



# Going concern

## Handbook

**US GAAP**

December 2025

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# A responsibility of management

The going concern presumption that an entity will be able to meet its obligations when they become due is foundational to financial reporting. This presumption may be challenged at any time, but especially during periods of economic disruption.

Economic disruptors have been prevalent in global markets over the last several years due to many unexpected macro events – uncertainty around tariffs and trade policies, supply chain disruptions, international conflicts, and fluctuating interest rates. The ever-evolving complexities attributable to economic disruption serve to amplify the subjectivity and difficulty of management’s going concern analysis.

When forecasting becomes less reliable and the past no longer predicts the future, the going concern assessment becomes increasingly difficult, and robust disclosures much more critical. These vulnerabilities continue to shine a bright light on management’s responsibility for its going concern assessment.

This Handbook provides an in-depth look at management’s going concern assessment. We have organized the discussion in steps to make it easier to identify which elements should be factored into the analysis and which disclosures are necessary as a result. We hope you find it useful.

Valerie Boissou and Tim Phelps

**Department of Professional Practice, KPMG LLP**

# Acknowledgments

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We would like to acknowledge the efforts of the main contributors to this edition:

[Tim Phelps](#)

[Leigh Louis](#)

[Gina Martin](#)

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# About this publication

The purpose of this Handbook is to assist management in performing its going concern assessment and making appropriate disclosures under Subtopic 205-40.

## Organization of the text

The chapters include excerpts from the FASB's Accounting Standards Codification® Subtopic 205-40. Practical in-depth explanations and examples are provided to assist with the real-world application of key concepts.

Our commentary is referenced to the Codification and other literature, where applicable. The following are examples.

- 205-40-50-1 is paragraph 50-1 of ASC Subtopic 205-40.
- ASU 2014-15.BC14 is paragraph 14 of the basis for conclusions to Accounting Standards Update 2014-15.
- FAS 165.A10 is paragraph A10 of FASB Statement No. 165, *Subsequent Events*.
- S-K Item 303(a) is Item 303(a) of SEC Regulation S-K.
- AS 2415.12 is paragraph 12 of PCAOB Auditing Standard 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*.
- AU-C 570.A51 is paragraph A51 of AICPA Statements on Auditing Standards (Clarified) Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- PCAOB SAPA 13 is PCAOB Staff Audit Practice Alert No. 13, *Matters related to the auditor's consideration of a company's ability to continue as a going concern*.
- 1933 Exchange Act Sec. 11(a) is Section 11(a) of the Securities Exchange Act of 1933.

## Terminology

Throughout this Handbook, we use the following terms:

### Going concern terminology

**Assessment date:** the date financial statements are issued or available to be issued (see ASU 2014-15.BC24 and [Question 2.3.20](#))

**Look-forward period:** the 12-month period that begins on the assessment date (see ASU 2014-15.BC 28, which refers to this period as the 'assessment period' and [Question 2.3.20](#))

**Probable:** likely to occur, which is interpreted to mean there is a high likelihood that the future event will occur (see [Question 2.3.50](#))

## Auditing standards terminology

**US auditing standards:** both PCAOB and AICPA auditing standards

**PCAOB auditing standards:** auditing standards issued by the PCAOB and followed by auditors in the preparation of audit reports for issuers – i.e. public companies and other issuers, and broker-dealers

**AICPA auditing standards:** auditing standards issued by the AICPA and followed by auditors in the preparation of audit reports of companies in the United States that are nonissuers – also known as US GAAS

## December 2025 edition

This edition of our Handbook includes new and updated interpretations based on our continued practical experience with entities applying Subtopic 205-40. New questions and examples are identified with \*\* and items that have been significantly updated or revised are identified with #. The [Index of changes](#) identifies all significant changes.

## Abbreviations

We use the following abbreviations in this Handbook:

AICPA	American Institute of Certified Public Accountants
FDA	Food and Drug Administration
ICFR	Internal control over financial accounting
MD&A	Management's Discussion and Analysis
PCAOB	Public Company Accounting Oversight Board

# 1. Executive summary

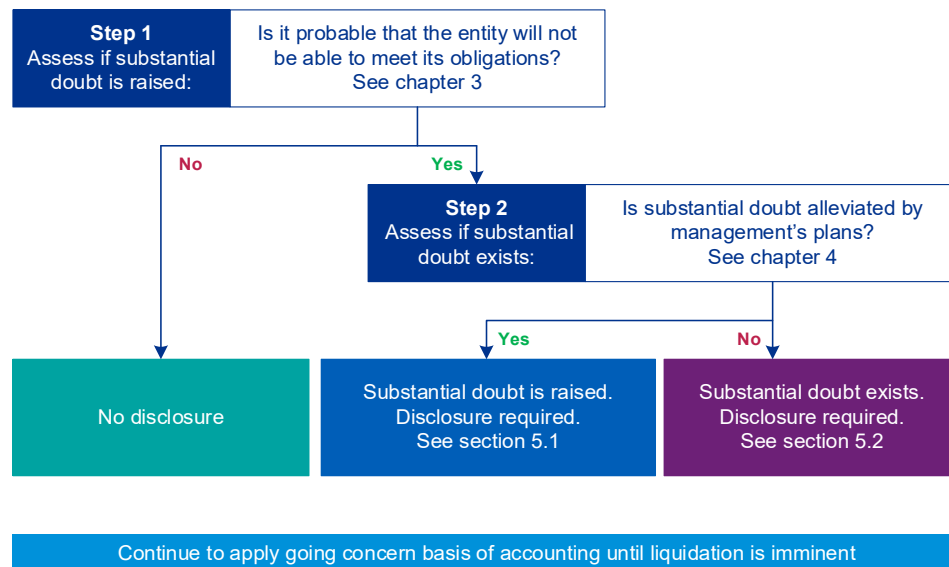
Since 2017, US GAAP has required management to assess an entity's ability to continue as a going concern. Subtopic 205-40 contains the requirements management must follow in conducting its going concern assessment and the disclosures the entity may have to make as a result. Conducting a going concern assessment requires considerable judgment.

Management's assessment is a two-step process that requires determining whether it is probable the entity will be unable to meet its obligations over a defined period. That period – referred to in this Handbook as the look-forward period – spans one year from the assessment date – i.e. the date the entity's financial statements are issued or are available to be issued.

Because management's assessment concludes on the assessment date, it reflects events or conditions that occurred after the reporting date up to the assessment date – i.e. subsequent events.

Management must perform the assessment at each reporting period, so the look-forward period is continuously rolling forward.

The assessment – summarized as follows – may lead the entity to disclose information about its ability to continue as a going concern but has no direct effect on its basis of accounting.



## Overview of going concern assessment

**Management's going concern assessment contains only two steps, but each step contains specific concepts and requires considerable judgment.**

Some of the key concepts in management's going concern assessment are:

- substantial doubt
- probable
- the look-forward period
- the assessment date

Understanding these concepts is essential to conducting a going concern assessment.

Read more: [chapter 2](#)

## Step 1: Assess whether substantial doubt is raised

**Substantial doubt about an entity's ability to continue as a going concern is raised when it is probable the entity will not be able to meet its obligations as they become due during the look-forward period.**

Under Step 1, management determines whether events and circumstances *raise* substantial doubt about the entity's ability to continue as a going concern. Management can make this determination by breaking the process into smaller steps that collectively identify what the entity *has*, *owes* and *needs* to continue to operate throughout the look-forward period. Step 1 notably requires a thorough analysis of the entity's debt arrangements and detailed cash flows forecasts.

If management determines events and circumstances do not raise substantial doubt, it concludes its going concern assessment with no disclosure or other action. Otherwise, management proceeds to Step 2 to determine whether substantial doubt exists and which disclosures to provide.

Read more: [chapter 3](#)

## Step 2: Assess whether substantial doubt exists

**Substantial doubt about an entity's ability to continue as a going concern exists when such doubt is raised and is not alleviated by management's plans.**

Under Step 2, management determines whether it has plans to alleviate the substantial doubt that is raised in Step 1. For its plans to alleviate the substantial doubt, management must establish that it is probable the plans will:

- be timely implemented, i.e. they are approved and feasible; and
- successfully mitigate the conditions and events that raise the substantial doubt.



Establishing this may prove challenging when key elements of the plan are beyond management's control. Additional forecasting to that done under Step 1 is often necessary.

Read more: [chapter 4](#)

## Disclosures

**Subtopic 205-40 is a disclosure standard. Therefore, the result of management's going concern assessment is potential disclosures. There is no direct effect on the entity's accounting.**

There are three potential disclosure outcomes from management's going concern assessment.

- **No disclosure:** No disclosure is required under Subtopic 205-40 if management concludes under Step 1 that substantial doubt has not been raised.
- **Disclosures when substantial doubt raised but alleviated:** Even when management's plans alleviate substantial doubt (Step 2), the entity needs to disclose certain information about its conclusions regarding the going concern assessment.
- **Disclosures when substantial doubt exists:** When management's plans do not alleviate substantial doubt, the entity needs to disclose that substantial doubt exists.

Read more: [chapter 5](#)

## Other considerations

**Although management's going concern assessment has no direct effect on an entity's accounting, it can have indirect implications. It also affects an entity's risk assessment and ICFR.**

Management's conclusion that substantial doubt is raised or exists can indirectly affect such accounting matters as hedge accounting, current versus noncurrent debt classification, deferred tax asset valuation allowances, and impairment testing.

Properly conducting a going concern assessment requires a strong risk assessment process and strong ICFR. Management can take certain steps to ensure these processes adequately address the going concern assessment.

An entity's auditors conduct a similar independent going concern assessment. A finding by the auditors that substantial doubt exists leads to either an explanatory paragraph (for PCAOB audits) or a going concern section (for US GAAS audits).

Read more: [chapter 6](#)

## 2. Overview of going concern assessment

### Detailed contents

#### How the standard works

##### 2.1 Overview

###### Questions

**Question 2.1.10** What is a 'going concern'?

**Question 2.1.20** Does the going concern assessment directly affect the entity's accounting?

**Question 2.1.30** What is the effect of management concluding that substantial doubt about the going concern presumption is raised?

##### 2.2 Going concern assessment

###### Questions

**Question 2.2.10** How should management perform the going concern assessment?

**Question 2.2.20** How frequently should management perform the going concern assessment?

##### 2.3 Key concepts

###### Questions

**Question 2.3.10** How is 'substantial doubt' defined?

**Question 2.3.20** How are the 'look-forward period' and 'assessment date' defined?

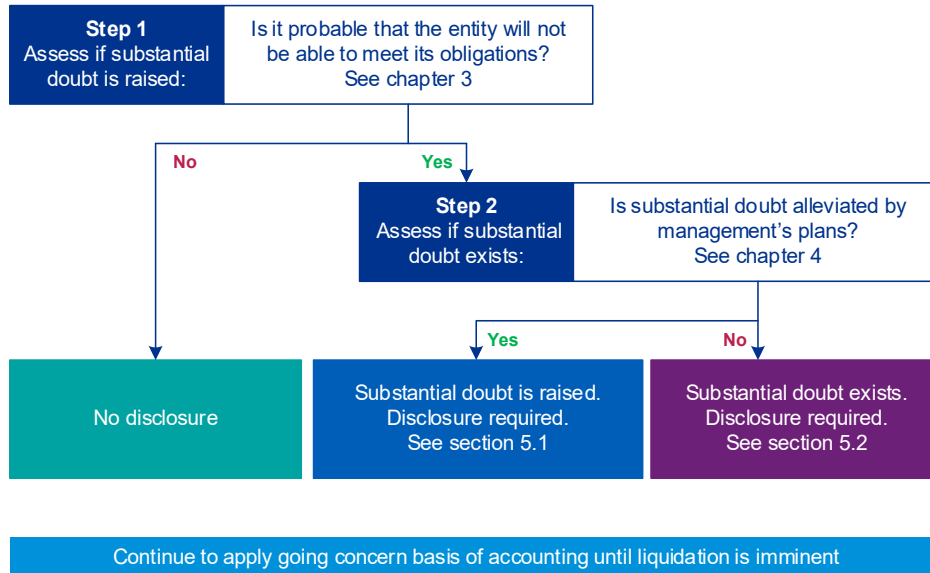
**Question 2.3.30** What does 'issued' or 'available to be issued' mean?

**Question 2.3.40** Should management's assessment go beyond the look-forward period?

**Question 2.3.50** How is the term 'probable' considered in the context of the going concern assessment?

## How the standard works

The going concern assessment in Subtopic 205-40 requires management to assess an entity's ability to continue as a going concern and provide related disclosures. The assessment covers a 12-month period (the look-forward period) that begins from the date the financial statements are issued or available to be issued (the assessment date). The two-step assessment is summarized as follows.



## 2.1 Overview

### Excerpt from ASC 205-40

**05-1** Continuation of an entity as a going concern is presumed as the basis for financial reporting unless and until the entity's **liquidation** becomes imminent. Preparation of financial statements under this presumption is commonly referred to as the going concern basis of accounting. If and when an entity's liquidation becomes imminent, financial statements are prepared under the liquidation basis of accounting in accordance with Subtopic 205-30 on the liquidation basis of accounting.

**05-2** Even if an entity's liquidation is not imminent, there may be conditions and events, considered in the aggregate, that raise **substantial doubt about the entity's ability to continue as a going concern**. In those situations, financial statements continue to be prepared under the going concern basis of accounting, but the guidance in this Subtopic should be followed to determine whether to disclose information about the relevant conditions or events.

**05-3** This Subtopic provides guidance for evaluating whether there is substantial doubt about an entity's ability to continue as a going concern and about related note disclosures.

> Entities

**15-1** The guidance in this Subtopic applies to all entities.

#### 20 Glossary

#### **Substantial Doubt about an Entity's Ability to Continue as a Going Concern**

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.

Each reporting period, an entity's management must assess whether there is substantial doubt about the entity's ability to continue as a going concern. Depending on the outcome of this assessment, the entity may need to provide certain disclosures in the notes to the financial statements. This requirement applies to all entities. [205-40 Glossary, 205-40-05-2, 15-1]

Subtopic 205-40 provides the principles for making this assessment by:

- providing a two-step framework to assess whether substantial doubt exists (see [Question 2.2.10](#));
- defining 'substantial doubt' (see [Question 2.3.10](#));
- requiring management to assess going concern from the 'assessment date' through the 'look-forward period' (see [Question 2.3.20](#)); and

- requiring certain disclosures if conditions or events raise substantial doubt about an entity's ability to continue as a going concern regardless of whether they are alleviated by management's plans (see [Question 2.1.30](#)).

### Observation The going concern assessment is management's responsibility

Subtopic 205-40 was introduced into the Codification through ASU 2014-15, *Presentation of Financial Statements—Going Concern*, which became effective in 2017. Before the ASU, there was no requirement in US GAAP that management assess an entity's ability to continue as a going concern or provide related disclosures in the notes to the financial statements.

In contrast, US auditing standards have long required that an auditor make such an assessment and adapt the audit report accordingly. [Section 6.3](#) explains how the auditor's assessment compares to management's assessment and the specific consequences on the audit report.

Although we expect these two assessments will result in consistent conclusions, they should be performed independently, with management's assessment being performed first as part of the preparation of the financial statements.

### Question 2.1.10 What is a 'going concern'?

**Interpretive response:** Subtopic 205-40 does not define 'going concern'. Instead, it notes that the continuation of an entity is presumed in preparing financial statements under US GAAP unless liquidation is *imminent*. [\[205-40-05-1, ASU 2014-15.BC14\]](#)

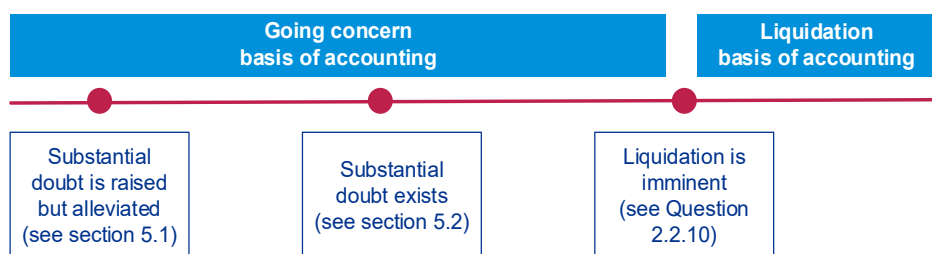
Liquidation is imminent when either of the following occurs. [\[205-30-25-2\]](#)

- A plan for liquidation has been approved by the person or persons with the authority to make such a plan effective, and the likelihood is remote that either of the following will occur:
  - execution of the plan will be blocked by other parties (e.g. those with shareholder rights); or
  - the entity will return from liquidation.
- A plan for liquidation is imposed by other forces (e.g. involuntary bankruptcy), and the likelihood is remote that the entity will return from liquidation.

