# CFA Institute Survey on "Going Concern"

## 27 March 2012

## Contents

## Executive Summary

81% of respondents said that the accounting concept of going concern is important in their analysis of a company, with 53% indicating *very* important.

61% of respondents indicated the global financial crisis has highlighted problems with the reporting on going concern.

81% of respondents indicated that the responsibility to report to investors when a question arises as to whether an entity will continue as a going concern lies with the management of the entity, followed by the entity's independent auditor (74%), and the entity's audit committee (58%).

92% of respondents think that the independent auditor's report should identify the basis and reasons for their conclusion that the entity may not continue as a going concern.

40% of respondents indicated that the threshold for the basis of reporting should be when it is more-likely-than-not that the entity will not continue as a going concern, 27% said when there is "substantial doubt" that the entity will continue as a going concern, and 25% indicated when it is reasonably possible that the entity will not continue as a going concern

44% of respondents indicated that the time period to assess whether an entity will continue as a going concern should be limited to the next twelve months from the date of the financial statements but also consider foreseeable events occurring shortly after the next twelve months while 32% think the time period to assess should be the foreseeable future, such as the next 1-3 years. 19% thought it should be limited to the next twelve months from the date of the financial statements.

If it is concluded by either the independent auditor and/or management that the entity may not continue as a going concern, the majority of respondents said the following disclosures should be provided to investors:

- disclosure of risks that directly or indirectly affect the determination that there is a question as to whether the entity is a going concern.
- disclosures on the expected courses of action that bear on the financial flexibility of the entity, and a reasonably detailed discussion of the entity's ability to generate sufficient cash to support its operations during at least the 12 months from the date of the financial statements.
- Of the members who think these disclosures should be provided to investors, 70% think that they should be included in the independent auditor's report, 56% think they should be in the notes to the audited financial statements, and 44% think they should be included in an unaudited MD&A.

## About the Survey

The purpose of the survey was to:

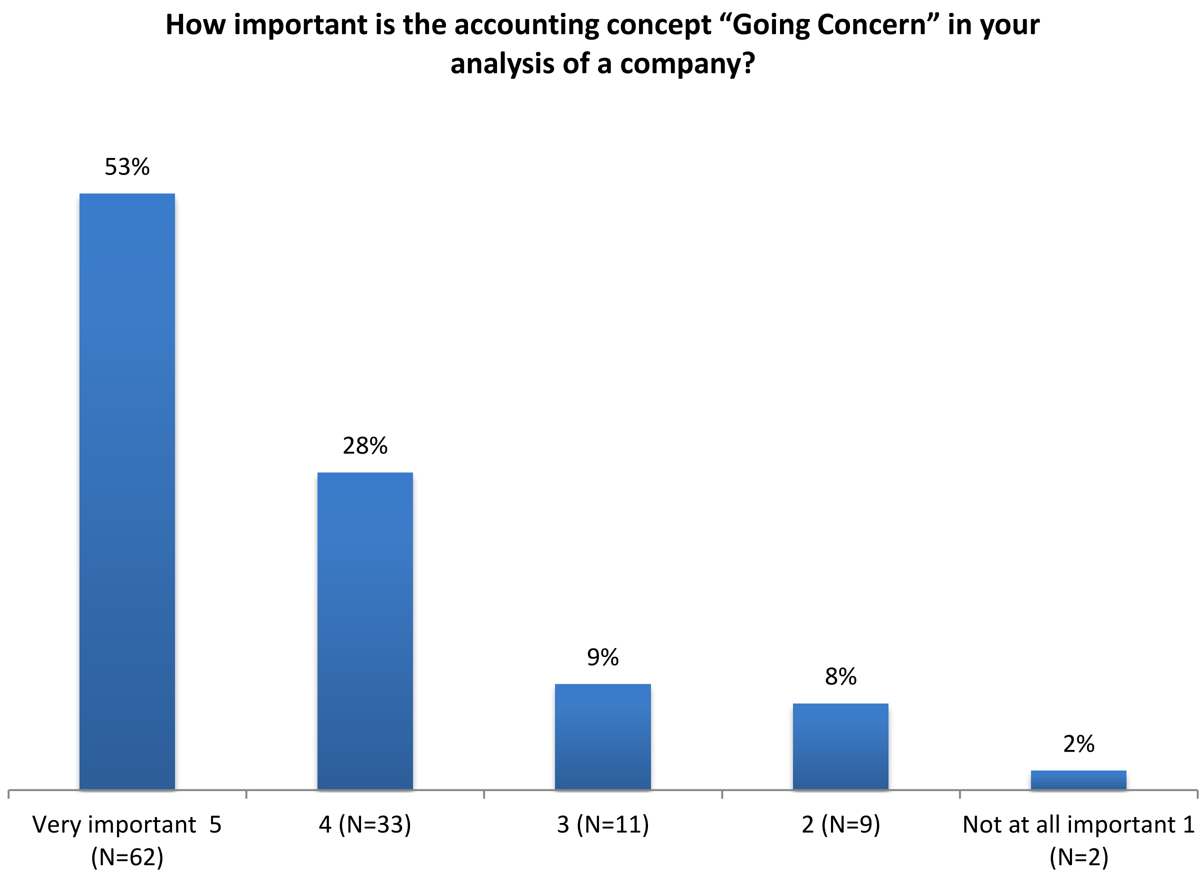
- Solicit investor feedback about how information regarding an entity's ability to continue as a going concern is reported.
- Obtain member views regarding when and where information should reported when it has been determined that there is substantial doubt about an entity's ability to continue as a going concern.

