# GOING CONCERN AND MANAGEMENT PLANS: MANAGEMENT OR AUDITOR BURDEN?

Maria L. Bullen, Clayton State University, Morrow, GA 30260, MariaBullen@Clayton.edu
Gregory S. Kordecki, Clayton State University, Morrow, GA 30260, GregKordecki@Clayton.edu

## ABSTRACT

This paper covers the argumentation for and against increased management reporting and disclosure requirements relating to the accounting issues of a "Going Concern" and the "Management Plans" associated with addressing the assessment. A long outstanding Exposure Draft (proposed Statement) on Going Concern still waits passage into the Accounting Standards Codification. The paper points to the relative burden placed on both the entity's management and the accounting firm performing the audit. The increased involvement will not come without cost. This paper describes the burden that lies ahead for the accounting profession, both inside and outside of the entity being audited.

## INTRODUCTION

In October, 2008, the Financial Accounting Standards Board issued two companion Exposure Drafts (ED) which contained disclosure information requirements by management and concerned time line reporting issues—Subsequent Events and Going Concern. The interesting parallel is that both of these proposed standards dealt with a download from the auditing literature into the financial reporting literature. While the proposed standard on subsequent events has been approved and elevated to authoritative generally accepted accounting principles (GAAP) through codification in the Accounting Standards Codification, going concern financial reporting and disclosure continues to be nonauthoritative. This paper addresses the key issues involved in the dilemma between management issuers, auditors, and the users of financial statement information. The paper does not conclusively defend any particular position, but rather extrapolates to other areas of the accounting and auditing literature where controversies exist, and where convergence is not easily resolved.

From the vantage point of practice, firms are pointing out that the going concern assertion is one of the most fundamental in financial reporting, and accordingly represents one of the most critical assertions considered by users of financial statements, Ernst & Young (2008). A strict downloading of the language from the SAS into the FASB Codification may backfire as pointed out by McGladrey & Pullen (2008): Paragraph 6 of the Exposure Draft reads, in part, that management's consideration relating to its plans may include…Plans to reduce or delay expenditures or increase ownership equity include "apparent feasibility of plans…" The usage of the term "apparent" may be appropriate for the auditor, but for management of the reporting entity, another modifier would make more sense.

## THE AUDITING AND FINANCIAL REPORTING LITERATURE

There has been little direct guidance historically on the issues of management's reporting on its own entity's ability to continue as a going concern. Much of the general knowledge in this area stems from Statement on Auditing Standards (SAS) No. 59, *The Auditor's Consideration on an Entity's Ability to Continue as a Going Concern,* Auditing Standards Board (1988). Embedded within this document are the requirements that the auditor assesses what management reports, presumably by means of footnote disclosure in the financial statements, or in the case of publicly held entities, in one of the other filing documents. Further implied is the disclosure by management of its plans to ameliorate the going concern issue(s).

Succinct summaries of the workability of SAS No. 59 are provided by Goldstein (1989) and by Behn, Pany, and Riley (1999). The integration of corporate governance and how management plans are drafted to be case specific are found in Behn, Kaplan, and Krumwiede (2001), and in Parker, Peters, and Turetsky (2005).

The Financial Accounting Standards Board (2008) Exposure Draft on going conern contains the disclosure requirements shown in Figure 1. If approved and ratified for the Codification, the location would be 205-30-50-1.

**Figure 1. Going Concern Disclosures**

| | |
|---|---|
| 50-1 | When management is aware, in making its assessment, of material uncertainties about events or conditions that may cast substantial doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. In particular, the entity shall disclose information that enables users of the financial statements to understand: |
| a. | Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern |
| b. | The possible effects of those conditions and events |
| c. | Management's evaluation of the significance of those conditions and events and any mitigating factors |
| d. | Possible discontinuance of operations |
| e. | Management's plans to mitigate the effect of the uncertainties and whether management's plans alleviate the substantial doubt about its ability to continue as a going concern |
| f. | Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities. |

Because the auditing literature preceded the current attempt for requiring management's assessment of going concern in the financial accounting and reporting literature, problems emerge in juxtaposition between management's assertions and the auditor's assessment. Ellingsen, Pany, and Fagan (1989) wrote immediately following the issuance of the SAS No. 59 that there is no requirement to make auditors responsible for predicting future events, nor is there any requirement generally for auditors to perform more procedures than they previously had done. Should management be subject to predicting future events? Should the scope of the audit work now be expanded in view of the expanded responsibility by management?

## KEY PROBLEM AREAS

### Definitions and Intent of Good Reporting

Grant Thornton (2008) notes that the proposed Statement refers to a "going concern" but is silent in defining the term, and that the term is also not defined anywhere in the Codification, nor in any other existing accounting guidance. The proposed standard fails to provide a clear definition of what is a going concern; it provides an example of what it is not by analogy by not meeting current debt obligations.