An entity remains a going concern even though the going concern presumption may be in doubt and disclosures about the going concern uncertainties are required under Subtopic 205-40. [\[205-40-05-2\]](#)

### Question 2.1.20 Does the going concern assessment directly affect the entity's accounting?

**Interpretive response:** No. As illustrated below, regardless of the outcome of management's going concern assessment, the entity continues to apply the going concern basis of accounting in its financial statements unless and until liquidation is imminent. The going concern basis of accounting commonly refers to the application of all other US GAAP except Subtopic 205-30 (liquidation basis of accounting).



This means financial statements continue to be prepared using the going concern basis of accounting as long as liquidation is not imminent even if management concludes it is probable the entity will be unable to meet its obligations as they become due during the look-forward period. [205-40-05-2]

Although the going concern assessment does not change the basis of accounting and may only directly affect disclosures (see [Question 2.1.30](#)), it can indirectly affect other accounting matters under the going concern basis of accounting (see [section 6.1](#)).

### Question 2.1.30 What is the effect of management concluding that substantial doubt about the going concern presumption is raised?

**Interpretive response:** Subtopic 205-40 does not explain how to recognize assets and liabilities when substantial doubt about an entity's ability to continue as a going concern is raised. Instead, management looks to other US GAAP for such guidance. Subtopic 205-40 contains disclosure requirements only. If management determines that substantial doubt is raised (whether or not that doubt is alleviated by management's plans), the entity must disclose information to help financial statement users understand: [205-40-50-12 – 50-13, 205-40-55-1]

- the principal conditions or events that raised substantial doubt;
- management's assessment of the significance of those conditions or events; and
- management's plans that alleviate substantial doubt or are intended to mitigate the conditions or events that raise substantial doubt.

See [section 5.1](#) for disclosures required if substantial doubt is alleviated by management's plans and [section 5.2](#) for disclosures required if substantial doubt is not alleviated by management's plans.

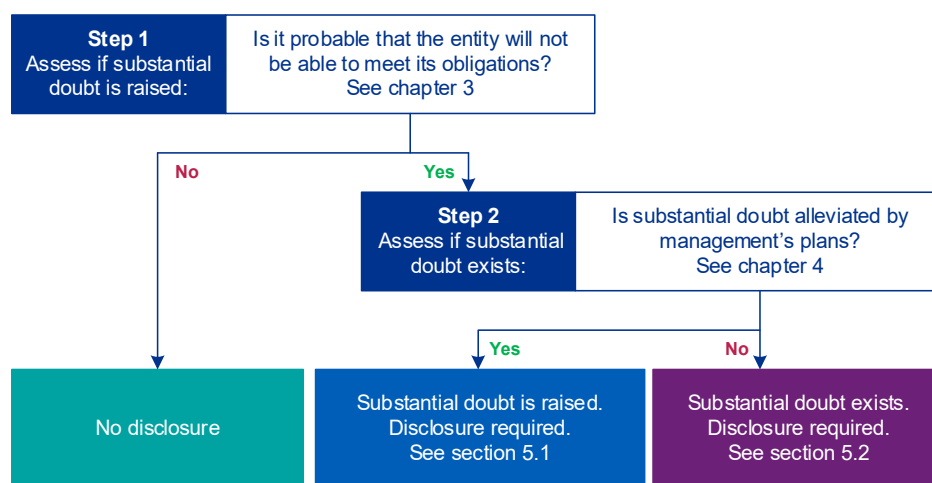
Subtopic 205-40 does not require disclosure if substantial doubt is not raised. Though the going concern assessment may only directly affect disclosures, it can indirectly affect other accounting matters (see [section 6.1](#)).

## 2.2 Going concern assessment

Subtopic 205-40 includes a flowchart of management's process for assessing whether there is substantial doubt about the entity's ability to continue as a going concern. See [Appendix A](#).

### Question 2.2.10 How should management perform the going concern assessment?

**Interpretive response:** The following decision tree summarizes the two-step going concern assessment. This assumes liquidation is not imminent.



Continue to apply going concern basis of accounting until liquidation is imminent

### Question 2.2.20 How frequently should management perform the going concern assessment?

**Interpretive response:** Management is required to perform the going concern assessment for each annual and interim reporting period. Each assessment covers a 12-month look-forward period from the assessment date (see [Question 2.3.30](#)). This results in the need for a rolling assessment, updated at each reporting date. Management should consider the going concern assessment in its risk assessment and internal processes and controls (see [section 6.2](#)).

### **Observation** The going concern assessment does not impact only entities in obvious distress

Subtopic 205-40 establishes a framework for determining whether the going concern presumption is in doubt, and when going concern uncertainties should be disclosed. The framework is based on an entity's ability to fulfill its short-term obligations – i.e. obligations due within 12 months of the assessment date. Even when an entity's management has no concern about the entity's immediate or long-term financial health, management may have to address issues raised by this framework.

Further, disclosures are typically required much earlier than when liquidation becomes imminent and often an entity will continue as a going concern instead of liquidating.

Like other periodic assessments required by GAAP (e.g. impairment, valuation allowance), the nature, extent and documentation of the going concern assessment will depend on an entity's facts and circumstances. The implementation and ongoing cost and effort generally would be lower for financially healthy entities. For example, a detailed analysis may not be necessary if an entity has a history of profitable operations, ready access to financial resources, and no significant near-term obligations in excess of its available liquid funds. In other cases, a more detailed analysis of the entity's financial condition and expected ongoing liquidity (see [chapter 3](#)) may be necessary along with an analysis of the expected effect of management's plans and the feasibility of those plans (see [chapter 4](#)). [ASU 2014-15.BC27]

## 2.3 Key concepts

### **Question 2.3.10** How is 'substantial doubt' defined?

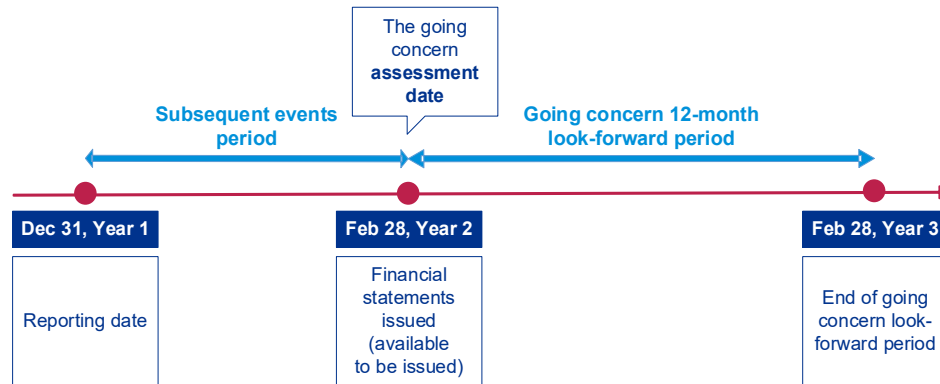
**Interpretive response:** Substantial doubt exists when there are conditions and events that, when considered in the aggregate, indicate it is probable the entity will be unable to meet its obligations as they become due during the look-forward period. In its project that culminated with the issuance of ASU 2014-15, the FASB concluded that an entity's *ability to meet its obligations* is the most appropriate (and the most familiar and understandable) factor in assessing an entity's ability to continue as a going concern.

### **Question 2.3.20** How are the 'look-forward period' and 'assessment date' defined?

**Interpretive response:** When performing a going concern assessment, management determines whether the entity can meet its obligations that come due during the look-forward period (also known as the assessment period), which is the period covered by the going concern assessment. It is the 12-



month period extending from the assessment date, as shown in the following timeline. [205-40-50-1, ASU 2014-15.BC24]



The assessment date is the date on which management concludes the going concern assessment – i.e. identifies conditions and events relevant to the assessment that are known and reasonably knowable (see [Question 3.1.10](#)). This is the date on which financial statements are: [205-40-50-1, 855-10-25-1A – 25-2]

- issued, for SEC filers and entities that are conduit bond obligors for conduit debt securities that are traded in a public market; or
- available to be issued, for all other entities.

See [Question 2.3.30](#) for definitions of ‘issued’ and ‘available to be issued’.

Said differently, the assessment date is the end of the subsequent events period as defined in Topic 855. This means that subsequent events up to that date are considered in the going concern assessment. [ASU 2014-15.BC24]

A nonpublic entity that does not widely distribute its financial statements is generally not required to continue to evaluate subsequent events for an extended period of time following the completion of its financial statements. We believe this is because, absent a formal authorization process, the financial statements are generally available for issuance shortly after completion. However, as indicated in [Question 2.3.30](#), ‘available to be issued’ is meant as a proxy for ‘issued’. Therefore, we would not expect a significant difference between the date the financial statements are available to be issued and their actual distribution. [FAS 165.A11]

Entities that are not SEC filers must disclose the date through which subsequent events have been evaluated (i.e. the assessment date) and whether that date is the date the financial statements were issued or available to be issued. [855-10-50-1]

Practically, management performs the going concern assessment over time and concludes on the assessment date. Best practices include starting early, engaging the stakeholders early in the process (e.g. accounting, finance, legal, etc.), and having processes to update the assessment for new information that arises during the subsequent events period.

### Question 2.3.30 What does 'issued' or 'available to be issued' mean?

**Interpretive response:** Financial statements are considered issued when they are widely distributed to shareholders and other financial statement users for general use and reliance in a form and format that complies with US GAAP. The issuance of an earnings release does not constitute issuance of financial statements. [205-40 Glossary, 855-10-S99-2]

Financial statements are considered available to be issued when they are complete in a form and format that complies with US GAAP and all approvals necessary for issuance have been obtained (e.g. from management, the board of directors, and/or significant shareholders). [205-40 Glossary]

The FASB distinguishes between 'issued' and 'available to be issued' because some nonpublic entities do not widely distribute their financial statements to shareholders or other financial statement users and may provide them to different users at different times. The FASB defined the term 'available to be issued' as it did partly because this approach would not require US entities to develop processes that authorize the issuance of their financial statements. This accommodation was meant to be representative of issuance, and therefore we do not expect a significant difference between the date the financial statements are available to be issued and the date they are distributed. [FAS 165.A10]

### Question 2.3.40 Should management's assessment go beyond the look-forward period?

**Interpretive response:** No. Management is required to perform the assessment only over the look-forward period. The FASB decided an appropriate upper time limit was important to ensure operability of the guidance, reduce diversity, and maintain the focus of the disclosures on the more significant and nearer term uncertainties. However, an entity is not prohibited from providing (and may be required to provide under other US GAAP) disclosures about the potential effect of conditions and events that may occur beyond 12 months. See [Question 5.3.30](#) and [Example 5.3.10](#) for consideration of risks extending beyond the look-forward period. [ASU 2014-15.BC29]

### Question 2.3.50 How is the term 'probable' considered in the context of the going concern assessment?

**Interpretive response:** *Probable* is defined in Topic 450 (contingencies) as *likely to occur*, which is interpreted to mean that there is a high likelihood that the future event will occur. [450-20 Glossary]

It is important to note that the term probable is used in Steps 1 and 2, but in opposite ways. [205-40-50-4, 205-40-50-7]

- In Step 1, substantial doubt is raised when conditions and events, considered in the aggregate, indicate it is probable (i.e. likely) that the entity will be unable to meet its obligations as they become due during the look-forward period (see [chapter 3](#)).
- In Step 2, substantial doubt is alleviated if management has mitigation plans that are probable of being both feasible (see [section 4.2](#)) and successful (see [section 4.3](#)).

The term probable is used when assessing both the existence of substantial doubt and the effectiveness of management's mitigation plans to alleviate the substantial doubt. In the case of substantial doubt, it is the likelihood of default that is being assessed. In contrast, in the case of alleviating substantial doubt it is the likelihood of success that is being assessed (i.e. the likelihood that management's mitigation plans will be successful).

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### **Observation** Determining substantial doubt involves judgment

Even with the inclusion of a likelihood-based threshold, determining whether substantial doubt exists involves significant judgment. Management needs to consider both qualitative and quantitative information about relevant conditions and events in the aggregate to determine whether substantial doubt is initially raised (see [chapter 3](#)) and whether it is alleviated by management's plans (see [chapter 4](#)). Management's judgment may be affected by the size and complexity of the entity, the nature and condition of its business and the degree to which it is impacted by external factors.

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# 3. Step 1: Assess whether substantial doubt is raised

## Detailed contents

**New item added in this edition: \*\***

**Item significantly updated in this edition: #**

### How the standard works

#### 3.1 Overview

##### Questions

**Question 3.1.10** What are 'known' and 'reasonably knowable' conditions and events?

**Question 3.1.20** When are management's plans relevant in Step 1?

**Question 3.1.30** Does management's intent to wind down operations within one year raise substantial doubt?

##### Examples

**Example 3.1.10** Fully implemented vs approved plans

**Example 3.1.20** Management's plan vs action in normal course for retail industry

**Example 3.1.30** Management's plan vs action in normal course for real estate industry\*\*

#### 3.2 Assess the entity's current financial condition

##### Questions

**Question 3.2.10** Is the ability to draw on an existing line of credit considered available access to credit?

**Question 3.2.20** How does management assess whether a line of credit is fully committed?

**Question 3.2.30** How does management assess a line of credit that is conditional?#

**Question 3.2.40** How does management assess the indirect effect of drawing on a line of credit on liquidity?

**Question 3.2.50** How does management consider the effect of parental support in its going concern assessment?

##### Example

**Example 3.2.10** Consideration of the ability to draw on an existing line of credit in assessing whether substantial doubt is raised

### 3.3 Assess the entity's obligations

#### Questions

**Question 3.3.10** How does management assess the entity's obligations?

**Question 3.3.20** Does a forecasted debt covenant violation indicate a condition or event that may raise substantial doubt?

**Question 3.3.30** How does management assess instruments with a cash settlement option?/

**Question 3.3.40** How does management consider contingent and other uncertain liabilities in the going concern assessment? \*\*

**Question 3.3.50** How does management assess nonrecourse loans coming due within the look-forward period? \*\*

#### Example

**Example 3.3.10** Nonrecourse loan coming due within the look-forward period \*\*

### 3.4 Assess the funds necessary to maintain the entity's operations (liquidity needs)

#### Question

**Question 3.4.10** How does management assess the entity's liquidity needs?

### 3.5 Assess other adverse conditions and events

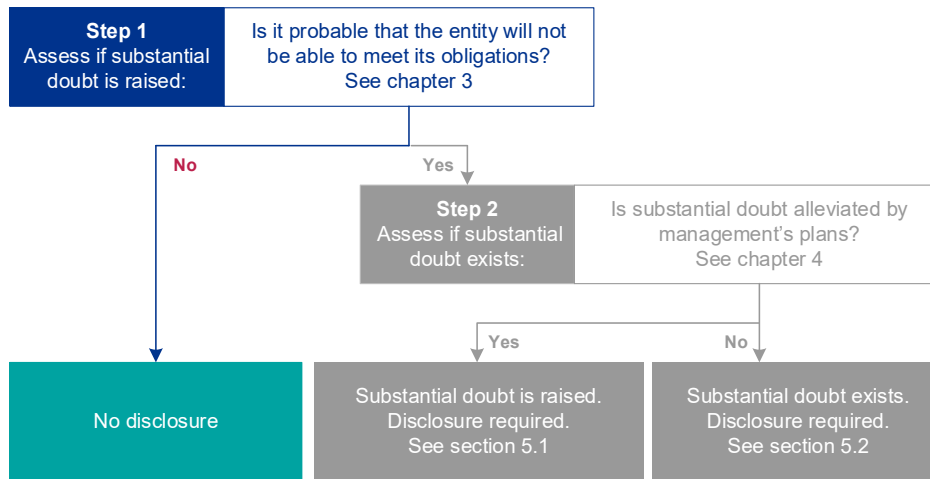
#### Questions

**Question 3.5.10** What are examples of other adverse conditions and events?

**Question 3.5.20** Are global events an adverse condition or event by themselves?

## 3. Step 1: Assess whether substantial doubt is raised

## How the standard works



The first step of the two-step going concern assessment is to determine if it is probable the entity will not be able to meet its obligations during the look-forward period – i.e. determine whether substantial doubt about its ability to continue as a going concern is raised. The step involves assessing what the entity:

- *has* – i.e. its current financial condition and access to liquidity;
- *owes* – i.e. its obligations coming due; and
- *needs* – i.e. how much it needs to fund its operations.

