STAFF PAPER

March 2013

IASB Meeting

Project	**Disclosure requirements about an assessment of going concern**
Paper topic	Proposed narrow-focus amendment to IAS 1

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Purpose of this paper

1. In June 2012, the IFRS Interpretations Committee ('the Interpretations Committee') received a request for clarification about IAS 1 *Presentation of Financial Statements*. This Standard includes guidance on when financial statements should be prepared on a going concern basis. It also requires that when management are aware of material uncertainties about the entity's ability to continue as a going concern, those uncertainties shall be disclosed. The submitter, the International Audit and Assurance Standards Board (IAASB), thinks that the guidance about the disclosure of these uncertainties is not clear.
2. At their November 2012 meeting, the Interpretations Committee tentatively decided to prepare a narrow-focus amendment to IAS 1 that answers two questions:
   - (a) When should an entity be required to disclose information about material uncertainties related to events or circumstance that cast significant doubts upon the entity's ability to continue as a going concern?
   - (b) What is the objective of those disclosures about material uncertainties about the entity's ability to continue as a going concern and what disclosures should be required?

3. The proposed narrow-focus amendment to IAS 1 was discussed at the January 2013 meeting of the interpretations Committee at which it recommended these proposals to the IASB for deliberation. The purpose of this paper is to present the proposed amendments to IAS 1 to you for discussion and review. At this meeting we will ask you:

   (a) whether you agree with the Interpretations Committee's recommendation to propose an amendment to IAS 1;

   (b) whether you have any comments or queries on the proposed amendment to IAS 1 contained in Appendices A and B; and

   (c) whether you approve exposing the proposed amendment to IAS 1 for public consultation?

Paper structure

4. The paper is organised as follows:

   (a) background;

   (b) requirements of the Standard;

   (c) summary of outreach conducted;

   (d) findings from outreach;

   (e) basis of the proposed amendments about disclosures;

   (f) recommendation of the Interpretations Committee;

   (g) Appendix A—proposed amendment to IAS 1, and

   (h) Appendix B—proposed amendment to IAS 1 in mark-up.

Background

Discussions at the Advisory Council

5. At the June 2012 meeting of the Advisory Council, Roger Marshall (Chair of the Accounting Council, UK Financial Reporting Council) briefed members of the Advisory Council on actions being taken in response to the Sharman Inquiry and

others. Lord Sharman recommended enhanced processes in three areas: management's review of the business; audit committees; and auditors' reports. One recommendation was to require more disclosure in financial statements, management commentary and the auditors' reports regarding material risks and uncertainties that could affect the reporting entity's ability to continue as a going concern.

6. Members of the Advisory Council expressed the view that this might be more of a governance issue; and that early warning signals to investors would be useful but must not become so commonplace or vague as to be meaningless. The suggestion was made that perhaps the IFRS Interpretations Committee or the IASB could provide guidance on disclosures relating to material uncertainties.

7. A formal submission from the IAASB, referring this issue to the Interpretations Committee, was received in June 2012.

Requirements of the Standard

8. Going concern is addressed in paragraph 25 of IAS 1:

> 25 When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

9. It is also addressed in the *Conceptual Framework*:

> 4.1 The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

10. At issue are the narrow criteria for assessing going concern in paragraph 25 of IAS 1. The threshold for not preparing the financial statements on a going concern basis is a high one—the intention to cease trading or liquidate, or that there is no reasonable way to avoid such a fate.

11. Some continue reading paragraph 25 as though the same high threshold also applies to the disclosure of material uncertainties about an entity's ability to continue as a going concern. If that is how the paragraph is interpreted, this interpretation leads to the conclusion that disclosure of material uncertainties will only occur when the going concern assumption is no longer appropriate and the entity is about to cease operations or go into liquidation. This is obviously too late to provide useful information—and would make the disclosure requirement meaningless.

Summary of outreach conducted

12. We sent requests to the International Forum of Accounting Standard-setters (IFASS), the European Securities and Markets Authority (ESMA), the International Organization of Securities Commissions (IOSCO) and the technical departments of the major accounting firms to ask whether the issues raised by the submitter are widespread and have practical relevance and whether there are significant divergent interpretations.

