Going Concern
Key Considerations Related to Performing a Comprehensive Assessment

Background
The requirement in U.S. GAAP to evaluate an entity's ability to continue as a going concern as of each annual and interim reporting date is not new. However, because of the financial and operational challenges that many entities are facing as a result of coronavirus disease 2019 (“COVID-19”), there is a renewed focus on an entity’s going-concern assessment. Accordingly, entities should take the opportunity to refresh their existing processes for assessing their ability to continue as a going concern.

Summary of the Going-Concern Accounting and Disclosure Requirements
Under U.S. GAAP, an entity’s financial statements are prepared under the assumption that the entity will continue as a going concern until liquidation is imminent (i.e., the “going concern basis of accounting”). Once liquidation is deemed imminent, an entity must apply the liquidation basis of accounting under ASC 205-30. 

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2 For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”
Before liquidation is deemed imminent, an entity may have uncertainties about its ability to continue as a going concern. In such situations, the entity should continue to prepare its financial statements by using the going-concern basis of accounting; however, the entity may be required to disclose information about its ability to continue as a going concern, depending on the level of uncertainty and management’s plans to mitigate the uncertainty.

ASC 205-40 provides guidance on (1) how management should perform a going-concern assessment and (2) when going-concern disclosures are required under U.S. GAAP. Under ASC 205-40-50-1, as of each annual and interim reporting date, an entity’s management must “evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable).”

The definition of “substantial doubt about an entity’s ability to continue as a going concern” in the ASC master glossary notes that such doubt “exists when conditions and events, considered in the aggregate, indicate that it is probable [(i.e., the future event or events are likely to occur)] 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.”

Management’s going-concern assessment as of each annual and interim reporting date consists of the following two steps:

1. Under ASC 205-40-50-4, management must “evaluate whether relevant conditions and events, considered in the aggregate, indicate that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued."

2. ASC 205-40-50-6 indicates that if “relevant conditions or events, considered in the aggregate, . . . indicate that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued . . . , management shall evaluate whether its plans that are intended to mitigate those conditions and events, when implemented, will alleviate substantial doubt about the entity’s ability to continue as a going concern.”

**Time Horizon**

The following diagram summarizes the critical dates a calendar-year-end entity with an expected financial statement issuance date of March 1 considers in performing an annual going-concern assessment:

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3 Throughout this publication, the “date financial statements are issued” or “financial statement issuance date” also refers to the date financial statements are available to be issued.
Step 1 of the Going-Concern Assessment

ASC 205-40-50-4 indicates that the first step in the going-concern assessment is to “evaluate whether relevant conditions and events, considered in the aggregate, indicate that it is probable[4] that an entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued.” This paragraph further states that the step 1 evaluation should not “take into consideration the potential mitigating effect of management’s plans that have not been fully implemented as of the date that the financial statements are issued (for example, plans to raise capital, borrow money, restructure debt, or dispose of [assets]).” Such plans are considered during the step 2 assessment.

In addition, ASC 205-40-50-5 states that when evaluating whether it is able to meet its obligations, an entity should consider “relevant conditions and events known and reasonably knowable[5] at the date that the financial statements are issued.” ASC 205-40-50-5 further notes that conditions and events an entity should consider include:

a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued . . .

b. The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements)

c. The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows . . .

d. The other conditions and events that may adversely affect the entity's ability to meet its obligations within one year after the date that the financial statements are issued.

Moreover, ASC 205-40-55-2 gives the following “examples of adverse conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern”:

a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios

b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets

c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations

d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood.

If, after performing the step 1 assessment, an entity concludes that there are no conditions or events, considered in the aggregate, that raise substantial doubt about its ability to continue as a going concern for one year after the financial statement issuance date, the entity is not required to include any disclosures on this topic in its current-period financial statements and does not need to conduct any further analysis. However, if the entity concludes that there are conditions or events, considered in the aggregate, that raise substantial doubt about its ability to continue as a going concern for one year after the financial statement issuance date, the entity must evaluate whether it is probable that its plans will alleviate the substantial doubt (i.e., continue to step 2 of the going-concern assessment).

