

FEBRUARY 2021

# RICHTER

## THE CFO SERIES

PLANNING FOR YEAR-END —  
CHANGES TO ACCOUNTING  
ESTIMATES AND THE COVID-19 IMPACT

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# OUR EXPERTS

PLANNING FOR YEAR-END – CHANGES TO  
ACCOUNTING ESTIMATES AND THE COVID-19 IMPACT



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RICHTER

# 1. INTRODUCTION



# INTRODUCTION

## OBJECTIVES

PART 1 –  
Accounting estimates (CAS 540)

PART 2 – COVID-19

- Understand the significant revisions in CAS 540 and how it will impact management's preparation of an accounting estimate;
  - Understand management's responsibilities for documenting significant aspects of their process in determining an accounting estimate;
  - Understand the impact on management because of changes to the auditor's responsibilities, including broad questions auditors are likely to ask those involved in the detailed aspects of the estimation process.
- 
- Understand how Covid-19 may impact the preparation of financial statements in the following areas:
    - Valuation of assets;
    - Debt modifications and covenant breaches; and
    - Going concern

## 2. PART 1 – ACCOUNTING ESTIMATES (CAS 540)



# ACCOUNTING ESTIMATES (CAS 540)

## WHY DO YOU NEED TO UNDERSTAND THE CHANGES TO THE AUDITING STANDARD OF ACCOUNTING ESTIMATES?

CHANGES WILL  
APPLY TO PERIODS  
BEGINNING  
ON OR AFTER  
DECEMBER 15, 2019

- Accounting estimates are the most complicated items to audit due to estimation uncertainty, complexity, and subjectivity.
- Changes to the audit standard, will in turn, result in **additional work for you**, specifically, in the following **two areas**:

1

Preparing the accounting estimate; and

2

Preparing information to respond to new requests from the auditor to obtain sufficient and appropriate audit evidence.

# ACCOUNTING ESTIMATES (CAS 540)

WHEN WE  
TALK ABOUT  
ACCOUNTING  
ESTIMATES  
WHAT ARE WE  
REFERRING TO?

CATEGORIES	EXAMPLES
ASSET VALUATION	<ul style="list-style-type: none"> <li>• Allowance for doubtful accounts</li> <li>• Inventory obsolescence and valuation</li> <li>• Depreciation methods for property, plant and equipment</li> <li>• Useful life of long-lived assets</li> <li>• Impairment of long-lived assets, or property and equipment held for disposal</li> <li>• Provision for expected credit losses (related to financial assets)</li> <li>• Fair value of financial assets, such as:                             <ul style="list-style-type: none"> <li>- Those traded in an active and open market</li> <li>- Derivative financial assets not publicly-traded</li> </ul> </li> </ul>
LIABILITY MEASUREMENT	<ul style="list-style-type: none"> <li>• Warranty obligations</li> <li>• Tax provisions</li> <li>• Costs arising from litigation settlements and judgments</li> <li>• Outcomes of litigation</li> <li>• Employee retirement benefit liabilities</li> <li>• Valuation of insurance contract liabilities</li> <li>• Fair value of equity in employee share-based payment</li> <li>• Fair value of services from non-employees</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

WHEN WE  
TALK ABOUT  
ACCOUNTING  
ESTIMATES  
WHAT ARE WE  
REFERRING TO?

CATEGORIES	EXAMPLES
REVENUE RECOGNITION	<ul style="list-style-type: none"> <li>Revenue recognition on long-term contracts using percentage of completion</li> </ul>
NON-MONETARY TRANSACTIONS	<ul style="list-style-type: none"> <li>Fair value of items exchanged (such as equipment) between unrelated parties for no monetary consideration</li> </ul>
BUSINESS COMBINATIONS	<ul style="list-style-type: none"> <li>Fair value of assets/liabilities acquired in a business combination, including goodwill and intangible assets</li> </ul>
DISCLOSURES	<ul style="list-style-type: none"> <li>Fair value disclosures</li> </ul>

ACCOUNTING  
ESTIMATES (CAS 540)

WHAT ARE THE CHANGES THAT WILL  
HAVE THE BIGGEST IMPACT ON YOU?