Responses received

13. We received 24 responses to this informal outreach:

Global firms	6

Regulators		4
IFASS:		
Europe	5	
Asia–Oceania	5	
Latin America	2	
North America	1	
Africa	1	14
Total		24

14. The results of outreach conducted were presented to the Interpretations Committee at its November 2012 meeting as Agenda Papers 12 A-C. These findings are summarised below to describe the Interpretations Committee's approach to this submission.

Findings from outreach

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

15. All respondents thought that the criteria in paragraph 25 of IAS 1 for assessing going concern as a suitable basis for the preparation of the financial statements are clear and that the rebuttal of the going concern presumption was set at a suitably high level—ie, intends to cease trading or liquidate or no realistic alternative but to do so. Some respondents noted that many jurisdictions have specific requirements that define insolvency or provide guidance about local conditions that determine 'going concern'. In these jurisdictions, judgements about going concern as a basis for the preparation of financial statements arise mainly from local auditing standards and regulatory requirements rather than from financial reporting standards.

Threshold for disclosure of material uncertainties about the going concern assessment

16. There was significant diversity among respondents about when disclosure of material uncertainties about an entity's ability to continue as a going concern should be made.

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

18. Most respondents take a view that disclosure about uncertainties is required at an earlier stage in order to forewarn users about those uncertainties and about the effect those uncertainties may have on the future activities of the entity. Even in cases, however, in which the broader threshold is acknowledged, many respondents note that a commonly-held view is that if management have a plan to remedy these uncertainties, that is sufficient to support the going concern assumption for the preparation of the financial statements: the uncertainties have been ‘resolved’ and disclosure of the uncertainties is not required. Most respondents think that we need to be clearer about what uncertainties require disclosure.

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

> In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

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

(a) operating losses;

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

(c) net deficit/ liability position;

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

(e) working capital deficiencies;

(f) inability to obtain new borrowings; or

(g) inability to repay debt.

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

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

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

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

(a) raise or renegotiate finance;

(b) materially curtail the entity’s operations;

(c) realise its assets; and/ or

(d) discharge its liabilities.

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

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

Nature of the disclosures about material uncertainties

24. Many respondents discussed the nature of the disclosures about material uncertainties about the entity's ability to continue as a going concern and the effect that these uncertainties could have on the entity's future cash flows.

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

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

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

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

27. Some respondents cautioned against trying to provide prescriptive requirements about what should be disclosed about material uncertainties relating to an entity's going concern assessment. They were concerned that such disclosures could become boilerplate. Others suggested detailed requirements about this disclosure, often drawn from their local guidance.

28. Some suggested that this disclosure was already covered by the requirements of IAS 1, either in paragraph 22 (disclosure of critical assumptions made in the preparation of the financial statements) or in paragraph 15 (fair presentation).

29. Many respondents also discussed the nature of the uncertainties in order to establish what should be disclosed about these uncertainties. The risks that give rise to material uncertainties about an entity's ability to continue as a going concern can be categorised into two types:

(a) liquidity risks; and

(b) business outlook risks.

Liquidity risks

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

(a) term borrowings falling due for repayment;

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

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

(d) outstanding judgements concerning fines or taxation.

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

Business outlook risks

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

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

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

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

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

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

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

Scope of the issues to be addressed

35. Comments received from respondents ranged over a number of additional aspects of the going concern assessment in addition to the questions asked about the disclosure of material uncertainties affecting the going concern assessment:

   (a) Some respondents think that we should specify who is responsible for the going concern assessment (auditors or management) and where this assessment should be presented (management commentary, audit report or financial statements) although most would consider that to be outside our remit.

   (b) Other respondents think that we should harmonise the requirements about going concern in IAS 1, for the presentation of financial statements, with the IAASB's work on improving the audit report in relation to going concern. This echoes the recommendations of the Sharman Inquiry that the UK Financial Reporting Council ('UK FRC'), the IASB and the IAASB should work together to provide an integrated framework for the assessment and reporting of the going concern status, based on existing guidance from requirements for corporate governance, financial reporting and auditing.

