Commitments, Contingencies & Going Concern Issues

Session 5D

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Marcithomas2018@gmail.com

Commitments, Contingencies & Going Concern Issues

- Last 3 years have been challenging for many NFPs resulting in issues related to commitments, contingencies and going concern.
- These issues are often overlooked because although some may result in accounting entries, others are simply disclosures (unrecognized contingencies).
- All are important, especially during these times because they provide necessary information to users of financial statements
- Professional literature related to commitments and contingencies can be found in ASC 440 for commitments and ASC 450 for contingencies. Guarantees are at ASC 460.
- Professional literature related to going concern is found in ASC 205-40-50

Commitments and Contingencies

- **Commitments-** contractual obligations
- **Contingencies-** existing situations, conditions or events that will be resolved the future when an event occurs or fails to occur.
  - create a current obligation, gain or loss
  - Primary accounting focuses on current liabilities
- Objectives:
  - have all of the commitments and contingencies been disclosed (completeness)
  - have all contingencies that need accrual been valued properly

Commitments & Contingencies

- *ASC 440 Commitments*, provides general guidance for commitments. The guidance is broken down into two categories of commitments: general commitments and unconditional purchase obligations.

- ASC 450, *Contingencies*, contains guidance on the recognition, measurement, presentation and disclosure requirements related to loss contingencies. Disclosures of gain and loss contingencies continue to be an area of focus for stakeholders, and auditors.

- ASC 460, *Guarantees*, provides guidance on a guarantor's recognition, measurement, and disclosures for certain guarantees, including **financial guarantees**, **performance guarantees**, **indemnifications**, **indirect guarantees of indebtedness of others**, and **product warranties**. The required disclosures include information on the nature of the guarantees, potential maximum payments under the guarantees, as well as possible recoveries.

Commitments

- ASC 440, *Commitments*- Some commitments like leases are recorded. ASC 842 requires all leases that do not meet the short-term lease criteria to be recorded on the balance sheet.
- Pension plans represent commitments to pay beneficiaries. (ASC 715)
- Other examples of commitments
  - Unused letters of credit
  - Assets pledged as security for loans
  - Commitments for plant acquisition
  - Obligation to maintain working capital or other covenant requirements

Commitments and NFPs

- ASC 440, *Commitments- Disclosure*
  - Terms of long-term contractual obligations with suppliers or customers for future purchases or sales at specific prices or amounts
  - Commitments to make grants to others
  - Provide for any material losses to be sustained
  - Purchase under unconditional purchase obligations/ with supplier financings
  - Lease commitments
  - Maturities of long-term debt
  - Obligations to reduce debt, maintain working capital
  - Unfunded commitments related to debt

Example Commitment Footnote

On June 22, 2020, the Council received loan proceeds in the amount of $1,250,000 under the Paycheck Protection Program (“PPP”). Established as part of the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”), the PPP provides for loans to qualifying organizations in amounts up to 2.5 times the organization’s average monthly payroll expenses. PPP loans and accrued interest are forgivable after a “covered period” (eight or 24 weeks) as long as the borrower maintains its payroll levels and uses the loan proceeds for eligible purposes, including payroll, benefits, rent, and utilities. The forgiveness amount will be reduced if the borrower terminates employees or reduces salaries during the covered period. Any unforgiven portion of a PPP loan is payable over two or five years at an interest rate of 1%, with a deferral of payments for 10 months after the end of the covered period. the Council intends to use PPP loan proceeds for purposes consistent with the PPP and apply for forgiveness within 10 months of the end of the covered period. To the extent that the Council is not granted forgiveness, the Council will be required to pay interest on the PPP loan at a rate of 1% per annum. If the application for forgiveness is not made within 10 months of the end of the covered period, payments of principal and interest will be required through the maturity date of Month, day, 202X. The terms of the loan provide for customary events of default, including payment defaults, breach of representation of warranties, and insolvency events. The PPP loan may be accelerated upon the occurrence of a default event.