Under such general presumption, virtually all start-up enterprises would be subject to a going concern as such entities are dependent upon possible future subsequent operational, investing, and financing success. Little of this can be quantified by management, and even less attested to by the auditors.

Is it necessary to have more of a trickle down into small and medium size enterprises? Widely-helds already are required by the SEC to disclose "risk factors," include comments in their "M,D,&A". All companies must meet the requirements for contingent liabilities and fair value accounting.

Deloitte (2008) states that the language applied in the companion Exposure Draft on subsequent events of "available to be issued" is far more reasonable than longer time lines. Accordingly, a period not to exceed 12 months from the balance sheet date, and on the basis of conditions and events that exist at or have occurred before the date the financial statements are issued or available to be issued, is easily captured.

## "Bright-Line" Time Issues

One of the Exposure Draft's specific questions was ". . .the Board decided to adopt the time horizon in IAS 1 (at least, but not limited to, twelve months from the end of the reporting period), instead of the time horizon considered in AU Section 341 (not to exceed one year beyond the date of the financial statements). The Board decided to use the time horizon in IAS 1 because it avoids the inherent problems that a bright-line time horizon would create for events or conditions occurring just beyond the one-year time horizon that are significant and most likely would have to be disclosed. It also would result in a convergent approach between U.S. generally accepted accounting principles and IFRS. Do you agree with the Board's decision to remove the bright-line time horizon in AU Section 341 I favor of the guidance in IAS 1? If not, why? Do you believe that this time horizon is helpful and operational? If not, why?" The issue then becomes—would the IAS 1 time horizon provide a higher degree of comfort to the financial statement users for going concern issues?

The New York State Society of CPAs (NYSSCPA) (2008) further argues against a long time line exceeding one year, as FASB Statement No. 6, *Classification of Short-Term Obligations Expected to be Refinanced*, applies the one-year guidance. The Technical Issues Committee of Private Companies Practice Section (PCPS) of the AICPA (2008) notes its support for management to carry the primary responsibility for assessing the ongoing viability of the reporting entity, though the indefinite time horizon for management's assessment in turn lengthens the assessment period that the auditor must evaluate.

PriceWaterhouseCoopers (2008) voiced concern that the requirement that management take into account "all available information about the future," coupled with an open-ended time horizon, imposes an unrealistic responsibility on preparers to look into the future. However, others, such as The Ohio Society of CPAs (2008) and the Washington Society of Certified Public Accountants, suggest that lengthening the bright-line time horizon is likely to lead to little abuse, and perhaps a time line of at least five years from the end of the reporting period may be appropriate for quality reporting and auditing.

## Potential Conflicts between the Parties

Grant Thornton (2008) believes there is consistency between the proposed standard with IAS 1, *Presentation of Financial Statements*, in limiting the consideration beyond one year to a reasonable period of time, but that qualification does exist in the authoritative auditing literature in the United States. The Exposure Draft's "all available information about the future" fails to limit the future to a reasonable period of time, which then requires an entity to consider information indefinitely into the future.

Deloitte (2008) further points out that the auditing literature is very specific for good reasons, originating with SAS No. 34, *The Auditor's Consideration When a Question Arises About an Entity's Continued Existence*, where the 12 month time period was discussed and subsequently brought forth into SAS No. 59. Deloitte further points to AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties,* where the time period does not exceed one year. Additional arguments could be made that financial statements would likely depart from the reliability criterion of Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information.*

To avoid conflict with disclosure requirements found in the auditing literature, management's plans should not only include discussion on how to mitigate the effect of uncertainties, but also the conditions that prompted the concern in the first place. Accordingly, resolution is then disclosed for alleviation, or successful turnaround, at least in thinking or assessing, if not in actuality. PriceWaterhouseCoopers (2008) suggests inclusion in the proposed Statement that "Substantial doubt about the entity's ability to continue as a going concern may have existed, but was alleviated prior to the issuance of the financial statements."

On the preparer side, the Institute of Management Accountants (2008) voiced practical concerns that the Exposure Draft as currently structured would impose limitations on the ability to predict how long an entity will continue in existence, and suggest that the one year window be retained and the new standard only require an evaluation of whether there is "substantial doubt about whether the entity will continue as a going concern for a reasonable period of time, not to exceed one year from the date of financial statements."

Ernst & Young (2008) point to an auditor's report that is modified to express substantial doubt about an entity's ability to continue as a going concern can become a self-fulfilling prophecy, and that the auditor's conclusion with respect to an entity's ability to continue as a going concern "is one of the most important judgments made during the course of the audit."