An e-mail invitation with a link to a web-based survey was sent to 495 CFA Institute members in the Financial Reporting Survey Panel on 15 March 2012 and a reminder was sent on 21 March 2012. The survey closed on midnight (EST) on 23 March 2012.

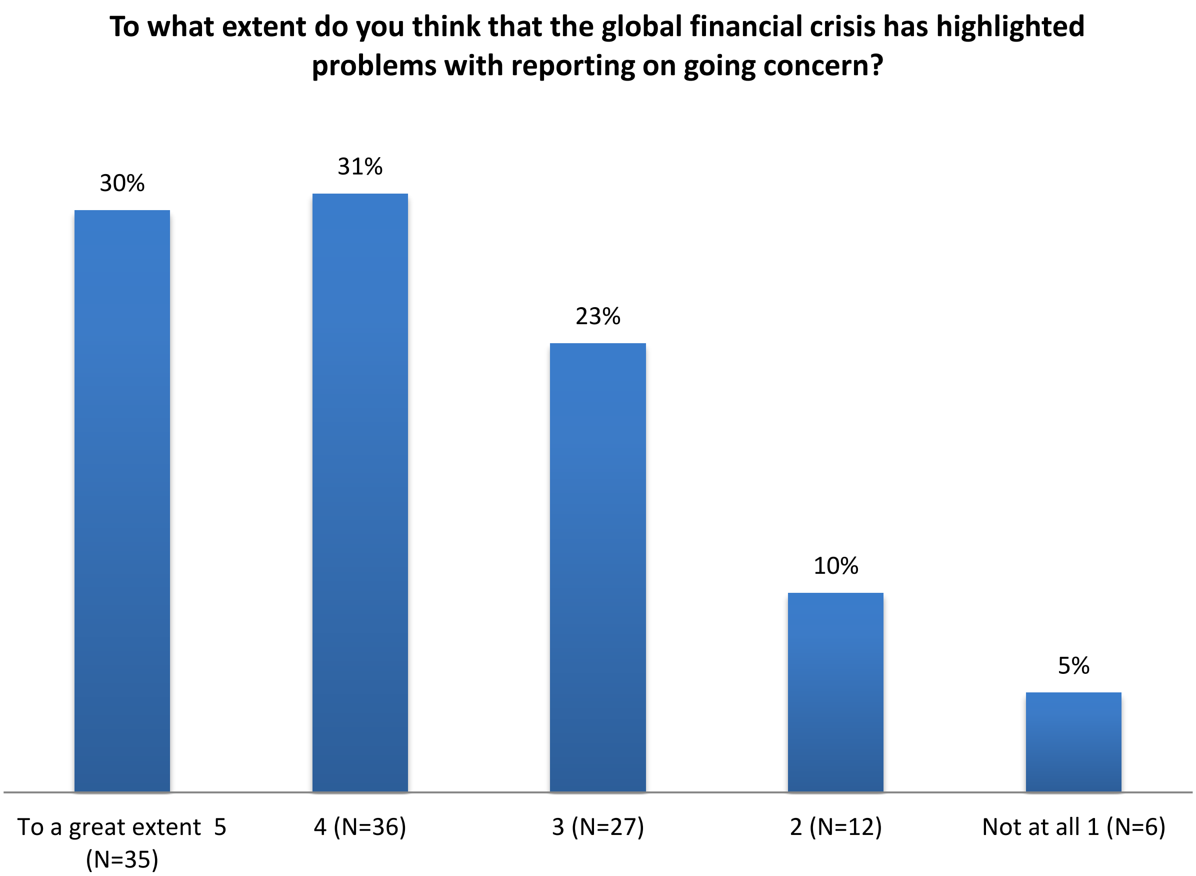
117 valid responses were received (AMER 52%, APAC 19% and EMEA 29%) for an overall response rate of 24%. The margin of error (based on the survey panel population) is ±7.9% at the 95 percent confidence level. Each question had a 'no opinion' option, which has been excluded from the calculations displayed in each chart; accordingly, the margin of error will vary by question, as the number of respondents varies by question.

