Securities and Exchange Commission and the US Public Company Accounting Oversight Board of the use of such words in standards.

42. Other respondents cautioned about trying to replace these terms. In their view:

    (a) Significant judgement will always be required in assessing any type of uncertainty.

    (b) Revising subjective wording is unlikely to improve the clarity of the guidance and is not likely to make a difference in practice.

    (c) Probing and developing 'material uncertainty' and 'significant doubts' could have unintended consequences for other Standards in which terms such as 'material' and 'significant' are used.

43. Some suggested, however, that the guidance could be simplified. The following sentence is considered by many to be too complex (bold added):

> 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.

44. One respondent suggested that the language could be simplified and the reference to 'significant doubts' removed by simply referring to (revision in bold):

> material uncertainties **about** the entity's ability to continue as a going concern.

Going concern disclosures as a self-fulfilling prophecy

45. Some respondents did not want entities to make these disclosures under any circumstances, because they think that they alarm stakeholders and that disclosing any information about uncertainties about the going concern assessment becomes a self-fulfilling prophecy. One respondent suggested, however, that there was evidence that the self-fulfilling attribution was false and that the 'survival rates' of entities that had made such disclosures were no lower than the survival rates of entities for which no such disclosures had been made. (For example, the research published by Louwers, Messina and Richard or Citron and Taffler.)

46. In contrast, some think that the transparency created by this disclosure would decrease investors' concerns about uncertainty and so reduce the negative consequences inherent in that assessment.

Summary of preliminary messages received from outreach

Limits to how IAS 1.25 should be revised

47. The preliminary comments received from respondents and our own analysis has identified some limits to any proposed changes to IAS 1.25:

    (a) There are two different notions about going concern assessment that are covered within IAS 1.25—the assessment as to whether going concern is an appropriate basis for the preparation of the financial statements and disclosure about material uncertainties in the assessment of whether the entity will continue as a going concern. Guidance about the assessment of going concern for the purposes of establishing the basis of preparation of the financial statements seems to work well and should not be revised. Simply splitting paragraph 25 into its components could clarify these distinctions.

(b) Harmonisation of auditing, regulatory and financial reporting requirements is unlikely to be feasible across multiple jurisdictions and is unnecessary for assessing going concern as a basis for preparation of the financial statements, where those assessments are generally thought to be appropriately and consistently made.

(c) To attempt to redraft IAS 1.25 in a way that removes subjective wording is neither possible nor helpful and may have unintended consequences.

Factors affecting how IAS 1.25 should be revised

48. The comments received from respondents, and our own analysis, have identified some further factors to consider in drafting any proposed changes to IAS 1.25:

(a) The deficiency that requires remedy is that many interpret IAS 1 to mean that management often do not disclose anything unless the entity is on the verge of liquidation.

(b) Respondents have provided a number of examples of factors that indicate the possible existence of material uncertainties.

(c) The trigger for disclosure is often the need for management to exercise judgement in assessing those uncertainties.

(d) The objective of that disclosure is to bring this judgement to the notice of users of the financial statements.

(e) The designation 'outside the normal course of business' highlights those transactions that may be entered into in order to resolve material uncertainties.

(f) The wording may be simplified in some cases.

Suggested revisions to IAS 1

49. On this basis, redrafting IAS 1.25 along the lines noted below might provide the clarification needed while avoiding any unintended consequences. Our suggestion would be that:

(a) revisions are kept to a minimum;

(b) the existing requirements of IAS 1.25 are retained (and in bold type as at present) ;

(c) IAS1.25 is split into separate paragraphs to deal with different aspects of the requirements;

(d) one part of that guidance is simplified (Revised IAS1.25B below);

(e) the draft, inserted guidance on the disclosure threshold should not be in bold type as it does not introduce a main principle into the Standard; and

(f) existing paragraph 26, which provides guidance about the assessment of going concern, should be reordered to follow the requirement in paragraph 25 to make that assessment.

50. Those revisions would result in a revised IAS 1.25-26 in the following form:

> **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.**
>
> 25 A (formerly 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.

25 B When management makes the assessment required by paragraph 25 and is aware ~~in making its assessment~~ of material uncertainties ~~related to events or conditions that may cast significant doubt upon~~ about the entity's ability to continue as a going concern, the entity shall disclose those uncertainties.

25 C In identifying when uncertainties should be disclosed judgement will need to be applied. In applying this judgement, management should consider what information will be useful to investors and other users of financial statements. The management should also consider the requirements of paragraph 122 for the disclosure of significant judgements. The need to disclose these uncertainties may be indicated when management has no realistic alternative but to take action outside the normal course of business in order to avoid liquidation or cessation, for example actions to raise or renegotiate finance, curtail its operations or realise its assets or discharge its liabilities.

25 D 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.

Assessment against the Interpretations Committee's agenda criteria

51. In this section, we assess the submission against the agenda criteria of the Interpretations Committee as follows:

Interpretations agenda criteria	
The issue is widespread and has practical relevance.	✓
The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).	✓
Financial reporting would be improved through the elimination of the diverse reporting methods.	✓
The issue can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework, and the demands of the interpretation process.	No
It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.	✓
If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?	✓

Annual improvements criteria	
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a	No

change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirements should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	✓
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	✓
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	✓

52. This is a matter that requires our attention because there is significant divergence in practice about when these disclosures are made. Our feedback informs us that in practice the frequency of disclosures is inadequate, because many entities do not make the required disclosures unless liquidation is unavoidable.

53. In our view, however, this issue should be addressed in the form of a narrow-scope amendment because:

(a) a discussion of the principle involved would exceed the scope of the interpretation process, and

(b) the guidance required would provide an addition to the principles contained in IAS 1 at present. We think that this issue, therefore, oversteps the annual improvement criteria. This lack of a clear principle in the Standard is exacerbated by the lack of a Basis for Conclusions for IAS 1, which means that the original intention with regard to the threshold for disclosure cannot be readily identified.

Staff recommendation

54. We think that the Interpretations Committee should recommend this topic (including the proposed revisions to IAS 1 set out in paragraphs 49- 50 of this paper) to the IASB for deliberation as a narrow-focus amendment to IAS 1.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation that this matter should be the subject of a narrow-focus amendment to IAS 1? 2. Does the Interpretations Committee agree with the staff's proposal that the narrow-focus amendment, including the proposed revisions to IAS 1 set out in paragraphs 49- 50, should be recommended to the IASB for deliberation? 3. Has the Interpretations Committee identified any messages in addition to those noted at paragraphs 47-49 that should be considered in any planned revisions to IAS 1.25? 4. Does the Interpretations Committee have any comments on the draft wording discussed in paragraphs 49-50 of the proposed amendment to IAS 1?