The Accounting Standards Executive committee (AcSEC) and Auditing Standards Board (ASB) of the AICPA drafted a joint letter of comment (2008) to the FASB, arguing that the lack of a definition of "going concern" would place a harsh burden on both preparers and the auditors as each must struggle with an unknown target. They made the point further that some language in the FASB's explanation, which is not part of the formal draft of the proposed standard would improve the usability, arguing that "management should consider events or conditions occurring 'just beyond' the one-year tine horizon that are significant and most likely would need disclosure." This may be the compromise we ultimately see.

**Legal, Social, and Macroeconomic Considerations**

The proposed standard does not provide descriptions of application guidance. If the time horizon of IAS 1 is utilized rather than the time horizon of AU 341, management as well as the auditors, will need to have examples of the application.

What the financial statement users really need is disclosure of the assumptions by management in assessing their own viability and continuity of being a going concern.

The expanded time horizon would most likely expose preparers and auditors to greatly increased and unwarranted liability. With a hostile legal environment, the longer, open-ended timeframe will permit the surfacing of charges by plaintiffs and regulators.

Asking management to "take into account all available information about the future, which is at least, but is not limited to, 12 months from the end of the reporting period," may likely be far too bold. In the current financial and economic environment, few external appraisers are able to predict with clarity. Accordingly, is it unreasonable to expect management to make valid and reliable judgments about events and conditions that exist in the future, especially beyond one year?

## CONCLUSIONS AND SUGGESTIONS FOR FURTHER RESEARCH

Macroeconomic conditions and entity-specific financial information are not the same thing, nor should they be expected to be. Taken to the extreme, the Exposure Draft would require that such knowledge (about the general economy) be presumed, assessed, and audited. Perhaps selective disclosure is warranted—stopgap safety measures are not required to be disclosed—how to fix the spill caused in an offshore drilling rig, dealing with a Tsunami flood, and other natural catastrophes. The existence or non-existence of backup systems may likely be of more concern to the financial statement users than the affixing of blame and hypothetical assessments.

The Exposure Draft was issued on October 9, 2008 with a brief comment period to December 8, 2008. While 29 letters of comment from individuals and accounting groups were submitted critiquing the Exposure Draft's nine brief paragraphs, the proposed statement is still a proposed statement. Once issued, it will be fruitful research to investigate which areas of the Exposure Draft were changed and why. It will be even more interesting working over the future years with a standard that was proposed quickly, then studied long and hard, and then hopefully, becomes part of the better exposition of financial accounting and reporting literature.

## REFERENCES

AcSEC and ASB of the American Institute of CPAs (2008). Letter of comment No. 13 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 7, 2008.

Auditing Standards Board of the American Institute of CPAs (1988). The auditor's evaluation of an entity's ability to continue as a going concern: Statement on Auditing Standards No. 59, *AICPA Auditing Standards*, New York, 1988.

Behn, Bruce K., Kurt Pany, and Richard Riley (1999). SAS No. 59: Going concern evidence, *The CPA Journal*, Vol 69(7), p. 52.

Behn, Bruce K., Steven E. Kaplan, and Kip R. Krumwiede (2000). Further evidence on the auditor's going-concern report: The influence of management plans, *Auditing*, Vol 20(1), pp. 13-28.

Deloitte & Touch LLP (2008). Letter of comment No. 21 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

Ellingsen, John E., Kurt Pany, and Peg Fagan (1989). SAS no. 59: How to evaluate going concern, *Journal of Accountancy*, Vol 167(1), pp. 24-31.

Ernst & Young (2008). Letter of comment No. 17 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

Financial Accounting Standards Board of the Financial Accounting Foundation (2008). Exposure draft—Proposed statement of financial accounting standards: Going concern, *Financial Accounting Series,* No. 1650-100, October 9, 2008.

Goldstein, Fred R. (1989). Documenting compliance with SAS 59, *The CPA Journal,* Vol 59(7), pp. 50-54.

Grant Thornton (2008). Letter of comment No. 24 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

Institute of Management Accountants, IMA (2008). Letter of comment No. 28 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 16, 2008.

McGladrey & Pullen (2008). Letter of comment No. 11 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 5, 2008.

New York State Society of CPAs, NYSSCPA (2008). Letter of comment No. 9 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

The Ohio Society of CPAs (2008). Letter of comment No. 26 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

Parker, Susan, Gary F. Peters, and Howard F. Turetsky (2005). Corporate governance factors and auditor going concern assessments, *Review of Accounting & Finance,* Vol 4(3), pp. 5-29.

Private Companies Practice Section PCPS of the AICPA (2008). Letter of comment No. 25 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

PriceWaterhouseCoopers (2008). Letter of comment No. 22 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.

Washington Society of Certified Public Accountants (2008). Letter of comment No. 16 on file reference No. 1650-100, going concern, *FASB Exposure Draft Response*, December 8, 2008.