Conditions and events that are known and reasonably knowable at the assessment date must be considered in the analysis.

If substantial doubt has been raised at the assessment date, specific disclosures are required; see [chapter 5](#).

## 3.1 Overview

### Excerpt from ASC 205-40

#### > Evaluating Conditions and Events That May Raise Substantial Doubt

**50-1** In connection with preparing financial statements for each annual and interim reporting period, an entity's management shall 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).

**50-2** Ordinarily, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern relate to the entity's ability to meet its obligations as they become due. Accordingly, management's evaluation of an entity's ability to continue as a going concern ordinarily is based on conditions and events that are relevant to an entity's ability to meet its obligations as they become due within one year after the date that the financial statements are issued.

**50-3** Management's evaluation shall be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued.

**50-4** Management shall 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. The evaluation initially shall 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 an asset that have been approved but that have not been fully implemented as of the date that the financial statements are issued).

**50-5** When evaluating an entity's ability to meet its obligations, management shall consider quantitative and qualitative information about the following conditions and events, among other relevant conditions and events known and reasonably knowable at the date that the financial statements are issued:

- a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)
- 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 within one year after the date that the financial statements are issued

## 3. Step 1: Assess whether substantial doubt is raised

- d. The other conditions and events, when considered in conjunction with (a), (b), and (c) above, that may adversely affect the entity's ability to meet its obligations within one year after the date that the financial statements are issued. See paragraph 205-40-55-2 for examples of those conditions and events.

> Implementation Guidance

• > Examples of Adverse Conditions and Events

**55-2** The following are examples of adverse conditions and events that may raise **substantial doubt about an entity's ability to continue as a going concern**. The examples are not all-inclusive. The existence of one or more of these conditions or events does not determine that there is substantial doubt about an entity's ability to continue as a going concern. Similarly, the absence of those conditions or events does not determine that there is no substantial doubt about an entity's ability to continue as a going concern. Determining whether there is substantial doubt depends on an assessment of relevant conditions and events, in the aggregate, that are known and reasonably knowable at the date that the **financial statements are issued** (or at the date the **financial statements are available to be issued** when applicable). An entity should weigh the likelihood and magnitude of the potential effects of the relevant conditions and events, and consider their anticipated timing.

- 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.

Step 1 of the going concern assessment requires management to 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. Substantial doubt is raised if conditions and events indicate it is *probable* (see [Question 2.3.50](#)) that the entity will be unable to meet its obligations as they become due during the *look-forward period* (see [Question 2.3.20](#)). [205-40-50-1 – 50-2]

Management's assessment is based on relevant conditions and events that are *known* and *reasonably knowable* (see [Question 3.1.10](#)) at the *assessment date* (see [Question 2.3.20](#)). Management should consider quantitative and qualitative information about the entity's current financial condition, conditional and unconditional obligations due or anticipated in the look-forward period, and



funds necessary to maintain operations during the look-forward period. Stated simply, management should consider what the entity *has*, *owes* and *needs*. [205-40-50-3, 50-5]

This chapter is structured along these lines, as follows.

<b>Assess the entity's current financial condition</b>	See <a href="#">section 3.2</a>
<b>Assess the entity's obligations</b>	See <a href="#">section 3.3</a>
<b>Assess the funds necessary to maintain the entity's operations (liquidity needs)</b>	See <a href="#">section 3.4</a>
<b>Assess other adverse conditions and events</b>	See <a href="#">section 3.5</a> and <a href="#">Appendix B</a>

When assessing the items above in Step 1, management can consider the mitigating effects of its plans only if the plans are fully implemented (see [Question 3.1.20](#)) at the assessment date. [205-40-50-4]

### Question 3.1.10 What are 'known' and 'reasonably knowable' conditions and events?

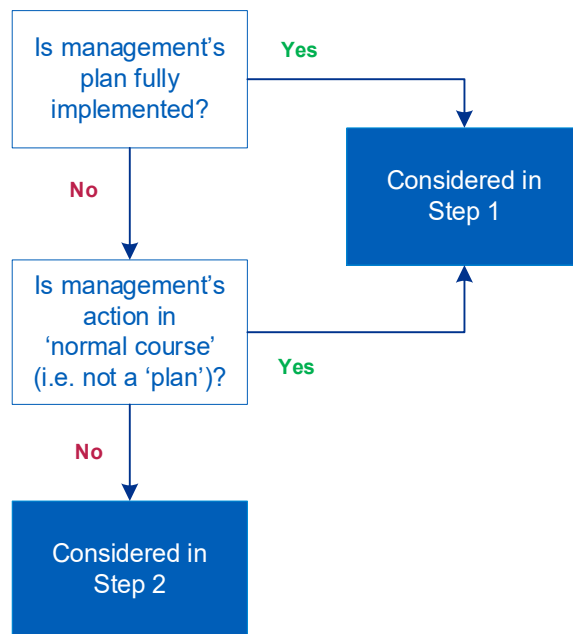
**Interpretive response:** Management's assessment is based on relevant conditions and events that are known and reasonably knowable at the assessment date. [205-40-50-3]

The term *known* is used in other Topics such as Topic 275 (risks and uncertainties). The term *reasonably knowable* was included in Subtopic 205-40 to emphasize that management should make a reasonable effort to identify conditions and events without undue cost and effort. For example, a sharp and significant decline in broader economic conditions after the assessment date may be a condition that was not reasonably knowable at the assessment date. In contrast, an entity's estimated operating losses for the upcoming look-forward period is a condition that likely is reasonably knowable at the assessment date. [ASU 2014-15.BC26]

This means that subsequent events (see [Question 2.3.20](#)) are considered in the going concern assessment. An adverse event or condition that occurs after the balance sheet date may raise substantial doubt – e.g. unfavorable settlement or ruling on litigation, debt covenant violation, or loss of a significant customer contract. Similarly, an adverse event or condition that after the balance sheet date becomes expected to occur during the look-forward period may also raise substantial doubt – see [Question 3.3.20](#) for forecasted debt covenant violation. [ASU 2014-15.BC24]

### Question 3.1.20 When are management's plans relevant in Step 1?

**Interpretive response:** Management's plans are considered in the going concern assessment as follows.



### ***Fully implemented vs approved***

When assessing whether substantial doubt is raised about the entity's ability to continue as a going concern, management can consider the mitigating effects of its plans only if those plans are fully implemented at the assessment date. *Implemented* is a higher hurdle than *approved*. The mitigating effects of approved but unimplemented plans are considered in Step 2 (see [chapter 4](#)) but are not relevant in Step 1. See [Example 3.1.10](#). [205-40-50-4, 50-8]

### ***Plan vs action in normal course***

Subtopic 205-40 does not define what a plan is or otherwise require plans to be differentiated from actions management would ordinarily take in normal course. [ASU 2014-15.BC31]

However, we believe making that distinction may help with the assessment. This is because plans are subject to further analysis – i.e. must be fully implemented at the assessment date for their mitigating effect to be considered in Step 1. In contrast, the effect of future actions in normal course is considered in Step 1.

We believe that 'management's plans' is intended to be a fairly broad concept and includes all strategies that are primarily intended to alleviate the specific conditions or events that could jeopardize an entity's ability to meet its obligations.

Differentiating plans from actions in normal course may require significant judgment, detailed analysis of the entity's cost structure (see [Example 3.1.20](#)) and consideration of management's past practices in making decisions. With respect to an entity's cost structure, management may decide to alter business activities in response to changing circumstances. For example, management may be able to readily take actions to reduce variable costs (e.g. reducing marketing expenses, eliminating discretionary employee bonuses). This may indicate that the related actions occur in the normal course of business.

Conversely, reducing fixed costs (e.g. ceasing construction on a new production facility, cancelling a long-term fixed-fee service contract) may require an established plan and executive-level approvals. We believe plans that alter fixed costs typically do not occur in the normal course of business.

When it is unclear if management's actions are taken in the normal course of business, we believe they should be considered plans, and their mitigating effect considered in Step 1 only if they are fully implemented at the assessment date.

### Question 3.1.30 Does management's intent to wind down operations within one year raise substantial doubt?

**Interpretive response:** Not necessarily. However, such situations require careful analysis of all relevant facts and circumstances.

When planning to wind down operations, management first assesses whether the liquidation basis of accounting must be applied. This is the case when liquidation is imminent unless the liquidation follows the plan specified in the entity's governing documents at the entity's inception (see [Question 2.1.10](#)). If liquidation is not imminent or if liquidation follows the plan specified at inception, the going concern basis of accounting continues to apply. [\[205-30-25-1\]](#)

Next, under the going concern basis of accounting, management assesses whether substantial doubt is raised – i.e. it is probable the entity will be unable to meet its obligations as they become due during the look-forward period (see [Question 2.3.10](#)).

- If the entity expects to have sufficient liquidity to meet its obligations (see [section 3.3](#)), substantial doubt about its ability to continue as a going concern may not be raised even though it plans to wind down operations during the look-forward period.
- If substantial doubt is raised, a plan to liquidate cannot be considered in Step 2 as a mitigating factor to alleviate substantial doubt (see [Question 4.1.10](#)).

Regardless of whether substantial doubt is raised, we believe the wind down procedures and their expected effects should be clearly disclosed.

### Example 3.1.10 Fully implemented vs approved plans

ABC Corp. has a repayment of all outstanding principal – i.e. a balloon payment – for a term loan coming due in September, Year 2 that, absent a refinancing, it will be unable to extinguish. There are no other conditions and events that raise substantial doubt. ABC issues its financial statements for the year ended December 31, Year 1 on March 31, Year 2 (the assessment date).

#### **Scenario 1: Fully implemented plan**

Before the assessment date, ABC obtains a binding commitment from its lender that the debt maturity date is extended to December 31, Year 4.

## 3. Step 1: Assess whether substantial doubt is raised

Because management obtains a binding commitment from its lender before the assessment date, it concludes that substantial doubt is not raised as a result of its fully implemented plan. Therefore, no disclosure is necessary other than the subsequent event disclosure under Topic 855.

**Scenario 2: Approved but not yet implemented plan**

Before the assessment date, ABC receives approval from its Board's Finance Committee to pursue a refinancing and begins negotiations with a third-party lender.

At the assessment date, management has only an expectation that the debt will be refinanced in the future, meaning the plan has not been fully implemented on that date. Therefore, ABC's management concludes that substantial doubt is raised under Step 1 and then evaluates in Step 2 whether the refinancing plan alleviates the substantial doubt (see [Example 4.2.10](#)). Disclosure is required because substantial doubt is raised (see [chapter 5](#)).

### Example 3.1.20 Management's plan vs action in normal course for retail industry

ABC Corp. is a retailer with seasonal demand fluctuations. Management routinely addresses seasonality through temporary hiring and termination of sales clerks, with swings of up to 20% of ABC's workforce.

Because of an economic downturn, ABC's in-store sales have significantly decreased and certain stores are loss-making. Management has concluded that this situation may raise substantial doubt about ABC's ability to continue as a going concern if considered on its own.

ABC is planning to reduce its workforce as further explained in each of the following scenarios. When assessing in Step 1 whether substantial doubt is raised, ABC needs to evaluate whether the effect of the economic downturn and decrease in sales should be considered in the aggregate with the cost savings expected from the workforce reduction.

**Scenario 1: Action in normal course**

At the assessment date, ABC is planning to reduce its workforce to seasonal low ranges by freezing hiring of temporary sales clerks, which is expected to have a significant cost saving impact in the short term. The decision has not yet been announced or executed; it can be executed through regular human resources protocols.

ABC concludes that the workforce reduction is an action in normal course, as it is at a normal level and is customary for its ongoing business activities. Therefore, the mitigating effect of the action, i.e. the cost savings, is considered as part of Step 1.

**Scenario 2: Management's plan**

At the assessment date, ABC is planning to permanently close half of its stores and sever all corresponding employees, including store back office clerks and

## 3. Step 1: Assess whether substantial doubt is raised

managers, representing half of its workforce. The decision has been internally approved and announced, but has not yet been executed – i.e. the plan is not fully implemented.

ABC's plans will reduce the workforce below normal seasonal ranges and beyond typical seasonal positions. Further, the workforce reduction is triggered by the permanent store closures instead of temporary cost-cutting measures. Therefore, ABC concludes that the workforce reduction is a plan by management, not an action in normal course. Because the plan is not fully implemented at the assessment date, the mitigation effect of the plan, i.e. the costs savings, is only considered as part of Step 2.

Disclosure is required because substantial doubt is raised (see [chapter 5](#)).

### Example 3.1.30 Management's plan vs action in normal course for real estate industry\*\*

ABC Corp. is a real estate entity that enters into loan agreements with lenders to provide financing. At the assessment date, ABC has a loan maturing during the look-forward period and management's cash flow projections are forecasting that ABC will have insufficient liquidity to repay the loan at the maturity date absent additional measures.

#### **Scenario 1: Action in normal course**

ABC owns a portfolio of 20,000 single-family rental homes. As part of its ongoing business model, ABC consistently disposes of homes, with a demonstrable history of disposing of approximately 200 properties each quarter. These sales are executed through established channels, and there is sustained market demand for single-family homes.

At the assessment date, ABC plans to use proceeds from sales of 650 single-family rental homes to repay the maturing loan. It concludes that the asset sales are an action in the normal course because the plans align with its business model and historical operating practices. Further, ABC has demonstrated its ability to execute such sales. Therefore, the mitigating effect of the action, i.e. asset sales, is considered as part of Step 1.

#### **Scenario 2: Management's plan**

ABC owns three commercial retail properties. At the assessment date, it plans to sell the property that serves as collateral for the maturing loan and use the proceeds to repay the maturing loan. ABC has not sold any properties in recent years and has historically held real estate assets for long-term investment purposes.

Because ABC does not have an established history of asset sales and has not yet executed a purchase and sale agreement with a buyer, it concludes that the asset sale is a plan by management, not an action in the normal course. Because the plan is not fully implemented as of the assessment date, the

mitigating effect of the plan, i.e. the asset sale, is only considered as part of Step 2.

Disclosure is required because substantial doubt is raised (see [chapter 5](#)).

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## 3.2 Assess the entity's current financial condition

In Step 1, when assessing relevant conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern, management considers the entity's current financial condition at the assessment date. Liquid funds and the entity's available access to credit can be important factors in this assessment. [\[205-40-50-5\(a\)\]](#)

### **Question 3.2.10** Is the ability to draw on an existing line of credit considered available access to credit?

**Interpretive response:** It depends. Access to an existing fully committed and unconditional line of credit does not require action on the part of management other than requesting a draw against the available access. Therefore, it is considered a liquidity source when assessing the entity's current financial condition in Step 1. [\[205-40-50-5\(a\)\]](#)

Assuming there are no other indicators of adverse conditions or events, if the available line of credit covers the entity's liquidity needs over the look-forward period, substantial doubt about the entity's ability to continue as a going concern would likely not be raised. Therefore, in such an instance no disclosure would be necessary.

#### ***Limitations on access to credit***

A line of credit is not considered 'available' at the assessment date if it is still under negotiation or not fully committed (see [Question 3.2.20](#)). If a line of credit is committed but subject to meeting certain conditions in the future (e.g. available collateral, absence of a material adverse change or event, required compliance with financial covenants such as a leverage), management must assess whether the conditions may limit the line of credit's availability (see [Question 3.2.30](#)).

If a line of credit is not available, the additional liquidity cannot be considered in Step 1 to assess whether substantial doubt is raised. If substantial doubt is raised, the potential mitigating effects of actions management may take to draw on the line of credit are considered in Step 2. Under Step 2, if feasibility and success of the plan are probable, then substantial doubt can be alleviated (see [Question 4.2.30](#) about the probability of success for plans that are beyond management's control). Nevertheless, if substantial doubt is raised under Step 1, disclosures are required (see [section 5.1](#)). [\[205-40-50-4, 50-7\]](#)

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### Question 3.2.20 How does management assess whether a line of credit is fully committed?

**Interpretive response:** A committed line of credit is a legally binding and documented commitment between a lender and borrower that allows the borrower, at the borrower's sole discretion, to draw funds for a specified period of time (i.e. the term of the line of credit).

In contrast, an uncommitted line of credit provides the lender with the option to deny a funding request from the borrower. It also typically permits the lender to declare any outstanding borrowings under the line of credit to be due on demand, regardless of whether material adverse change or other default events have occurred.

We believe that a binding commitment from the lender to lend, in sufficient amounts and at appropriate times, is necessary to support management's assertion that the line of credit is fully committed. A borrower should consult with its legal counsel when there is uncertainty as to the nature of the underlying credit agreement.

