

## Not-for-Profit Topics

# Changing Going Concern Environment - New Disclosures

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Management is now responsible for evaluating and documenting a not-for-profit's (NFP or the entity) ability to continue operations, and additional financial statement disclosures could be required as a result of the going concern evaluation. The following provides a detailed overview of the changes and how it may impact your organization.

## Background

Under accounting principles generally accepted in the United States (GAAP), financial statements are prepared under what is commonly referred to as the going concern basis of accounting. This basis of accounting presumes the continuation of an entity unless an entity's liquidation becomes imminent. However, well before liquidation becomes imminent, conditions or events may exist that raise substantial doubts about an entity's ability to continue as a going concern. When such conditions arise, management was not required to make disclosures in the financial statements as GAAP were silent on management's responsibility to assess, and potentially disclose, conditions and events that raise substantial doubt about an entity's ability to continue as a going concern. However, that changed with the issuance of Accounting Standards Update (ASU) [2014-15](#), *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*.



The ASU shifts the assessment and disclosure responsibilities from the auditors to management and provides management specific guidance for the assessment. Management must understand the reporting triggers to ensure they are compliant with the ASU.

## Key Provisions of New Going Concern Model

Key provisions of the new model include:

- Defining substantial doubt
- Requiring a going concern evaluation at each annual and interim reporting period
- Providing guidance to assist management in determining whether their plans will mitigate the going concern risk
- Requiring certain disclosures when management's plans mitigate the going concern risk
- Requiring an express statement and certain disclosures when management's plans do not mitigate the going concern risk

### Substantial Doubt Defined

Substantial doubt is defined as:

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

Probable is synonymous with "likely to occur". Although there is no bright-line test, a 70% or greater confidence level is generally considered probable. This is higher than the "more-likely-than-not" threshold used elsewhere in GAAP.

### Evaluation Period

Management must evaluate the entity's ability to continue as a going concern at each annual and interim financial reporting period. The "look forward period" for the evaluation is one year beyond the date the financial statements are issued (or available to be issued).

This is a significant change from the prior practice of looking forward one year from the balance sheet date. The additional time between the balance sheet date and the date the financial statements are issued could substantially increase the exposure period, thereby inserting more subjectivity and uncertainty into the going concern determination.

### Going Concern Evaluation

Management's evaluation will include an assessment of quantitative and qualitative information, as well as other information known or reasonably knowable to the entity. Information that meets the "reasonably knowable" criteria includes information that management may not already know, but could be reasonably identified without excessive cost or effort. The ASU specifies that management may consider the following in its assessment:

- a. Current financial conditions, including liquidity sources at the date the financial statements are issued
- b. Conditional and unconditional obligations due or anticipated within one year after the date the financial statements are issued
- c. Funds necessary to maintain operations, considering the current financial condition, obligations and other anticipated cash flows within one year after the date the financial statements are issued
- d. Other conditions and events, when considered in conjunction with a., b., and c., that could negatively impact the entity's ability to meet its obligations within one year after the date the financial statements are issued

Conditions and events management may consider in its evaluation include:

- Recurring negative balance in change in net assets
- Negative cashflow from operating activities
- Adverse key operating and liquidity ratios
- Credit concerns on upcoming debt maturities or default
- Legal proceedings
- Non-compliance with agreements
- Significant investment risk

The level of analysis required will vary greatly depending on the entity's specific fact pattern. For example, entities with profitable operations, positive cash flows and no liquidity concerns will likely complete a simple analysis demonstrating consideration of the standard. However, given the extended look forward period uncertainties that are not visible at year end could create substantial doubt under the new guidance.

If management determines that no substantial doubt exists, their work is done for the reporting period. If a condition or event gives rise to substantial doubt, management must evaluate its plans to mitigate such risk and make certain disclosures in the financial statements.