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[4] The ASC master glossary states that probable refers to the fact that “the future event or events are likely to occur.”

[5] The phrase “reasonably knowable” is intended to emphasize that an entity should make a reasonable effort to identify conditions and events that it may not readily know but would be able to identify without undue cost or effort.
Step 2 of the Going-Concern Assessment

In step 2 of the going-concern assessment, an entity must apply the guidance in ASC 205-40-50-6, which requires the entity to “evaluate whether its plans that are intended to mitigate [the conditions and events identified in step 1], when implemented, will alleviate substantial doubt about the entity’s ability to continue as a going concern.” To conclude that an entity’s plans, when implemented, will alleviate substantial doubt about the entity’s ability to continue as a going concern, the entity must demonstrate both of the following in accordance with ASC 205-40-50-7:

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.

Further, ASC 205-40-50-8 states, in part:

The evaluation of whether it is probable that management’s plans will be effectively implemented [is] based on the feasibility of implementation of management’s plans in light of an entity’s specific facts and circumstances. Generally, to be considered probable of being effectively implemented, management (or others with the appropriate authority) must have approved the plan before the date that the financial statements are issued.

In addition, ASC 205-40-50-10 notes that in performing this assessment, management should 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 that those plans intend to mitigate.” Examples of plans that an entity’s management may implement to mitigate conditions and events that raise substantial doubt about the entity’s ability to continue as a going concern include plans to (1) dispose of an asset or business, (2) borrow money or restructure debt, (3) reduce or delay expenditures, and (4) increase ownership equity.

Disclosure Requirements

If an entity identifies events or conditions that raise substantial doubt about its ability to continue as a going concern and is required to perform step 2 of the going-concern assessment, the entity’s footnote disclosures must contain the following information:

<table>
<thead>
<tr>
<th>If Substantial Doubt Is Raised but Is Alleviated by Management’s Plans, Disclosures Should Include:</th>
<th>If Substantial Doubt Is Raised and Is Not Alleviated, Disclosures Should Include:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Principal conditions or events that raise substantial doubt.</td>
<td>• Principal conditions or events that raise substantial doubt.</td>
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<tr>
<td>• Management’s evaluation of the significance of those conditions and events.</td>
<td>• Management’s evaluation of the significance of those conditions and events.</td>
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<tr>
<td>• Management’s plans that alleviated the substantial doubt.</td>
<td>• Management’s plans that are intended to mitigate the substantial doubt.</td>
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<td></td>
<td>• Statement that there is “substantial doubt about the entity’s ability to continue as a going concern.”</td>
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</table>

Management must use judgment in determining the extent of an entity’s disclosures about its ability to continue as a going concern. If management determines that there are conditions or events, in the aggregate, that raise substantial doubt about its ability to continue as a going concern but its plans alleviate the substantial doubt, management need not include an explicit statement in its disclosures that substantial doubt was raised. Rather, management may be able to meet the disclosure objective in ASC 205-40 without that explicit statement.
An entity should continue to provide disclosures in subsequent reporting periods. These disclosures may change over time as new information becomes available. Once substantial doubt about an entity’s ability to continue as a going concern is alleviated, the entity should disclose that fact and explain how the substantial doubt was resolved.

**Tying It All Together**

The flowchart below is reproduced from ASC 205-40-55-1 and depicts the decision process an entity could use in determining whether going-concern disclosures are required.

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1. **Are the criteria met for the liquidation basis of accounting?**
   - **Yes**: Apply the liquidation basis of accounting. (Subtopic 205-30)
   - **No**: Consider management’s plans intended to mitigate the adverse conditions or events. (paragraphs 205-40-50-6 through 50-11)

2. **Are there conditions or events, considered in the aggregate, that raise substantial doubt about an entity’s ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued)?**
   - **No**: No disclosures are required specific to going concern uncertainties under Subtopic 205-40. See Topics 275 and 450 for other disclosures about risks, uncertainties, and contingencies, as applicable.
   - **Yes**: Consider management’s plans intended to mitigate the adverse conditions or events. (paragraphs 205-40-50-6 through 50-11)

