IAS 1: Disclosures about an Assessment of Going Concern

Extract, IFRS Discussion Group Report on Meeting – May 31, 2016

The IFRS Interpretations Committee received a submission from the International Auditing and Assurance Standards Board (IAASB) in 2012, requesting clarification about the disclosures required for material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The IAASB noted that the guidance was unclear as to when the disclosures required by paragraph 25 of IAS 1 *Presentation of Financial Statements* should be provided, and what information should be disclosed about such material uncertainties.

The IFRS 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. The IASB acknowledged that information about going concern is important to investors. Information about the events and conditions that cast significant doubt upon an entity's ability to continue as a going concern is also useful to investors and creditors. However, many IASB members were concerned about the sensitive nature of these disclosures and some were concerned that the act of disclosure could become a self-fulfilling prophecy. As such, the IASB decided not to proceed with a narrow-scope amendment to IAS 1.

Consequently, the IFRS Interpretations Committee removed the topic from its agenda. In its July 2014 agenda decision, the IFRS Interpretations Committee discussed a situation in which management has considered events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The IFRS Interpretations Committee observed that "in the circumstances discussed, the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern."

Fact Pattern

An entity is currently experiencing significant financial difficulties and is considering whether there are material uncertainties related to events or conditions that may cast significant doubt upon its ability to continue as a going concern. Management has several plans to mitigate the effect of these material uncertainties, including private equity-based financings, negotiations to defer certain debt repayments and cost reduction initiatives.

Management considered all the relevant information, including the feasibility and effectiveness of management's mitigation plans, and concluded that there are no material uncertainties that would require disclosure in accordance with paragraph 25 of IAS 1. This fact pattern is intended to depict a "close call" situation and in reaching this conclusion, management applied significant judgment.

Issue: Given that management applied significant judgment in reaching its conclusion, would further disclosures of the significant judgment be required by paragraph 122 of IAS 1?

View A – Disclosure of the significant judgment applied in reaching its conclusion is not required under paragraph 122 of IAS 1.

Under this view, the disclosures required by paragraph 122 of IAS 1 are significant judgments made by management in applying an entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Proponents of this view note that the disclosures of judgments about material uncertainties do not relate to applying an entity's accounting policies as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and do not have a significant effect on the amounts recognized in the financial statements.

View B – Disclosure of the significant judgment applied in reaching the conclusion is required under paragraph 122 of IAS 1.

Under this view, the disclosures required by paragraph 122 of IAS 1 would apply because management applied significant judgment in determining and assessing the events or conditions around the material uncertainty and the mitigating factors in reaching its conclusion.

Proponents of this view note that, in some circumstances, the judgment applied could have a significant effect on the amounts recognized in the financial statements because if a different conclusion was reached, the amounts recognized in the financial statements would be on a liquidation basis, if appropriate.

The Group's Discussion

One Group member asked for an example of a mitigation plan. An example might be that management is looking to the private market to raise capital. A plan is in place but judgment is made on the probability of whether the entity would receive the required cash flows. This Group member observed that typically auditors would need persuasive evidence from the entity to avoid a going concern disclosure. If such evidence does not exist, a going concern note disclosure would be needed. Another Group member raised the question that, if disclosure on significant judgments in a close call situation is required, how explicit does the note disclosure have to be? Would having the information about the mitigation plans in the financial statements be sufficient so that a user can draw his or her own conclusion?

A few Group members approached the discussion from a user perspective. If an entity experiences financial difficulties, a user would like to see this information in the financial statements and look for an explanation as to why the entity continues to be a going concern, including the significant judgments made in the process. However, one Group member raised a question on the purpose of the additional disclosure and the intended message for the users in situations when management and the auditors are satisfied that a going concern disclosure is not needed. Disclosing significant judgments would seem more useful when there is a clear linkage to how the situation would affect the measurement of certain balances in the financial statements.

Another Group member pointed out that a broader issue is determining when an entity needs to have a going concern disclosure and that under IAS 1, an entity is a going concern unless management intends to liquidate, cease trading, or has no realistic alternative to do so. This Group member indicated support for View A in most circumstances.

The Canadian member of the IFRS Interpretations Committee clarified the intent of the international discussion. The agenda decision was intended to address a situation when an entity was facing significant financial difficulty and a material uncertainty exists about its ability to continue as a going concern. If management concluded that there are mitigating factors that dispelled the material uncertainty, it would be important to users that the significant judgments made in reaching such a conclusion are disclosed in the financial statements. Thus, the IFRS Interpretations Committee's intent was that View B applies in the situation described above because management applied significant judgment in determining and assessing the events or conditions around the material uncertainty and the mitigating factors in reaching its conclusion. The reference to paragraph 122 of IAS 1 in the agenda decision was intended to be read broadly, as opposed to narrowly, with a focus on the significant judgments management made in a close call situation.

The Canadian Securities Administrators (CSA) observers at the meeting indicated that they understand the intent of the IFRS Interpretation Committee's discussion and consider that disclosures about the significant judgments made in a close call situation provide useful information to users. Regulators are emphasizing compliance with disclosure requirements for management discussion and analysis so that users are provided with information that will allow them to understand the entity's liquidity and plans. However, the CSA representatives observe differing levels of significant judgment disclosures for close call situations in the financial statements.

The Group recommended that the issue be discussed with the AcSB to determine whether it should be raised to the IASB or IFRS Interpretations Committee.

(For a full understanding of the discussions and views expressed, listen to the audio clip).