



Agenda Item 1G

Proposed Amendments to SAS 132

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Statement on Auditing Standards, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

Introduction

Scope of This Statement on Auditing Standards

1. This Statement on Auditing Standards (SAS) addresses the auditor's responsibilities in the audit of financial statements relating to the entity's ability to continue as a going concern and the implications for the auditor's report. This SAS applies to all audits of a complete set of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework.¹
2. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for a reasonable period of time. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate. (Ref: par. A1–A2)
3. Special purpose financial statements² may or may not be prepared in accordance with an applicable financial reporting framework for which the going concern basis of accounting is relevant. As a result, when the going concern basis of accounting is not relevant, the requirement of this SAS to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting do not apply. However, irrespective of whether the going concern basis of accounting is relevant in the preparation of special purpose financial statements, the requirements of this SAS apply regarding the auditor's responsibilities to perform the following:
 - a. Conclude, based on the audit evidence obtained, whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time
 - b. Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time
4. The auditor's responsibilities under this SAS apply even if the applicable financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific evaluation of the entity's ability to continue as a going concern.

¹ *General purpose* and *special purpose frameworks* are defined in AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), and AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), respectively.

² AU-C section 800 addresses audits of a complete set of financial statements prepared in accordance with special purpose frameworks.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

5. Some financial reporting frameworks explicitly require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time and provide disclosures related to the entity's ability to continue as a going concern. For example, FASB *Accounting Standards Codification*³ (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity'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, when applicable).³ Similarly, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, requires financial statement preparers to evaluate whether there is substantial doubt about a governmental entity's ability to continue as a going concern for 12 months beyond the date of the financial statements. GASB Statement No. 56 further requires that, if information is currently known to the governmental entity that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.⁴ Law or regulation may also set forth requirements regarding management's responsibility to evaluate the entity's ability to continue as a going concern for a defined period of time and related financial statement disclosures. (Ref: par. A3)

6. Management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of conditions or events. The following factors are relevant to that judgment:

- a. The degree of uncertainty associated with the outcome of a condition or event increases significantly the further into the future a condition or event or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management evaluation specify the period for which management is required to take into account all available information.
- b. The size and complexity of the entity, the nature and condition of its business, and the degree to which it is affected by external factors affect the judgment regarding the outcome of conditions or events.
- c. Any judgment about the future is based on conditions or events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued, when applicable). Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made. (Ref: par. A4–A5)

³ "Pending Content" in FASB *Accounting Standards Codification*[®] (ASC) 205-40-50-1.

⁴ Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

When Management Is Not Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

7. In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, when the going concern basis of accounting is a fundamental principle in the preparation of financial statements, as discussed in paragraphs 2–3, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

Inherent Limitations in Evaluating the Entity's Ability to Continue as a Going Concern

8. The potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The auditor cannot predict such future conditions or events. Accordingly, the absence of any reference to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in an auditor's report cannot be viewed as a guarantee of the entity's ability to continue as a going concern for a reasonable period of time.

Effective Date

9. This SAS will be effective for audits of financial statements for periods ending on or after _____.

Objectives

10. The objectives of the auditor are as follows:

- a. To obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements
- b. To conclude, based on the audit evidence obtained, whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists
- c. To evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time
- d. To report in accordance with this SAS

Definition

11. For purposes of this SAS, the following term has the meaning attributed as follows:

Reasonable period of time. The period of time required by the applicable

financial reporting framework or, if no such requirement exists, 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, when applicable). (Ref: par. A6)

Requirements

Risk Assessment Procedures and Related Activities

Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern

12. When performing risk assessment procedures as required by AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*),⁵ the auditor should consider whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions or events exist: (Ref: par A7–A16)

- a. If such an evaluation has been performed, the auditor should discuss the evaluation with management and determine whether management has identified conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time and, if so, understand management's plans to address them.
- b. If such an evaluation has not yet been performed, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire of management whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events

13. The auditor should remain alert throughout the audit for audit evidence of conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par.A17)

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation

14. The auditor's evaluation should
- a. address management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a

⁵ Paragraph .05 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*).

going concern for a reasonable period of time. (Ref: par. A18–A24)

- b. cover the same period as that used by management in its evaluation as required by the applicable financial reporting framework. (Ref: par. A19)
- c. include consideration of whether management’s evaluation includes all relevant information of which the auditor is aware as a result of the audit.

Period Beyond Management’s Evaluation

15. The auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management’s evaluation that may have an effect on the entity’s ability to continue as a going concern. (Ref: par. A23, A25–A27)

Additional Audit Procedures When Events or Conditions Are Identified

16. The auditor should obtain sufficient appropriate audit evidence to determine whether conditions and events identified, considered in the aggregate, raise substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time by performing additional audit procedures, including consideration of mitigating factors. These procedures should include the following: (Ref: par. A28)

- a. Requesting management to make an evaluation when management has not yet performed an evaluation
- b. Evaluating management’s plans in relation to its going concern evaluation, with regard to whether it is probable that (Ref: par. A29)
 - i. management’s plans can be effectively implemented and
 - ii. the plans would mitigate the relevant conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time
- c. When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in evaluating management’s plans, (Ref: par. A30–A31)
 - i. evaluating the reliability of the underlying data generated to prepare the forecast and
 - ii. determining whether there is adequate support for the assumptions underlying the forecast, which includes considering contradictory audit evidence
- d. Considering whether any additional facts or information have become available since the date on which management made its evaluation

