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Evaluating "going concern" concerns

Under U.S. Generally Accepted Accounting Principles (GAAP), financial statements are normally prepared based on the assumption that the company will continue normal business operations into the future. When liquidation is imminent, the liquidation basis of accounting may be used instead.

It's up to the company's management to decide whether there's a so-called "going concern" issue and to provide related footnote disclosures. But auditors still must evaluate the appropriateness of management's assessment. Here are the factors that go into a going concern assessment.

Substantial doubt and potential for mitigation

The responsibility for making a final determination about a company's continued viability shifted from external auditors to the company's management under Accounting Standards Update (ASU) 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*. The updated guidance requires management to decide whether there are conditions or events that raise substantial doubt about the company's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, to prevent auditors from holding financial statements for several months after year end to see if the company survives).

Substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it's probable that the company won't be able to meet its current obligations as they become due. Examples of adverse conditions or events that might cause management to doubt the going concern assumption include:

- Recurring operating losses,
- Working capital deficiencies,
- Loan defaults,
- Asset disposals, and
- Loss of key franchise, customer or supplier.

After management identifies that a going concern issue exists, it should consider whether any mitigating plans will alleviate the substantial doubt. Examples of corrective actions include plans to raise equity, borrow money, restructure debt, cut costs, or dispose of an asset or business line.

Aligning the guidance

After the FASB updated its guidance on the going concern assessment, the Auditing Standards Board (ASB) unanimously voted to issue a final going concern standard. The ASB's Statement on Auditing Standards (SAS) No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, was designed to promote consistency between the auditing standards and accounting guidance under U.S. GAAP.

The updated guidance requires auditors to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements. It also addresses uncertainties auditors face when the going concern basis of accounting isn't applied or may not be relevant.

For example, SAS No. 132 doesn't apply to audits of single financial statements, such as balance sheets and specific elements, accounts, or items of a financial statement. Some auditors contend that the evaluation of whether there's substantial doubt about a company's ability to continue as a going concern can be performed only on a complete set of financial statements at an enterprise level.

Prepare for your next audit

With increased market volatility, rising inflation, supply chain disruptions, labor shortages and skyrocketing interest rates, the going concern assumption can't be taken for granted. Management must take current and expected market conditions into account when making this call — and be prepared to provide auditors with the appropriate documentation. Contact us before year end if you have concerns about your company's going concern assessment. We can provide objective market data to help evaluate your situation.