(c) Some respondents think that we should conduct a comprehensive review of those parts of IFRS that deal with liquidity risks, curtailment of operations or disclosure of uncertainty. Related Standards include:

   (i) IFRS 4 *Insurance Contracts* and IFRS 7 *Financial Instruments: Disclosures*–IFRS 4.15 and IFRS 7.39 relate to liquidity;

   (ii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*–relates to contingencies; and

   (iii) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—IFRS 5.13 relates to abandonment.

(d) A few respondents think that we should address what they see as a more fundamental issue, namely that we should set out requirements for the preparation of the financial statements when the going concern basis of preparation is not appropriate.

36. Audit firms in general wanted a clearer link between audit guidance and the IASB's requirements. Standard-setters and securities regulators, on the other hand, warned about the difficulties in trying to achieve an international solution on a topic that affects auditing, corporate governance, financial reporting and compliance. Many think that a local level of guidance is currently adequate to reflect local regulatory concerns.

37. At its November 2012 meeting the Interpretations Committee tentatively decided to limit its proposed amendment to address only questions about material uncertainties about an entity's ability to continue as a going concern:

(a) when should disclosure of these uncertainties take place, and what should be disclosed about the material uncertainties; and

(b) what time period should be used in assessing these uncertainties?

38. In developing these proposals, however, the Interpretations Committee subsequently asked whether differences between the Standard and local auditing requirements could be reduced with respect to the assessment time frame. At its January 2013 meeting the Interpretations Committee recommended including a question in the Exposure Draft about whether the proposals should also include an

alignment of the going concern assessment time frame with the assessment time frame set out in local auditing requirements. The time period over which the entity's ability to continue as a going concern is assessed is the subject of Agenda Paper 3B *Time frame for an assessment of going concern*.

Basis of the proposed amendments about disclosure

39. At its November 2012 meeting, the Interpretations Committee tentatively decided to address the issue of when material uncertainties should be disclosed and what should be disclosed about those uncertainties. An extract of the November 2012 *IFRIC Update* is included below for reference:

> IAS 1 *Presentation of Financial Statements*—Disclosures about going concern
>
> The Interpretations Committee received a request for clarification on IAS 1 *Presentation of Financial Statements*. This Standard requires that when management are aware of material uncertainties about the entity's ability to continue as a going concern, those uncertainties shall be disclosed. The Interpretations Committee tentatively decided to deal only with two questions about this disclosure—when to disclose and what to disclose about these uncertainties.
>
> The Interpretations Committee tentatively decided that these two questions should be addressed as a narrow-focus amendment to IAS 1.
>
> The Interpretations Committee tentatively agreed that:
>
> - the high threshold for preparing financial statements on a basis other than going concern is appropriate;
> - a threshold for the disclosure of material uncertainties should be identified more clearly in the Standard;

- the Standard should include objectives for this disclosure; and
- the staff should prepare a proposal about what specific disclosures, if any, should be required.

Related literature

40. For completeness in preparing the proposed amendments, and in addition to reviewing our own outreach, we have also reviewed the following related documents and projects:

    (a) guidance produced by the submitter, the IAASB;

    (b) the work of the Sharman Inquiry; and

    (c) the current going concern project of the FASB.

Guidance produced by the IAASB

41. Auditing guidance about the going concern assumption has developed in recent years. The International Standard of Auditing 570 *Going Concern* was effective from 15 Dec 2009. In addition, in June 2012 the submitter, the IAASB, initiated public consultation on improving the audit report *Invitation to Comment: Improving the Auditor's Report*.

42. The comments received on this public consultation were discussed at the December 2012 meeting of the IAASB, where it was decided to continue to explore what statements should be made about going concern in audit reports. The IAASB also decided to continue to monitor developments about going concern here and at the US-based standard-setter, the Financial Accounting Standards Board ('FASB').

Sharman Inquiry

43. In 2011 the UK FRC commissioned the Sharman Inquiry's report *Going Concern and Liquidity Risks: Lessons for Companies and Auditors* (Preliminary report issued November 2011; Final report issued June 2012). The report includes a detailed discussion about the issues involved in assessing and reporting on going

concern and recommends that the current corporate governance, financial reporting and auditing going concern requirements should be moulded into a more integrated framework. It also recommends that the IASB and the IAASB should work closely together to achieve this.