Contingencies

- The accounting and reporting framework for loss contingencies was established many years ago in the early 1970's form of FASB 5.
- The literature was subsequently superseded by the substantively same guidance om the form of ASC 450-20 loss contingencies.
- Gain contingencies are addressed in ASC 450-30.
- Terminology
  - Probable (likely)
  - Reasonably possible (<probable, > remote)
  - Remote
  - Realized or realizable

Contingencies

- Examples
  - Possible payback of grant funds
  - Settlement or other payout on a lawsuit
  - Contingency related to violations of donor requirements
  - Contingency related to violations of laws or regulations
  - Guarantees
  - Casualty loss on damaged equipment
  - Workers compensation loss
  - Malpractice loss

Contingencies

- ASC 450, *Contingencies*
  - Accrual depends on whether the occurrence is probable, reasonably possible or remote that event will give rise to a gain or loss
  - **Loss**- required if both conditions are met
    - Information available prior to F/S issuance indicates it is probable that an asset has been impaired, or liability incurred at date of F/S
    - Amount of the loss is reasonably estimable
  - **Gain**- Not generally reflected in the accounts but needs disclosure taking care to avoid misleading implications as to the likelihood

Contingencies- Example

A NFP sustained a fire at one of its properties. When the loss occurred, the CFO **recorded an immediate write-off of the net carrying amount of the destroyed property, with a corresponding debit to record the loss on the income statement.**

He expected insurance proceeds to cover some of the incurred loss but did not expect any proceeds until the next accounting period. He recorded the insurance proceeds recoverable at year end but only to the extent that receipt was **probable** (likely to occur). The corresponding credit was recorded as a reduction of the loss incurred from the write-off of the carrying value of the related property.

The FASB does not permit the amount of the receivable and the related income statement credit to exceed the carrying amount of the property that was written off, even if it is probable that insurance proceeds in excess of the asset's net carrying amount will be recovered.

This is because any expected recoveries in excess of losses incurred are viewed as gain contingencies under ASC 450-30, which states expected recoveries in excess of losses incurred are to be recorded only when the insurance proceeds are received, or when all contingencies related to the insurance claim are resolved, as of the balance-sheet date.

Contingencies- Example

A NFP was involved in litigation related to claims made by a patient's family that their loved one had sustained an injury. The organization's attorney negotiated a settlement and believed that the outcome would be at least at that level. At year end the settlement had been proposed to the attorney of the injured party but not accepted.

The amount of settlement should be accrued because even though not finalized, it represented the lower end of the probable loss and could be reasonably estimated. Peer reviewers have noted that this is not always considered.

Remember that it is important to update the legal letter if there are any issues at least with the entity to determine if an updated request for a letter should be sent.

Contingencies- Disclosure

- If there is a reasonable possibility of a loss but other conditions are not met, then a disclosure is required
    - Nature of contingency
    - Estimate of the loss or range or statement that an estimate cannot be made
    - Disclosure of unasserted claims is not necessary unless an underlying event has occurred indicating a potential loss or liability and it is probable the claim will be asserted and reasonably possible the outcome would be unfavorable.
        - Self insured losses for worker’s compensation, self funded health benefits, malpractice or other injury claims.

Contingencies- Disclosure

- Nature and amount of an accrued loss contingency, if the disclosure is necessary to keep the financial statements from being misleading

- Unaccrued loss contingency or when the exposure to loss exists greater than the amount accrued, if there is at least a reasonable possibility that a loss or additiona loss may have occurred-

  - Nature of contingency

  - Estimate of possible loss or range of loss or a statement that an estimate cannot be made

- Contingencies that might result in gains should be adequately disclosed but not accrued.

Contingencies- NFP Specific

- Notes to NFP financial statements may need to include information about:
  - Noncompliance with donor-imposed restrictions
  - Issues with the NFP's tax exempt status or that a determination letter has not bee received
  - Issues related to uncertain tax positions

Contingencies- Disclosure

Disclose:

- If it is at least reasonably possible that the effect of significant estimates involving contingencies will change within one year of the financial statements due to future confirming events and the effect would be material:
  - Disclose that it is reasonably possible that a change will occur in the near term.
- If a change from occurrence-based insurance to claims made insurance (claims made at a future date vs during the policy period unless there is a tail.
- If insurance coverage as been eliminated or significantly reduced and it is reasonably possible a loss has been incurred.