### **Management's Plans to Mitigate the Going Concern Risk**

If management concludes that there is substantial doubt following the initial assessment, management must evaluate its plans to mitigate such doubt and determine whether those plans, when implemented, will alleviate such doubt. Management's plan should be considered only to the extent that the information available as of the issuance date meets the following conditions:

- a. It is probable that management's plans will be effectively implemented within one year after the date that the financial statements are issued
- b. It is probable that management's plans, when implemented, will mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued

Generally, for such plans to be considered probable, the plan needs to be approved by management and the board of directors before the issuance date. Management must also consider the expected magnitude and timing of the mitigating effect of its plans in relation to the magnitude and timing of the relevant conditions or events being mitigated to ensure such plans are probable of obtaining effective implementation and the mitigating effects necessary to avoid substantial doubt.

Management's plans may include plans to dispose of an asset or business, plans to borrow money or restructure debt, plans to delay expenditures and plans to recapitalize or otherwise increase net assets. Determining whether such plans effectively mitigate the substantial doubt will require significant judgment and forward looking estimates.

## **Disclosures**

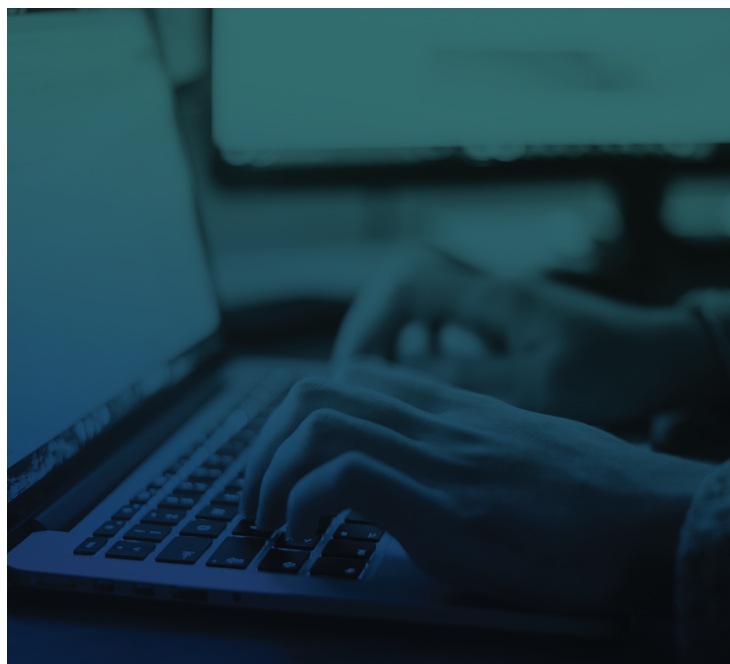
### **No Substantial Doubt**

No disclosures are required if the initial assessment did not indicate there is substantial doubt about the entity's ability to continue as a going concern.

### **Substantial Doubt Alleviated**

If management believes its plans mitigate the substantial doubt about the entity's ability to continue as a going concern, it must disclose the following:

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



The ASU specifically allows for a NFP to refer to disclosures included elsewhere in the financial statements such as net asset or debt footnotes when substantial doubt is alleviated by management's plans. This may be appropriate when portions of management's plans are detailed elsewhere in the financial statement disclosures.

### **Substantial Doubt NOT Alleviated**

If management believes its plans do not mitigate the substantial doubt about the entity's ability to continue as a going concern, it must disclose the following:

- a. A statement indicating there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued
- b. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern
- c. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
- d. Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern

If substantial doubt continues in subsequent reporting periods, the ASU requires the disclosures become more robust and include information on changes to conditions and events from prior reporting periods. When substantial doubt ceases to exist (before or after considering management's plans), management must disclose this fact and describe how the conditions or events that gave rise to substantial doubt were rectified.

### **Effective Date**

The ASU is effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter.

### **Final Thoughts**

In conjunction with the above information, management may want to consider the decision flowchart in appendix A when navigating the going concern requirements.

Management should thoroughly document its going concern evaluation, the basis for its conclusion and, if necessary, the rationale behind its disclosures. Documenting the process should make subsequent going concern evaluations easier and provides critical information to an entity's auditors.

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## Appendix A – Decision Flowchart

The ASU's implementation guidance contains the following decision flowchart to assist entities in their going concern evaluation and determining whether and which disclosures are required.