44. The UK FRC is currently consulting on this report. The Consultative Paper *Implementing the Recommendations of the Sharman Panel* is available for comment until 28 April 2013.

FASB project on going concern

45. At its November 2012 meeting the FASB agreed to pursue a project that requires management to formally perform going concern assessments and to provide related footnote disclosures. This represents a significant change in practice in the US where the onus to perform a going concern assessment currently rests with auditors.

46. The FASB has decided that management would start to provide disclosures when it is more likely than not that the entity will be unable to meet its obligations. The FASB have also decided that management would assert that there is substantial doubt about an entity's ability to continue as a going concern when the likelihood reaches 'probable'.

47. The FASB expect to publish an Exposure Draft of their proposals by late March or early April 2013.

Recommendation of the Interpretations Committee

48. The proposed narrow-focus amendment to IAS 1 is attached for your review:

    (a) Appendix A contains a 'clean' form of the revised paragraph 25 of IAS 1 as it would appear in the revised Standard. In our view, it is easier to understand the proposed guidance in this form without the distraction of the drafting mark-up.

    (b) Appendix B contains the proposed amendments in mark-up in order to highlight the changes made.

49. The following comments summarise the basis used for preparing the proposed narrow-scope amendment to IAS 1.

(a) In drafting the proposed amendments we have tried to change the existing guidance as little as possible. In the absence of a Basis for Conclusions for IAS 1, we are wary of altering the IASB's wording for fear of unintended consequences. In particular, the section relating to going concern as a basis of preparation for the financial statements, which works well in practice, remains substantially unchanged.

(b) We have inserted "for the foreseeable future" into the guidance because it is the time frame used in the *Conceptual Framework* in relation to going concern. We think that this clarifies the time frame required by the IASB in making this assessment and it also harmonises the wording of IAS 1 with that of the *Conceptual Framework*. Before amendment, paragraph 26 refers simply to 'the future'. 'Foreseeable future' is also compatible with the wording used in international auditing standards.

(c) The Standard, as originally issued, dealt with both going concern as a basis for the preparation of financial statements and also with a requirement to disclose material uncertainties about an entity's ability to continue as a going concern. Outreach conducted suggested that part of the reported diversity in practice arose because the distinction between these two requirements was not sufficiently clear in the Standard. For clarity we have restructured the going concern section into three separate topics—basis of preparation, identification of material uncertainties and disclosure.

(d) The proposed amendment consists mainly of entirely new requirements (paragraphs 25D-25H) that provide guidance on how to identify material uncertainties and what to disclose in relation to material uncertainties. We met with a sub-group of the IAASB (who are working on the changes to audit reporting) in developing this guidance.

(e) We received conflicting advice on how detailed this guidance should be. Some think that providing examples of conditions that may indicate whether uncertainties are material or providing examples of conditions that may give rise to material uncertainties is useful; others argue that such examples blur the principles involved and can lead to divergence in practice. The members of the submitter's sub-group that we consulted think that this additional guidance is very helpful. They think that this guidance would be fundamental to addressing the concerns that were raised by the submitter.

We have retained the more detailed level of guidance in drafting the proposed amendments. The Interpretations Committee recommend including a question in the Exposure Draft about whether this level of guidance is helpful.

(f) The Interpretations Committee decided that the amendments should apply prospectively, because they did not think that retrospective information about an entity's ability to continue as a going concern would be useful for prior periods or that this information could be prepared without the use of hindsight.

50. The Interpretations Committee recommend the proposed amendment to IAS 1 to the IASB for deliberation.

Questions for the IASB
1. Do you agree with the Interpretations Committee's recommendation to propose an amendment to IAS 1? 2. Do you have any comments or queries on the proposed amendment to IAS 1 contained in Appendices A and B? 3. Do you approve exposing the proposed amendment to IAS 1 for public consultation?

Appendix A

Proposed amendment to IAS1 *Financial Statement Presentation*

Revised paragraphs 25-26, after amendment

Going concern

Basis of preparation of financial statements

25 When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern for the foreseeable future. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

25A In assessing whether the going concern assumption is appropriate, management takes into account all available information about the foreseeable future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

25B When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Identification of material uncertainties

25C when management is aware, in making its going concern assessment, of material uncertainties about the entity's ability to continue as a going concern for the foreseeable future, the entity shall disclose those uncertainties.