Financial Support by Third Parties or the Entity’s Owner-Manager

17. When management’s plans include financial support by third parties or the entity’s owner-manager (hereinafter referred to as “supporting parties”) and such support is necessary in supporting management’s assertions about the entity’s ability to continue as a going concern for a

reasonable period of time, the auditor should obtain sufficient appropriate audit evidence about the following:

- a. The intent of such supporting parties to provide the necessary financial support, including written evidence of such intent, and (Ref: par. A32–A37)
- b. The ability of such supporting parties to provide the necessary financial support (Ref: par. A24, A38)

The failure to obtain the written evidence required by item (a) constitutes a lack of sufficient appropriate audit evidence regarding the intent of the supporting parties to provide financial support. Therefore, the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. A32–A34)

Written Representations

18. If the auditor believes, before consideration of management's plans pursuant to paragraph 16, that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should request the following written representations from management: (Ref: par. A39–A40)

- a. A description of management's plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the probability that those plans can be effectively implemented
- b. That the financial statements disclose all the matters of which management is aware that are relevant to the entity's ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management's plans

Auditor Conclusions

Use of the Going Concern Basis of Accounting

19. The auditor should evaluate whether sufficient appropriate audit evidence has been obtained and conclude on the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

20. Based on the audit evidence obtained, the auditor should conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

21. If the auditor concludes that management’s use of the going concern basis of accounting is appropriate in the circumstances but substantial doubt exists about an entity’s ability to continue as a going concern for a reasonable period of time, the auditor should evaluate the adequacy of the financial statement disclosures as required by the applicable financial reporting framework. (Ref: par. A41–A44)

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management’s Plans

22. If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management’s plans, the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. (Ref: par. A45–A47)

Implications for the Auditor’s Report

Use of Going Concern Basis of Accounting Is Inappropriate

23. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor’s judgment, management’s use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor should express an adverse opinion. (Ref: par. A48–A50)

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified

24. If, after considering identified conditions or events and management’s plans, the auditor concludes that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor’s report under the heading “Substantial Doubt About the Entity’s Ability to Continue as a Going Concern” to: (Ref: par. A51–A58)

~~a.~~ Draw attention to the note in the financial statements that discloses the conditions or events identified as well as management’s plans that deal with these conditions or events; and

a. that these conditions or events indicate that substantial doubt exists about the entity’s ability to continue as a going concern for a reasonable period of time , and

b. State that the auditor’s opinion is not modified in respect of the matter.

25. The description in the Going Concern section about the entity’s ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The auditor should not use conditional language concerning the existence of substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.

Adequate Disclosure About an Entity's Ability to Continue as a Going Concern Is Not Made in the Financial Statements

26. If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should:

- a. express a qualified opinion or adverse opinion, as appropriate, in accordance with AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*), and
- b. in the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that
 - i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter, or
 - ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

Management Unwilling to Perform or Extend Its Evaluation

27. If management is unwilling to perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework when requested to do so by the auditor, the auditor should consider the implications for the auditor's report. (Ref: par. A59)

Communication With Those Charged With Governance

28. Unless all those charged with governance are involved in managing the entity,⁶ the auditor should communicate with those charged with governance regarding conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Such communication with those charged with governance should include the following:

- a. Whether the conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time constitute substantial doubt
- b. The auditor's consideration of management's plans
- c. Whether management's use of the going concern basis of accounting, when relevant, is appropriate in the preparation of the financial statements
- d. The adequacy of related disclosures in the financial statements
- e. The implications for the auditor's report

⁶ Paragraph .09 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*).

Comparative Presentations

29. If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis and that doubt has been removed in the current period, the going concern section included in the auditor's report on the financial statements of the prior period should not be repeated. (Ref: par. A60–A61)

Eliminating a Going Concern Section From a Reissued Report

30. Management may request that the auditor reissue an auditor's report and eliminate a going concern section contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going concern status of the entity by doing the following:

- a. Performing audit procedures related to the events or transactions that prompted the request to reissue the report without the going concern section
- b. Performing the procedures listed in AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*), at or near the date of reissuance, including procedures to evaluate the adequacy of the proposed disclosures regarding management's plans to mitigate the conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time⁷
- c. Considering the matters described in paragraphs 16–18 of this SAS based on the conditions or circumstances at the date of reissuance
- d. Considering the implications for the auditor's report in accordance with AU-C section 560⁸ (Ref: par. A62–A63)

Significant Delay in the Issuance of Financial Statements

31. If there is significant delay in the expected issuance of the financial statements by management or those charged with governance, the auditor should inquire about the reasons for the delay. If the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, the auditor should perform additional audit procedures as necessary, as described in paragraph 16, as well as consider the effect on the auditor's conclusion regarding the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, as described in paragraph 21.

Documentation

⁷ Paragraphs .09–.11 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*).

⁸ Paragraph .13 of AU-C section 560.

32. If conditions or events are identified that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans, the auditor should document the following: (Ref: par. A64)

- a. The conditions or events that led the auditor to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, if applicable.
- c. The audit procedures performed to evaluate the significant elements of management's plans and evidence obtained, if applicable.
- d. The auditor's conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated. If substantial doubt remains, the auditor should also document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor should also document the auditor's conclusion regarding the need for, and, if applicable, the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt and management's plans that alleviated the substantial doubt.
- e. The auditor's conclusion with respect to the effects on the auditor's report.