Example Footnote- Estimates and Assumptions

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples of estimates and assumptions include: for revenue recognition- determining the nature and timing of satisfaction of performance obligations, determining the standalone selling price of performance obligations, variable consideration, and other obligations such as product returns and refunds; **loss contingencies**; **product warranties**; the fair value of and/or potential impairment of goodwill and intangible assets for our reporting units; product life cycles; useful lives of our tangible and intangible assets; allowances for doubtful accounts; the market value of, and demand for, our inventory; stock-based compensation forfeiture rates; when technological feasibility is achieved for our products; the potential outcome of uncertain tax positions that have been recognized in our consolidated financial statements or tax returns; and determining the timing and amount of impairments for investments. Actual results and outcomes may differ from management's estimates and assumptions due to risks and uncertainties.

Example Policy Footnote

Legal and Other Contingencies

The outcomes of legal proceedings and claims brought against us are subject to significant uncertainty. An estimated loss from a loss contingency such as a legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. In determining whether a loss should be accrued we evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our consolidated financial statements.

Example Contingency Footnote

Indemnifications and Contingencies

The organization has indemnification agreements with our directors and our executive officers that require us, among other things, to indemnify them for costs associated with any fees, expenses, judgments, fines, and settlement amounts incurred by any of those persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person’s service as a director or officer, including any action by us, arising out of that person’s services as our director or officer or that person’s services provided to any other company or enterprise at our request. We maintain director and officer insurance coverage that may enable us to recover a portion of any future indemnification amounts paid. To date, there have been no claims under any of our directors’ and executive officers’ indemnification provisions.

Example- Contingency Footnote

NOTE 23—CONTINGENCIES COVID-19 Pandemic

The COVID-19 pandemic, whose effects first became known in January 2020, is continuing to have a broad and negative impact on commerce and financial markets around the world and COVID-19 variants have produced a sequence of infection spikes that require changes to how our economy operates. The United States and global markets experienced significant disruption resulting from uncertainty caused by the pandemic. The Council is closely monitoring its investment portfolio and its liquidity and is actively working to manage the continuing impact of the pandemic . The extent of the impact of COVID-19 on the Council's operational and financial performance will depend on certain developments, including the duration of the pandemic and its impacts on the Council's donors, customers, employees, and vendors, all of which at present, cannot be determined. Accordingly, the extent to which COVID-19 may impact the Council's financial position and changes in net assets and cash flows is uncertain and the accompanying consolidated financial statements include no adjustments relating to the effects of this pandemic.

Example- Contingency Footnote

NOTE 23—CONTINGENCIES (CONTINUED)

The Council has been named as a defendant or has been made aware of personal injury claims against it. The Council has and will continue to vigorously defend these actions. These claims are covered by the National Council, Boy Scouts of America's general liability insurance program ("GLIP"). At the present time, management is unable to estimate a probable outcome of these matters and accordingly no provision for liabilities, if any, has been made in the accompanying financial statements. Changes in state law could result in additional claims being asserted against the Council.

The National Council has been named as a defendant in lawsuits alleging sexual abuse, including claims for compensatory and punitive damages. Some of these claims arise out of conduct occurring on Council property and/or were committed by Council employees or volunteers, and in some cases the Council is named as a co-defendant with the National Council. The National Council has disclosed that in the event that its GLIP or its reserves are insufficient to resolve such claims, it is their opinion that the total amount of payments to resolve current and future claims could have a significant impact on the financial position or results of operations of the National Council.

Example- Contingency Footnote

NOTE 23—CONTINGENCIES (CONTINUED)

The National Council provides the Council with a charter, program materials and support for administration as well as sponsoring certain benefit plans for Council employees. Since 1978 the National Council has operated a GLIP in which the Council participates. On February 18, 2020, the National Council filed for protection under chapter 11 of the United States Bankruptcy Code. The National Council continues to operate its business in the ordinary course and has received bankruptcy court approval to continue its relationship with the Councils including the benefit and insurance programs noted above. Neither the Council nor any other local council are currently parties to the bankruptcy proceeding. The court has granted a stay on litigation against both the National Council and local councils and the National Council has proposed a plan of reorganization that would protect local councils from any further legal exposure for abuse claims arising prior to February 18, 2020. Such plan will require a contribution from local councils.