3. **Is it probable that management’s plans will be effectively implemented?**
   - **Yes**: An entity shall disclose information to help users understand the following when substantial doubt is alleviated by management’s plans:
     1. Principal conditions or events that raised substantial doubt, before consideration of management’s plans
     2. Management’s evaluation of the significance of those conditions or events
     3. Management’s plans that alleviated substantial doubt.
   - **No**: An entity shall disclose information to help users understand the following when substantial doubt is not alleviated:
     1. Principal conditions or events that raise substantial doubt
     2. Management’s evaluation of the significance of those conditions or events
     3. Management’s plans that are intended to mitigate the conditions or events that raise substantial doubt.

The entity also should include in the footnotes a statement indicating that there is substantial doubt about the entity’s ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued). (paragraph 205-40-50-13)
Where to Find Additional Information
If you have questions about the going-concern guidance in ASC 205-40 or need assistance with interpreting its requirements, please contact either of the following Deloitte professionals:

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Appendix: COVID-19 Considerations

In performing the going-concern assessment, entities will need to perform additional procedures to model the impact of COVID-19 on their businesses and operations and to reflect this impact in their financial statements and forecasts. Given the fast-moving nature of the current environment, management will need to carefully review and update models and valuations until the financial statements are issued.

1. Assess level of operational disruption

Management should be considering the threat of COVID-19 to the business model and operations, including:
- Significant drop in demand and reduced customer base.
- Risk of single point of failure in the supply chain.
- Limited distribution channels.
- Restricted ability to operate because of changes in public policy.
- Geographical implications of group operations.
- Employee absence or home-based working.
- Formulation of contingency plans.

2. Consider the legal/contractual framework

Management will need to take preemptive action to address any conduct issues arising on potential breach of regulations.

Businesses will need to think ahead so that they are ready to resolve any contractual challenges or navigate contentious scenarios to protect the future of the business and preserve important commercial relationships.

Falling asset values and compressed bond yields are likely to contribute to larger pension deficits for which additional security or funding may be required.

3. Liquidity and working capital

If a business is relying on third-party funding or government support, this should be a material assumption used in the forecast. If there is no contractual agreement in place and the business is relying on this funding, or the third party is unable to provide the funding, management should assess the implications.

Management should be conducting robust reforecasting and scenario analysis, including reverse stress testing to consider what it would take for a business to fail (e.g., x months of worst-case revenue projections) and how much it would take to breach covenants. Management should assess and document the mitigating actions within its control.

For subsidiaries whose date of issuance is later than that of the parent, management will need to revisit the parent’s forecasts to reflect the revised fact pattern and the ability to provide support.

4. Access to capital

When there is limited headroom or a potential covenant breach, management should be actively exploring channels of additional capital (debt/equity/noncore disposals, regearing unencumbered assets) or negotiating covenant waivers to avoid default.

Audit opinion modifications may trigger a covenant breach.

Even for entities that have not yet been adversely affected, management should consider preemptively seeking new committed facilities (even if not drawn) as a fallback plan in case the period of disruption becomes prolonged.

5. Asset valuations

Downward asset valuations may trigger legal and compliance issues or lead to liquidity challenges, business resilience concerns, or both. Management should prepare documentation that sets out the supporting evidence for the fair value or carrying value of assets and whether they are impaired, if applicable.

6. Reporting

Disclosures need to be informative and timely and comply with ASC 205-40-50. In addition, such disclosures should:
- Describe specifics about the potential impact of COVID-19 on the business, how this has been assessed at a point in time, and the mitigating actions taken.
- Set out in detail the uncertainties and scenarios related to significant assumptions.
- Incorporate from all key reporting areas (principal risks and uncertainties, estimations and judgements, going concern, viability statement, subsequent events).

Further, when there is a potential impact on reporting time frames and market announcements, early dialogue with the regulator should be encouraged. If the entity cannot produce the financial statements, the entity should consider how it can update the market on trading performance and full disclosure of the challenges preventing full reporting should be encouraged.
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