## Results

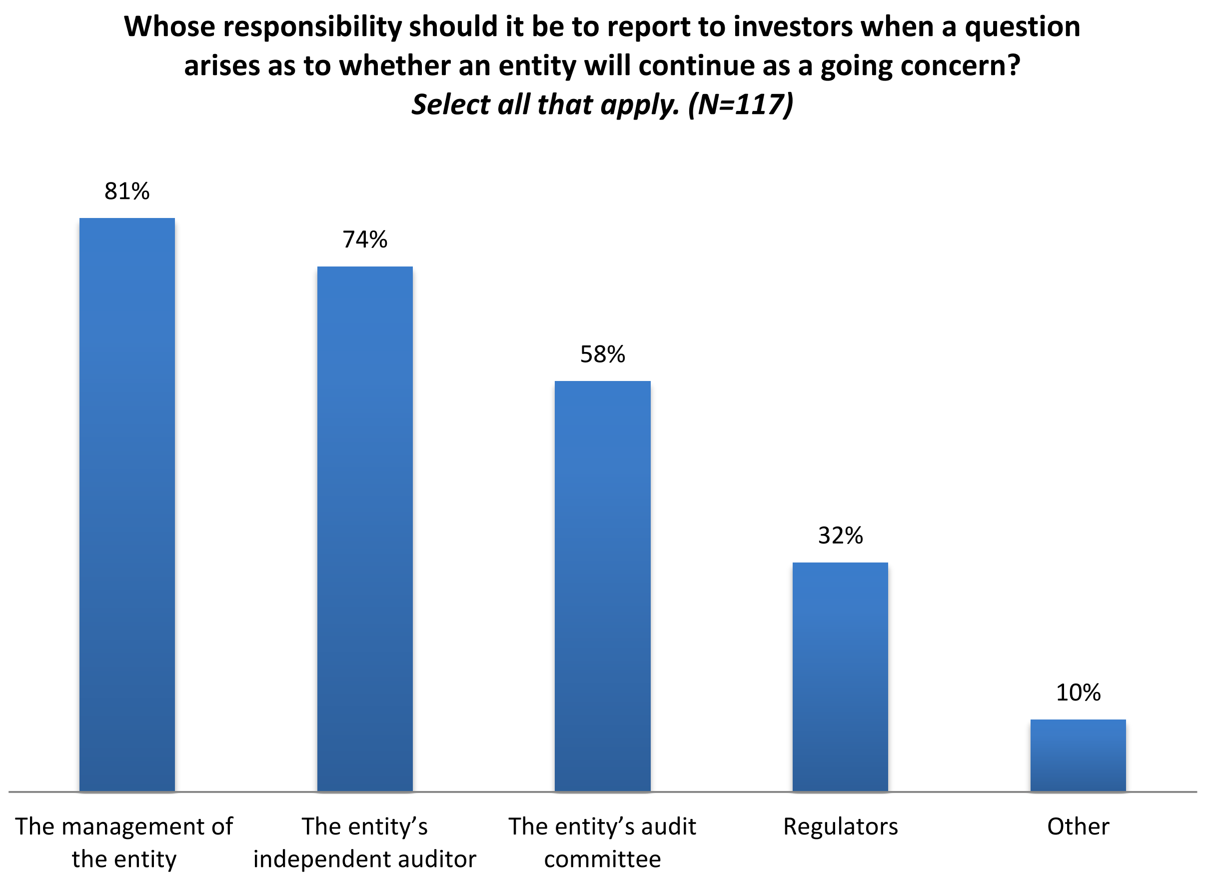
### Importance of “Going Concern” in analysis of a company



## Global financial crisis and problems with going concern



## Responsibility of reporting to investors

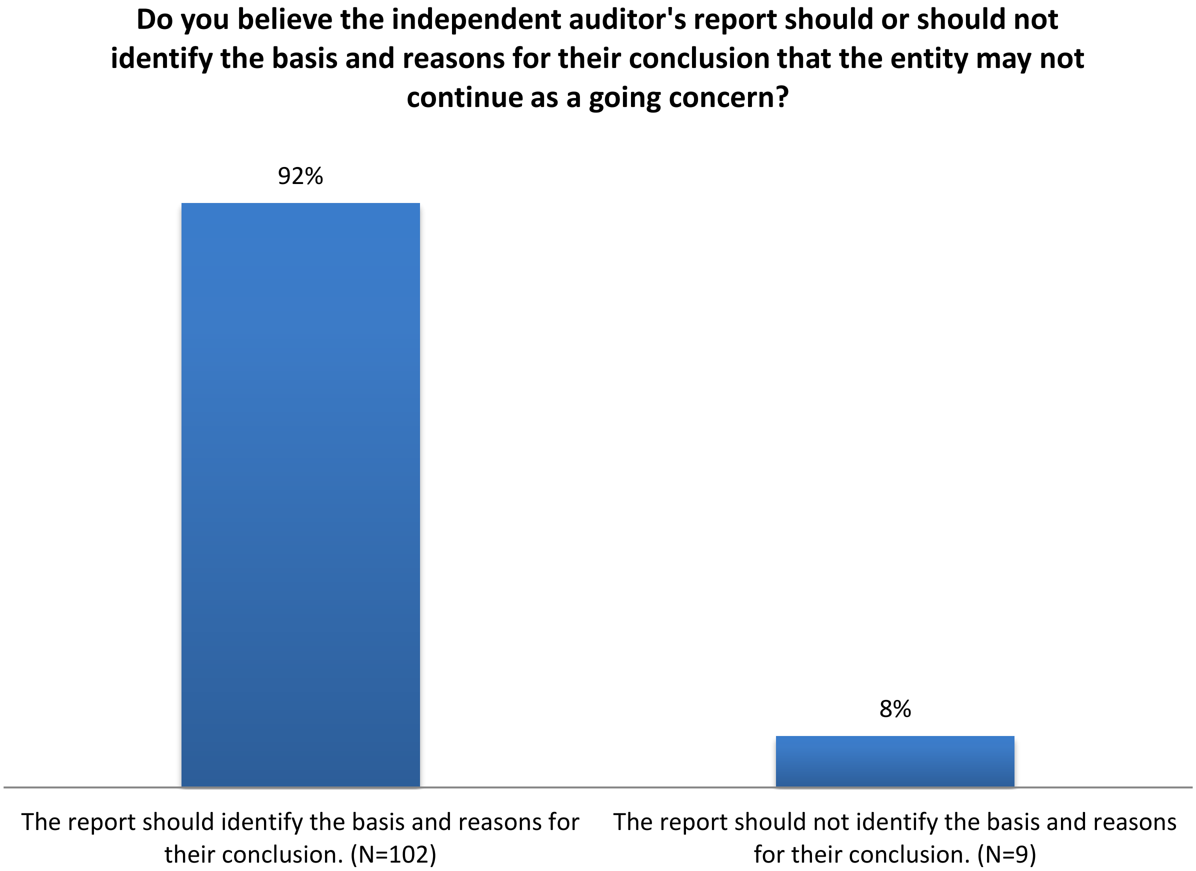



Respondents who indicated "Other" had the following opinion on whose responsibility it should be:

- Analysts following the stock.  Absent analysts management should address the issue if it gets close.
- Board of Directors
- Employees, especially the Finance and Accounting staff
- Entire board (not just audit committee)
- Internal managers are biased, evaluation should be external
- Media
- Other agencies, supervisory board
- Rating agencies
- Securities analysts
- There is an element of "selling" in financial reporting and you can't tell a salesperson to reveal the flaws in their product.