As of this date, the Council's contribution is expected to be $__________, however that may increase. The ability of the National Council to confirm such a plan is unknown. Management of the Council is unable to assess the effect, if any, the resolution of these matters by the National Council may have on the Council's operations or its financial statements.

Example- Contingency Footnote

Other Contingencies

We also are subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. Although management currently believes that resolving claims against us, individually or in aggregate, will not have a material adverse impact in our consolidated financial statements, these matters are subject to inherent uncertainties and management's view of these matters may change in the future.

As of June 30, 2022, we accrued aggregate legal liabilities of $364 million. While we intend to defend these matters vigorously, adverse outcomes that we estimate could reach approximately $600 million in aggregate beyond recorded amounts are reasonably possible. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact in our consolidated financial statements for the period in which the effects become reasonably estimable

Contingency- Amount to Accrue

- If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, that amount should be accrued.
- When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.
- Even though the minimum amount in the range is not necessarily the amount of loss that will be ultimately determined, it is not likely that the ultimate loss will be less than the minimum amount.

Contingency Exercise

Helping Hands Home Health company that provides home care to patients. Two years an elderly patient’s family filed a $1 million lawsuit stating that a home health caregiver was careless in their treatment of an elderly patient causing significant bruising and a broken arm. At the end of the year, the attorneys for both companies have concluded that it is probable that the family will win the lawsuit, putting its chances of success of between 75-80%. In addition, Helping Hand’s lawyers believe the family will settle the lawsuit in the coming year, costing Helping Hands between $500,000 and $750,000.

Consider	Your Answer
Helping Hands should or should not disclose the loss contingency related to the lawsuit.	
Helping Hands should or should not accrue for the loss contingency related to the lawsuit.	
If you said yes to the second question, how much should Helping Hands accrue?	

Contingency Exercise

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Consider	Your Answer
Helping Hands should or should not disclose the loss contingency related to the lawsuit.	Disclose
Helping Hands should or should not accrue for the loss contingency related to the lawsuit.	Accrue it probable the loss will occur
If you said yes to the second question, how much should Helping Hands accrue?	If there is no better estimate, $500,000

Product Warranties

Warranties (ASC 460)

- Warranty obligations fall within the definition of a contingency. Losses from warranty obligations shall be accrued when it is probable that customers will make claims under warranties relating to goods or services.

- Experience of an entity is generally used but if there is none then other information from the experience of other entities in the same business may be appropriate.

- Inability to make a reasonable estimate of the amount of a warranty obligation at the time of sale due to significant uncertainty about possible claims may **cause the entity to question whether a sale should be recorded** before expiration of the warranty period or until sufficient experience has been gained to permit a reasonable estimate of the obligation.
- Accounting for extended warranties falls under ASC 606.

Guarantees- Guarantor

- ASC 460, *Guarantees*
  - **Community Foundations** and other NFPs provide guarantees to other NFPs as a program service
  - Enables NFP to receive a lower rate of interest
  - A guarantor recognizes a liability for the fair value of the guarantee at inception because of the stand ready provision
  - If a guarantee is issued as a contribution to an **unrelated party** the liability should be measured at its **fair value** (noncontingent element) or loss contingency (**probable and reasonably estimated**) whichever is greater.
  - Since it is not likely that an observable fair value of the noncontingent element is available, the CF could **consider the interest differential as a proxy for FV.**

Guarantees- Guarantor

- ASC 460, *Guarantees*
  - With a CF the initial recognition would be to debit contribution expense and credit to guarantee liability
  - Subsequent accounting according to ASC 460 **is not specifically prescribed** but would typically be to a revenue account. In the case of a **CF it is more likely that contribution expense would be reduced**.
  - The guarantor would evaluate the guarantee of debt for expected credit losses
  - Disclosures are necessary

Guarantees- NFP Recipients of Guarantees

- NFP **recipient** will record a guarantee **even when it is not probable** that payments will be required under the guarantee.
- Guarantee is **part conditional contribution** (promise of the guarantor to make payments in future periods on default) and also **unconditional** contribution- **gift of credit support**
- The FinREC believes that in the absence of observable market inputs for measuring the premium, **the fair value of the guarantee may be estimated as the present value of the NFP's interest savings.**
- The recipient would record an expense and a contribution since this is treated in the same way a below market interest rate loan.