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### Question 3.2.30 How does management assess a line of credit that is conditional?#

**Interpretive response:** We believe management should review relevant terms and conditions that may limit a line of credit's availability. The importance of this assessment increases as the entity's need to draw on existing lines of credit during the look-forward period increases.

For example, if the line of credit is an asset-backed lending arrangement collateralized by accounts receivable or inventories, the forecasted timing and balances of the relevant collateral during the look-forward period should be considered. The entity's ability to draw on existing lines of credit may depend on amounts of eligible accounts receivable or inventories that meet specific aging, concentration or quality criteria, which may be negatively affected or deferred by reduced sales forecasts.

Other conditions such as material adverse change or event clauses may also limit the line of credit's availability. Such clauses, if triggered, may give the lender the right to demand accelerated repayment, impose draw-stops (e.g. limit further borrowings) or change interest rates and terms. Material adverse change or event clauses are typically negotiated on an agreement-by-agreement basis and their labelling may vary across agreements.

Further, as discussed in [Question 3.3.20](#), management should assess whether the entity is and will remain in compliance with relevant debt covenants, including those in other debt agreements, when considering the ability to draw on the line of credit during the look-forward period.

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### Question 3.2.40 How does management assess the indirect effect of drawing on a line of credit on liquidity?

**Interpretive response:** While the direct effect of drawing on a line of credit (i.e. increased borrowings) is apparent, we believe management should also consider indirect effects.

#### ***Indirect effects on the line of credit***

Effects may include impacts to debt covenants or increased interest or other costs on the line of credit itself.

Management should consider whether the line of credit agreement includes any 'bring-down' representation requirements. These requirements may include representations made by management to the lender regarding material adverse effect or change clauses, as defined in the line of credit agreement.

#### ***Indirect effects on other financing arrangements***

Draws on a line of credit may impact other financing arrangements and other debt covenants, all of which should be evaluated for potential impact on liquidity throughout the look-forward period.

Further, while infrequent, management should consider whether any financing arrangements include features such as warrants or 'equity kickers', or requirements for 'excess cash' to be used to pay down obligations (whether at any time or under event of default). These requirements may impact the ability to draw on the line of credit.

### Example 3.2.10 Consideration of the ability to draw on an existing line of credit in assessing whether substantial doubt is raised

ABC Corp's management is assessing whether there are conditions and events that raise substantial doubt about ABC's ability to continue as a going concern in the look-forward period. In its assessment, management identifies the following.

- ABC had \$1,000 in cash at the end of the fiscal year (and the same at the financial statement issuance date).
- Cash flow needs in excess of operating cash generated during the look-forward period are estimated to be \$3,000.
- ABC has a committed line of credit at year-end of \$10,000, fully undrawn. For simplicity, assume there are no restrictions or other requirements that ABC must satisfy prior to drawing down on the line, the line matures in three years, there are no indicators the lender will be unable to perform, and the interest rate on the line is 10%.
- There is limited ability to reduce discretionary spend without impacting revenues and operating profitability.



- There are no other indicators of adverse conditions and events as described in paragraph 205-40-55-2.

ABC's operating cash flow shortfall in the look-forward period is a condition that could raise substantial doubt about ABC's ability to continue as a going concern. However, this condition should be assessed in the aggregate with ABC's intent and ability to draw down on its existing line of credit throughout the year as needed to fund operating cash flow requirements. Specifically, management considers the ability to draw down \$3,000 from the line of credit to fund cash flow needs and the impact of the incremental interest costs ( $\$3,000 \times 10\%$ , or \$300) during the look-forward period.

Based on these facts, management concludes that the operating cash flow shortfall in the look-forward period is adequately covered by the existing access to credit. Therefore, substantial doubt is not raised, and disclosures are not required.

### Question 3.2.50 How does management consider the effect of parental support in its going concern assessment?

**Interpretive response:** We believe parental support should be considered as a source of available financing when assessing the entity's current financial condition in Step 1, if the parent:

- executes a commitment letter to the entity; and
- has the financial ability to provide support in the amount and timing needed under the circumstances.

When met, these conditions demonstrate that the parent is willing and able to cover the obligations of the entity, in which case substantial doubt is not raised (absent other adverse conditions or events).

Though parental support is most relevant in Step 1 of management's going concern assessment, we believe it is also acceptable to consider the effect of parental support only in Step 2, similar to a plan of management. In this case, substantial doubt would be raised, but assuming the parent is willing and able to cover the obligations of the entity, substantial doubt would be alleviated.

Regardless of the approach selected, we believe management should disclose the entity's reliance on parental support to meet its obligations. This is required under Subtopic 205-40 if the support is only considered in Step 2 (see [section 5.1](#)), or under Topic 275 if the support is considered in Step 1 to help users assess major risks and uncertainties. [\[205-40-50-12\(c\), 275-10-10-1\]](#)

## 3.3 Assess the entity's obligations

In Step 1, when assessing relevant conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern, management considers the entity's conditional and unconditional obligations due or anticipated during the look-forward period. [\[205-40-50-5\(b\)\]](#)

### Question 3.3.10 How does management assess the entity's obligations?

**Interpretive response:** We believe that management should carefully review the entity's contractual arrangements and other commitments to identify conditional and unconditional obligations and understand when these obligations become due.

#### ***Identify conditional and unconditional obligations***

Example contractual obligations may include:

- financing contracts with commitments such as debt maturities and related interest costs;
- lease payments;
- required capital expenditures;
- unconditional purchase obligations; and
- pension funding requirements.

Obligations may also arise from noncontractual sources, such as:

- declared dividend payments;
- income or payroll tax payments;
- environmental remediation obligations; and
- settlement of litigation.

The analysis includes not only obligations that exist at the assessment date but also those that will arise during the look-forward period. Obligations may be relevant to the assessment even though they are not recognized as liabilities at the balance sheet date.

#### ***Understand when identified obligations become due***

After identifying obligations, management should then understand when the obligations become due. The going concern assessment is performed at the assessment date instead of the balance sheet date. As such, a cursory review of the balance sheet current liabilities may not be sufficient to understand the entity's obligations coming due during the look-forward period. For example, a financial liability due 13 months from the balance sheet date may be classified as noncurrent at that date; however, if the assessment date is more than a month after the balance sheet date, this liability would become due during the look-forward period. Conversely, a trade payable classified as current at the balance sheet date may be repaid before the assessment date and may be irrelevant at the assessment date.

Careful analysis should be given to contractual acceleration clauses, which may require repayment of debt earlier than anticipated – e.g. if a debtor fails to maintain satisfactory operations, if covenant requirements are violated, if a material adverse change or event occurs. Generally, material adverse change or event clauses within loan agreements include subjective language, and management should discuss such language with its lender(s) and legal counsel to confirm the applicability of such clauses to the entity's particular circumstances at the assessment date.

When analyzing contractual acceleration clauses, management should evaluate all debt covenants and the potential for violation (see [Question 3.3.20](#)) and retain sufficient evidence to support the calculations and projections used in the evaluation, as applicable.

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### **Question 3.3.20** Does a forecasted debt covenant violation indicate a condition or event that may raise substantial doubt?

**Interpretive response:** Yes. A forecasted covenant violation and related maturity acceleration can be a condition or event that raises substantial doubt about the entity's ability to continue as a going concern if the entity does not have sufficient liquidity to satisfy the forecasted acceleration of debt maturities. In this instance, management needs to also consider additional cross-default violations from other obligations. Management should be mindful that a forecasted covenant violation can occur within or across interim periods, not just at year-end. See [Question 6.1.10](#) for discussion of the potential impact of debt covenant violations on debt classification.

See [Question 4.2.40](#) for consideration of management's plan to negotiate a covenant waiver in Step 2 of the going concern assessment.

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### **Question 3.3.30** How does management assess instruments with a cash settlement option?

**Background:** Instruments, such as share-based payment awards, warrants or preferred shares often include a cash settlement feature whereby the instrument may be settled in cash or any combination of shares and cash. The settlement option may be controlled by the holder or the issuer (the entity).

Depending on their characteristics, the entity accounts for these instruments as either financial instruments (e.g. Topic 815, Topic 480) or share-based payments (Topic 718). Each has separate requirements relative to balance sheet classification. For example, financial instruments with a cash settlement option controlled by the holder are classified as liabilities or temporary ('mezzanine') equity.

Share-based payment awards, however, are classified as liabilities or equity based on several factors, such as:

- which party controls the settlement option;
- whether the holder is exposed to the risks and rewards of the shares for a reasonable period of time; and
- the entity's past settlement practice.

For example, an award puttable to the entity by its employee for cash in six months and a day from grant date, might be classified as equity if all other conditions for equity classification are met. Conversely, an award that has a settlement option controlled by the entity may still be liability-classified if the entity has a past practice of settling similar awards in cash.

**Interpretive response:** We believe the analysis should focus on who controls the cash settlement option during the look-forward period, irrespective of balance sheet classification.

***Cash settlement is controlled by the entity***

When the entity has the discretion and the ability to settle in shares instead of cash, we believe the entity will select the settlement alternative (cash or shares) by considering its overall liquidity position and should therefore be able to meet its obligation under the instrument. Therefore, we believe the cash settlement option can be ignored in the going concern assessment.

Assessing whether the entity has the ability to settle in shares may require judgment considering available outstanding shares and required shareholders' approval.

***Settlement is controlled by the holder***

When the entity does not control the method of settlement, it may be obligated to settle in cash. If the holder can demand settlement during the look-forward period, we believe the settlement amount should be included in the entity's obligations to determine whether substantial doubt is raised.

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**Question 3.3.40** How does management consider contingent and other uncertain liabilities in the going concern assessment? \*\*

**Interpretive response:** Many contingencies involve significant judgment in determining timing and outcome. When a contingent liability, including pending litigation, meets the recognition threshold under Topic 450 (i.e. it is both probable and reasonably estimable), we believe management should assess the timing of the expected outflow and evaluate whether the liability is expected to result in an obligation that will be settled during the look-forward period. If so, the related cash outflow is included in Step 1 of the going concern assessment as an amount the entity owes.

Even if a contingency does not meet the recognition threshold (i.e. it is not probable or not reasonably estimable), it may still warrant consideration in the aggregate with other known and reasonably knowable conditions and events. We believe management should assess the likelihood and magnitude of all potential cash outflows associated with the contingency and determine whether those outflows could adversely affect the entity's ability to meet its obligations during the look-forward period.

When evaluating legal contingencies, whether recognized under Topic 450 or not, management should consider whether adverse rulings, settlements or regulatory actions are expected to occur within the look-forward period and whether such outcomes could affect liquidity.

In contrast to contingent liabilities, contractual liabilities under Topic 405 are generally included in management's projection of cash outflows, until the entity is legally released from being the primary obligor under the liability, either

judicially or by the creditor, because the existence of a contractual obligation implies a legal obligation to settle.

In addition to the required disclosures under Subtopic 205-40, disclosure under Topic 275 (risks and uncertainties) or Topic 450 (contingencies) may be required if the contingency could significantly affect the amounts reported in the financial statements in the near term, even if the liability is not recognized.

### Question 3.3.50 How does management assess nonrecourse loans coming due within the look-forward period? \*\*

**Interpretive response:** In general, substantial doubt about an entity's ability to continue as a going concern is raised when an entity lacks sufficient liquidity or committed financing to repay or refinance the maturing loan.

However, in our view, it may be possible for management to conclude that substantial doubt is not raised if the maturing loan is nonrecourse and secured by an insignificant portion of the entity's total assets, and the entity can satisfy its obligation by transferring the collateral (e.g. office building) to the lender through foreclosure or deed in lieu of foreclosure. In such limited cases, the entity may be able to settle the liability without jeopardizing its ability to meet its obligations during the look-forward period.

This evaluation requires significant judgment and management should perform a detailed evaluation and carefully consider and document the following.

- **Understand relevant terms and conditions:** Management should assess the terms of all relevant debt agreements, including specifically the lender's rights in the event of default. Management should not speculate as to which action a lender might take in the event of default and should involve appropriate specialists such as internal and external legal counsel to assist in interpreting the rights of each party as stated in the debt agreement. Because the lender may contractually be entitled to multiple remedies in the event of default, management should consider the effect of all the actions contractually available to the lender inclusive of whether any guarantees exist and whether the event of default would trigger any cross-default or cross-collateralization terms and conditions for this loan and other debt agreements that exist.
- **Evaluate effects of the asset's transfer on the entity's liquidity:** Management should prepare its cash flow projections, considering the effects of the asset's transfer. Such effects may include loss of revenues, reduction in total asset values and modifications in operational capacity.
- **Evaluate effects on debt covenants:** Management must determine if the entity, after considering the asset's transfer, is in compliance with all debt covenants and evaluate whether any other covenant violations are forecasted during the look-forward period (see [Question 3.3.20](#)).

Subtopic 205-40 does not require disclosure if substantial doubt is not raised. However, Topic 275 requires disclosure of risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near

term or the near-term functioning of the reporting entity. In our view, when an entity intends to satisfy its obligation by transferring collateral to the lender, management should disclose such plans. See chapter 7 of KPMG Handbook, [Financial statement presentation](#). [275-10-05-02]

### Example 3.3.10 Nonrecourse loan coming due within the look-forward period\*\*

#### Background

ABC Corp. owns 12 office buildings and routinely enters into loan agreements with lenders to provide financing. At the going concern assessment date, ABC has a loan maturing during the look-forward period and management's cash flow projections forecast that ABC will have insufficient liquidity to repay the loan at the maturity date. The loan is collateralized by one of the office buildings that represents approximately 8% of ABC's total assets. The loan agreement permits ABC to settle the liability by transferring the building to the lender with no further recourse to ABC.

#### Evaluation

In evaluating its ability to satisfy the obligation, management considers whether the liability can be settled by transferring the collateral to the lender through a deed in lieu of foreclosure. Management considers the following facts:

- The collateral represents less than 10% of ABC's total assets.
- The loan agreement permits ABC to settle the liability by transferring the building to the lender, with no further recourse.
- The transfer does not trigger any cross-default or cross-collateralization provisions in this or other lending arrangements.
- Excluding the effect of the lost building, the remaining 11 buildings generate sufficient rental revenue to meet ABC's remaining liquidity needs during the look-forward period.
- Following the transfer, ABC projects to remain in compliance with all debt covenants.

Based on these facts, management concludes that the loan maturing within the look-forward period can be adequately settled through the planned transfer of collateral to the lender. Therefore, substantial doubt is not raised. ABC discloses the planned transfer of collateral to the lender and its potential effect on operations in the notes to the financial statements.

## 3.4 Assess the funds necessary to maintain the entity's operations (liquidity needs)

In Step 1, when assessing relevant conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern,

management considers the funds necessary to maintain the entity's operations considering its current financial condition (see [section 3.2](#)), obligations (see [section 3.3](#)), and other expected cash flows during the look-forward period. [205-40-50-5(c)]

### Question 3.4.10 How does management assess the entity's liquidity needs?

**Interpretive response:** Generally, management will need to prepare cash flow forecasts that cover the look-forward period to evaluate liquidity needs. A best practice is to develop a forecasted statement of cash flows. While less granular, EBITDA forecasts may sometimes serve as a proxy for operating cash flows, combined with forecasted investing and financing cash flows, in developing an overall cash flow forecast.

We believe the timing of projected cash flow sources and uses is critical to the cash flow forecast and may require significant judgment. Management should carefully consider the need to develop cash flow forecasts across multiple periods (monthly, quarterly, etc.) to understand the liquidity needs and working capital balances at various points throughout the look-forward period. For example, if an entity has a covenant requirement with a 15-day average liquidity threshold, depending on the risk and implications of breaching that covenant, management may need to prepare cash flow forecasts at a level of granularity sufficient to manage the risk of breaching the covenant. Further, where debt covenants are at risk of violation, management should carefully consider the relevant compliance dates for each covenant, including whether those dates differ from the entity's normal internal or external reporting periods (see [Question 3.3.20](#)).

Management will need to design and implement proper controls over the preparation of the forecast as well as the completeness and accuracy of the information and reasonableness of the assumptions used in the forecast. See [section 6.2](#) for internal control considerations of the going concern assessment.

When using projected financial information to assess the entity's liquidity needs, management should consider the relationship between the going concern assessment and related information from other analyses that require forecasts of future operations (see [Question 6.1.10](#)). For example, assumptions used in the going concern assessment generally should be consistent with:

- assumptions in the analysis of the need for a valuation allowance against deferred tax assets;
- the analysis of the potential impairment of long-lived assets or goodwill; and
- other relevant statements by management, such as statements included in Management's Discussion and Analysis for public companies.