25D Even when management determines that the going concern assumption is a suitable basis for the preparation of the financial statements, information about these material uncertainties about an entity's ability to continue as a going concern will still provide useful information to users of the financial statements.

25E Management will need to apply judgement in identifying whether these uncertainties about an entity's ability to continue as a going concern are material. In making that judgement, management should consider the following factors:

(a) the nature of the uncertainty;

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

(c) the likelihood of that event or condition occurring; and

(d) the likely timing of the event or condition giving rise to the uncertainty.

25F Examples of conditions that might give rise to material uncertainties about an entity's ability to continue as a going concern include:

(a) the breach, or foreseeable breach, of borrowing or other contractual covenants;

(b) the inability to make new investments essential to sustain the business;

(c) reliance on obtaining or retaining one specific contract or customer;

(d) changes in an entity's markets or regulatory environment; and

(e) the discontinuance or curtailment of some operations.

Such uncertainties are also signified when the entity foresees levels of financial distress that mean that management may have no realistic alternative but to take remedial action outside its intended normal course of business. This situation may be indicated by events or conditions such as:

(a) the need to raise or renegotiate finance; and

(b) the disposal of the entity's assets earlier than planned at the time of acquisition of the asset or other than through its normal trading activities.

Disclosure

25G When material uncertainties are identified with respect to an entity's ability to continue as a going concern, an entity shall disclose information that enables users of the financial statements to understand the judgements made and assumptions used in assessing whether going concern is an appropriate basis for the preparation of the financial statements. The entity shall disclose information that enables users of financial statements to:

(a) identify those uncertainties regarded as material;

(b) assess the feasibility of the remedial actions or mitigating factors available to the entity; and

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

25H To comply with paragraph 25G, the disclosures should:

(a) describe the critical judgements made and assumptions used in relation to management's assessment of the entity's ability to continue as a going concern;

(b) describe the principal events or conditions that give rise to any material uncertainties with respect to the entity's ability to continue as a going concern;

(c) provide information about remedial or mitigating actions available to the entity, their effectiveness and the extent to which management can control those actions ;

(d) include details of any other facts and circumstances required to meet the objectives of paragraph 25G; and

(e) state clearly that these circumstances were identified as part of management's assessment of the entity's ability to continue as a going concern.

[26 Deleted]

Transition arrangements and effective date

139L [Draft] *Disclosures Relating to Material Uncertainties about Going Concern (Amendments to IAS 1)* issued in [date], amended and reordered paragraph 25, renumbered paragraph 26 as paragraph 25A and added paragraphs 25D-H to the Standard.

139M An entity shall apply these amendments prospectively for annual periods beginning on or after [date.] Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Basis for Conclusions on IAS 1 *Presentation of Financial Statements*

Going concern Identification and disclosure of material uncertainties—2013

This Basis for Conclusions accompanies, but is not a part of, the proposed amendment.

Introduction

BC1 The IFRS Interpretations Committee ('the Interpretations Committee') received a request for clarification about two aspects of the guidance relating to the disclosure of material uncertainties about an entity's ability to continue as a going concern:

When should an entity be required to disclose information about material uncertainties related to events or circumstance that cast significant doubts upon the entity's ability to continue as a going concern?

What is the objective of those disclosures about material uncertainties about the entity's ability to continue as a going concern and what disclosures should be required?

BC 2 The Interpretations Committee conducted outreach to standard-setters, securities regulators and major accounting firms in August and September 2012. At issue was the question of whether the criteria for management's use of the going concern assumption as the basis for the preparation of the financial statements (ie management does not intend to liquidate or to cease trading) were the same as those for disclosure of material uncertainties. The Interpretations Committee asked outreach participants whether the threshold for disclosure and for preparation were considered to be the same in their jurisdiction and what approach was adopted in their jurisdiction for identifying and disclosing material uncertainties about an entity's ability to continue as a going concern.

BC 3 All respondents thought that the criteria in IAS 1 for assessing going concern as a suitable basis for the preparation of the financial statements are clear and that the rebuttal of the going concern presumption is set at a suitably high level—ie, intends to cease trading or liquidate or has no realistic alternative but to do so.