Guarantees- Subsequent Measurement

- The FinREC notes that the recipient of the **guarantee** should amortize the amount of the gift (the **guarantee**) over the life of the loan using the effective interest method.
- Straight-line amortization is allowable if the difference between the straight-line amortization amount and the amount using the effective interest method is immaterial.
- The FinREC believes that **if there is a default** the NFP recipient would recognize contribution revenue if any subsequent amount the guarantor pays on its behalf is not repayable or a liability if it is.

Guarantees and the Current Expected Credit Loss Standard- Guarantors

- A guarantee in the scope of Subtopic 326-20 consists of two components, one of which is recognized and measured under Topic 460, Guarantees, and the other under Subtopic 326-20, Credit Losses.

Non-contingent obligation to stand ready to perform	Contingent obligation to make future payments if specific conditions occur

Guarantees and the Current Expected Credit Loss Standard

- **Non-contingent** stand-ready obligation- liability is recognized under ASC 460 at fair value at inception.
  - The fair value of a guarantee inherently includes a market participant's assumptions regarding credit risk in the guarantee.
  - FinREC recommends using the interest differential as the amount of the non-contingent portion of the guarantee for a NFP.
- **Contingent obligation-** a separate liability for off-balance sheet credit risk is recognized under **ASC 326-20** for expected credit losses related to the contingent obligation.
- The FASB decided that this approach was necessary to appropriately present expected credit losses on guarantees without affecting the accounting for the non-contingent obligation.

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Guarantees and the Current Expected Credit Loss Standard

- Two aspects of the guarantor's estimation of expected credit losses for the **contingent** obligation:
  - the likelihood that the guarantor will have to fulfill the obligation
  - an estimate of expected credit losses on the obligation.
- The estimate of expected credit losses on the obligation considers the risk attributes of the guarantee.

Guarantees and the Current Expected Credit Loss Standard

- Measurement of the guarantee liability for the **contingent aspect** of the guarantee is determined under ASC 326-20. At each reporting date, an organization estimates expected credit losses and adjusts the liability for off-balance sheet credit losses through net income.
- This is expected to result in larger liability because previously the incurred model was used for the contingent liability.

Guarantees and Product Warranties Disclosure

- Nature of the guarantee, including the term, how it arose and the events or circumstances that would require the entity to perform.
- Current status at balance sheet date of payment/performance risk of the guarantee
- Maximum potential amount of future payments the entity could be required to make (undiscounted and not reduced by recoveries under recourse or collateral provision) or reason why an estimate cannot be made (NA for product warranties)
- Carrying amount of the liability including any amount recognized as a loss contingency
- Recourse provisions that would enable the entity to recover amounts paid under the agreement.

Guarantees and Product Warranties Disclosure

- Tabular reconciliation of the changes in the entity’s aggregate liability for product warranties
  - including the beginning balance
  - aggregate reductions for payments made
  - aggregate changes for accruals related to guarantees issued during the period
  - aggregate changes to preexisting accruals (change in estimate and enging liability balance.

Guarantees- Example Footnote

Note F. Guarantee of Debt

In connection with its programs to benefit the community the Community Foundation has guaranteed approximately $1,000,000 of the debt of local not-for-profit organizations. The guarantees is scheduled to expire at varying dates from 20X3-20X6. Should the not-for-profit organizations default on their loans due to failure to service their debt or violate financial covenants the Community Foundation would be required to provide a cash payment pursuant to the guarantee. The Community Foundation recorded a liability for the fair value of the guarantee which approximates the interest savings to the not-for-profits on the guarantees. Based on information gathered as part of its monitoring of risks, the Community Foundation has assessed the expected credit losses should the not-for-profits not remain current with their debt payments and the Community Foundation would be required to perform under the guarantee. The amount of expected credit losses is not expected to be material.