As discussed in [Question 3.1.20](#), management can only consider plans and related liquidity impacts that have been fully implemented as of the assessment date when forecasting future cash flows for the Step 1 evaluation.

Management often needs to perform additional forecasting in Step 2 to assess the mitigating effects of its plans (see [Question 4.3.10](#)).



Overall, the depth and complexity of cash flow forecasts may depend on the entity's size and liquidity needs, and the risks surrounding the ability of the entity to meet its obligations.

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## 3.5 Assess other adverse conditions and events

In Step 1, when assessing relevant conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern, management considers the other conditions and events (in conjunction with the items discussed in [sections 3.2, 3.3 and 3.4](#)), that may adversely affect the entity's ability to meet obligations that are due during the look-forward period. [\[205-40-50-5\(d\)\]](#)

### Question 3.5.10 What are examples of other adverse conditions and events?

**Interpretive response:** Prior sections in this chapter address how the following items affect the substantial doubt analysis:

- the entity's current financial position ([section 3.2](#));
- obligations due by the end of the look-forward period ([section 3.3](#)); and
- funds necessary to maintain the entity's operations ([section 3.4](#)).

Other internal and external matters that are known or reasonably knowable (see [Question 3.1.10](#)) at the assessment date may also initially raise substantial doubt about an entity's ability to continue as a going concern when considered with the above items. Examples of such matters include the following.

- Illiquid credit markets that may adversely affect an entity's ability to refinance or renew existing credit lines consistent with previous periods and with management's current plans, including the affordability of those necessary financings.
- Insufficient unpledged assets to meet margin requirements of asset-backed lenders (which may result in the need to sell assets under adverse market conditions or allow lenders to terminate lending agreements entirely).
- A credit rating downgrade coupled with a material adverse change clause in the entity's principal debt arrangement (such a clause typically provides the lender the option to declare an event of default if and when it believes a material adverse change has occurred).
- Refusal by a long-time significant vendor to deliver additional goods, or the vendor's insistence that it will deliver goods only on a cash-on-delivery basis.
- Inability to meet obligations as they came due during the year, causing increased reliance on support from investors and deferral of payments to trade creditors beyond stipulated payment terms.

See [Appendix B](#) for additional examples of conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern.

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### Question 3.5.20 Are global events an adverse condition or event by themselves?

**Interpretive response:** No. We believe global events such as pandemics, war, general economic downturns and financial crises are typically not adverse events by themselves. However, these events do often translate into adverse conditions or events.

Adverse conditions or events are specific to each entity and not all entities may be impacted the same way by such global events. For example, as a result of COVID-19, certain industries saw a dramatic decrease in revenues and cash flows (e.g. airlines, retail, restaurants). Conversely, some industries saw benefits from stay-at-home orders (e.g. couriers, delivery services, online grocers, certain technology companies). Similarly, the Russia-Ukraine war and subsequent international economic sanctions imposed on Russia may affect entities differently depending on, for example, their footprint in affected geographies and exposure to increased commodity prices and supply chain disruptions.

However, global events that are large in scale and depth are more likely to significantly disrupt the global economy and trigger several of the adverse conditions or events listed in [Appendix B](#). The prolonged effects of these events may need to be monitored over several reporting periods. All adverse conditions or events identified as a result of global events need to be assessed in the aggregate to determine if substantial doubt is raised.

# 4. Step 2: Assess whether substantial doubt exists

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##### Examples

**Example 4.2.10** Management plans to execute refinancing

**Example 4.2.20** Management plans to raise capital

## 4. Step 2: Assess whether substantial doubt exists

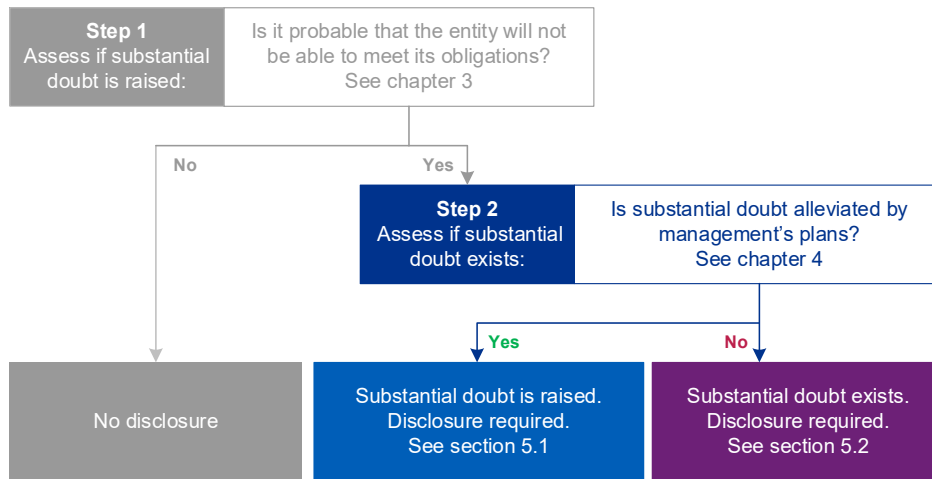
**4.3 Assess if management's plans are probable of being successful****Questions**

**Question 4.3.10** How does management assess the mitigating effect of implementing its plans?

**Question 4.3.20** Can a plan to liquidate alleviate substantial doubt?

4. Step 2: Assess whether substantial doubt exists

## How the standard works



If substantial doubt about an entity's ability to continue as a going concern is raised in Step 1, the second step of the going concern assessment is to determine whether that substantial doubt is alleviated by management's plans. For management's plans to alleviate the substantial doubt, it has to be probable that the plans will be timely implemented and will successfully mitigate the relevant conditions or events that raise substantial doubt.

## 4.1 Overview

### Excerpt from ASC 205-40

#### > Consideration of Management's Plans When Substantial Doubt Is Raised

**50-6** When relevant conditions or events, considered in the aggregate, initially 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** (and therefore they raise **substantial doubt about the entity's ability to continue as a going concern**), 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.

**50-7** The mitigating effect of management's plans shall be considered in evaluating whether the substantial doubt is alleviated only to the extent that information available as of the date that the financial statements are issued indicates both of the following:

- 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.

#### • > Examples of Adverse Conditions and Events

**55-3** The following are examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern. The examples are not all-inclusive. Below each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is **probable** that the plan will be effectively implemented within one year after the date that the financial statements are issued.

- a. Plans to dispose of an asset or business:
  1. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loan or similar agreements, or encumbrances against the asset or business
  2. Marketability of the asset or business that management plans to sell
  3. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt:
  1. Availability and terms of new debt financing, or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale and leaseback of assets
  2. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  3. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral

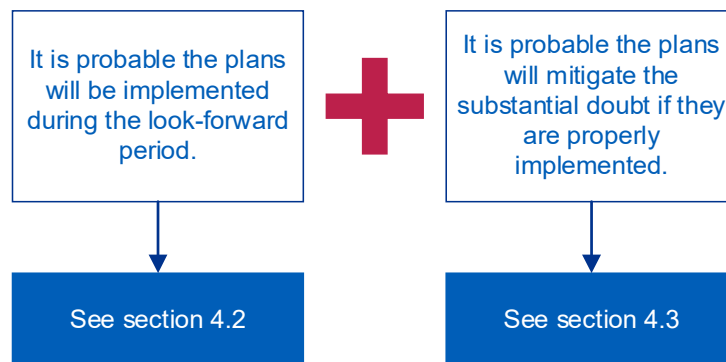
- c. Plans to reduce or delay expenditures:
  1. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  2. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity:
  1. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  2. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors.

Step 2 of the going concern assessment requires management to determine whether its plans alleviate substantial doubt that is raised about an entity's ability to continue as a going concern. Management may implement a variety of mitigation plans, such as disposing of assets or a business, borrowing money, restructuring debt, reducing or delaying expenditures or increasing ownership equity. [205-40-55-3]

### Question 4.1.10 When are management's plans relevant in Step 2?

**Interpretive response:** Only plans that have *not* been fully implemented by the assessment date are considered in Step 2. Fully implemented plans are considered in Step 1. Further, actions taken in the normal course of managing the entity do not constitute management's plans to be considered in Step 2 (see [Question 3.1.20](#)).

To be considered in Step 2, a plan that has not been fully implemented must nevertheless have been approved by management or others with appropriate authority before the assessment date. A properly approved plan is analyzed under Step 2 to determine whether it meets the following two conditions. [205-40-50-7]



Because the plans considered in Step 2 are not fully implemented, they only alleviate substantial doubt about the entity's ability to continue as a going concern if they meet both of these conditions.

## 4.2 Assess if management's plans are probable of being effectively implemented (feasibility)

### Excerpt from ASC 205-40

> Consideration of Management's Plans When Substantial Doubt Is Raised

**50-8** The evaluation of whether it is probable that management's plans will be effectively implemented within one year after the date that the financial statements are issued shall be 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. Paragraph 205-40-55-3 provides examples of plans that management may implement and information that management should consider for each plan in evaluating the feasibility of the plans.

**50-9** The mitigating effect of management's plans that are not probable of being effectively implemented within one year after the date that the financial statements are issued shall not be considered in evaluating whether substantial doubt about an entity's ability to continue as a going concern is alleviated.

If at the assessment date it is not probable that management's plans will be effectively implemented, their mitigating effect is ignored – i.e. it is irrelevant whether they might alleviate substantial doubt about the entity's ability to continue as a going concern. [205-40-50-9]

### Question 4.2.10 How does management assess the feasibility of implementing its plans?

**Interpretive response:** We believe the following two considerations are inherent in the assessment of whether it is probable (see [Question 2.3.50](#)) management's plans will be effectively implemented – i.e. whether they are feasible:

- whether, and to what extent, the plans are within or beyond management's control (see [Question 4.2.20](#)); and
- management's history in forecasting and executing similar plans and how this history supports the achievability of current plans under current conditions (see [Question 4.2.35](#)).

We believe management's plans should be precise, specific and actionable. Actions that lack specificity generally cannot, on their own, alleviate substantial doubt. For example, in order to rely on a reduction in force as a plan to reduce cash outflows and alleviate substantial doubt, management needs to identify the roles and related salaries to be eliminated rather than rely on a generic plan to reduce an unknown number of positions.

### Question 4.2.20 When is a plan beyond management's control?

**Interpretive response:** We believe a plan is typically beyond management's control when the outcome of critical elements of the plan depends on:

- action from at least one external counterparty – e.g. lender renegotiating a financing arrangement or waiving covenant violations, court reversing a regulatory judgment, customer renewing a revenue contract, vendor reducing contractual pricing or extending payment terms, investors purchasing additional shares; or
- uncontrollable external market forces – e.g. favorable evolution of credit markets, change in customer behaviors, future availability of currently scarce resources.

### Question 4.2.30 Can a plan beyond management's control be probable of being implemented?

**Interpretive response:** Generally, no. The intent of management to implement such a plan is not sufficient, as management's ability to execute the plan must be probable. When the ability to execute a plan is beyond management's control, we believe it is more challenging to demonstrate that the plan is probable of being effectively implemented.

If the ability to execute a plan is beyond its control, management may consider its historical ability to obtain a favorable outcome from the counterparty. However, management should assess whether a counterparty's past actions indicate future intentions given current facts and circumstances. For example, we believe a counterparty's past actions may not be indicative of its future intentions when those past actions occurred before substantial doubt is raised due to a decline in the entity's financial health or general economic environment, such as during the COVID-19 pandemic (see [Question 3.5.20](#)). Therefore, in such circumstances, management's plans dependent on those actions are generally *not* considered probable of being effectively implemented.

Management may also consider the status of contractual negotiations or legal proceedings with the counterparty when assessing whether a plan is probable of being implemented.

See [Question 4.2.40](#) (plan to obtain a debt covenant waiver), [Question 4.2.50](#) (plan to execute a refinancing) and [Question 4.2.60](#) (plan to increase ownership equity) for additional considerations.

### Question 4.2.35 How is management's history in forecasting and executing similar plans relevant to the feasibility of current plans?

**Interpretive response:** As explained in [Question 4.2.10](#), we believe management's history in forecasting and executing similar plans should be



## 4. Step 2: Assess whether substantial doubt exists

considered when assessing the feasibility of management's current plans. However, while important, past success with forecasting and executing similar plans is not sufficient by itself to demonstrate the feasibility of a current plan because conditions may have changed.

We believe management should critically analyze and document its historical ability to develop reliable forecasts and achieve goals and targets to inform the reasonableness of current projections. Any disconfirming evidence that draws into question the feasibility of management's plans should be carefully considered.

The following table includes examples of activities and considerations (not all inclusive) that management considers in its analysis.

Activities	Considerations
<b>Compare projections to actual results for past periods and the current period, including the subsequent events period</b> (see <a href="#">Question 2.3.20</a> )	Performance in recent periods, including the subsequent events period, may support or draw into question the feasibility of management achieving projected results for the remaining projection period. Evaluating management's ability to meet projections in the subsequent events period provides timely evidence as to the feasibility and achievability of those projections.
<b>Assess its experience and qualifications in the industry, including in developing projections</b>	Management's experience and qualifications in the industry could significantly affect their ability to develop feasible plans and to execute on established plans.
<b>Assess its historical ability to execute on similar plans</b>	Management's ability (or inability) to execute on past similar plans may reflect their ability (or inability) to develop feasible plans and/or to execute on established plans.
<b>Evaluate the underlying basis for its projections</b>	The feasibility of management's plans is easier to demonstrate when projections are based on: <ul style="list-style-type: none"> <li>• signed contracts or firm commitments from customers or vendors; or</li> <li>• activity rooted in recurring historical trends not expected to change during the projection period.</li> </ul>
<b>Consider how the predictability of projections may be affected by internal and external factors</b>	Projections could be affected by any number and variety of internal and external factors faced by an entity. Examples include changes in leadership, economic conditions, regulatory environment, competitive landscape and technological advancements. The timing and significance of these factors could affect the feasibility of management achieving projected results.

### Question 4.2.40 What should be considered when management's plans include obtaining a debt covenant waiver?

**Interpretive response:** Management may expect a lender will provide a covenant waiver after the assessment date (potentially based on historical experience of obtaining waivers or current discussions with the lender). Such a plan requires the lender's approval, which is a critical element of the plan and is outside of management's control.

[Question 4.2.30](#) explains that plans with critical elements outside of management's control are generally *not* considered probable of being effectively implemented. We believe this is the case even if the lender has provided waivers in the past because a lender's past actions may not indicate future intentions. This may be especially true if the credit markets or the entity's financial health have significantly declined since the lender granted the previous covenant waivers.

A debt covenant waiver provided by a lender before the assessment date is a fully executed management plan and can be considered in the assessment of whether substantial doubt has been raised in Step 1 (see [Question 3.3.20](#)).

### Question 4.2.50 What should be considered when management plans to execute a refinancing?

**Interpretive response:** Management may expect that currently uncommitted funding sources (see [Question 3.2.20](#)) will be made available to the entity in sufficient amounts and at appropriate times during the look-forward period. Such a plan requires the lender's approval, which is a critical element of the plan and is outside of management's control.

[Question 4.2.30](#) explains that plans with critical elements outside of management's control are generally *not* considered probable of being effectively implemented. We believe this is the case even when the lender has provided refinancing in the past because a lender's past actions may not be indicative of future intentions. This is especially true if the credit markets or the entity's financial health have significantly declined since the last refinancing. In such circumstance, it is unlikely that management will be able to demonstrate an ability to renew, restructure or refinance outstanding obligations without evidencing committed funding arrangements.

Nevertheless, in rare circumstances, we believe it may be possible to rely on a past successful refinancing to demonstrate that the refinancing plan is probable of being effectively implemented. An example of such rare circumstances may be when significant doubt was raised only because of debt falling due during the look-forward period (i.e. the entity is otherwise in good financial health). However, we believe it is very difficult even in this instance to demonstrate that plans beyond management's control can be probable of being effectively implemented.

## 4. Step 2: Assess whether substantial doubt exists

We believe the analysis to determine whether it is probable that a refinancing will occur should consider, at a minimum, the factors listed in the following table. Concluding on each factor requires objective and persuasive evidence and a comprehensive analysis of all relevant facts. Also, the example facts listed in the table are not necessarily sufficient to conclude the corresponding factor has been sufficiently addressed. Any disconfirming evidence that draws into question the feasibility of management's plans should be carefully considered.