BC 4 However, some respondents reported reading the Standard as though the same high threshold also applies to the disclosure of material uncertainties about the entity's ability to continue as a going concern. In their view, if that is how the paragraph is interpreted, material uncertainties will only be identified when the going concern assumption is no longer appropriate and the entity is about to cease operations or go into liquidation. Many respondents expressed concern that such disclosures will be reported too late to provide useful information to investors. Many respondents also expressed concern about the diversity in the information disclosed about material uncertainties.

Basis for the revision to the Standard

BC 5 The Standard, as currently issued, deals with both going concern as a basis for the preparation of financial statements and also with a requirement to disclose material uncertainties about an entity's ability to continue as a going concern. The outreach that the Interpretations Committee conducted suggested that part of the reported diversity in practice arises because the distinction between these two requirements is not sufficiently clear in the Standard.

BC 6 In order to clarify this distinction, the IASB proposes that the going concern section should be restructured into three separate topics—basis of preparation, identification of material uncertainties and disclosure. In order to separate the existing guidance into these three categories the IASB proposes that:

the original paragraph 25 is split into paragraphs 25, 25B and 25C, and the original paragraph 26 is renumbered as 25A.

Basis of preparation

BC 7 The IASB proposes that the guidance on going concern as a basis for the preparation of financial statements should remain largely unchanged, but nevertheless the IASB's proposals do revise this guidance in one respect.

BC 8 Before amendment, paragraph 26 refers simply to "the future" when considering the time frame for the assessment of going concern. The IASB proposes inserting 'for the foreseeable future' into the guidance because that is the time frame used in the Conceptual Framework in relation to going concern. The IASB thinks that this will clarify the time frame required in making this assessment and will harmonise the wording of IAS 1 with that of the *Conceptual Framework*. 'Foreseeable future' is also compatible with the wording used in international auditing standards.

Identification of material uncertainties

BC 9 In the IASB's proposals, paragraphs 25B and 25C are shown separately from the original paragraph 25 to emphasise the distinction in the guidance between (i) going concern as a basis for preparation of the financial statements and (ii) the requirement for disclosures about material uncertainties about the entity's ability to continue as a going concern.

BC 10 The proposed amendments also include new requirements (paragraphs 25D-25F) that provide guidance on how to identify material uncertainties. The IASB proposals include factors that indicate material uncertainty and examples of the types of conditions that may give rise to these uncertainties.

BC 11 The IASB discussed different views on how detailed this guidance should be. Some thought that quoting factors that may indicate whether uncertainties are material or providing examples of conditions that may give rise to material uncertainties is useful; others argue that such examples blur the principles involved and can lead to divergence in practice. A question is included in the ED to ascertain whether that level of guidance is helpful.

Disclosure of material uncertainties

BC12 The proposed amendments also include new requirements (paragraphs 25G-25H) that provide guidance about what to disclose in relation to material uncertainties about an entity's ability to continue as a going concern. The IASB proposes objectives for the disclosures that are made about material uncertainties and provides examples of the types of information that should be disclosed about material uncertainties.

BC13 In drafting these proposals, the IASB discussed different views on how detailed this guidance should be. Some think that providing this guidance is useful; others argue that such examples detract from the clarity of the disclosure objective and can lead to divergence in practice. A question is included in the ED to ascertain whether that level of guidance is helpful.

Effective date and transition

BC14 The IASB proposes that the amendments should apply prospectively because they do not think that information about an entity's ability to continue as a going concern would be useful for prior periods or that this information could be prepared without the use of hindsight. The IASB also decided that no amendment to IFRS 1 *First-time adoption of International Financial Reporting Standards* should be proposed. This is because the IASB's proposals relate to the going concern assumption, which is an underlying assumption of the *Conceptual*

Framework and this clarification should not alter that assessment.

Appendix B

Proposed amendment to IAS 1 *Financial Statement Presentation*

Paragraph 25 and 25A are amended and paragraph 26 is renumbered as 25B. Paragraphs 25C-H are inserted. New text is underlined.