Example Disclosure- Accounting Policy

Product Warranty (NFP software development company)

We provide for the estimated costs of fulfilling our obligations under hardware and software warranties at the time the related revenue is recognized. For hardware warranties, we estimate the costs based on historical and projected product failure rates, historical and projected repair costs, and knowledge of specific product failures (if any). The specific hardware warranty terms and conditions vary depending upon the product sold and the country in which we do business, but generally include parts and labor over a period generally ranging from 90 days to three years. For software warranties, we estimate the costs to provide bug fixes, such as security patches, over the estimated life of the software. We regularly reevaluate our estimates to assess the adequacy of the recorded warranty liabilities and adjust the amounts as necessary.

Guarantees and Product Warranties Disclosure Example

Note 8 Warranties		
A reconciliation of accrued warranty and related expenses follows:		
Year ended May 31,		
(In thousands)		
	20X1	**20X0**
Balance at the beginning of the period	$ 5,870	$ 4,966
Accruals for warranty settlements	5,191	5,990
Settlements made during the period	(5,179)	(5,086)
Balance at the end of the period	$ 5,882	$ 5,870
Noncurrent balance included in other deferred liabilities	$ 2,200	$ 2,000

The provision for warranties relates mainly to paper sold during 20X1 and 20X0. The provision has been estimated based on historical warranty data associated with similar products and services. The Group expects to settle the majority of the liability over the next year. The Company expects reimbursement of warranty expense incurred of $250,000 following a supplier accepting responsibility for the defective products. This settlement has not been recorded in the financial statements.

Commitments and Contingencies-Risk Assessment Procedures

- When the auditor performs a risk assessment, he/she will be concerned about identifying risks and uncertainties, especially where loss contingencies are present.

- This means understanding of the entity's internal controls around uncertainties be they related to litigation, self-insured risks, guarantees, concentrations of credit risk and going concern.

- Management may overlook contingencies and ultimately many may be disclosures but not recognized.

- The FASB requires disclosure of certain contingencies, so that financial statement users will be able to understand an entity's risks and how they could potentially affect the financial statements.

Audit Procedures- Commitments and Contingencies

- Determine completeness – reading minutes, contracts, loan agreements, etc., review legal expense and correspondence, correspondence from taxing authorities or other regulators. Send letters to legal counsel. Management representations
- Evaluate valuation
    - Legal
    - Commitments to purchase materials
    - Environmental hazards (special rules)
    - Impairment of property
    - Self-insured or partially insured liabilities
    - Warrantees
    - Letters of credit

Audit Procedures- Inquiries of Legal Counsel

- Client did not consult a lawyer
  - Inquiries of management and representation
- Dating of lawyers’ response- close to report date or at least confirm lose to the report date (subsequent events)
- Depending on the original letter the update may need to be written but often oral confirmation is enough

Risks and Uncertainties

- Disclosure of risks and uncertainties
    - Nature of operations- description of major products, services including location
    - Use of estimates in the preparation of financial statements- standardized
    - Certain significant estimates (if reasonably possible that the estimate will change in the near term and material)
    - Vulnerability due to certain concentrations
        - Volume of business transacted with a customer, supplier
        - Concentration of revenue from products, services
        - Market or geographic area

Risks and Uncertainties- Disclosure

Topic	When it is required	Disclosure
The nature of the entity's operations	Always	• A description of the entity's major products or services. Not-for-profit entities should briefly describe the principal services performed and the primary source of revenue. • The principal markets (e.g., industries and types of customers) for the entity's products or services. • The relative importance of each line of business, together with the basis for making that determination (e.g., based on sales, assets, earnings). This information need not be quantified; however, relative importance could be conveyed through the use of terms such as "predominantly," "about equally," or "major."
Use of estimates (general)	Always	The footnotes should include a general statement that the preparation of financial statements requires the use of estimates by management.

Risks and Uncertainties- Disclosure

Topic	When it is required	Disclosure
Significant estimates	When it is at least reasonably possible that the estimate of the effect on the financial statements could change in the near term due to future confirming events and the change in estimate would have a material effect on the financial statements.	• Nature of the uncertainty. Include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term (i.e., within one year of the date of the financial statements). • If the estimate involves a loss contingency covered by ASC 450 the disclosure also should indicate an estimate of the possible loss or range of loss, or a statement that such an estimate cannot be made. • Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required. • Disclosure of the risk-reduction techniques used to mitigate losses, or the uncertainty of future events is likewise encouraged but not required.

