STAFF PAPER

13-14 November 2012

IFRS Interpretations Committee Meeting

Project	Disclosure requirements about an assessment of going concern		
Paper topic	What to disclose about material uncertainties		
CONTACT(S)	April Pitman	apitman@ifrs.org	+44(0)20 7246 6492

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 what should be disclosed about these uncertainties. It should be read with paper 12A, which discusses the wider aspects of this topic.

2. The requirement for the disclosure of these material uncerttainties is contained in paragraph 25 of 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. …

3. The Standard does not specify what disclosures are required.

Paper structure

4. This paper is organised as follows:

   (a) summary of outreach conducted;

   (b) preliminary findings from outreach;

   (c) other topics raised in outreach;

   (d) summary of messages received from outreach;

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

   (f) staff recommendations.

Summary of outreach conducted

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

Preliminary findings from outreach

6. Our outreach was designed to answer a question about whether there is diversity in practice in the disclosure of material uncertainties about an entity's ability to continue as a going concern:

   > 2 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.

Diversity of disclosure

7. The majority of respondents reported that there was no diversity within their jurisdiction. Generally, within each jurisdiction, disclosure is made consistently in accordance with local requirements. Jurisdictional requirements are discussed further in paragraphs 19 - 21.

8. However, there was a widely-held view that the material uncertainties that require disclosure are often inadequately identified by entities in different jurisdictions. In a number of jurisdictions, no disclosure is made of these uncertainties if the going concern presumption as a basis for the preparation of the financial statements can be justified. There is considerable diversity, therefore, in the identification of the material uncertainties that are subject to the disclosure requirements of IAS 1.25. These diversities are discussed further in paragraphs 15 - 18.

9. A number of respondents complained about boilerplate disclosures. Some examples given suggest that typical disclosure at present would be a statement that the financial statements are prepared on a going concern basis, but that material adjustments would be necessary if the entity were no longer a going concern. The level of detail disclosed about the effect varies considerably between entities depending on the specific facts and circumstances, such as the particular stage of financial distress and the nature of each entity's plans to remedy the situation.

Nature of disclosures

10. Many respondents discussed the general nature of disclosures that should be made about material uncertainties when performing the going concern assessment.

11. Some respondents warned 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 provided detailed requirements about this disclosure from their local guidance.

12. Some suggested that this disclosure was already covered by the requirements of IAS 1.122 (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).

Other topics raised in outreach

13. In addition to answering the question about diversity in disclosure, many respondents identified a number of topics that provide background information about the disclosure of material uncertainties about an entity's ability to continue as a going concern. These further considerations related to:

    (a) the identification of material uncertainties that require disclosure;

    (b) jurisdictional requirements;

    (c) the nature of the uncertainties;

    (d) the use of judgement;

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

    (f) the significance of transactions outside the normal course of business.

14. These considerations are discussed below.

The identification of material uncertainties that require disclosure

15. As noted in paper 12B, there is considerable diversity in practice in identifying those material uncertainties that should be disclosed. Some think that material uncertainties do not need to be disclosed if management have a viable plan to overcome these uncertainties. That is to say, some hold the view that if the going concern assumption can be justified as a basis for the preparation of the financial statements, the uncertainties are no longer 'uncertain' and are not required to be disclosed.

16. One respondent suggests that there is more diversity in what is a 'material uncertainty' than in the disclosures made when one is identified.

17. Some respondents have expressed concern that disclosures that entities make when management is aware of material uncertainties that may cast significant doubt about the ability of the entity to continue as a going concern cannot be clearly distinguished from disclosures that other entities might make about similar matters that do **not** cast significant doubt. This question was submitted to the Interpretations Committee in 2010. In the agenda decision, the Interpretations Committee noted that for this disclosure about uncertainties to be useful, it must identify that the disclosed uncertainties may cast doubt upon the entity's ability to continue as a going concern. Some respondents suggest that an explicit statement should be added to the disclosures required by IAS 1.25 to confirm whether the uncertainties cast doubt on going concern.

18. Another respondent requested that we should clarify that uncertainties that are remote do not need to be disclosed, however significant an impact they might have. The respondent notes that this is consistent with the treatment of the disclosure of contingent liabilities in IAS 37 *Provisions, Contingent Liabilities and Contingent assets*.