Application and Other Explanatory Material

Scope of This Statement on Auditing Standards (Ref: par. 2)

A1. The applicable financial reporting framework might contain explicit requirements regarding when the liquidation basis of accounting is appropriate. For example, FASB *Accounting Standards Codification*⁹ (ASC) requires that if and when an entity's liquidation becomes imminent financial statements should be prepared under the liquidation basis of accounting.⁹ Accordingly, this SAS does not apply to an audit of a complete set of general purpose financial statements prepared under the liquidation basis of accounting.

Considerations Specific to Governmental Entities

A2. Management's use of the going concern basis of accounting is also relevant to financial statements of governmental entities. For example, GASB Statement No. 56, *Codification of*

⁹ FASB ASC 205-30.

Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards, addresses the issue of the ability of governmental entities to continue as a going concern for 12 months beyond the financial statement date, and requires consideration of information known to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months).¹⁰ Going concern indicators may arise in, but are not limited to, situations in which governmental entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Conditions or events that raise substantial doubt about a governmental entity's ability to continue as a going concern for a reasonable period of time may include situations in which the governmental entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the governmental entity.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework (Ref: par. 5–6)

A3. FASB ASC defines *substantial doubt about an entity's ability to continue as a going concern* as follows:

Substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The term *probable* is used consistently with its use in topic 450 on contingencies.¹¹

Other financial reporting frameworks may use different terms that are similar to the concept of substantial doubt. For example, International Financial Reporting Standards (IFRS) use the terms *material uncertainty* and *significant doubt*. Also, other financial reporting frameworks may not use *probable* as their threshold. For example, IFRS uses "may cast significant doubt on the entity's ability to continue as a going concern."¹² This SAS uses the terminology of FASB ASC and the GASB statements; if an audit is performed on financial statements prepared under another financial reporting framework, the requirements and application material may need to be adapted as necessary.

A4. In addition to the factors in paragraph 6, FASB ASC requires management to consider quantitative and qualitative information about the following conditions and events:¹³

- a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)

¹⁰ Paragraphs 16–19 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standard*.

¹¹ "Pending Content" in FASB ASC 205-40-20.

¹² See paragraph 25 of International Accounting Standard (IAS) 1, *Presentation of Financial Statements*.

¹³ "Pending Content" in FASB ASC 205-40-50-5.

- b. The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements)
- c. The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued
- d. The other conditions and events, when considered in conjunction with the preceding items, that may adversely affect the entity's ability to meet its obligations within one year after the date the financial statements are issued. See paragraph A7 for examples of those conditions and events.

A5. As explained by FASB, *reasonably knowable* means that an entity should make a reasonable effort to identify conditions and events that it may not readily know but would be able to identify without undue cost and effort.¹⁴

Definition (Ref: par. 11)

A6. Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

- a. *FASB*. 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, when applicable).¹⁵
- b. *GASB*. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.¹⁶
- c. *International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.¹⁷

Risk Assessment Procedures and Related Activities

Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern (Ref: par. 12)

A7. The following list includes examples of adverse conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of

¹⁴ See paragraph BC26 of the "Background Information and Basis for Conclusions" section of "Pending Content" in FASB ASC 205-40.

¹⁵ "Pending Content" in FASB ASC 205-40-50-1.

¹⁶ Paragraph 16 of GASB Statement No. 56.

¹⁷ Paragraph 26 of IAS 1.

time. This list is not all-inclusive. The existence of one or more of these conditions or events does not establish that there is substantial doubt about the entity's ability to continue as a going concern. Similarly, the absence of these conditions or events does not establish that there is no substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Determining whether there is substantial doubt depends on an assessment of relevant conditions and events, in the aggregate, that are known and reasonably knowable at the date that the financial statements are issued (or at the date the financial statements are available to be issued, when applicable). An entity should weigh the likelihood and magnitude of the potential effects of the relevant conditions and events and consider their anticipated timing.¹⁸

- a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios
- b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

A8. The significance of such events or conditions can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable¹⁹ that the plan will be effectively implemented within one year after the date that the financial statements are issued.²⁰

- a. Plans to dispose of an asset or business
 - i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loan or similar agreements, or encumbrances against the asset or business
 - ii. Marketability of the asset or business that management plans to sell

¹⁸ "Pending Content" in FASB ASC 205-40-55-2.

¹⁹ The FASB ASC master glossary defines *probable* as "the future event or events are likely to occur."

²⁰ "Pending Content" in FASB ASC 205-40-55-3.

- iii. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt
 - i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
 - ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
 - iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures
 - i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
 - ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity
 - i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
 - ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

Considerations Specific to Governmental Entities

A9. The GASB statements also include the following examples of indicators that there may be substantial doubt about a governmental entity's ability to continue as a going concern:²¹

- a. *Negative trends.* For example, recurring periods in which expenses or expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios
- b. *Other indications of possible financial difficulties.* For example, default on bonds, loans, or similar agreements; proximity to debt and tax limitations; denial of usual trade credit from suppliers; restructuring of debt (other than refundings); noncompliance with statutory capital or reserve requirements; or the need to seek new sources or methods of financing or to dispose of substantial assets
- c. *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations

²¹ Paragraph 17 of GASB Statement No. 56.

