STAFF PAPER

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REG IASB Meeting

Project	**Conceptual Framework**
Paper topic	Going concern

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Purpose of paper

1. The purpose of this paper is to present our proposals for incorporating the going concern assumption into the revised *Conceptual Framework* in the light of the feedback received on the IASB's Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the 'Discussion Paper').

Summary of staff recommendations

2. We recommend that:
   (a) the going concern assumption should be treated as an underlying assumption. The revised *Conceptual Framework* should include the current description of the going concern assumption with the amendments suggested in paragraph 11.
   (b) the IASB should not provide additional guidance on the going concern assumption in the *Conceptual Framework*.
   (c) the IASB should not address guidance on the preparation of financial statements by entities that are not going concerns as part of this project.
   (d) the IASB should not address additional disclosures about going concern as part of this project.

Structure of paper

3. The paper is organised as follows:

   (a) background (paragraphs 4–6);

   (b) feedback (paragraph 7);

   (c) staff analysis (paragraphs 8–31);

   (d) staff recommendations and question for the IASB (paragraph 32).

Background

4. The going concern assumption is described as an underlying assumption in paragraph 4.1 of the existing *Conceptual Framework*:

   > 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.

5. The Discussion Paper listed three situations in which the going concern assumption is relevant:

   (a) when measuring assets and liabilities;

   (b) when identifying liabilities (for example, liabilities that arise only on liquidation do not meet the definition of a present obligation); and

   (c) when making disclosures about the entity.

6. Respondents to the Discussion Paper were asked if there are any other situations in which the going concern assumption might be relevant. The reason for identifying the relevant situations was to find out whether a broad principle should be retained or whether the revised *Conceptual Framework* could just refer to going concern in particular affected areas.

Feedback

7. Less than half of the respondents to the Discussion Paper commented on the going concern issue. Most of them agreed with the situations identified by the IASB. However, some respondents:

   (a) expressed concern that the discussion of going concern in the Discussion Paper appeared to downplay the importance of the going concern concept;

   (b) asked for additional guidance on going concern, including clarification of the time horizon and the link between going concern and notions such as ‘practically unconditional’ and ‘no realistic alternative’;

   (c) requested guidance on financial statements that are prepared when an entity is not a going concern; and

   (d) suggested that additional disclosures about going concern are needed.

Staff analysis

Going concern—an underlying assumption

8. Although most of those who commented on the going concern issue agreed with the situations identified by the IASB, some were concerned that listing only specific situations in which the going concern assumption is relevant might understate its importance. Also, some respondents identified other situations in which the going concern assumption might be relevant, including:

   (a) when making decisions about the presentation of items as current or non-current in the statement of financial position; and

   (b) when assessing control in the asset definition, for example, when an investors’ agreement requires the transfer of joint assets to the other investors if one investor is unable to continue in operation as a going concern.

9. We agree with those respondents who argue that simply identifying situations in which going concern might be relevant downplays its importance. We recommend that the going concern assumption should continue to be treated as an underlying assumption relevant to all aspects of accounting and financial reporting, because:

(a) If an entity is not a going concern, recognition, measurement, presentation and disclosure requirements may need to be very different.

(b) Listing specific situations when going concern is relevant runs the risk of missing some situations (see paragraph 8).

(c) The importance of assessing going concern has been highlighted by the recent financial crisis. Information on going concern is of significant value to investors and other users. There is also an increased focus on going concern by regulators. Even though the *Conceptual Framework* itself does not require an entity to assess whether it is a going concern or provide disclosures about going concern, identifying the going concern assumption as an underlying assumption in the *Conceptual Framework* provides a basis for including such requirements in other Standards (as done currently in IAS 1 *Presentation of Financial Statements*).

10. We recommend retaining the current description of the going concern assumption (see paragraph 4) in the revised *Conceptual Framework* because:

(a) it was considered to be broadly appropriate by the respondents; and

(b) it is broadly in line with the descriptions provided by other standard-setting bodies, for example, by the International Auditing and Assurance Standards Board (IAASB) and the International Public Sector Accounting Standards Board (IPSASB) (see Appendix A).

11. The only amendment to the current description that we recommend is to replace the phrase ‘curtail materially the scale of its operations’ with ‘cease trading’. The new description would be as follows (deleted text is struck through and new text is underlined):

> 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~~ <u>cease trading</u>; 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.

12. We recommend this change because the current wording is inconsistent with the wording used in IAS 1 and IAS 10 *Events after the Reporting Period* (see Appendix B). We believe that the wording in the *Conceptual Framework* should be changed rather than the wording in IAS 1 or IAS 10 because:

    (a) the phrase ‘curtail materially’ may lead to the conclusion that an entity is not a going concern and may trigger the change from the going concern basis of accounting either earlier or more often than the wording in IAS 1 and IAS 10; and

    (b) preparers are required to apply IAS 1 and IAS 10 and changing the wording in the Standards to align it with the *Conceptual Framework* could lead to changes in practice.

13. The revised description will also be more consistent with the descriptions used by other standard-setting bodies (see Appendix A).