**Additional Comments**

- A going concern should have a clause that certain events “could” create a “going concern” in the near-term (rather than within 12 months).
- Although it is not likely any insider would be willing to report so, any external party should not be responsible as it's not their job.
- As always, material related to the financial statements is the responsibility of management!
- As management has the overall responsibility for the business, it is also his responsibility to communicate about going concern of the entity. The latter is both an economic and a strategic issue (a business can be discontinued although there is no real economic need to do so, based on intentions), which cannot be delegated to an internal or external control committee, but from management itself.
- Going concern is often in the eye of the beholder. Personally, I believe investors and analysts need to do the work themselves.
- I think this question should be refocused to assuring better disclosure about the most important risks a business faces (i.e. risk management should make its way into financial reporting). There would need to be safe harbors built around this.
- If management above refers to line management only, the entire board is responsible.
- In my opinion, it's a yes/no question. If there is a question about going concern, it's a problem. If not, I ignore it.
- It is usually too late when going concern is raised.
- Management first, audit committee second and auditor last. The problem is management is reluctant to include such a note because it might become a self-fulfilling prophecy. In addition there is a great deal of work required because the basis of accounting shifts from historical numbers to liquidation values. For an entity in bad shape this extra cost generates little benefit.
- Management is the one group incapable of having an objective view of going concern questions.
- Management knows best whether the company is a going concern but they likely have the most to lose by reporting a liquidity crunch that may exacerbate a run on the company.
- Management should have the greatest responsibility. Ethical is the key to the issue, otherwise lot of monitoring costs being spent without much benefit.
- Primary responsibility should be management; however they might not do it for obvious reasons.
- Regulators only when there is implicit or explicit taxpayer backstop, (i.e., financials, insurance, real estate).
- The primary responsibility for the going concern assessment and preparation of financial statements on that basis rests with management. Therefore, management and the audit committee should be reporting on this matter.
- They should all be on the lookout for signs of not meeting the going concern and all have the capability to alert the other listed stakeholders to this. In theory, this would kick off a separate analysis conducted by all parties to assess the legitimacy of the claim.




**Additional Comments by response options.**

Respondents who selected “The report *should* identify the basis and reasons for their conclusion”:

- "May not" does not fit accounting speak for contingencies.  "Material uncertainty" should trigger discussion/disclosure.
- An important consideration for the auditor and for the users of audited financial reports.
- As long as it does not cause an adverse opinion that will be rejected by regulators.  Regulators require "clean" unqualified opinions results in any qualification by an auditor as akin to a nuclear option.
- Audit report should confirm that the assessment of management has been independently tested and verified, or that the auditors were able to reach a similar conclusion in an independent process.
- Auditors should be independent in reaching their conclusions and communicate them to shareholders. Management should take their stance on the auditor's opinion. Of course, there is a risk that a wrong audit opinion breaks up a business, since in a distressed situation; the auditors get more credibility than management.

- I would love to know the reasons why there is a question, but I also recognize that by identifying it, the company's vulnerability is exposed and can be exploited by competitors to the point that it's a self-fulfilling prophecy.
- Including the basis and reason allows investors to better understand the conclusion and determine whether they agree with that conclusion.
- It must include this information as the basis of the audit us underpinned by the going concern assumption.
- Solid evidence should be sought and discussed with management/board.
- Technically the external auditor should not pass the buck that they relied on information provided by management only. They need to delve further and not only appraise the policies and assumptions.
- The report should highlight the note reference in the f/s where management has discussed their analysis of going concern.
- Valuation of assets and liabilities depends on valuation basis. Auditor supposes to give an independent view on financial statement. Without assessing the valuation base, auditor would not have sufficient and appropriate audit evidence to draw any reasonable conclusion. Of course, the problem will be lesser when the economy is performing well.

Respondents who selected "The report *should not* identify the basis and reasons for their conclusion":