- d. *External matters.* For example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood

A10. The indicators listed in paragraph A9 may be mitigated by other factors. For example, taxing power and borrowing capabilities together with the constant demand for the provision of public services are factors that may diminish the possibility that a governmental entity would be unable to continue as a going concern.²²

Other Considerations

A11. The risk assessment procedures required by paragraph 12 are intended to assist the auditor in determining whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is likely to be an important issue in planning and performing the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans for addressing any potential going concern matters identified.

A12. In the absence of guidance provided by the applicable financial reporting framework that illustrates adverse conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time or plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, the auditor may consider the guidance in paragraphs A7–A10.

A13. As discussed in paragraph A7, FASB ASC contains guidance for determining whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time. Other financial reporting frameworks may contain other relevant guidance.

A14. If management is preparing interim financial statements, FASB ASC requires management to perform a going concern evaluation for the interim periods.²³ As a result, the auditor may consider management's interim evaluation(s) of whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern in completing the risk assessment procedures in paragraph 12.

Considerations Specific to Smaller, Less Complex Entities

A15. The size of an entity may affect its ability to withstand adverse conditions. Smaller, less complex entities may be able to respond quickly to exploit opportunities but may lack reserves to sustain operations.

A16. Conditions of particular relevance to smaller entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise, or other legal agreement.

²² Paragraph 18 of GASB Statement No. 56.

²³ "Pending Content" in FASB ASC 205-40-50-1.

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events (Ref: par. 13)

A17. AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*), requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence that affects the auditor's assessment of risk is obtained during the course of the audit.²⁴ If conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time are identified after the auditor's initial risk assessments are made, in addition to performing the procedures in paragraph 16 of this SAS, the auditor's assessment of the risks of material misstatement may need to be revised. The existence of such conditions or events may also affect the nature, timing, and extent of the auditor's further procedures in response to the assessed risks. AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (AICPA, *Professional Standards*), establishes requirements and provides guidance on this issue.

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation (Ref: par. 14)

A18. Management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is an important consideration with respect to the auditor's conclusion on management's use of the going concern basis of accounting and whether substantial doubt exists.

A19. If management is not required by the applicable financial reporting framework to make an evaluation about whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, then the period that the auditor's evaluation covers is 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, when applicable), as discussed in paragraph 11.

A20. It is not the auditor's responsibility to rectify the lack of analysis by management to support its evaluation. In some circumstances, however, the auditor may be able to conclude whether substantial doubt exists in the circumstances despite the lack of detailed analysis by management. For example, when a history of profitable operations and a ready access to financial resources exists, management may make its evaluation without a detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's evaluation may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether there is substantial doubt in the circumstances. However, in situations in which management is required by the applicable financial reporting framework to make an evaluation about the entity's ability to continue as a

²⁴ Paragraph .32 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*).

going concern for a reasonable period of time, a lack of a detailed analysis when needed may be an indicator of a deficiency in internal control. An auditor's evaluation is required to determine whether this constitutes a significant deficiency or material weakness, in accordance with AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*).

A21. In other circumstances, evaluating management's evaluation of whether there is substantial doubt, as required by paragraph 14, may include an evaluation of the process management followed to make its evaluation, the assumptions on which the evaluation is based, management's plans, and whether management's plans are feasible in the circumstances to alleviate substantial doubt.

A22. For financial reporting frameworks that require the entity to perform an evaluation about whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, for example, FASB ASC and the GASB statements,²⁵ the auditor's conclusions might be primarily based on the auditor's procedures performed to evaluate management's compliance with the applicable financial reporting framework.

Considerations Specific to Smaller, Less Complex Entities (Ref: par. 14)

A23. In many cases, management of smaller entities may not have prepared a detailed evaluation of whether there is substantial doubt, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this SAS, the auditor is required to evaluate management's evaluation of whether there is substantial doubt. For smaller entities, it may be appropriate to discuss the medium and long-term financing of the entity with management.

A24. Financial support by owner-managers is often important to smaller entities' ability to continue as a going concern. When a smaller entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a smaller entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner-manager supporting a loan for the entity by providing a guarantee with the owner-manager's personal assets as collateral. See paragraphs A32–A38 for further guidance about financial support from the owner-manager.

Period Beyond Management's Evaluation (Ref: par. 15)

A25. The inquiry required by paragraph 15 is not intended to require management to extend its evaluation beyond the requirements of the applicable financial reporting framework. Other than inquiry of management, the auditor does not have a responsibility to perform any other audit procedures to identify conditions or events that may raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time beyond the period evaluated by management.

²⁵ "Pending Content" in FASB ASC 205-40 and paragraphs 16–19 of GASB Statement No. 56.

A26. The applicable financial reporting framework may provide guidance about whether or how conditions or events that occur after the period required by the applicable financial reporting framework may affect the evaluation of whether substantial doubt about an entity's ability to continue as a going concern exists. For example, the GASB statements require that, if a governmental entity currently knows of information that may raise substantial doubt shortly after one year beyond the financial statement date, such information should be considered in the evaluation of substantial doubt.²⁶

A27. FASB ASC requires the evaluation to include events and conditions that may raise substantial doubt about the entity'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, when applicable).²⁷ Therefore, the conditions or events known after this time period will not affect the evaluation of whether substantial doubt exists but may affect other disclosure requirements or consideration of whether the financial statements are fairly presented.