Factor	Examples of relevant facts that may support that management's plans are probable of being effectively implemented
<b>History of successful refinancing</b>	<ul style="list-style-type: none"> <li>• Management has a history of successfully refinancing or renewing the entity's debt obligations as they come due.</li> <li>• The entity is not pursuing an initial debt restructuring.</li> </ul>
<b>Entity's financial health and operations</b>	<ul style="list-style-type: none"> <li>• The entity's financial health has not declined, and its operations have not changed significantly since consummating the current financing arrangements.</li> </ul>
<b>Extent of funding needed</b>	<ul style="list-style-type: none"> <li>• The uncommitted funding amount is not significant relative to committed funding amounts.</li> <li>• The total funding amount needed is not significant to the total needs of the entity to meet its obligations.</li> </ul>
<b>Forecasted cash flows</b>	<ul style="list-style-type: none"> <li>• Reasonable forecasts of cash flows meet necessary debt coverage ratios (i.e. cash flows from relevant assets, such as cash flows from the underlying property for a real estate entity, and other cash flows a lender would consider important).</li> <li>• The planned funding is reasonable considering relevant financing factors, including, but not limited to, loan-to-value ratios, timing, term, interest rates and financial and other covenants.</li> </ul>
<b>Conditions of the credit markets</b>	<ul style="list-style-type: none"> <li>• The credit markets within which the entity intends to pursue funding have not declined since consummating the current financing arrangements.</li> <li>• The specific type of financing sought is consistent with strategies of the lender.</li> </ul>
<b>Status of management's negotiations with lenders</b>	<ul style="list-style-type: none"> <li>• Management has made sufficient progress in negotiating with the lender(s) and there is evidence to support that progress.</li> <li>• There is sufficient time to consummate the financing relative to the due date(s) of existing debt arrangements.</li> <li>• Financial covenants that would be attached to the proposed funding are not overly restrictive and it</li> </ul>

Factor	Examples of relevant facts that may support that management's plans are probable of being effectively implemented
	is likely that the entity will be able to comply with such covenants.
<b>Quality and value of available collateral</b>	<ul style="list-style-type: none"> <li>The value of the assets (e.g. the value of an account receivable or inventory in an asset-backed lending arrangement or the loan-to-value ratio in a securitized lending arrangement) collateralizing the existing obligation has not declined subsequent to origination of the debt or the previous renewal.</li> <li>The quality of the assets has not otherwise significantly decreased as a result of a catastrophic event or neglect.</li> </ul>

Example 4.2.10 illustrates an assessment of several of the factors noted above.

### Example 4.2.10 Management plans to execute refinancing

ABC Corp. has determined substantial doubt about its ability to continue as a going concern is raised because a balloon payment for a term loan is coming due in the look-forward period (see Example 3.1.10).

#### **Scenario 1: Relationship with lender is not strong**

ABC does not have a strong and cooperative relationship with its current lender (Lender), and management has requested debt agreement covenant waivers on several recent occasions. Further, the proposed collateral has decreased in value since the last financing and the liquidity need is significant in relation to ABC's financial position.

Under these facts, a binding commitment from Lender to refinance (in sufficient amounts and at appropriate times) generally would be necessary to support management's assertion that a refinancing can be effectively implemented.

#### **Scenario 2: Tightened credit markets and decline in market value of assets**

ABC has a history of successful refinancing with Lender, having completed two refinancings in the past two years. While ABC has not yet initiated discussions with Lender regarding another refinancing, ABC is confident that the process would go smoothly and quickly. However, the liquidity need is significant in relation to ABC's financial position. Since the last refinancing, credit markets have tightened, and the market value of assets collateralizing the existing obligation has declined.

Under these facts, despite the history of successful refinancing, management has not demonstrated that it is probable that a refinancing can be effectively implemented. A binding commitment from Lender to refinance (in sufficient amounts and at appropriate times) generally would be necessary to support management's assertion that a refinancing can be effectively implemented.

### Question 4.2.60 What should be considered when management's plans involve increasing ownership equity?

**Interpretive response:** An increase in ownership equity generally is highly susceptible to uncontrollable market forces and potential regulatory approval. Therefore, critical elements of the plans are outside of management's control. [Question 4.2.30](#) explains that plans with critical elements outside of management's control are generally *not* considered probable of being effectively implemented.

Nevertheless, there may be rare circumstances in which management can demonstrate that such plans meet the feasibility requirement, but we believe this is very difficult to demonstrate. One instance may be when management has the unilateral ability to cause these arrangements to be executed.

The following table contains several types of information management should consider when assessing the feasibility of plans to increase ownership equity – some suggested by Subtopic 205-40 and others that we believe should be considered. [\[205-40-55-3\(d\)\]](#)

Types of information listed in Subtopic 205-40
Existing or committed arrangements to raise additional capital (or other plans to increase ownership equity) (see <a href="#">Question 4.2.65</a> )
Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusion from affiliates or other investors
Additional types of information to consider
The feasibility of new or secondary stock issuances in light of the economic climate and existing restrictions. We believe at-market pricing of shares in an at-the-market offering is not itself sufficient to conclude feasibility because the proceeds from issuance are subject to investor demand (see <a href="#">Example 4.2.20</a> ).
The timing of the planned issuance
The effects of increased ownership equity on the entity
The availability of authorized shares to issue and potential shareholder approval requirements
The need for regulatory approval and any uncertainties that may exist in that process
The ability of the parties committed to provide capital to execute on their commitment (e.g. solvency)

### Question 4.2.65 Can expected proceeds from an IPO (or other security offering) alleviate substantial doubt?

**Interpretive response:** No. We believe expected proceeds from a future Initial Public Offering (IPO) cannot be relied upon to alleviate substantial doubt, even if the registration statement has been declared effective by the SEC. As explained in [Question 4.2.60](#), plans with critical elements outside of management's

control (e.g. the amount of capital raised in an IPO) are generally *not* considered probable of being effectively implemented.

Upon completion of the offering and receipt of the funds, the proceeds from an IPO can be considered in the assessment of whether substantial doubt has been raised in Step 1 (see [Question 3.3.20](#)).

### Example 4.2.20 Management plans to raise capital

ABC Corp. has determined substantial doubt about its ability to continue as a going concern is raised because a balloon payment for a term loan is coming due in the look-forward period (see [Example 3.1.10](#)).

ABC has an existing at-the-market (ATM) facility available, which allows management to sell a variable number of shares in the market at the prevailing market price. At the assessment date, management plans to initiate an ATM offering with their broker in time to repay the loan. Management expects to raise sufficient capital by issuing the necessary number of shares. However, ABC has no purchase commitments from any investors.

At the assessment date, the price and quantity of shares that may be sold under the ATM facility are dependent upon investor demand, which is outside of management's control. Therefore, management concludes that the ATM offering cannot be utilized as a plan to alleviate substantial doubt.

Disclosure is required because substantial doubt is raised and exists at the assessment date (see [section 5.2](#)).

### Question 4.2.70 What should be considered when management's plans involve significant growth in revenue or gross margins?

**Interpretive response:** If management's plans involve significant revenue growth or increases in gross margins, we believe management should consider the following when assessing the plans' feasibility:

- availability of financing alternatives to fund growth initiatives (e.g. procure inventory);
- ability to secure sourcing (e.g. find suppliers and assemble sufficient workforce);
- historical evidence of growth and profitability (adjusting historical evidence for current economic climate);
- extent of current sales backlog and/or signed contracts;
- reliability of sales forecasts;
- ability to finance significant marketing campaigns including significant discounting initiatives;
- effects of industry developments; and
- effects of current economic climate.

All relevant information available up to the assessment date should be considered in the analysis, including a comparison of actual results to-date to forecasts to-date (see [Question 4.2.35](#)).

### Question 4.2.80 What should be considered when management's plans involve a reduction in workforce?

**Interpretive response:** All contractual, legal or regulatory restrictions are considered when assessing the entity's ability to effectively implement its planned workforce reduction. Restrictions may include notification requirements, union or works council negotiations, employment agreement modification or other agreements. Restrictions may also vary by jurisdictions.

[Question 4.2.30](#) explains that plans with critical elements outside of management's control are generally *not* considered probable of being effectively implemented. We believe that if management's plans involve a reduction in workforce subject to substantive barriers to completion, such as the above restrictions, management may not be able to demonstrate feasibility until those restrictions are lifted. [\[205-40-50-8\]](#)

## 4.3 Assess if management's plans are probable of being successful

### Excerpt from ASC 205-40

#### > Consideration of Management's Plans When Substantial Doubt Is Raised

**50-10** As required in paragraph 205-40-50-7, management shall further assess its plans that are probable of being effectively implemented to determine whether it is probable that those plans will mitigate the conditions or events that raise substantial doubt about an entity's ability to continue as a going concern. In this assessment, management shall 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.

**50-11** A plan to meet an entity's obligations as they become due through **liquidation** (as defined in Subtopic 205-30 on the liquidation basis of accounting) shall not be considered as part of management's plans in evaluating whether substantial doubt is alleviated even if liquidation is probable of occurring.

Even if management's plans are probable of being effectively implemented, management must also determine if it is probable that the effectively implemented plans will alleviate the substantial doubt raised in Step 1. [\[205-40-50-10\]](#)

If it is not probable that management's plans will be successful, their mitigating effect is ignored – i.e. it is irrelevant whether they might alleviate substantial doubt about the entity's ability to continue as a going concern. [205-40-50-9]

### Question 4.3.10 How does management assess the mitigating effect of implementing its plans?

**Interpretive response:** To estimate the mitigating effect of implementing its plans, management needs to consider the expected magnitude and timing of those effects and how the plans mitigate the entity's liquidity needs throughout the look-forward period. For this reason, management often needs to perform additional forecasting to that done for purposes of Step 1 (see [Question 3.4.10](#)). Management may also benefit from preparing sensitivity analyses on significant assumptions to aid in supporting the probability of results in varying market conditions. [205-40-50-10]

When assessing the mitigating effect of its plans, management also should consider the indirect effects of implementing the plans. For example, a refinancing of one debt instrument may appear to mitigate substantial doubt that is raised. However, the terms of that probable transaction may result in disruption of other areas of the entity's operations or an adverse change in the contractual terms of other arrangements.

Further, management's plans to alleviate substantial doubt may have significant cost effects to consider. For example, a location closure may have a mitigating effect on payroll and occupancy expenses but may also cause significant severance and lease termination costs. All impacts of plans intended to alleviate substantial doubt should be considered, not only the beneficial impact of such plans.

### Question 4.3.20 Can a plan to liquidate alleviate substantial doubt?

**Interpretive response:** No. When substantial doubt is raised, a plan to liquidate is not considered a mitigating event, even if probable. An entity that plans to liquidate cannot conclude on the basis of its planned liquidation that there is no substantial doubt about its ability to continue as a going concern. [205-40-50-11, ASU 2014-15.BC32]

Conversely, a plan to liquidate does not necessarily indicate that substantial doubt is raised. [Question 3.1.30](#) discusses going concern considerations when management intends to wind down operations, including through a planned liquidation.



# 5. Disclosures

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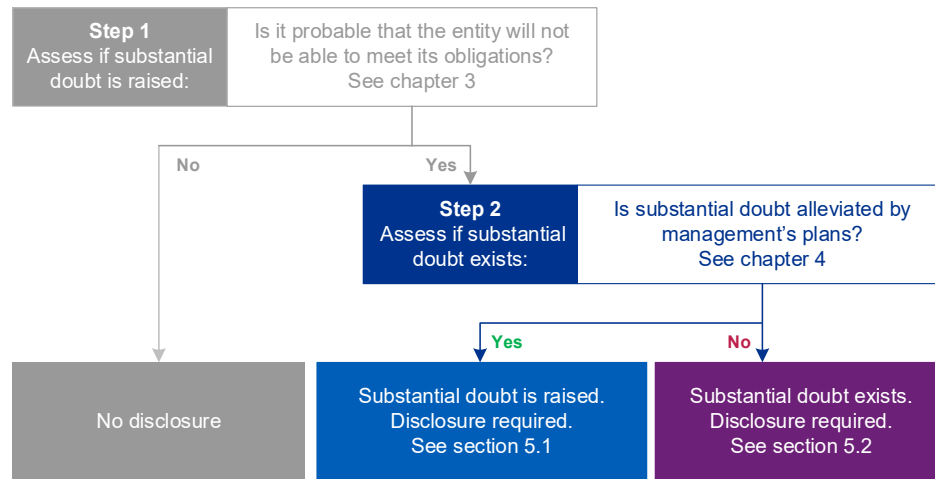
**Question 5.3.30** Should risks extending beyond the look-forward period be considered?

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##### Example

**Example 5.3.10** Risks extending beyond the look-forward period

## How the standard works



There are two types of disclosures under Subtopic 205-40:

- disclosures when substantial doubt is raised but is alleviated by management's plans;
- disclosures when substantial doubt exists – i.e. it is not alleviated by management's plans.

The disclosure requirements are summarized as follows.

Substantial doubt is <i>raised</i> but alleviated	Substantial doubt <i>exists</i>
Disclose principal conditions or events that raise substantial doubt (before consideration of management's plans)	Disclose principal conditions or events that raise substantial doubt
Disclose management's assessment of the significance of those conditions or events in relation to the entity's ability to meet its obligations	
Disclose management's plans that alleviated substantial doubt	Disclose management's plans intended to alleviate substantial doubt
No statement that substantial doubt was raised is required	Include an explicit statement in the notes that indicates there is substantial doubt

The disclosures should be updated in each period as conditions and events change. When substantial doubt ceases to exist during a period, the disclosures should explain how the relevant conditions or events that raised substantial doubt were resolved (see [Question 5.3.10](#)).

Additional disclosures may also be appropriate, such as those related to risks and uncertainties under Topic 275 or contingencies under Topic 450 (see [Question 5.3.20](#)).

## 5.1 Disclosures when substantial doubt is alleviated

### Excerpt from ASC 205-40

> Disclosures When Substantial Doubt Is Raised but Is Alleviated by Management's Plans (Substantial Doubt Does Not Exist)

**50-12** If, after considering management's plans, **substantial doubt about an entity's ability to continue as a going concern** is alleviated as a result of consideration of management's plans, an entity shall disclose in the notes to financial statements information that enables users of the financial statements to understand all of the following (or refer to similar information disclosed elsewhere in the notes):

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

When substantial doubt is raised but alleviated by management's plans, the entity must still disclose information about the substantial doubt and management's plans. Specifically, the requirements are to disclose: [\[205-40-50-12\]](#)

- the principal conditions or events that raised the substantial doubt (before consideration of management's plans);
- management's assessment of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
- management's plans to alleviate the substantial doubt.

### Question 5.1.10 Where in the notes should the disclosures appear when substantial doubt is alleviated by management's plans?

**Interpretive response:** Subtopic 205-40 does not require that these disclosures be provided in a going concern note or include the term *substantial doubt* in the note. Instead, the guidance acknowledges that similar information may be disclosed elsewhere in the notes. [\[205-40-50-12\]](#)

For example, when substantial doubt is initially raised only as a result of debt coming due but is alleviated because of management's refinancing plans, we believe it may be acceptable for management to incorporate the required disclosure elements in the debt note.

However, where the conditions or events that raised substantial doubt or management's plans that alleviated substantial doubt are more pervasive, we believe more prominent and extensive disclosures (see [Question 5.3.10](#)) may be needed. A separate going concern note may better enable financial

statement users to holistically understand the conditions or events that raised the substantial doubt and management's plans in mitigating those conditions or events.

### Example 5.1.10 Illustrative disclosure when substantial doubt is alleviated

#### Background

ABC Corp is a calendar year-end company engaged in the fabrication and bending of metals for customers in the aircraft and automotive industries. Sales have historically been divided evenly between these two operating segments.

During Year 1, the airline industry experienced a rapid decrease in business and demand for air travel. As a result, ABC experienced a significant decline in revenue from aircraft customers and in renewals of aircraft customer contracts leading to a substantial net loss for the year ended December 31, Year 2.

ABC's financial statements for Year 1 are issued on March 10, Year 2. ABC's cash flow forecasts indicate it is probable that ABC will not be able to meet its obligations as they become due within the look-forward period (i.e. from March 10, Year 2 to March 10, Year 3). As of March 10, Year 2, management has approved a restructuring plan to mitigate substantial doubt about ABC's ability to continue as a going concern. Management has assessed that this plan is probable of being implemented and successful in mitigating the conditions that raise the substantial doubt.

#### Illustrative disclosures

The following financial statement note excerpt illustrates how ABC may disclose the information required under Subtopic 205-40. Other approaches may also be acceptable.