Risks and Uncertainties- Disclosure

Topic	When it is required	Disclosure
Entity's vulnerability due to concentrations	Concentration is present at the financial statement date increases the company's vulnerability to the risk of a near-term severe impact and it is reasonably possible that the events able to cause the severe impact could occur in the near term. Potentially significant impact.	• Disclosure of concentrations should be sufficient to inform users of the general nature of the associated risk.

Risks and Uncertainties- Example Footnotes

Concentrations of Credit Risk

The Company and its subsidiaries are engaged primarily in the manufacture and sale of highly diversified lines of medical, agricultural, and chemical products principally in North America. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers.

The credit risk for trade accounts receivable is concentrated because most of the balances are due from individuals located in the same geographical region. Charges to the results of operations for changes in estimates of the amount collectible from trade accounts receivable totaled $22.045 in 20X5 and $17,863 in 20X4. The valuation allowance is $45,000 at the end of 20X5 and 20X4.

Concentrations of Credit Risk Arising from Cash Deposits in Excess of Insured Limits

The Company maintains its cash balances in one financial institution located in Fort Worth, Texas. The balances are insured by the Federal Deposit Insurance Corporation up to $250,000. At December 31, 20X1, the Company's uninsured cash balances total $427,000.

Going Concern

- Going concern literature changed when ASC 205-40-50,
- Now an entity’s management is required to evaluate whether there are conditions or events, considered in the aggregate, 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 (or within one year after the date that the financial statements are available to be issued when applicable).
- Interim and annual
- Management’s evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial statements are available to be issued when applicable).

Going Concern Considerations

- Going concern is an assumption related to the basis of accounting.
- ASC 205-40-50 provides guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures, which should reduce diversity in the timing and content of footnote disclosures. The standard:
  - Requires management to assess an entity's ability to continue as a going concern
  - Provides a definition of the term substantial doubt about an entity's ability to continue as a going concern
  - Requires an evaluation every reporting period, including interim periods
  - Provides principles for considering the mitigating effect of management's plans

Going Concern Considerations- Risk Indicators

Financial Indicators
- Negative trends in cash flows from operating activities;
- Lack of available liquid funds or highly liquid assets;
- Recurring operating losses;• Lack of ability to obtain additional financing;
- Heavy reliance on related party for financial support;
- Defaults on debt, debt covenants, or both;
- Arrearages in dividends;
- Inadequate capitalization; and
- Adverse financial ratios.

Operational indicators
- Turnover of key management or other positions;
- Work stoppages or other labor difficulties;
- Substantial dependence on particular project success;
- Uneconomic long-term commitments;

Going Concern Considerations

Operational indicators

- Entrance into an unprofitable market
- Legal proceedings
- Legislative or regulatory proceedings jeopardizing operations
- Uninsured catastrophic event

COVID related indicators

- Curtailed operations
- Other governmental restrictions
- Deteriorating conditions of customers
- Supply chain impacts
- Cash flow and liquidity
- Access to credit
- Debt covenant and other contractual requirements

Going Concern Considerations

- Going concern is an assumption related to the basis of accounting.

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 ASC 450, Contingencies.- Glossary

Going Concern Considerations

- ASC 205-40 provides guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The standard:
  - Requires management to assess an entity's ability to continue as a going concern
  - Provides a definition of the term substantial doubt about an entity's ability to continue as a going concern
  - Requires an evaluation every reporting period, including interim periods
  - Provides principles for considering the mitigating effect of management's plans

Going Concern - Example

A NFP liberal arts college had a long history of subsidies from a few large donors who valued its religious principles. Beginning in 20X5 it began to see a drop in student enrollment. The development staff were informed by its large donors that due to its size and its market demographics the college needed to become more relevant to the students of the 21st century. This meant offering more online programs and residential program where a viable skill was taught such as medical technical skills and auto mechanics.

The college did not embrace these recommendations and was forced to draw down on its endowment to pay salaries and operating costs. The large donations of the past were not forthcoming. By 20X8 debt covenants were not being met, and management prepared a business continuity footnote. In 201X the college the college lost its accreditation. Management revised the footnote stating that it believed that circumstances were such that it would not remain a going concern. The auditors included a going concern paragraph in the auditor’s report.