Additional Audit Procedures When Events or Conditions Are Identified (Ref: par. 16)

A28. Audit procedures that may be relevant to performing the requirements in paragraph 16 include the following:

- a. Analyzing and discussing cash flow, profit, and other relevant forecasts with management
- b. Analyzing and discussing the entity's latest available interim financial statements
- c. Reading the terms of debentures and loan agreements and determining whether any have been breached
- d. Reading minutes of the meetings of shareholders, those charged with governance, and relevant committees, for reference to financial difficulties
- e. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's evaluations of their outcome and the estimate of their financial implications
- f. Evaluating the entity's plans to deal with unfilled customer orders
- g. Performing audit procedures regarding subsequent events to identify those that either mitigate or exacerbate substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- h. Confirming the existence, terms, and adequacy of borrowing facilities
- i. Obtaining and reviewing reports of regulatory actions
- j. Determining the adequacy of support for any planned disposals of assets

²⁶ Paragraph 16 of GASB Statement No. 56.

²⁷ "Pending Content" in FASB ASC 205-40-50-1.

Evaluating Management's Plans (Ref: par. 16b–c)

A29. Evaluating management's plans may include performing audit procedures that the auditor considers necessary in the circumstances regarding management's plans for future action, including, for example, its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital. For governmental entities, evaluating management's plans may also include management's plans for future actions, including, for example, its plans to increase taxes to the extent allowable by law (as well as obtaining the necessary approvals to do so) or to issue additional debt up to the legal debt limit. See paragraphs A8–A10 for examples of other plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

A30. In addition to the procedures required in paragraph 16c, the auditor may compare

- a. the prospective financial information used in recent prior periods with historical results and
- b. the prospective financial information used in the current period with results achieved to date.

A31. When evaluating a cash flow forecast, an example of contradictory evidence may include assumptions in the cash flow forecasts that are inconsistent with assumptions used for other purposes, such as forecasts used to evaluate the recoverability of deferred tax assets or potential impairment of goodwill or long-lived assets.

Financial Support by Third Parties or the Entity's Owner-Manager

Intent

Support Letters or Written Confirmations

A32. The auditor's evaluation of the support letter (as further described in paragraph A33) or written confirmation includes consideration of the terms and conditions of the commitment and may include, as applicable, considerations of the legality and enforceability of the commitments.

A33. The intent of supporting parties to provide the necessary financial support may be evidenced by either of the following:

- a. Obtaining from management written evidence of a commitment from the supporting party to provide or maintain the necessary financial support (sometimes referred to as a "support letter").
- b. Confirming directly with the supporting parties (as described in paragraph A35) the existence of commitments to provide or maintain the necessary financial support. Confirmation may be necessary if management only has oral evidence of such financial support.

A34. When the financial support is provided by an owner-manager, the evidence regarding

intent may be in the form of a support letter or a written representation.²⁸

Obtaining Written Confirmations

A35. If the auditor obtains a support letter as described in paragraph A33a, the auditor may still request a written confirmation in accordance with AU-C section 505, *External Confirmations* (AICPA, *Professional Standards*), from the supporting parties regarding the contents of the support letter. For example, such written confirmation may be requested when, in the auditor's professional judgment, a written confirmation is necessary to determine the validity of the support letter as well as the accuracy and completeness of the related terms and conditions.

Illustration of the Third-Party Support Letter

A36. The purpose of the support letter from supporting parties is to provide sufficient appropriate audit evidence about the supporting parties' intent to provide financial support to the entity. The support letter may also include additional material facts and circumstances that may be pertinent to the determination of whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. The following is an illustration of a support letter that may be requested from the supporting parties when the applicable financial reporting framework is FASB ASC. The illustrative wording also includes an assertion about the supporting party's ability to provide financial support, but such wording does not, by itself, provide sufficient appropriate audit evidence regarding ability.

(Supporting party name) will, and has the ability to, fully support the operating, investing, and financing activities of *(entity name)* through at least one year and a day beyond [insert date]²⁹ *(the date the financial statements are issued or available for issuance, when applicable)*.

Depending on the facts and circumstances, this written support letter may be adapted, for example, by adding the following wording:

This also applies to any amounts that may ultimately be due to the Internal Revenue Service as a result of the recent judgment against *(entity name)* and also applies should *(entity name's)* debt not be refinanced when the debt becomes due in the next year.

A37. In accordance with AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standard*), the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.³⁰ Accordingly, in order to cover the assessment period required by the applicable financial reporting framework, the support letter or the written confirmation defines a specific date through which the supporting

²⁸ See AU-C section 580, *Written Representations* (AICPA, *Professional Standards*).

²⁹ See paragraph A37.

³⁰ Paragraph .41 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*).

party intends to provide support. For example, for financial statements prepared in accordance with FASB ASC, the date would be a year and a day beyond the date that the financial statements are issued (or available to be issued, when applicable). Specifying a date in the support letter or written confirmation that is later than the expected date that the financial statements will be issued (or will be available to be issued, when applicable) may obviate the need to obtain updated information from the supporting parties. The period covered by the support letter or written confirmation may be shorter if there is another source of support that management intends to utilize in order to continue as a going concern through the assessment period. Such other support would be subjected to the same auditing procedures discussed in this SAS.