##### (1) Summary of Significant Accounting Policies

##### *Basis of Presentation*<sup>a</sup>

##### Going Concern

These consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) assuming the Company will continue as a going concern.

Primarily due to a decline in sales associated with the aircraft line of business,<sup>b</sup> the Company generated a net loss of \$X,XXX and net cash outflows from operations of \$X,XXX for the year ended December 31, Year 1. At December 31, Year 1, the Company had negative working capital of \$X,XXX and cash and cash equivalents of \$XXX. Absent any other action, the Company will require additional liquidity to continue its operations over the next 12 months.<sup>c</sup>

As discussed in Note X (restructuring), the Company's board of directors has approved a restructuring plan to shift operations focused on the aircraft line of business to the automotive line of business. The Company projects this

restructuring plan, to be completed in mid-Year 2, will reduce expenses and increase revenues, thereby reducing ongoing liquidity needs to enable continuation of operations for the foreseeable future.<sup>d</sup>

Notes:

- a. See [Question 5.1.10](#) for discussion of where the disclosures should appear in the notes.
- b. Subtopic 205-40 requires disclosure of the principal conditions or events that raise substantial doubt. [\[205-40-50-12\(a\)\]](#)
- c. Subtopic 205-40 requires disclosure of management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations. [\[205-40-50-12\(b\)\]](#)
- d. Subtopic 205-40 requires disclosure of management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern. [\[205-40-50-12\(c\)\]](#)

## 5.2 Disclosures when substantial doubt exists

### Excerpt from ASC 205-40

> Disclosures When Substantial Doubt Is Raised and Is Not Alleviated (Substantial Doubt Exists)

**50-13** If, after considering management's plans, **substantial doubt about an entity's ability to continue as a going concern** is not alleviated, the entity shall include a statement in the notes to financial statements 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**. Additionally, the entity shall disclose information that enables users of the financial statements to understand all of the following:

- a. Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
- 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 are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

Substantial doubt exists when it is raised and not alleviated by management's plans. When substantial doubt exists, the entity must disclose information about the substantial doubt and management's plans. Specifically, the requirements are to disclose: [\[205-40-50-13\]](#)

- the principal conditions or events that raised the substantial doubt;
- management's assessment of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and
- management's plans intended to mitigate those conditions or events.

In contrast to disclosures when substantial doubt is alleviated (see [section 5.1](#)), when substantial doubt exists, the notes *must* include a statement indicating that *there is substantial doubt* about the entity's ability to continue as a going concern during the look-forward period. [\[205-40-50-13\]](#)

### Question 5.2.10 Where in the notes should the disclosures appear when substantial doubt exists?

**Interpretive response:** Subtopic 205-40 does not require that the specified disclosures be provided in a going concern note. However, a going concern note is generally the most effective way to enable users to understand the entity's facts and circumstances culminating in a conclusion that substantial doubt exists. At a minimum, we believe that the disclosures should be:

- provided in a single location; and
- prominent within the notes (i.e. not obscured by other disclosures).

### Example 5.2.10 Illustrative disclosure when substantial doubt exists

#### Background

ABC Corp is a calendar year-end company engaged in the fabrication and bending of metals for customers in the aircraft and automotive industries. Sales have historically been divided evenly between these two operating segments.

During Year 1, the airline industry experienced a rapid decrease in business and demand for air travel. As a result, ABC experienced a significant decline in revenue from aircraft customers and in renewals of aircraft customer contracts leading to a substantial net loss for the year ended December 31, Year 2.

ABC's financial statements for Year 1 are issued on March 10, Year 2. ABC's cash flow forecasts indicate it is probable that ABC will not be able to meet its obligations as they become due within the look-forward period (i.e. from March 10, Year 2 to March 10, Year 3). On March 10, Year 2, it cannot be demonstrated yet that management's plans to alleviate substantial doubt about ABC's ability to continue as a going concern are probable of being implemented or, if implemented, will be probable of being successful in mitigating the conditions that raise the substantial doubt.

#### Illustrative disclosures

The following financial statement note excerpt illustrates how ABC may disclose the information required under Subtopic 205-40. Other approaches may also be acceptable.

## (1) Summary of Significant Accounting Policies

### *Basis of Presentation<sup>a</sup>*

#### Going Concern

These consolidated financial statements have been prepared in accordance with US generally accepted accounting principles (GAAP) assuming the Company will continue as a going concern. The going concern assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, substantial doubt about the Company's ability to continue as a going concern exists.<sup>b</sup>

As discussed in Note X, the Company experienced a significant decline in sales associated with the aircraft line of business.<sup>c</sup> This decline resulted in a net loss of \$X,XXX and net cash outflows from operations of \$X,XXX for the year ended December 31, Year 1. At December 31, Year 1, the Company had negative working capital of \$X,XXX and cash and cash equivalents of \$XXX. The Company will require additional liquidity to continue its operations over the next 12 months.<sup>d</sup>

The Company is evaluating strategies to obtain the required additional funding for future operations. These strategies may include, but are not limited to, obtaining equity financing, issuing debt or entering into other financing arrangements, and restructuring of operations to grow revenues and decrease expenses.<sup>e</sup> However, given the impact of the economic downturn on the U.S. and global financial markets, the Company may be unable to access further equity or debt financing when needed. As such, there can be no assurance that the Company will be able to obtain additional liquidity when needed or under acceptable terms, if at all.

The consolidated financial statements do not include any adjustments to the carrying amounts and classification of assets, liabilities, and reported expenses that may be necessary if the Company were unable to continue as a going concern.

#### Notes:

- a. See [Question 5.2.10](#) for discussion of where the disclosures should appear in the notes.
- b. Subtopic 205-40 requires the entity to include a statement in the notes indicating that *there is* substantial doubt about the entity's ability to continue as a going concern. [\[205-40-50-13\]](#)
- c. Subtopic 205-40 requires disclosure of the principal conditions or events that raise substantial doubt. Due to the pervasive effect on the financial statements as a whole, these conditions or events are often disclosed in detail in another note to the financial statements. [\[205-40-50-13\(a\)\]](#)
- d. Subtopic 205-40 requires disclosure of management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations. [\[205-40-50-13\(b\)\]](#)
- e. Subtopic 205-40 requires disclosure of management's plans that are intended to mitigate the conditions or events that raise substantial doubt. [\[205-40-50-13\(c\)\]](#)

## 5.3 Other disclosure considerations

### Excerpt from ASC 205-40

> Disclosures When Substantial Doubt Is Raised and Is Not Alleviated (Substantial Doubt Exists)

**50-14** If conditions or events continue to raise substantial doubt about an entity's ability to continue as a going concern in subsequent annual or interim reporting periods, the entity shall continue to provide the required disclosures in paragraphs 205-40-50-12 through 50-13 in those subsequent periods. Disclosures should become more extensive as additional information becomes available about the relevant conditions or events and about management's plans. An entity shall provide appropriate context and continuity in explaining how conditions or events have changed between reporting periods. For the period in which substantial doubt no longer exists (before or after consideration of management's plans), an entity shall disclose how the relevant conditions or events that raised substantial doubt were resolved.

Once management starts making disclosures under Subtopic 205-40, it has to provide updated disclosures in subsequent periods, until substantial doubt is no longer raised. [205-40-50-14]

### Question 5.3.10 How does management update going concern disclosures in subsequent periods?

**Interpretive response:** It depends on whether substantial doubt continues to be raised, or no longer exists or is no longer raised. Each reporting period, management is required to update its going concern assessment; disclosures are updated accordingly to reflect the specific facts and circumstances for the period.

#### ***Substantial doubt continues to be raised***

Disclosures under Subtopic 205-40 are required as long as substantial doubt continues to be raised. The subsequent period disclosures update financial statement users on the conditions or events that continue to raise substantial doubt about the entity's ability to continue as a going concern. The updated disclosures should become more extensive as additional information becomes available about these conditions or events or about management's plans to alleviate or mitigate the effects of these conditions or events. [205-40-50-14]

The FASB did not intend 'extensive' to be interpreted in terms of length of the disclosures. Appropriate context and continuity should be provided in explaining how conditions or events and management's plans have changed between reporting periods. These updates may or may not lengthen the disclosures. [ASU 2014-15.BC37]



***Substantial doubt no longer exists or is no longer raised***

In the period substantial doubt ceases to exist (after consideration of management's plans) or is no longer raised, the disclosures should say so and explain why – either because management's plans have successfully alleviated the substantial doubt or because the conditions or events raising the substantial doubt are no longer present or are sufficiently resolved. The disclosures should also explain how the conditions or events that raised the substantial doubt were resolved. [205-40-50-14]

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**Question 5.3.15** Should going concern disclosures be repeated in annual disclosures when substantial doubt was raised and ceased to be raised in interim periods?

**Background:** Assume that substantial doubt was raised in Q1 and ceases to be raised in Q2. By year-end, substantial doubt is not raised. This may occur, for example, when a covenant breach in one interim period is remediated in the next.

**Interpretive response:** It depends on whether the entity regularly reports interim financial information.

***Entity regularly reports interim financial information***

If substantial doubt is raised in an interim period, disclosures are required in that period (see [sections 5.2](#) and [5.3](#)). These disclosures continue until a period in which substantial doubt ceases to exist, at which time the entity discloses that fact and explains why (see [Question 5.3.10](#)). If the conditions or events leading to substantial doubt being raised in an interim period are no longer present in the following interim periods or at year-end, we believe disclosures under Subtopic 205-20 in annual financial statements are not required – i.e. it is not necessary to repeat the disclosure from the interim period in which substantial doubt was raised or existed.

However, Topic 275 requires an entity to disclose those risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term. Management should carefully assess the events and conditions that led to substantial doubt being raised and whether they could repeat in the future.

***Entity does not regularly report interim financial information***

If the conditions or events leading to substantial doubt being raised within the entity's fiscal year are no longer present at year-end, we believe the entity should disclose the conditions or events leading to substantial doubt being raised. We believe the entity should also disclose how the conditions or events that raised substantial doubt were resolved.

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### Question 5.3.20 What are the requirements to disclose the possible effects of adverse conditions and events?

**Interpretive response:** There are no requirements in Subtopic 205-40 to disclose the possible effects of the conditions and events on an entity because the FASB considered that information to be overly subjective and forward-looking for disclosure in the financial statement notes. However, disclosure requirements exist in other guidance as discussed below. [\[ASU 2014-15.BC34\]](#)

#### ***US GAAP disclosure requirements in the financial statements***

An entity may have related US GAAP disclosure requirements other than those in Subtopic 205-40. For example, Topic 275 (risks and uncertainties) requires disclosure of those risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term. Topic 450 (contingencies) requires disclosure of certain contingencies as soon as there is a reasonable possibility that a loss will be incurred, regardless of the timing of the potential loss. [\[275-10-05-2, 450-20-50-3\]](#)

Further, it may be appropriate to provide additional disclosure about the potential effect of known conditions and events that may occur beyond the look-forward period (see [Question 5.3.30](#) and [Example 5.3.10](#)).

#### ***SEC disclosure requirements outside the financial statements***

SEC registrants have additional reporting requirements outside the financial statements. For example, Regulation S-K requires a registrant to disclose in its MD&A information about trends and uncertainties that are reasonably likely to have a material effect on the registrant's liquidity, capital resources and results of operations. [\[S-K Item 303\(a\)\]](#)

### Observation Disclosure inconsistency\*\*

In comment letters, the SEC staff regularly enquires about perceived inconsistency in the nature of disclosures in MD&A, the notes, and the auditors' report. For example, the SEC has observed instances where a company's disclosure in the notes states that substantial doubt exists, whereas the disclosure in its MD&A is silent about the uncertainty. Management should ensure that the nature of disclosures is consistent.

### Question 5.3.30 Should risks extending beyond the look-forward period be considered?

**Interpretive response:** Management is only required to perform the assessment over the look-forward period. However, the FASB did not intend to prohibit management from considering and providing disclosure about the potential effect of known conditions and events that may occur beyond the look-forward period. Those known conditions and events often are required to be disclosed under other US GAAP (e.g. as part of the loss contingencies, risk

and uncertainties or the debt notes) or in accordance with the SEC's rules and regulations. See [Question 5.3.20](#) and [Example 5.3.10](#). [ASU 2014-15.BC29]

### Example 5.3.10 Risks extending beyond the look-forward period

ABC Corp's principal customer advises management it will not renew its existing purchase contract that expires 13 months after the assessment date. Potential replacement customers are limited in number and operate in an industry sector currently facing significant economic challenges. Further, to date, management has been unable to identify likely replacement customers.

Because the loss of the customer contract will occur outside the look-forward period, it does not alone raise substantial doubt about ABC's ability to continue as a going concern. Therefore, absent any other condition or event, substantial doubt is not raised because it is not probable ABC will be unable to meet its obligations during the look-forward period.

Nevertheless, disclosure of these facts and other information relative to management's plans may be necessary under Topic 275, and, if ABC is a registrant, under Item 303 of Regulation S-K.

Further, ABC likely will be required to make Subtopic 205-40 disclosures the next reporting period, as the look-forward period will shift to 12 months from the assessment date of the next periodic financial statements and will include the expiration of the existing purchase contract.

### Question 5.3.40 How should a registration statement reflect changes in circumstances that may lead to different substantial doubt conclusions than those made at the date of the last financial statements' issuance?

**Background:** In certain instances, management of a public company may want to reissue the audited financial statements in conjunction with a sale of securities – e.g. to include them in a registration statement or offering document. Changes in circumstances since the date of the financial statements' issuance may raise questions about substantial doubt.

**Interpretive response:** In these circumstances, management should provide complete disclosure as discussed in [sections 5.1](#) and [5.2](#) in the registration statement or offering document, outside of the financial statements. Alternatively, if the financial statements are included in the registration statement, management can add an unaudited subsequent event note to the financial statements. The auditor is not required to modify the consent in this circumstance. [AS 3110.08, AS 4101.02, 1933 Exchange Act Sec. 11(a)]

## 6. Other considerations

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###### Question

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**Question 6.3.10** What is the auditor's responsibility for assessing the entity's ability to continue as a going concern and how does that differ from management's responsibility?

**Question 6.3.20** What are the implications on the auditor's report if substantial doubt is raised?

## How the standard works

### ***Impact on other accounting matters***

Subtopic 205-40 contains only disclosure requirements. A conclusion under this Subtopic that substantial doubt exists does not require the entity to discontinue applying the going concern basis of accounting (see [Question 2.1.20](#)). Instead, Subtopic 205-30 (liquidation basis of accounting) governs whether an entity must discontinue applying the going concern basis of accounting.

However, the going concern assessment can have indirect effects on other accounting matters, such as hedge accounting, current versus noncurrent debt classification, deferred tax assets valuation allowances and impairment testing.

### ***Risk assessment and ICFR***

A critical part of performing a going concern assessment is having a strong risk assessment process and strong ICFR.

A properly designed process for identifying and assessing relevant risk will allow management to recognize certain conditions and events that could raise substantial doubt as to the entity's ability to continue as a going concern.

Further, properly designed internal controls can help manage the risks associated with making projections and other judgments inherent in the going concern assessment.

### ***Auditor's assessments***

Like an entity's management, an entity's auditors perform their own going concern assessment. The requirements in US auditing standards and US GAAP are similar, but some differences exist. When an auditor finds that substantial doubt exists as to the entity's ability to continue as a going concern, it includes either an explanatory paragraph (in audits based on PCAOB auditing standards) or a going concern section (in audits based on AICPA auditing standards) in the auditor's report.