14. The exact placement of the description of the going concern assumption will be discussed closer to the date of the Exposure Draft. Possible locations include:

    (a) in the revised Introduction, which could discuss the purpose and status of the *Conceptual Framework* and the underlying assumption for preparation of the financial statements; or

    (b) as part of the discussion of relevance because in virtually all cases in which general purpose financial statements are prepared, information prepared on a going concern basis is most relevant.

Additional guidance on going concern

15. A few respondents expressed the view that the going concern assumption is often misunderstood and asked for additional guidance. In particular, they asked for additional guidance on:

    (a) the meaning of ‘foreseeable future’; and

    (b) the link between the going concern assumption and identifying a present obligation.

Foreseeable future

16. The existing *Conceptual Framework* states that an entity is a going concern if it will continue in operation for the foreseeable future. Some interpret 'foreseeable future' as a short-term planning horizon for which detailed budgets make sense. Others take it to mean a much longer term, ie 'as far as you can see'.

17. We believe that it is not necessary to explain the term further at the *Conceptual Framework* level, because it is more appropriately addressed at the Standards-level. Currently, the time horizon for assessing going concern is explained in paragraph 26 of IAS 1:

> 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.[…]

18. We would also like to highlight that other Standards use the term foreseeable future (see Appendix C). Confining the term to a certain period in the *Conceptual Framework* could lead to unforeseen changes in applying those Standards. Currently, those Standards do not explain the term but imply a longer term horizon, which does not contradict how the term is used in IAS 1.

Link between the going concern assumption and identifying a present obligation

19. There was also a request from respondents for an explanation of the link between the going concern assumption and concepts such as 'practically unconditional' and 'no realistic alternative', which were included in Section 3 *Additional guidance to support the asset and liability definitions* of the Discussion Paper.

20. The role of the going concern assumption in identifying a present obligation will be discussed in June.

Guidance for non-going concern entities

21. Some respondents, including standard-setters, regulators, accounting firms and accountancy bodies, asked for guidance on the preparation of financial statements when an entity is not a going concern. Some asked for clarification about whether financial statements prepared on a non-going concern basis could be described as complying with the Standards.

22. The existing *Conceptual Framework* does not specify what changes should be made to the financial statements if it is determined that an entity is not a going concern. It simply states that the new basis of accounting should be disclosed.

23. We do not recommend providing guidance in this project on the preparation of financial statements by entities that are not going concerns for the following reasons:

    (a) The primary reason for financial statements of entities that are not going concerns is to provide relevant information for liquidation. Many jurisdictions will have specific requirements on what information should be provided in liquidation, so the benefit of providing further requirements on an international level might be limited.

    (b) If considered necessary, such guidance should be provided at a Standards-level. This view was shared by many of the respondents who had asked for guidance. Therefore, we do not reject the possibility of the IASB issuing Standards-level guidance on accounting for non-going concern entities if a future agenda consultation indicates it as a priority.[1]

Additional disclosures about going concern

24. Some respondents asked for additional disclosures about going concern. Several accountancy bodies recommended that the IASB should work with the IAASB on the subject of going concern.

[1] One standard-setter who has already issued guidance for non-going concern entities is the US national standard-setter, the Financial Accounting Standards Board (FASB). On 22 April 2013 the FASB issued an Accounting Standard Update No 2013-07 *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*.

25. The respondents suggested that additional disclosures may be necessary because the auditor's report cannot have more information than that disclosed by the management in the financial statements. They thought that additional disclosures about the going concern status of an entity and material uncertainties related to going concern may be necessary in order to implement the proposals in the IAASB Exposure Draft of ISA 570 *Going Concern.*

26. The existing *Conceptual Framework* only requires disclosure if the financial statements are prepared on a different (ie non-going concern) basis. Other disclosures about going concern are currently required in paragraph 25 of IAS 1:

> 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.[…]

27. In June 2012 the IFRS Interpretations Committee (the 'Interpretations Committee') received a submission from the IAASB requesting clarification about the disclosures required in relation to such material uncertainties.

28. The Interpretations Committee proposed to the IASB that it should make a narrow-scope amendment to change the disclosure requirements in IAS 1 in response to this issue to clarify:

    (a) when a disclosure of material uncertainties about an entity's ability to continue as going concern should be made; and

    (b) that a separate disclosure should be required about a material uncertainty and about management's remedial actions to address such a material uncertainty.

29. At its meeting in November 2013 the IASB considered the amendments proposed by the staff, but decided not to proceed with them.

30. Following the IASB's decision, the Interpretation Committee highlighted that an additional disclosure on the judgements made by management in the going concern assessment may be necessary in cases when, on balance, management has concluded that no material uncertainty exists (on the basis of paragraph 122 of IAS 1).

31. We recommend that the IASB should not address additional disclosures about going concern as part of the *Conceptual Framework* project. If necessary, any additional disclosures about material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern could be considered as part of a project to revise IAS 1 or in a separate project.

Staff recommendations and question for the IASB

32. We recommend that:

    (a) the going concern assumption should be treated as an underlying assumption. The revised *Conceptual Framework* should include the current description of the going concern assumption with the amendments suggested in paragraph 11.