Ability

A38. With respect to the supporting party's ability to provide support, matters to which the auditor may give consideration include the following:

- a. Audit evidence of past support obtained from the supporting party when such support was needed.
- b. The solvency of the supporting party and the sufficiency of the evidence supporting the solvency assertion. The auditor may obtain financial statements of the supporting party audited by a reputable auditor as evidence of the ability of the supporting party to provide the needed support. If the financial statements have not been audited, the auditor may perform other procedures, such as obtaining bank statements and evidence regarding the valuation of assets held by the supporting party that may be used to provide the needed support. However, these procedures might not provide evidence regarding other claims on the pledged assets that would limit the ability of the supporting party to use the assets to provide the support to the reporting entity.
- c. The ability to provide the needed support in a timely manner for the reporting entity to meet its obligations.
- d. When the entity and supporting party are in different countries, the ability of the supporting party to transfer the necessary funds (or other financial support) to the entity. Factors such as trade embargos, financial transfer restrictions, and war may limit the ability to transfer the necessary financial support.

Given the nature of these matters, the auditor may consult with legal counsel, as appropriate.

Written Representations (Ref: par. 18)

A39. The auditor may consider it appropriate to request specific written representations beyond those required in paragraph 18 in support of audit evidence obtained regarding management's plans in relation to its going concern evaluation and the feasibility of those plans to alleviate substantial doubt.

A40. Paragraph .26 of AU-C section 580, *Written Representations* (AICPA, *Professional Standards*), addresses situations in which management does not provide one or more of the

requested written representations.

Auditor Conclusions

Substantial Doubt About the Entity's Ability to Continue as a Going Concern (Ref: par. 20–21)

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

A41. Some financial reporting frameworks provide requirements about management's responsibilities to evaluate whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time and provide explicit requirements about financial statement disclosures.

A42. For example, under FASB ASC, if, after considering management's plans, substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is not alleviated—that is, substantial doubt exists—the entity is required to include a statement in the notes to the financial statements indicating that there is substantial doubt about the entity'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 the financial statements are available to be issued, when applicable). Additionally, the entity is required to disclose information that enables users of the financial statements to understand³¹

- a. principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- b. management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.
- c. management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

A43. For example, under the GASB statements, if it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, the notes to the financial statements are required to include disclosure of the following, as appropriate:³²

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the governmental entity's ability to continue as a going concern for a reasonable period of time
- b. The possible effects of such conditions and events
- c. Government officials' evaluation of the significance of those conditions and events and any mitigating factors

³¹ "Pending Content" in FASB ASC 205-40-50-13.

³² Paragraph 19 of GASB Statement No. 56.

- d. Possible discontinuance of operations
- e. Government officials' plans (including relevant prospective financial information)
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

A44. Under the GASB statements, management's discussion and analysis (MD&A) is required to include a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the governmental entity's financial position or results of operations. If it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, it may be necessary to include a discussion of going concern issues in the MD&A, depending on the facts and circumstances.³³ This discussion of going concern issues is presented as required supplementary information, and the auditor is required to perform procedures on the required supplementary information in accordance with AU-C section 730, *Required Supplementary Information* (AICPA, *Professional Standards*), as applicable.³⁴

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans (Ref: par. 22)

A45. Even in situations when events or conditions that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time have been identified, but management concludes that no substantial doubt exists after considering its plans, the auditor is required by paragraph 22 to evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. For example, FASB ASC states that, if substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is alleviated as a result of consideration of management's plans, an entity shall disclose in a note to the financial statements information that enables users of the financial statements to understand all of the following (or shall refer to similar information disclosed elsewhere in the footnotes):³⁵

- a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time (before consideration of management's plans)
- b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
- c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time

A46. The auditor's evaluation about whether the financial statements achieve fair presentation includes the consideration of the overall presentation, structure, and content of the financial statements and whether the financial statements, including the related notes, represent the

³³ Paragraph 11h of GASB Statement No. 34, and paragraph 19 of GASB Statement No. 56.

³⁴ Paragraph 129 of GASB Statement No. 34.

³⁵ "Pending Content" in FASB ASC 205-40-50-12.

underlying transactions and events in a manner that achieves fair presentation.³⁶ Depending on the facts and circumstances, the auditor may determine that additional disclosures are necessary to achieve fair presentation.

A47. In the absence of disclosures explicitly required by the applicable financial reporting framework that address management’s evaluation of the entity’s ability to continue as a going concern for a reasonable period of time, the auditor may consider the disclosure guidance set out in paragraphs A42–A46 in considering whether the financial statements are fairly presented.

Implications for the Auditor’s Report

Use of Going Concern Basis of Accounting Is Inappropriate (Ref: par. 23)

A48. The requirement in paragraph 23 for the auditor to express an adverse opinion applies regardless of whether the financial statements include disclosure of the inappropriateness of management’s use of the going concern basis of accounting.

A49. When the use of the going concern basis of accounting is not appropriate in the circumstances, management may be required, or may elect, to prepare the financial statements on another basis (for example, under FASB ASC, the entity is required to comply with FASB ASC 205-30 and prepare the financial statements using the liquidation basis of accounting when an entity’s liquidation becomes imminent).

A50. Interpretation No. 1, “Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting” (AICPA, *Professional Standards*, AU-C sec. 9700 par. .01–.05), of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, addresses the situation in which an auditor issues an unmodified opinion on the entity’s financial statements prepared under the liquidation basis of accounting and the auditor determines an emphasis-of-matter paragraph is appropriate.

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified (Ref: par. 24–1.a)

Conditions and Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

A51. The identification of substantial doubt is a matter that is important to users’ understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity’s ability to continue as going concern alerts users to this circumstance.