By the end of the following year, operations ceased and the assets were being sold. As liquidation was imminent, the going concern basis was no longer appropriate.

Going Concern Considerations

Accountant/Auditor notes **no** going concern issues

Management's assessment is inherent in preparation of F/S

No disclosures required

Accountant/Auditor notes going concern issues

Ask management for their assessment.

Auditor determines that the entity is able to meet its obligations – apparent before report issuance (available to be issued)

No specific disclosures required for going concern. May talk about other issues- renegotiation of debt etc.

Going Concern Considerations

Accountant/Auditor notes going concern issues

Ask management for their assessment. Management believes going concern issue will be alleviated in timeframe

Auditor determines that it is probable that the entity will be able to meet its obligations within one year after F/S are issued (available to be issued)

Disclose circumstances giving rise to issue, management's plans to alleviate going concern issue. Auditor may include emphasis of a matter paragraph.

Ask management for their assessment. Management believes going concern issue will not be alleviated in timeframe

Auditor determines that it is probable that the entity will **not** be able to meet its obligations within one year after F/S are issued (available to be issued)

Disclose circumstances giving rise to issue, management's plans to alleviate going concern issue. Management concludes that the entity will not be able to continue as a going concern. If liquidation is not imminent, then going concern basis is used.

Auditor includes a going concern issue paragraph in the report. New audit requirements require this title.

Going Concern Considerations

- If a special purpose framework is used, then the requirement for management's specific evaluation is not applicable. The auditor will still:
  - conclude, based on the audit evidence obtained, whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time
  - Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time
- SAS 132 amended the audit language
- SSARS 24 and 25 amend the language and procedures

Going Concern Considerations- SSARS

- Language in the standard and the accountant's report is amended to conform
- If the financial reporting framework includes concept of going concern, perform review procedures related to:
  - whether the going concern basis of accounting is appropriate
  - management's evaluation of whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
  - if there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters
  - adequacy of the related disclosures in the financial statements.
- If financial reporting framework does not require management's evaluation the accountant will still perform procedures and evaluate disclosures

Going Concern Considerations

- The accountant should include an emphasis-of-matter paragraph in the accountant's review report they conclude that substantial doubt about the entity's ability to continue as a going concern for a reasonable time remains.
- The account may not reference the review or audit report of other accountants if that accountant's report includes an alert that restricts the use of the report.
- Remember that a review of financial statements is not designed to identity conditions or events that raise doubts about an entity's ability to continue as a going concern for a reasonable period of time.
- The accountant may be aware of conditions that existed at the date of the prior year's financial statements or identify conditions during the review procedures.

Going Concern Example Footnote

During March 2020, a global pandemic was declared by the World Health Organization related to the rapidly growing outbreak of a novel strain of coronavirus ("COVID-19"). The pandemic has significantly impacted the economic conditions in the U.S., accelerating during the first half of March, as federal, state, and local governments reacted to the public health crisis, creating significant uncertainties in the U.S. economy. In March 20X0, we announced the temporary closure of all stores for an unknown period of time and significant actions taken to mitigate the ongoing impact of the COVID-19 pandemic on our cash flows to protect our business and associates for the long term in response to the crisis. Such actions include targeted reductions in discretionary operating expenses such as advertising and payroll expenses, including furloughing our employees and seeking funding from our investors. We started reopening stores on January 1, 20X1. At December 31, 20X1 we have reopened our stores. Continued impacts of the pandemic have had a material adverse impact on our revenues, earnings, liquidity, and cash flows, and may require significant additional actions in response, including, but not limited to, further employee furloughs, reduced store hours, store closings and expense reductions, to mitigate such impacts. The extent of the impact of the pandemic on our business and financial results will depend largely on future developments, including future outbreaks and return of tenants to the office buildings in which we have our stors, all of which are highly uncertain and cannot be predicted. This situation is rapidly changing and additional impacts to the business may arise that we are not aware of currently. **Management has concluded that the Company may not be able to continue as a going concern and meet its obligations for the coming year, from the date of the issuance of these financial statements.**

Going Concern Example- Special Paragraph

Substantial Doubt Exists About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

KAPLAN