    (b) the IASB should not provide additional guidance on the going concern assumption in the *Conceptual Framework*.

    (c) the IASB should not address guidance on the preparation of financial statements by entities that are not going concerns as part of this project.

    (d) the IASB should not address additional disclosures about going concern as part of this project.

Question for the IASB
Do you agree with the staff recommendations in paragraph 32?

Appendix A – Descriptions of going concern by other standard-setting bodies

IAASB	Proposed ISA 570 (Revised) *Going concern*[2] **Going Concern Basis of Accounting**[3] 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 the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is relevant (for example, the going concern basis of accounting is not relevant for some financial statements prepared on a tax basis in particular jurisdictions). When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.
IPSASB	IPSAS 1 *Presentation of Financial Statements*[4] **Going concern** 38. When preparing financial statements, an assessment of an entity's ability to continue as a going concern shall be made. This assessment shall be made by those responsible for the preparation of financial statements. Financial statements shall be prepared on a going concern basis unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so. When those responsible for the preparation of the financial statements are aware, in making their assessment, of material uncertainties related to events and conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed. When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

[2] IAASB published the Exposure Draft of the Proposed International Standard on Auditing 570 (Revised) *Going Concern* on 25 July 2013. The document can be found here: http://www.ifac.org/sites/default/files/publications/files/Proposed%20ISA%20570%20(Revised)-final.pdf

[3] The main change from the current description in ISA 570 is that the standard now refers to 'going concern basis of accounting' rather than 'going concern assumption'.

[4] The IPSASB is currently developing a Conceptual Framework for financial reporting by public sector entities. However, going concern is not discussed in the proposed Conceptual Framework.

FASB	Proposed Accounting Standards Update *Presentation of Financial Statements (Topic 205): Disclosure of Uncertainties about an Entity's Going Concern Presumption*[5] **Going Concern Presumption** The inherent presumption in preparing financial statements under U.S. generally accepted accounting principles that an entity will be able to continue as a going concern; that is, the entity will continue to operate such that it will be able to realize its assets and meet its obligations in the ordinary course of business. However, in light of the feedback received on the Exposure Draft, the Board decided not to define the term 'going concern presumption', but rather to specify that the going concern basis of accounting would be used until an entity's liquidation is imminent. FASB are now performing further outreach to get feedback on this proposal.

[5] The FASB issued the Exposure Draft of Proposed Accounting Standards Update *Presentation of Financial Statements (Topic 205): Disclosure of Uncertainties about an Entity's Going Concern Presumption* on 26 June 2013. It can be found here: http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175827205763&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=591155&blobheadervalue1=filename%3DProposed_ASU_Presentation_of_Financial_Statements_%2528Topic_205%2529_Disclosure_of_Uncertainties_about_an_Entity%2527s_Going_Concern.pdf&blobcol=urldata&blobtable=MungoBlobs.

Appendix B – References to going concern in the Standards

IAS 1 *Presentation of Financial Statements*	**Going concern** **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.** 26 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.
IAS 10 *Events after the Reporting Period*	**Going concern** **14 An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.** 15 Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting. 16 IAS 1 specifies required disclosures if: (a) the financial statements are not prepared on a going concern basis; or (b) management is aware 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 events or conditions requiring disclosure may arise after the reporting period.

Appendix C – References to 'foreseeable future' in the Standards

IAS 12 *Income Taxes*	**39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:** **(a) the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and** **(b) it is probable that the temporary difference will not reverse in the *foreseeable future*.** 40 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the *foreseeable future* the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches. 42 An investor in an associate does not control that entity and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the *foreseeable future*, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate. In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount. 43 The arrangement between the parties to a joint arrangement usually deals with the distribution of the profits and identifies whether decisions on such matters require the consent of all the parties or a group of the parties. When the joint venturer or joint operator can control the timing of the distribution of its share of the profits of the joint arrangement and it is probable that its share of the profits will not be distributed in the *foreseeable future*, a deferred tax liability is not recognised. **44 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, to the extent that, and only to the extent that, it is probable that:** **(a) the temporary difference will reverse in the *foreseeable future*; and**

	(b) taxable profit will be available against which the temporary difference can be utilised.
IAS 21 *The Effects of Changes in Foreign Exchange Rates*	**Net investment in a foreign operation** 15 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the *foreseeable future* is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 32 and 33. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables. 15A The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the *foreseeable future*. This would also be true if Subsidiary A were itself a foreign operation.
IAS 28 *Investments in Associates and Joint Ventures*	38 If an entity's share of losses of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognising its share of further losses. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. For example, an item for which settlement is neither planned nor likely to occur in the *foreseeable future* is, in substance, an extension of the entity's investment in that associate or joint venture. Such items may include preference shares and long-term receivables or loans, but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognised using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (ie priority in liquidation).
IAS 38 *Intangible Assets*	**Useful life** **88 An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no *foreseeable limit to the period* over which the asset is expected to generate net cash inflows for the entity.**