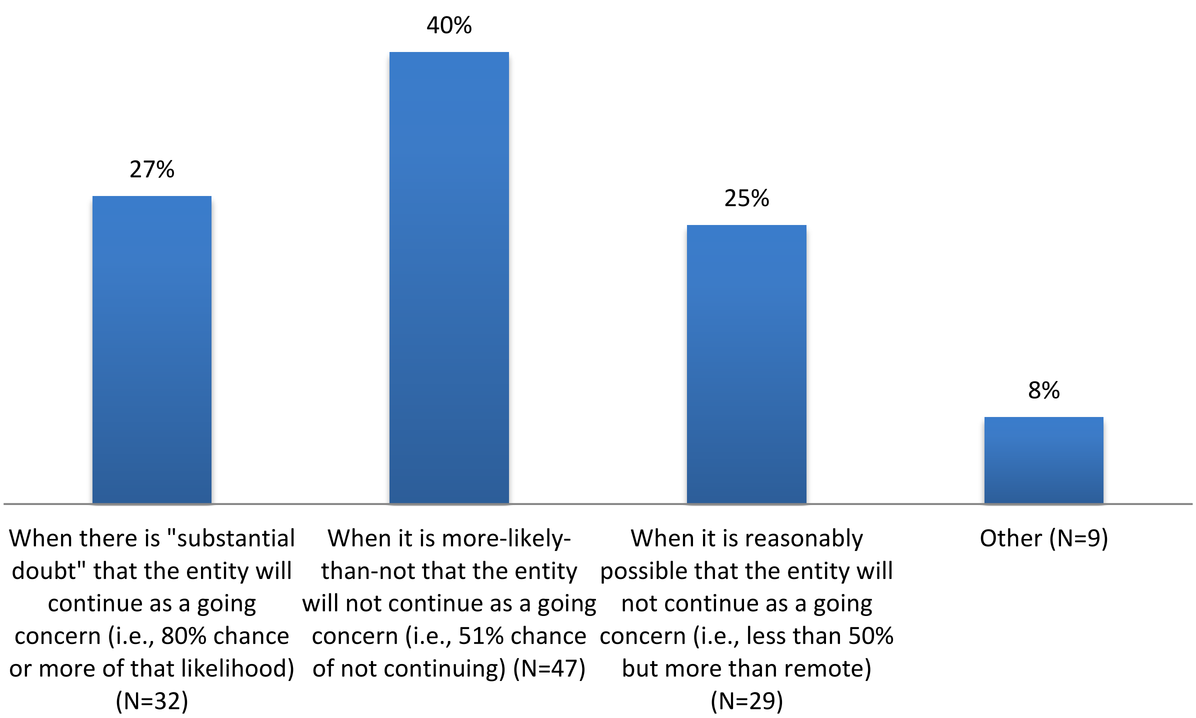
- It management's job to be optimistic and the auditor's job to be pessimistic. The rationale should be more important. The opinion should emphasize the time frame and hurdles. Perhaps calling it "Continuation Issues" and having all companies include it may be a better idea than a term that implies instantaneous failure.
- Relating back to the question "whose responsibility is it," the auditor's already bear an undue proportion of this burden.

Respondents who selected "No opinion":

- No auditor would want the additional liability that attaches with an explanatory paragraph. Short of writing another MD&A, how much could an auditor really say?

## Thresholds for basis of reporting

**Which of the following thresholds should be the basis for reporting whether there is a question about an entity's ability to continue as a going concern?**




Respondents who indicated "Other" had the following opinion on the thresholds for basis of reporting:

- As soon as there is any doubt that business will be discontinued.
- Business continuation should be an element in an every company's audit report. That way the analyst and investor can assess the issues. I've seen companies that get a going concern opinion for poor reasoning or nothing changing and watched the stock tank despite the company's successful continuation beyond the auditor's inaccurate scenario.
- How do you link this to materiality?
- Rather than having a single, specific threshold regarding when a report is done, there should be a framework more akin to a spectrum, and there should always be a report placing the company somewhere (perhaps in a range) along that spectrum of likelihood to continue as a going concern.
- See response above to enhance risk disclosures. This could largely obviate the need for the type of threshold proposed here.
- They should state which of the above using the exact language above.
- When there are events or factors upon which the entity is dependent upon the outcome to continue as a going concern - whether or not it is probable or possible etc.

**Additional Comments by response options.**

Respondents who selected “When it is more-likely-than-not that the entity will not continue as a going concern”:

- Any sooner than this would be harmful to the entity itself and could essentially become a self-fulfilling prophesy.
- Reporting a "going concern" alarm based on the substantial doubt threshold is leaving the reporting of a vital issue too late. On the other hand, a low threshold (reasonable possibility) is inappropriate as many firms will fall into this category from time to time.

Respondents who selected “When there is "substantial doubt" that the entity will continue as a going concern”:

- I agree with 80% approach. But I can imagine it will very hard for most of the industries, except the financial services industry which can come up will such a sophisticated analysis. Of course, going concern assumption should be quite obvious for most of the business.
- It is not possible to determine a probability of more or less 50%, that's something nobody knows. How should an auditor be able to determine that threshold?
- There is no reason to be in a constant state of alarm and panic about a company's viability. It would waste resources and time; and would be highly capital inefficient. Only in more serious cases should a flag be raised that causes multiple stakeholders to perform independent assessments and then collectively review their findings.