Jurisdictional requirements

19. In many jurisdictions, respondents think that disclosures about material uncertainties identified in the going concern assessment are made principally as a result of local audit and regulatory requirements, rather than in response to the requirements of IFRSs.

20. Many jurisdictions have separate requirements outside of financial reporting standards that require that each entity should disclose why using going concern as the basis for preparing the financial statements is appropriate. This disclosure often includes a summary of the main assumptions made that justify the use of the going concern assumption. A few jurisdictions also require that forecast information must be disclosed in the management commentary in support of the going concern assumption.

21. Adding such disclosure requirements to IAS 1 would ensure that any material uncertainties would be disclosed—along with any other factors in that assessment. However, in our view, including an analysis of all factors included in the assessment of an entity's ability to continue as a going concern in the financial statements would represent a burden to preparers and auditors and would result in excessive disclosure for the majority of entities, for which the justification of the going concern assumption is straightforward.

The nature of the uncertainties

22. Many respondents discussed the nature of the uncertainties to be disclosed. The risks that give rise to material uncertainties about an entity's ability to continue as a going concern can be categorised into two types:

    (a) liquidity risks; and

    (b) business outlook risks.

Liquidity risks

23. Many respondents discussed the nature of future events that can give rise to uncertainty about an entity's liquidity, such as:

    (a) term borrowings falling due for repayment;

    (b) the insolvency of, or concerns about collectibility from, a significant customer or sector of customers;

    (c) the outcome of pending litigation about customer claims; and

    (d) outstanding judgements concerning fines or taxation.

24. Some think that disclosure of these risks is already adequately covered by IFRS 7.39 and need not be addressed by IAS 1. Some respondents also noted that the definition of insolvency will vary by jurisdiction.

Business outlook risks

25. Other risks relate to uncertainties about the entity's operations or business model, such as:

(a) regulatory changes to how business in the entity's industry or jurisdiction is conducted;

(b) the employment contracts of key personnel coming to an end;

(c) the expiration of rights granted to the entity such as exploration rights or licences; and

(d) the expiration of the entity's own intangible assets such as patents.

26. There were some suggestions that disclosure about these types of operational risks should be discussed in the management commentary and not in the financial statements. One respondent noted that because financial and liquidity risks are usually disclosed in notes relating IFRS 7, and other important risk factors and uncertainties related to the business are disclosed in the management commentary, it is difficult to gain an overall view of the uncertainties involved.

27. In our view, it is important that all information that is required to understand the basis of preparation of the financial statements should be contained within the financial statements. In accordance with that view, we think that this information should appear in the notes to the financial statements. Additional disclosure in the management commentary should complement and expand upon uncertainties identified in the financial statements.

The use of judgement

28. Many respondents noted that determining what disclosures need to be made about uncertainties in the assessment of the entity's ability to continue as a going concern will require significant judgement. In addition, many think that this need for judgement has increased in recent years as a result of the financial crisis, because judgements are now compounded by increased risks arising from the financial crisis in addition to other entity-specific risks.

29. A few respondents suggest that explicit wording should be included to state that where judgement is required to conclude that the material uncertainties identified in assessing an entity's ability to continue as a going concern no longer apply, information about those uncertainties should be disclosed.

30. Some note that these types of judgements already require disclosure in accordance with IAS 1.122 about significant judgements made.

The importance of the disclosures to investors and others

31. Investors are interested in predicting future results and cash flows. When events or conditions indicate that the entity may not be able to continue as a going concern in the foreseeable future, investors expect that information to be disclosed to them. Investors want information about what could change their predictions by disclosing the possibility of any change in the entity's activities that arise from uncertainties about its ability to continue as a going concern.

The significance of transactions outside the normal course of business

32. Investors are particularly interested in information about significant future transactions that cannot be anticipated from the underlying operating trends of the business. These types of significant transactions will include:

    (a) curtailing or suspending loss-making activities or customer contracts;

    (b) initiating restructuring or cost-cutting exercises;

    (c) rescheduling existing loans or obtaining other sources of external finance;

    (d) obtaining finance through rights issues; and

    (e) applying for protection from creditors if locally available.