A52. The Appendix to this SAS provides illustrations of the statements that are required to be included in the auditor’s report on the financial statements. Illustrations 1 and 3 provide examples when GAAP (under the FASB standards) isare the applicable financial framework is the applicable financial reporting framework. Illustration 2 provides an example when the GASB statements isare the applicable financial reporting framework. If an applicable financial reporting

³⁶ Paragraph .17 of AU-C section 700.

framework other than GAAP (either under the FASB standards or the GASB statements) is used, the wording in the illustrative reports in the Appendix to this SAS may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

A53. When GAAP or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the auditor's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate.

Conditions and Events Have Been Identified and Substantial Doubt Has Been Alleviated

A54. If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.³⁷ In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the auditor concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the auditor is required by paragraph 24 of this [AU section/SAS] to include a separate going concern section in the auditor's report.

A55. As indicated in proposed SAS, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, the use of an emphasis-of-matter paragraph is not appropriate if

- a. the matter has been determined to be a key audit matter when proposed SAS, *Communicating Key Audit Matters in the Independent Auditor's Report* applies, or
- b. the auditor would be required to modify the opinion in accordance with proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*,"³⁸ as a result of the matter.

A56. As indicated in the proposed SAS, *Modifications to the Opinion in the Independent Auditor's Report*, in circumstances where conditions and events have been identified and the

³⁷ Paragraphs ~~.06-.0708-.09~~ of the proposed SAS, *AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report** (AICPA, *Professional Standards*).

³⁸ Paragraph ~~.08~~ of proposed SAS, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

auditor concludes that, based on the audit evidence obtained, the disclosures are materially misstated, the auditor is required to modify the auditor's report.³⁹

Inappropriate Use of Conditional Language

A55-A57. Examples of conditional language that are inappropriate to use in the going concern section include the following:

- a. If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- b. The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

Communication With Regulators

A56-A58. When the auditor of a regulated entity considers that it may be necessary to include a reference to going concern matters in the auditor's report, the auditor may have a duty to communicate with the applicable regulatory, enforcement, or supervisory authorities. (Ref: par. 24)

Management Unwilling to Perform or Extend Its Evaluation (Ref: par. 27)

A57-A59. In certain circumstances, the auditor may believe it necessary to request that management perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework. If management is unwilling to do so, a qualified or adverse opinion in the auditor's report may be appropriate. For example, management may be unwilling to extend its evaluation because it believes it has satisfied the requirements to conclude whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time when the applicable financial reporting framework requires management to make this evaluation. If, in the auditor's judgment, management's conclusion is not adequately supported, the auditor may conclude that a qualified or adverse opinion for a departure from the applicable financial reporting framework is appropriate in these circumstances. AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*), provides guidance related to the modification of the auditor's opinion. In addition, management's unwillingness to make or extend its evaluation to meet the period of time required by the applicable financial reporting framework may be an indicator of a deficiency in internal control that is required to be evaluated to determine whether it constitutes a significant deficiency or material weakness in accordance with AU-C section 265.

Comparative Presentations (Ref: par. 29)

A58-A60. Substantial doubt about the entity's ability to continue as a going concern for a

³⁹ Paragraph .07 of AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, does not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. AU-C section 700 provides guidance on reporting when financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period.

A59.A61. A financial reporting framework may contain disclosure requirements in a subsequent period in which substantial doubt no longer exists. For example, FASB ASC states that for the period in which substantial doubt no longer exists (before or after consideration of management's plans), an entity shall disclose how the relevant conditions or events that raised substantial doubt were resolved.⁴⁰

Eliminating a Going Concern Section From a Reissued Report (Ref: par. 30)

A60.A62. After the auditor has issued the auditor's report containing a going concern section, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the going concern section that appeared in the original report. Such requests may occur after the conditions or events that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing.

A61.A63. The auditor may perform procedures in addition to those required by paragraph 30 that the auditor deems necessary in the circumstances.

Documentation (Ref: par. 32)

A62.A64. AU-C section 230, *Audit Documentation* (AICPA, *Professional Standards*), addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements.⁴¹ The documentation requirements of paragraph 32 of this SAS are incremental to AU-C section 230 and apply when the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans.

⁴⁰ "Pending Content" in FASB ASC 205-40-50-14.

⁴¹ Paragraph .01 of AU-C section 230, *Audit Documentation* (AICPA, *Professional Standards*).

Appendix— Illustrations of Auditor's Reports Relating to Going Concern (Ref: par. A51–A53)|

A63-A65.

Illustration 1—An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements that Conditions or Events Have Been Identified and Substantial Doubt Exists, and Disclosure In The Financial Statements is Adequate.

Illustration 2—An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management is Not Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements that Conditions or Events Have Been Identified, Substantial Doubt Exists, and Disclosure in the Financial Statements is Adequate.

~~Illustration 3—An Auditor's Report Containing a Qualified Opinion When Conditions or Events Have Been Identified, the Auditor Has Concluded that Substantial Doubt Exists, and the Financial Statements are Materially Misstated Due to Inadequate Disclosure.~~

~~Illustration 4—An Auditor's Report Containing an Adverse Opinion When Conditions or Events Have Been Identified, the Auditor Has Concluded that Substantial Doubt Exists, and the Financial Statements Omit the Required Disclosures Relating to the Conditions or Events Have Been Identified and Substantial Doubt.~~

~~Illustration 5~~Illustration 3—An Auditor's Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated.