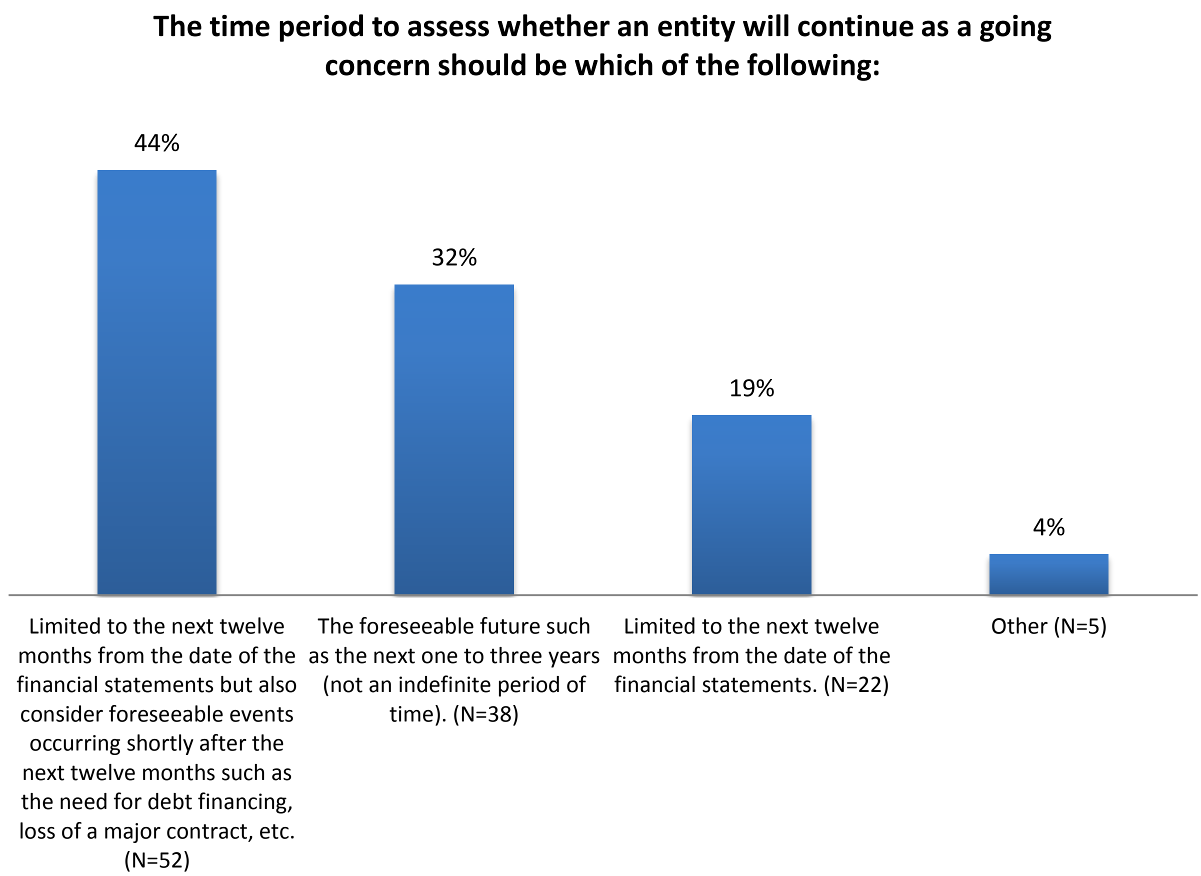
Respondents who selected “When it is reasonably possible that the entity will not continue as a going concern”:

- At least that reminds investors there are always a risks and what the risks are. Ironic that there is lots of discussion over financial risk but none on business risk. #1 risk generating revenue. #2 risk collecting revenue!
- The going concern is a critical accounting assumption.

Respondents who selected “No opinion”:

- As soon as it gets a strategic option for management to discontinue the business based on an adverse economic or political situation, this should be communicated to shareholders, showing the options available and the economic consequences.

## Time period for continuation of an entity as a going concern




Respondents who indicated "Other" had the following opinions on the time period:

- 12 month as a rule, more if there are reasons to believe relevant political events could occur.
- 12 months from Board approving the financial statements
- 90 days
- The auto companies were insolvent for decades.

**Additional Comments by response options.**

Respondents who selected "Limited to the next twelve months from the date of the financial statements but also consider foreseeable events occurring shortly after the next twelve months":

- Any more than that becomes pure speculation and again could be detrimental to the entity itself.
- Anything more is likely to generate bulk boilerplate disclosures and big legal fees without generating useful information.

- The 'foreseeable future' is a varied and inconsistent period (which may not reach 12 months)
- The foreseeable future should be discussed to the extent possible in MD&A.

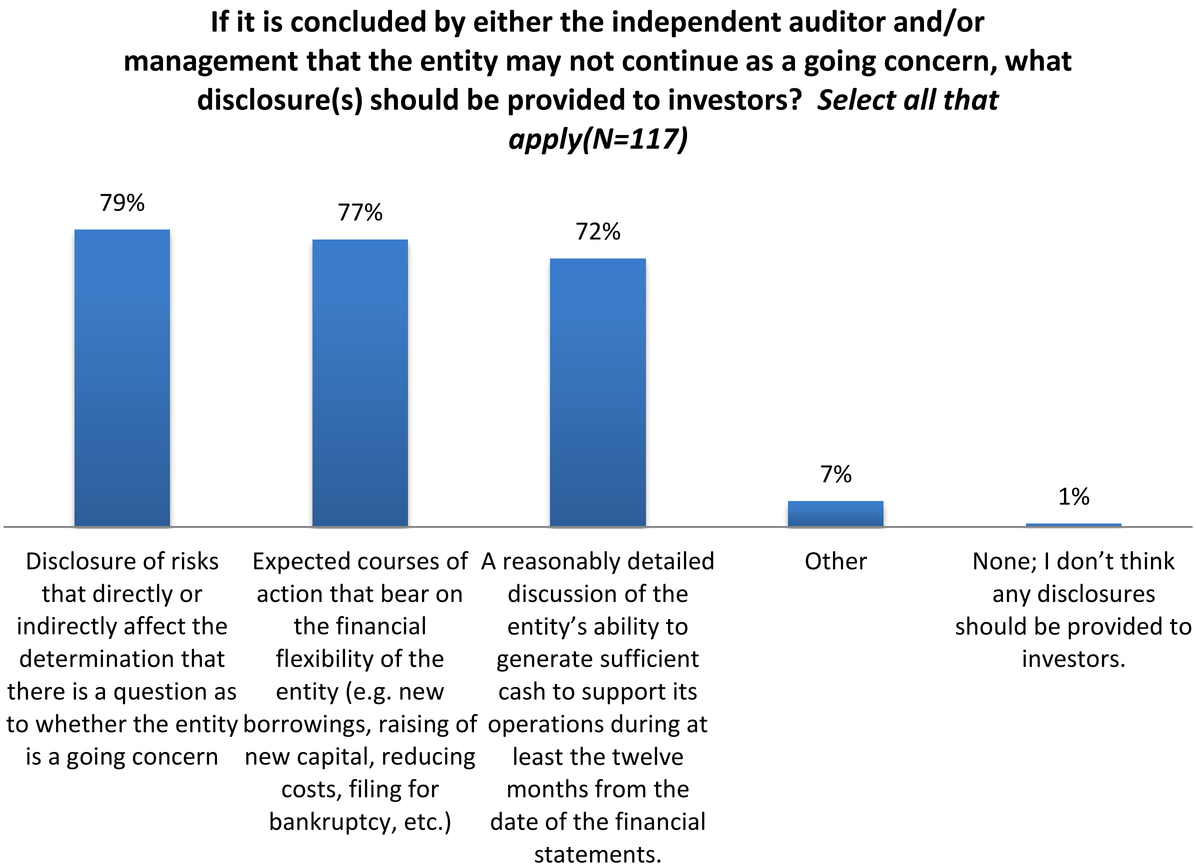
Respondents who selected “The foreseeable future such as the next one to three years (not an indefinite period of time)”:

- The 'Going Concern' principle should not limit itself to the immediate future as a particular company might be able to tide over the next 12 months but in the absence of significant positive cash flow or assets that could possibly be disposed of, it might not be able to continue as a going concern, say, the year after. Hence the assessment period should be looking out to at the short- to medium-term, i.e. 3 to 5 years, to provide a safety cushion to the investors in the company.
- The horizon should ideally consistent with the value generation cycle of the firm (i.e., if these are long term contracts a long term going concern view would be appropriate)
- Tough question but given that financing can be pushed out the maturity curve, it might seem imprudent to assess only a 12 month basis if there is a balloon payment of debt maturing in month 13.

Respondents who selected “Limited to the next twelve months from the date of the financial statements”:

- It can be difficult to project too far into the future and therefore onerous for management and/or auditors to assess and evaluate going concern issues into the far future.

## Disclosures to investors



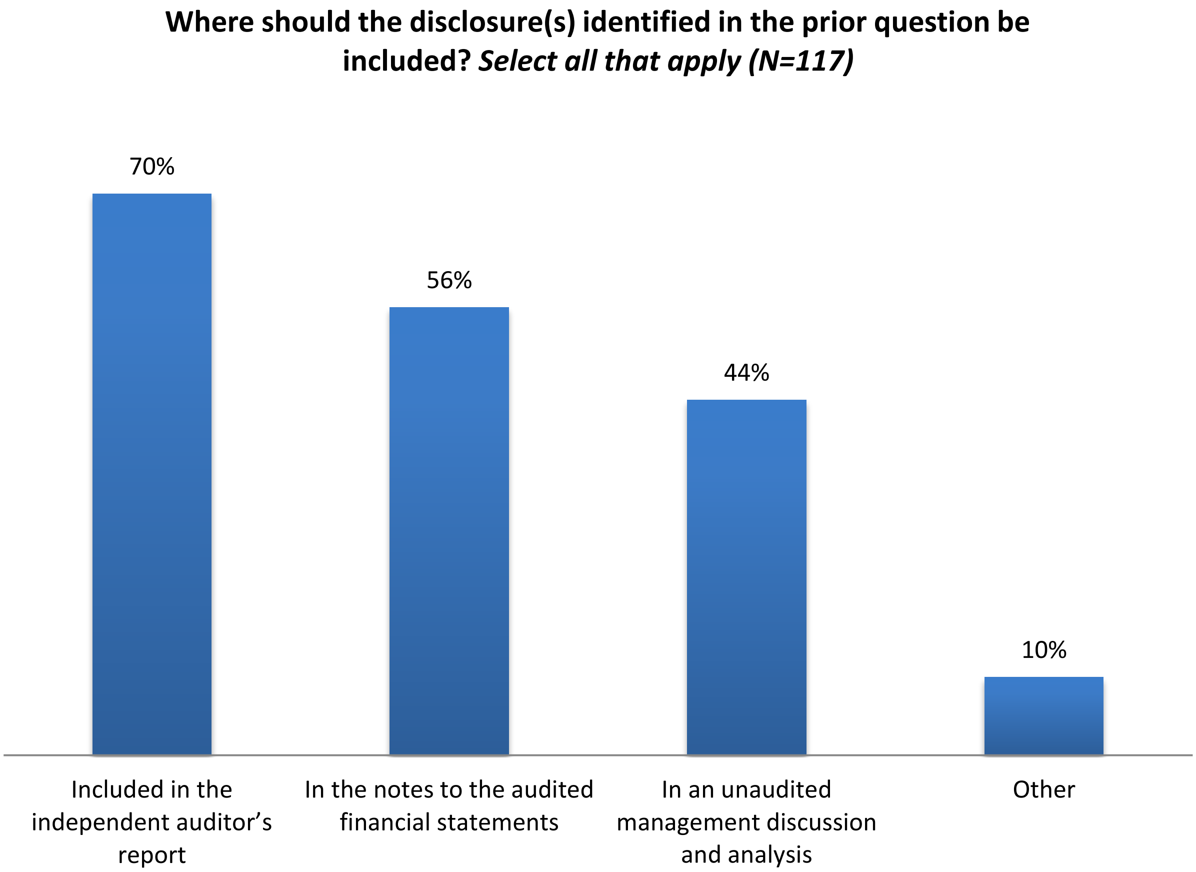

Respondents who indicated "Other" had the following opinions on what disclosures should be provided to investors:

- Discussion of the inherent uncertainty that exists in this type of assessment, noting that stakeholders should use it as one factor in their own assessment.
- Disposal values of the company's assets / investments
- Just provide the facts on liquidity needs and off balance sheet liabilities.
- Need to be careful. Improper disclosure could ruin whatever chances the entity has to survive
- Once alerted, mgmt. must provide to investors a response/strategy to mitigate this scenario/risk
- Reasons for conclusion that company is not going concern anymore.
- What would be the likely impacts on the business and financial statements if unable to continue as a going concern
- Whether the management and auditor have the same or different views

**Additional Comments**

- A lot of these discussions should be outside the financial statements and in the MD&A. Auditing these types of disclosures will be costly and very difficult. The level of discussion will be depending on the situation facing the entity as well.
- Auditors should be forced to disclose transactions of the reporting entity that were entered into to give the perception that the entity can continue as a going concern for longer (i.e., generate short term profit at the expense of future periods).
- Disclosure of creditors and payment hierarchy.
- I believe that current literature would require once a going concern uncertainty is disclosed that the disclosure address management plans.
- I would require risk factors, expected courses and financial flexibility as well as success criteria
- If the going concern assumption is no longer valid, a full and frank discussion and disclosure needs to be undertaken.
- This is a really good undertaking from the CFA Institute to raise awareness of reporting vis-a-vis the solvency of companies and what it means for investors.

## Location of disclosures to investors




Respondents who indicated "other" had the following opinions on where the disclosures should be included:

- Best would be in a MD&A with some audit related opinion
- Chairman's letter of Management discussion
- Form 8-K filed in conjunction with company's 10-K
- In an 8K filing
- In MD&A with reference from the notes to audited FS.
- Independent auditor must make clear up front, supporting details may appear later/notes, etc.
- It depends who makes the disclosure
- It should be included in the auditor's report, but management should also be permitted to provide a separate statement on the auditor's conclusions.
- Management Discussion and Analysis
- The disclosure should initially be prominently and separately placed at the start of the set of financial reports and accounts. The auditor's report and MD&A should then have further discussion on the matter.

- The factual data regarding going concern should be included in the notes, with the unaudited MD&A containing management's analysis and plans to manage the issue.

## Additional comments on the concept of going concern

- As a Chartered Accountant and CFA who has worked in various roles such as investor, CFO and auditor, it's astonishing to see this question tackled in such a different way from the accounting bodies. There seems to be a disconcerting disconnect in expectations and outcomes of investors, auditors and management.
- Auditors can and should do a better job of assessing going concern and providing useful information to stakeholders. However, we cannot lose sight of the fact that investors and other stakeholders also bear responsibility for their own assessment and cannot solely rely on the auditor to do their assessment.
- Few investors pay attention to the notes and assume it is the same recurring issues mentioned. On the auditor's report, it would be easy to capture such. The management letter is also not usually readily available to be shared by external investors.
- Going concern is a very subjective assessment. Sometimes by highlighting it in the accounts it becomes self-fulfilling prompting customers and (or) suppliers to lose confidence in the company which accelerates its demise. We need to be very cautious here.
- Going concern is the basis of the account which is very important.
- I believe the current definition of going concern should be modified to include language that allows auditors to use it without getting fired. For example, a going concern should have a clause that certain events "could" create a "going concern" in the near-term (rather than within 12 months). Cash to sustain business operations over the near-term is key.
- I would argue that the entire above are already required under Form 8-K required disclosure rules.
- If the conclusion is that the reporting entity can continue as going concern, the auditor should be required disclose whether the topic was discussed with management and the reasons why they concluded the way they did. This would force disclosures that have a better predicting capability than currently (i.e., currently investors have information when things are already quite negative - forcing disclosures of the auditor's analysis could provide information about how things are potentially degrading).
- If there are big enough problems that "going concern" is in question, information should be provided across multiple platforms.
- MD&A when a risk factor but not reasonably possible, notes when reasonably possible (audited), if there is a disagreement with the auditor in auditor's report, and in both notes and audit report when more likely than not.
- Shouldn't need disclosures if no reportable issues, though would be helpful for management to have to make a positive statement regarding going concern irrespective of uncertainties i.e. force them to go on record and therefore consider it in their financial statement sign off processes.
- Thank you for this opportunity to speak on such an important issue. I have been observing this for the last forty years. Generally, and like the public downgrading of a company's public debt, going concern opinions are issued only AFTER the markets have concluded, based on other information, that the company is no longer a going concern. Obviously, this renders the auditors' and companies' announcements of the condition worthless. Auditors seem to require certainty to report. Certainty occurs only when the bankruptcy filing is made. So, the threshold applied to the announcement, certainty, needs to be revised to reflect a reasonable possibility. The auditors argue that this renders the situation a self-fulfilling prophecy. But

they fail to render value to investors if they are only willing to provide worthless information, and investors should not be expected to pay huge sums for worthless information. Information on pending bankruptcy and going concern questions are the most valuable information investors can receive because the potential loss is greatest in such cases.

- The best would be to not require this disclosure at all. Any such disclosure has the potential of bankrupting otherwise potentially viable companies (the self-fulfilling prophesy). Each CFA should make his/her own determination based on his/her judgment of the prospects of a company, including going concern.
- Upon a triggering condition to call into question the firms going concern multiple independent stakeholders should be responsible for proving and/or disproving the viability of the claim. The findings should be discussed internally and a unified conclusion reached which should be included in the notes of the audited fin statements.