Going concern

<u>Basis of preparation of financial statements</u>

25 When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern <u>for the foreseeable future</u>. An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

25A (formerly 26) In assessing whether the going concern assumption is appropriate, management takes into account all available information about the <u>foreseeable</u> future, which is at least, but is not limited to, twelve months from the end of the reporting period. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, the entity may reach a conclusion that the going concern basis of accounting is appropriate without detailed analysis. In other cases, management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

25<u>B</u> (order changed) **When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it**

prepared the financial statements and the reason why the entity is not regarded as a going concern.

Identification of material uncertainties

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

25D Even when management determines that the going concern assumption is a suitable basis for the preparation of the financial statements, information about these material uncertainties about an entity's ability to continue as a going concern will still provide useful information to users of the financial statements.

25E Management will need to apply judgement in identifying whether these uncertainties about an entity's ability to continue as a going concern are material. In making that judgement, management should consider the following factors:

(a) the nature of the uncertainty;

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

(c) the likelihood of that event or condition occurring; and

(d) the likely timing of the event or condition giving rise to the uncertainty.

25F Examples of conditions that might give rise to material uncertainties include:

(a) the breach, or foreseeable breach, of borrowing or other contractual covenants;

(b) the inability to make new investments essential to sustain the business;

(c) reliance on obtaining or retaining one specific contract or customer;

(d) changes in the entity's markets or regulatory environment;

(e) the discontinuance or curtailment of some operations.

Such uncertainties are also signified when the entity foresees levels of financial distress that mean that management may have no realistic alternative but to take remedial action outside its intended normal course of business. This situation may be indicated by events or conditions such as:

(a) the need to raise or renegotiate finance; and

(b) the disposal of the entity's assets earlier than planned at the time of acquisition of the asset or otherwise than through its normal trading activities.

Disclosure

25G When material uncertainties are identified with respect to an entity's ability to continue as a going concern, an entity shall disclose information that enables users of the financial statements to understand the judgements made and assumptions used in assessing whether going concern is an appropriate basis for the preparation of the financial statements. The entity shall disclose information that enables users of financial statements to:

(a) identify those uncertainties regarded as material;

(b) assess the feasibility of the remedial actions or mitigating factors available to the entity; and

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

25H To comply with paragraph 25G, the disclosures should:

(a) describe the critical judgements made and assumptions used in relation to the management's assessment of the entity's ability to continue as a going concern;

(b) describe the principal events or conditions that give rise to any material uncertainties with respect to the entity's ability to continue as a going concern;

(c) provide information about remedial or mitigating actions available to the entity, their effectiveness and the extent to which management can control those actions;

(d) include details of any other facts and circumstances required to meet the objectives of paragraph 25G; and

(e) state clearly that these circumstances were identified as part of management's assessment of the entity's ability to continue as a going concern.

[26 Deleted]

Transition arrangements and effective date

139L [Draft] *Disclosures Relating to Material Uncertainties about Going Concern (Amendments to IAS 1)* issued in [date], amended and reordered paragraph 25, renumbered paragraph 26 as paragraph 25A and added paragraphs 25D-H to the Standard.

139M An entity shall apply these amendments prospectively for annual periods beginning on or after [date.] Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

Basis for Conclusions on IAS 1 *Presentation of Financial Statements*

Going concern Identification and disclosure of material uncertainties—2013

This Basis for Conclusions accompanies, but is not a part of, the proposed amendment.

Introduction

BC1 The IFRS Interpretations Committee ('the Interpretations Committee') received a request for clarification about two aspects of the guidance relating to the disclosure of material uncertainties about an entity's ability to continue as a going concern:

When should an entity be required to disclose information about material uncertainties related to events or circumstance that cast significant doubts upon the entity's ability to continue as a going concern?

What is the objective of those disclosures about material uncertainties about the entity's ability to continue as a going concern and what disclosures should be required?

BC 2 The Interpretations Committee conducted outreach to standard-setters, securities regulators and major accounting firms in August and September 2012. At issue was the question of whether the criteria for management's use of the going concern assumption as the basis for the preparation of the financial statements (ie management does not intend to liquidate or to cease trading) were the same as those for disclosure of material uncertainties. The Interpretations Committee asked outreach participants whether the threshold for disclosure and for preparation were considered to be the same in their jurisdiction and what approach was adopted in their jurisdiction for identifying and disclosing material uncertainties about an entity's ability to continue as a going concern.