Illustration 1—An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements that Conditions or Events Have Been Identified and Substantial Doubt Exists, and Disclosure In The Financial Statements is Adequate.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with GAAPFASB standards.
- The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.

- The auditor has concluded, after considering identified conditions or events and management's plans, that substantial doubt remains and the disclosures of the conditions or events and management's plans are adequate.
- ~~Management's plans do not alleviate substantial doubt.~~
- Management is required under the ~~applicable financial reporting framework~~FASB standards to include a statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

Opinion

[To be inserted]

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

[To be inserted]

[Auditor Address]

[Date]

Illustration 2—An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management is Not Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements that Conditions or Events Have Been Identified and Substantial Doubt Exists, and Disclosure in the Financial Statements is Adequate.

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with ~~GAAP~~the GASB statements.
- The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.
- The auditor has concluded, after considering identified conditions or events and management’s plans, that substantial doubt remains and the disclosures of the conditions or events and management’s plans are adequate.
- ~~Management’s plans do not alleviate substantial doubt.~~
- Management is not required under the ~~applicable financial reporting framework~~GASB Statements to include a statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.

INDEPENDENT AUDITOR’S REPORT

To the City Council of X, State Y [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

Opinion

[To be inserted]

Substantial Doubt About the ~~Company’s~~City’s Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the ~~Company~~City of X, State Y will continue as a going concern. As discussed in Note X to the financial statements, the ~~Company~~City has suffered recurring losses from ~~operations~~its governmental activities and has a ~~net capital deficiency~~fund balance deficit that raise substantial doubt about its ability to continue as a going concern. Management’s evaluation of the events and conditions and management’s plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our opinion is not modified with respect to this matter.

[To be inserted]

[Auditor Address]

[Date]

~~Illustration 3—Qualified Opinion When Conditions or Events Have Been Identified, the Auditor Has Concluded that Substantial Doubt Exists, and the Financial Statements are Materially Misstated Due to Inadequate Disclosure~~

~~For purposes of this illustrative auditor's report, the following circumstances are assumed:~~

- ~~• Audit of a complete set of financial statements prepared in accordance with GAAP.~~
- ~~• The auditor has concluded, after considering identified conditions or events and management's plans, that substantial doubt exists. Note X to the financial statements describes the magnitude of financing arrangements, the expiration and the total financing arrangements; however, the financial statements do not include disclosure about the impact or the availability of refinancing or conclude that this situation constitutes substantial doubt.~~
- ~~• Management is required under the applicable financial reporting framework to include a statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.~~
- ~~• The financial statements are materially misstated due to the inadequate disclosure of management's plans to mitigate the conditions or events that give rise to substantial doubt. A qualified opinion is being expressed because the auditor concluded that the effects on the financial statements of this inadequate disclosure are material but not pervasive to the financial statements.~~

~~INDEPENDENT AUDITOR'S REPORT~~

~~To the Shareholders of ABC Company [or Other Appropriate Addressee]~~

~~Report on the Audit of the Financial Statements~~

~~Qualified Opinion~~

~~We have audited the financial statements of the Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.~~

~~In our opinion, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.~~

~~Basis for Qualified Opinion~~

~~As discussed in Note X, the Company's financing arrangements expire and amounts outstanding are payable on March 19, 20X2. The Company has represented to us that it has been unable to conclude re-negotiations or obtain replacement financing, and as a result, the Company will not be able to meet its obligations as they become due. This situation raises substantial doubt about the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.~~

~~...~~

~~[Auditor Address] [Date]~~

~~Illustration 4—Adverse Opinion When Conditions or Events Have Been Identified, the Auditor Has Concluded that Substantial Doubt Exists, and the Financial Statements Omit the Disclosures Required by the Applicable Financial Reporting Framework.~~

~~For purposes of the illustrative auditor's report, the following circumstances are assumed:~~

- ~~• Audit of a complete set of financial statements prepared in accordance with GAAP.~~
- ~~• The auditor has concluded, after considering identified conditions or events and management's plans, that substantial doubt exists. The Company is considering filing for bankruptcy. The financial statements omit the disclosures required by GAAP.~~

~~regarding these conditions or events and management's plans. An adverse opinion is being expressed because the effects on the financial statements of such omission are material and pervasive.~~

INDEPENDENT AUDITOR'S REPORT

~~To the Shareholders of ABC Company [or Other Appropriate Addressee]~~

Report on the Audit of the Financial Statements

Adverse Opinion

~~We have audited the financial statements of the Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.~~

~~In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.~~

Basis for Adverse Opinion

~~The Company's financing arrangements expired and the amount outstanding was payable on December 31, 20X1. The Company represented to us that it has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation raises substantial doubt about the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.~~

~~We conducted our audit in accordance with auditing standards generally accepted in the United States. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the AICPA Code of Professional Conduct together with the ethical requirements that are relevant to our audit of the financial statements in the United States of America, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.~~

...

[Auditor Address] [Date]

Illustration 3—An Auditor’s Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated.

For purposes of the illustrative auditor’s report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with GAAP.
- Management has disclosed conditions or events, considered in the aggregate, that raised substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.
- Management has disclosed its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity’s ability to meet its obligations.
- Management has disclosed that the substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time has been alleviated by management’s plans.
- The auditor has concluded that management’s disclosures are adequate.

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

[To be inserted]

Emphasis of Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management’s evaluation of the events and conditions and management’s plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

...

[Auditor Address] [Date]