33. Both the fact of the uncertainty about going concern and the significant future transactions or activities that may need to be taken to remedy the uncertainties are useful information for investors and other users of the financial statements.

Summary of messages received from outreach

Objective of the disclosure

34. The objective of the disclosure about these uncertainties is to provide information to users and others to allow them to:

    (a) assess the entity's ability to continue as a going concern;

    (b) understand the judgements made regarding material uncertainties in assessing whether going concern is an appropriate basis for the preparation of the financial statements;

    (c) assess the feasibility of any mitigating actions planned; and

    (d) understand the effect of any significant future transactions that may be taken by management to ensure the entity continues as a going concern.

Preferred characteristics of the disclosure requirements

35. Although we did not ask for a response to the question about what disclosures should be given about material uncertainties, some respondents shared their views with us.

36. Most of those respondents think that it is very difficult to prescribe disclosures, because the individual circumstances vary significantly and the nature of the uncertainties involved are highly specific to the individual entity. A few respondents were concerned that prescriptive requirements would lead to boilerplate disclosures. One respondent thinks that excessively prescriptive guidance may result in an illusion of consistent application rather than providing better information to investors. Some respondents suggested that it might be more helpful to provide some general guidance about the types of uncertainty that should be disclosed.

37. The general consensus is that disclosure requirements should remain broad because applying these requirements to entity-specific facts and circumstances

must continue to be a matter of judgement. What to disclose about each uncertainty will also always be largely a matter of judgement.

Suggested disclosures

38. Several respondents provided some general suggested guidance on what to disclose about these uncertainties:

    (a) the nature of the uncertainty;

    (b) the magnitude of the potential impact if the event giving rise to the uncertainty occurs;

    (c) the likelihood of that event occurring;

    (d) the availability and effectiveness of any remedial action proposed by management; and

    (e) the likely timing of the event giving rise to the uncertainty and any proposed remedies.

39. A few respondents suggested that an explicit statement should be added to these disclosures to confirm whether the uncertainties cast doubt on going concern.

40. Many think that each area of uncertainty should be disclosed separately. In addition, one respondent thinks that investors want to know the gross uncertainties before mitigation to provide transparency on the risks. That transparency itself would reduce uncertainty and its negative consequences and could be a factor in overcoming management reluctance to disclose information about these risks.

41. The staff is also aware of a survey published by the CFA Institute *CFA Institute Survey on "Going Concern"* (March 2012) that could be used when planning further outreach on this topic or as input to that research.

Assessment against the Interpretations Committee's agenda criteria

42. In our view this deficiency cannot be remedied through the interpretation process. Although IAS 1.25 is explicit in requiring that disclosures should be made, it

gives no indication of what those disclosures should be. In addition, IAS 1 does not include a Basis for Conclusions and there is insufficient information elsewhere, so the intentions of the IASB cannot be interpreted.

Annual improvements criteria

43. Assessing the issue against the annual improvements criteria:

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 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.	The solution would provide guidance about the disclosures required by the Standard when none is given in the Standard itself.
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	Yes
(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.	Yes—there is a great deal of existing guidance available.
(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.	This is a narrower topic than the wider issues to be addressed by the disclosure framework project.

Staff recommendations

44. We recommend that:

(a) this topic satisfies the criteria for an annual improvement;

(b) the Interpretations Committee combine this improvement with the narrow-focus amendment recommended in Agenda paper 12B for efficiency; and

(c) we use the messages received from preliminary outreach (paragraphs 34- 41) as a basis for outreach that would be conducted to identify what disclosures should be required about material uncertainties about an entity's ability to continue as a going concern. At this stage, we think that this outreach would be conducted this year and draft proposed disclosures would be brought to the Interpretations Committee in Q1 2013.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree: (a) with the staff's recommendation that this topic satisfies the criteria for an annual improvement revision to IAS 1; (b) that this matter needs to be addressed together with the question of when disclosure should take place and should, therefore, be combined with the narrow-focus amendment recommended in Agenda paper 12 B; and (c) that the messages received from preliminary outreach (paragraphs 34-41) should be used as a basis for outreach conducted to determine what disclosures should be required about these uncertainties? 2. Does the Interpretations Committee have any advice or comments about the nature of the required disclosures in addition to the messages received from the preliminary outreach as discussed in paragraphs 34-41?