BC 3 All respondents thought that the criteria in IAS 1 for assessing going concern as a suitable basis for the preparation of the financial statements are clear and that the rebuttal of the going concern presumption is set at a suitably high level—ie, intends to cease trading or liquidate or has no realistic alternative but to do so.

BC 4 However, some respondents reported reading the Standard as though the same high threshold also applies to the disclosure of material uncertainties about the entity's ability to continue as a going concern. In their view, if that is how the paragraph is interpreted, material uncertainties will only be identified when the going concern assumption is no longer appropriate and the entity is about to cease operations or go into liquidation. Many respondents expressed concern that such disclosures will be reported too late to provide useful information to investors. Many respondents also expressed concern about the diversity in the information disclosed about material uncertainties.

Basis for the revision to the Standard

BC 5 The Standard, as currently issued, deals with both going concern as a basis for the preparation of financial statements and also with a requirement to disclose material uncertainties about an entity's ability to continue as a going concern. The outreach that the Interpretations Committee conducted suggested that part of the reported diversity in practice arises because the distinction between these two requirements is not sufficiently clear in the Standard.

BC 6 In order to clarify this distinction, the IASB proposes that the going concern section should be restructured into three separate topics—basis of preparation, identification of material uncertainties and disclosure. In order to separate the existing guidance into these three categories the IASB proposes that:

the original paragraph 25 is split into paragraphs 25, 25B and 25C, and

the original paragraph 26 is renumbered as 25A.

Basis of preparation

BC 7 The IASB proposes that the guidance on going concern as a basis for the preparation of financial statements should remain largely unchanged, but nevertheless the IASB's proposals do revise this guidance in one respect.

BC 8 Before amendment, paragraph 26 refers simply to "the future" when considering the time frame for the assessment of going concern. The IASB proposes inserting 'for the foreseeable future' into the guidance because that is the time frame used in the Conceptual Framework in relation to going concern. The IASB thinks that this will clarify the time frame required in making this assessment and will harmonise the wording of IAS 1 with that of the *Conceptual Framework*. 'Foreseeable future' is also compatible with the wording used in international auditing standards.

Identification of material uncertainties

BC 9 In the IASB's proposals, paragraphs 25B and 25C are shown separately from the original paragraph 25 to emphasise the distinction in the guidance between (i) going concern as a basis for preparation of the financial statements and (ii) the requirement for disclosures about material uncertainties about the entity's ability to continue as a going concern.

BC10 The proposed amendments also include new requirements (paragraphs 25D-25F) that provide guidance on how to identify material uncertainties. The IASB proposals include factors that indicate material uncertainty and examples of the types of conditions that may give rise to these uncertainties.

BC11 The IASB discussed different views on how detailed this guidance should be. Some thought that quoting factors that may indicate whether uncertainties are material or providing examples of conditions that may give rise to material uncertainties is useful; others argue that such examples blur the principles involved and can lead to divergence in practice. A question is included in the ED to ascertain whether that level of guidance is helpful.

Disclosure of material uncertainties

BC12 The proposed amendments also include new requirements (paragraphs 25G-25H) that provide guidance about what to disclose in relation to material uncertainties about an entity's ability to continue as a going concern. The IASB proposes objectives for the disclosures that are made about material uncertainties and provides examples of the types of information that should be disclosed about material uncertainties.

BC13 In drafting these proposals, the IASB discussed different views on how detailed this guidance should be. Some think that providing this guidance is useful; others argue that such examples detract from the clarity of the disclosure objective and can lead to divergence in practice. A question is included in the ED to ascertain whether that level of guidance is helpful.

Effective date and transition

BC14 The IASB decided that the amendments should apply prospectively because they did not think that information about an entity's ability to continue as a going concern would be useful for prior periods or that this information could be prepared without the use of hindsight. The IASB also decided that no amendment to IFRS 1 *First-time adoption of International Financial Reporting Standards* should be required. This is because the IASB's proposals relate to the going concern assumption, which is an underlying assumption of the *Conceptual Framework* and this clarification should not alter that assessment.