## 6.1 Impact on other accounting matters

### Question 6.1.10 How does the going concern assessment affect other accounting matters?

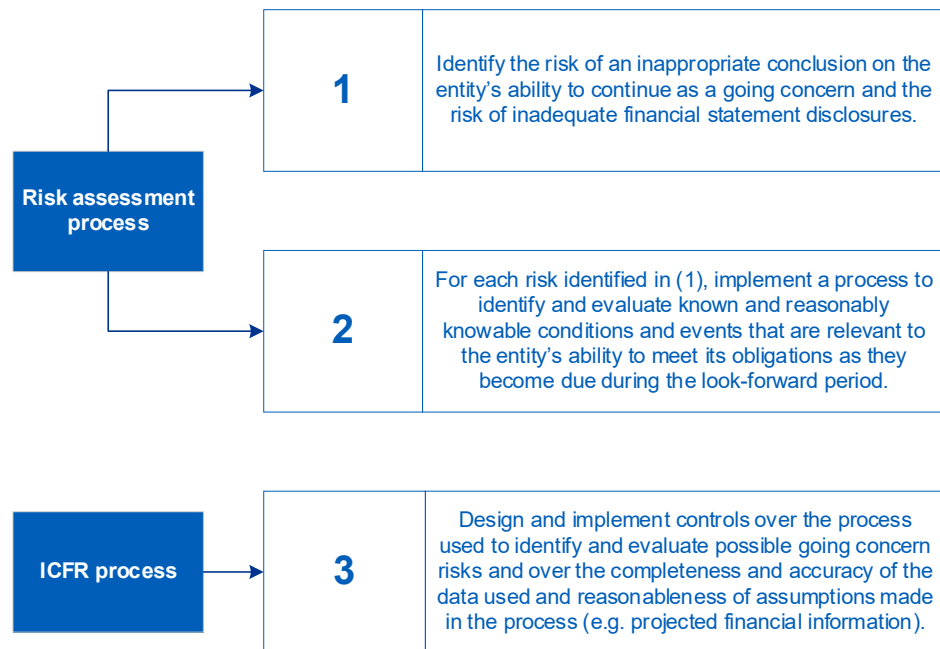
**Interpretive response:** Assumptions used in the going concern assessment should be consistent with assumptions used in other evaluations (see [Question 3.4.10](#)). Further, judgments made in the going concern assessment may require management to revisit other accounting matters, such as the following.

- A determination that certain future forecasted transactions may no longer be probable of occurring could require a reassessment of hedge accounting for related hedging relationships. See chapter 6 of KPMG Handbook, [Derivatives and hedging](#).
- Forecasted debt covenant violations may require current versus noncurrent debt classification to be revisited. For example, an entity's debt agreement may contain a covenant that restricts it from receiving an audit report on its annual financial statements that includes a going concern modification (see [Question 6.3.20](#)). Therefore, issuance of such an audit report would trigger a covenant violation, making the debt callable by the creditor.
- A determination that the ability to generate taxable income is compromised may result in the need to adjust the valuation allowance for deferred tax assets. Specifically, we believe that substantial doubt disclosure generally necessitates a valuation allowance for all deferred tax assets that are not realizable through the reversal of existing taxable temporary differences or taxable income in carryback years. See Example 4.19 in KPMG Handbook, [Accounting for income taxes](#).
- A determination that long-lived assets have significantly decreased in market value may signal impairment if the carrying value of those assets may no longer be recoverable.
- Plans to sell an asset or a group of assets should be assessed for probability under the held-for-sale guidance in Subtopic 360-10. We expect the probability assessment to be consistent with that in Step 2 of the going concern assessment. See section 4.2.50 in KPMG Handbook, [Discontinued operations and held-for-sale disposal groups](#).
- Management's plans to mitigate liquidity concerns through furloughs or a reduction in workforce may affect the accounting for share-based payments and other employee benefit and compensation arrangements.
- A reduced workforce may compromise the ability to deliver on growth expectations. The growth rate assumption used in the goodwill impairment test should be adjusted accordingly.

## 6.2 Risk assessment and internal control over financial reporting

### Question 6.2.10 How does the going concern assessment affect management's consideration of risks and ICFR?

**Interpretive response:** Performing the following steps can help management develop its risk assessment and ICFR to adequately address the risk associated with applying Subtopic 205-40.



Management's assessment typically includes an analysis of the entity's current and forecasted financial condition and liquidity (see [section 3.2](#)) as well as the forecasted effect of management's plans to mitigate conditions and events that give rise to a going concern uncertainty, if any (see [Question 4.3.10](#)). In those situations, proper controls will need to be designed and implemented over the preparation of these forecasts, over the completeness and accuracy of the information and reasonableness of the assumptions used in the forecasts, and the appropriateness of relevant disclosures. Because of the judgment likely involved in the assessment, the related controls may include management review controls. Management may be able to leverage existing processes and controls over projected financial information used in other areas of its financial reporting.

## 6.3 Auditor's responsibility

**Question 6.3.10** What is the auditor's responsibility for assessing the entity's ability to continue as a going concern and how does that differ from management's responsibility?

**Interpretive response:** US auditing standards require that an auditor independently evaluate whether there is substantial doubt about an entity's ability to continue as a going concern.

The auditor's specific responsibilities are to:

- obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
- conclude, based on the audit evidence obtained, whether substantial doubt exists about the entity's ability to continue as a going concern during the look-forward period; and
- evaluate the possible financial statement effects (including the adequacy of disclosure) regarding the entity's ability to continue as a going concern during the look-forward period.

The AICPA going concern standard, AU-C 570, was amended after the issuance of Subtopic 205-40 to align the going concern assessment to that of the accounting framework applied by the entity – e.g. US GAAP or IFRS® Accounting Standards. Therefore, conclusions under AICPA auditing standards and US GAAP should be consistent.

The PCAOB going concern standard, AS 2415, is similar to the US GAAP requirements but was not amended to specifically reflect the guidance in Subtopic 205-40. The PCAOB issued a staff position paper that stated auditors should look to the requirements in the accounting framework applied by the entity, but noted that a determination by management that no disclosure is required under Subtopic 205-40 is not conclusive as to whether an explanatory paragraph is required in the auditor's report (see [Question 6.3.20](#)). In an audit conducted under PCAOB auditing standards, the auditor makes a qualitative assessment based on the relevant conditions and events and other considerations set forth in AS 2415. However, we expect that the conclusions under PCAOB auditing standards and US GAAP will be consistent. [[PCAOB SAPA 13](#)]



### Question 6.3.20 What are the implications on the auditor's report if substantial doubt is raised?

#### Interpretive response:

##### ***Substantial doubt is raised but alleviated and disclosures are adequate***

If substantial doubt is raised but alleviated by management's plans, the auditor may consider including an emphasis-of-matter paragraph in the auditor's report. If the auditor decides to include such a paragraph, it highlights the liquidity issues related to the entity's disclosures without affecting the auditor's opinion. [AS 3101.19, AU-C 570.A54]

##### ***Substantial doubt exists and disclosures are adequate***

If substantial doubt is raised but not alleviated by management's plans and the auditor concludes that the disclosures are adequate, the auditor's report will reflect that conclusion in either:

- an explanatory paragraph (for audits conducted under PCAOB auditing standards); or [AS 2415.12]
- a going concern section (for audits conducted under AICPA auditing standards). [AU-C 570.24, AU-C 700.29]

The PCAOB uses different terms for paragraphs included in the auditor's report when matters are required to be reported (explanatory paragraph) and when they are optional (emphasis-of-matter paragraph). The AICPA requires auditors to use a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as a going concern. These paragraphs do not affect the auditor's opinion under either PCAOB or AICPA auditing standards. [AS 3101.18, AS 3101.19, AU-C 570.A51]

Additionally, the AICPA specifies that going concern matters are, by their nature, key audit matters, but they should not be described in the Key Audit Matters section of the auditor's report. Instead, the auditor includes a reference to the going concern section in the key audit matters section if the auditor has been engaged to report on key audit matters. [AU-C 701.14]

##### ***Going concern disclosures are not adequate***

If the auditor determines the going concern disclosures are inadequate, the auditor may issue a qualified or adverse opinion due to the departure from US GAAP. [AS 2415.14, AU-C 570.26]

There could be circumstances when multiple uncertainties exist that make it impossible to form an opinion on the financial statements as a whole due to the interaction and possible cumulative effects of the uncertainties resulting in a disclaimer of opinion (i.e. the auditor does not express any opinion). [AS 3105.45, AU-C 705.10]

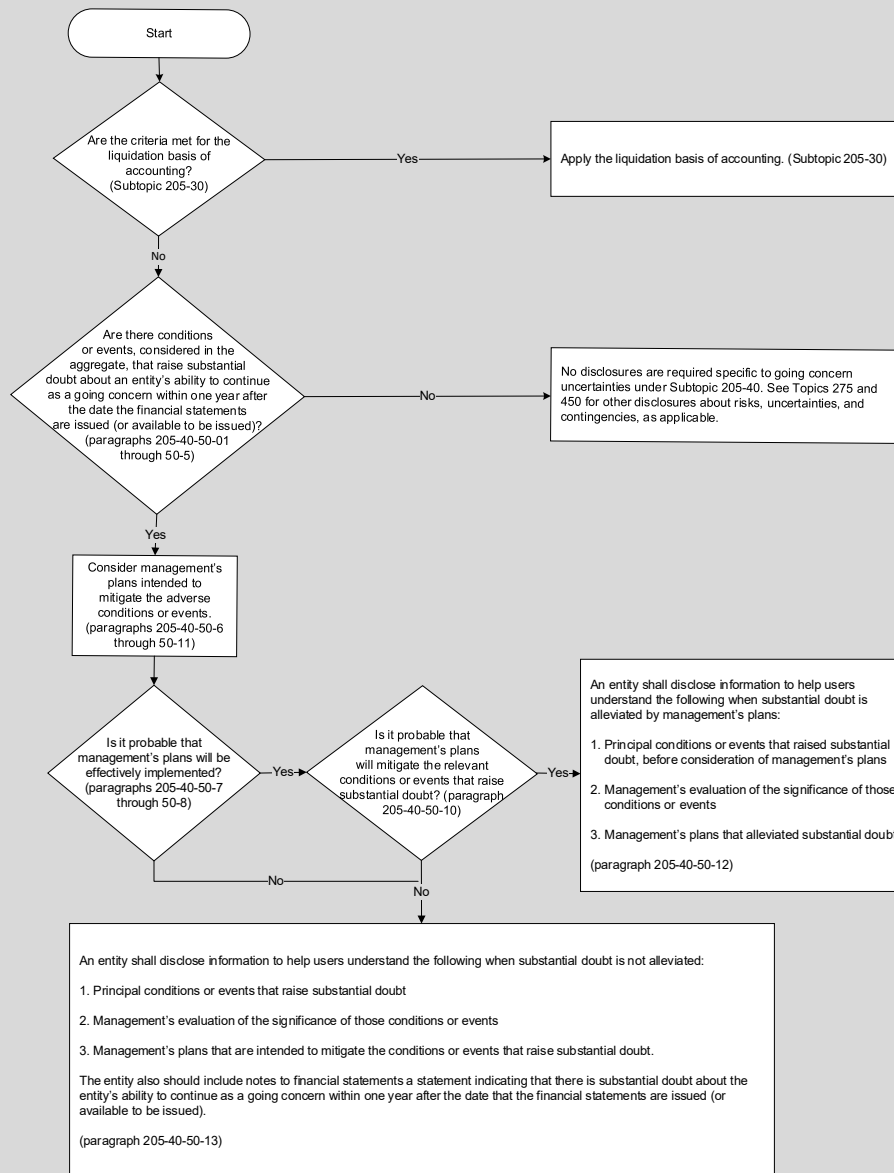
# Appendix A: Decision flowchart

## Excerpt from ASC 205-40

> Implementation Guidance

• > Decision Flowchart

**55-1** The following flowchart depicts the decision process to follow for evaluating whether there is substantial doubt about an entity's ability to continue as a going concern and determining related disclosure requirements.



# Appendix B: Examples

Examples of conditions or events that, individually or collectively, may raise substantial doubt about the entity's ability to continue as a going concern. Some examples are suggested by Subtopic 205-40 and others are additional examples that we believe should be considered. [205-40-55-2]

At the assessment date, is the entity experiencing (or expecting to experience within the look-forward period) any of the following?	
<b>Customer demand</b>	<ul style="list-style-type: none"> <li>• Loss of a principal customer or major market</li> <li>• Significant decline in customer demand or adverse changes in consumption behavior</li> <li>• Adverse changes in pricing</li> <li>• Emergence of a highly successful competitor</li> </ul>
<b>Supply chain</b>	<ul style="list-style-type: none"> <li>• Loss of a principal supplier</li> <li>• Production delays or product shortages</li> <li>• Supply chain shortages or restrictions in import/export of machinery, components or raw materials</li> <li>• Adverse changes in the price of significant product inputs, such as commodities</li> </ul>
<b>People</b>	<ul style="list-style-type: none"> <li>• Loss of key management or key person without replacement</li> <li>• Unexpected management changes</li> <li>• Staffing shortages or other labor difficulties</li> <li>• Adverse changes in labor laws and regulations</li> </ul>
<b>Operations</b>	<ul style="list-style-type: none"> <li>• Intentions to liquidate the entity or cease operations</li> <li>• Plant, store, office or other facility closures</li> <li>• Loss of a major franchise, license or patent</li> <li>• Lack of success in a project critical to the entity (e.g. failure to obtain FDA approval on the entity's main new drug candidate)</li> <li>• Significant uneconomic long-term commitments</li> <li>• Need to significantly revise operations</li> <li>• Unexpected organizational changes</li> <li>• Fundamental and significant changes in the industry in which the entity operates</li> <li>• Economical and geopolitical instability in regions where the entity operates (e.g. significant currency devaluation, economy becoming highly inflationary)</li> </ul>
<b>Markets</b>	<ul style="list-style-type: none"> <li>• Significant exposure to volatile markets, such as: <ul style="list-style-type: none"> <li>— Exchange rates</li> <li>— Commodities (e.g. crude oil prices)</li> <li>— Stocks</li> <li>— Interest rates</li> </ul> </li> </ul>
<b>Assets</b>	<ul style="list-style-type: none"> <li>• Natural disaster (e.g. drought, earthquake, flood) or cyber attack, for which the entity is uninsured or underinsured</li> <li>• Loss of assets or loss of asset value due to physical destruction, abandonment, theft, seizing or change in regulation</li> </ul>

At the assessment date, is the entity experiencing (or expecting to experience within the look-forward period) any of the following?	
<b>Liquidity and overall financial condition</b>	<ul style="list-style-type: none"> <li>• Debt becoming due or callable, e.g. debt covenant violation</li> <li>• Net liability or net current liability position (e.g. working capital deficiency)</li> <li>• Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment</li> <li>• Excessive reliance on short-term borrowings to finance long-term assets</li> <li>• Indications of withdrawal of financial support by debtors and other creditors</li> <li>• Negative operating cash flows or substantial operating losses</li> <li>• Adverse key financial ratios</li> <li>• Significant deterioration in the value of assets used to generate cash flows</li> <li>• Arrears or discontinuance of dividends</li> <li>• Inability to pay creditors on due dates</li> <li>• Inability to comply with the terms of loan agreements</li> <li>• Change from credit to cash-on-delivery transactions with suppliers</li> <li>• Inability to obtain financing for essential new product development or other essential investments</li> <li>• Debt restructuring (other than refinancing)</li> <li>• Need to seek new sources or methods of financing or dispose of substantial assets</li> <li>• Changes in trade terms, including availability of trade credit</li> <li>• Greater reliance on non-traditional financing arrangements</li> <li>• Greater restrictions on access to necessary capital and credit</li> <li>• Downward revisions to the entity's credit agency ratings</li> <li>• Significant increase in the level of bad debts or insolvency of significant customers or other debtors</li> <li>• Adverse changes in the credit risk ascribed to transaction counterparties</li> </ul>
<b>Regulatory environment</b>	<ul style="list-style-type: none"> <li>• Non-compliance with capital or other statutory, regulatory, or reserve requirements, such as solvency or liquidity requirements for financial institutions</li> <li>• Pending tax, legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy</li> <li>• Adverse changes in law, regulation or government policy</li> <li>• Unstable or changing regulatory environments, including more proactive regulatory oversight</li> <li>• Regulatory inquiries into the entity's operations or financial reporting</li> </ul>

# Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. The following symbols are used throughout this Handbook to indicate the types of revisions made in this edition for sections, Questions, Examples and other items:

- \*\* new item
- # significant updates or revisions to the item

## 3. Step 1: Assess whether substantial doubt is raised

### Questions

**Question 3.2.30** How does management assess a line of credit that is conditional?#

**Question 3.3.40** How does management consider contingent and other uncertain liabilities in the going concern assessment? \*\*

**Question 3.3.50** How does management assess nonrecourse loans coming due within the look-forward period? \*\*

### Examples

**Example 3.1.30** Management's plan vs action in normal course for real estate industry \*\*

**Example 3.3.10** Nonrecourse loan coming due within the look-forward period \*\*

## 5. Disclosures

5.3 Other disclosure considerations

**Observation** Disclosure inconsistency \*\*

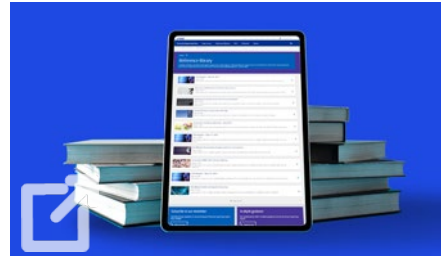
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