1

Enhanced risk assessment procedures related to obtaining an understanding of the entity and its environment

2

New concept of inherent risk factors : estimation uncertainty, complexity and subjectivity

3

New concept of scalability to recognize the spectrum of inherent risk

4

Objectives-based work effort requirements directed to methods, data and assumptions

5

Enhanced disclosure requirements

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## ACCOUNTING ESTIMATES (CAS 540)

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# ACCOUNTING ESTIMATES (CAS 540)

ENHANCED RISK ASSESSMENT PROCEDURES RELATED TO OBTAINING AN UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>• More granular assessments regarding the risk that accounting estimates are materially misstated.</li> </ul>	<ul style="list-style-type: none"> <li>• Consider the conditions and events that are likely to cause the accounting estimates to be materially misstated.</li> <li>• Consider whether the system of internal control is likely to prevent material misstatements, or if a material misstatement occurs, is likely to detect and correct it.</li> </ul>	<ul style="list-style-type: none"> <li>• The auditor may place more emphasis on obtaining an understanding of the nature and extent of your estimation process and key aspects of the related policies and procedures which will require additional documentation.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

## ENHANCED RISK ASSESSMENT PROCEDURES RELATED TO OBTAINING AN UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT

### UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

#### BEFORE



#### NOW



Historically, you were asked to provide an overview of your business and the environment you operate in.



Now you will be asked to provide an overview that is specific to an accounting estimate:

- Transactions and other events and conditions that may give rise to the need for, or changes in, accounting estimates.
- The requirements of the applicable financial reporting framework.
- Regulatory factors relevant to accounting estimates.
- The nature of the accounting estimates and related disclosures.

# ACCOUNTING ESTIMATES (CAS 540)

## ENHANCED RISK ASSESSMENT PROCEDURES RELATED TO OBTAINING AN UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT

OBTAIN AN UNDERSTANDING OF THE ENTITY'S SYSTEM OF INTERNAL CONTROLS

COMPONENTS	WHAT SHOULD YOU CONSIDER DOCUMENTING FOR EACH ACCOUNTING ESTIMATE?
1. CONTROL ENVIRONMENT	<ul style="list-style-type: none"> <li>• The nature and extent of oversight and governance in place over the financial reporting process relevant to accounting estimates</li> <li>• How you considered the need for specialized skills or knowledge, including the use of an expert</li> </ul>
2. RISK ASSESSMENT	<ul style="list-style-type: none"> <li>• How your risk assessment process identifies and addresses risks relating to accounting estimates</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

## ENHANCED RISK ASSESSMENT PROCEDURES RELATED TO OBTAINING AN UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT

OBTAIN AN UNDERSTANDING OF THE ENTITY'S SYSTEM OF INTERNAL CONTROLS

COMPONENTS	WHAT SHOULD YOU CONSIDER DOCUMENTING FOR EACH ACCOUNTING ESTIMATE?
3. INFORMATION & COMMUNICATION	<ul style="list-style-type: none"> <li>• How you identify the relevant methods, assumptions or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework</li> <li>• Understands the degree of estimation uncertainty, including through considering the range of possible measurement outcomes</li> <li>• Addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements</li> </ul>
4. CONTROL ACTIVITIES	<ul style="list-style-type: none"> <li>• Control activities relevant to the audit over your process for making accounting estimates.</li> </ul>
5. MONITORING	<ul style="list-style-type: none"> <li>• How you review the outcome(s) of previous accounting estimates and respond to the results of that review</li> </ul>

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## ACCOUNTING ESTIMATES (CAS 540)

WHAT ARE THE CHANGES THAT WILL  
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Enhanced risk assessment procedures related to obtaining an understanding of the entity and its environment

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**New concept of inherent risk factors: estimation uncertainty, complexity and subjectivity**

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New concept of scalability to recognize the spectrum of inherent risk

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Objectives-based work effort requirements directed to methods, data and assumptions

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Enhanced disclosure requirements

# ACCOUNTING ESTIMATES (CAS 540)

NEW CONCEPT  
OF INHERENT  
RISK FACTORS:  
ESTIMATION  
UNCERTAINTY,  
COMPLEXITY  
AND SUBJECTIVITY

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>Focus on appropriately responding to the levels of estimation uncertainty, complexity and subjectivity in accounting estimates.</li> </ul>	<ul style="list-style-type: none"> <li>The extent of the auditor's required work effort depends on the risk the accounting estimate may be materially misstated.</li> <li>This risk is impacted by the degree of estimation uncertainty, complexity, and subjectivity involved in making that accounting estimate.</li> </ul>	<ul style="list-style-type: none"> <li>If the auditor determines the risk of your accounting estimate being materially misstated is higher, the work effort will increase, which in turn will likely impact how much, and the type of, information you need to provide the auditor.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

NEW CONCEPT  
OF INHERENT  
RISK FACTORS:  
ESTIMATION  
UNCERTAINTY,  
COMPLEXITY  
AND SUBJECTIVITY

- Take into account and document the degree to which the accounting estimate is subject to, or affected by the following inherent risk factors
- Communicate with those charged with governance on whether these give rise to material misstatements



As these are involved in:

- Selection and application of the method, assumptions and data
- Selection of management's point estimate and related disclosures

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## ACCOUNTING ESTIMATES (CAS 540)

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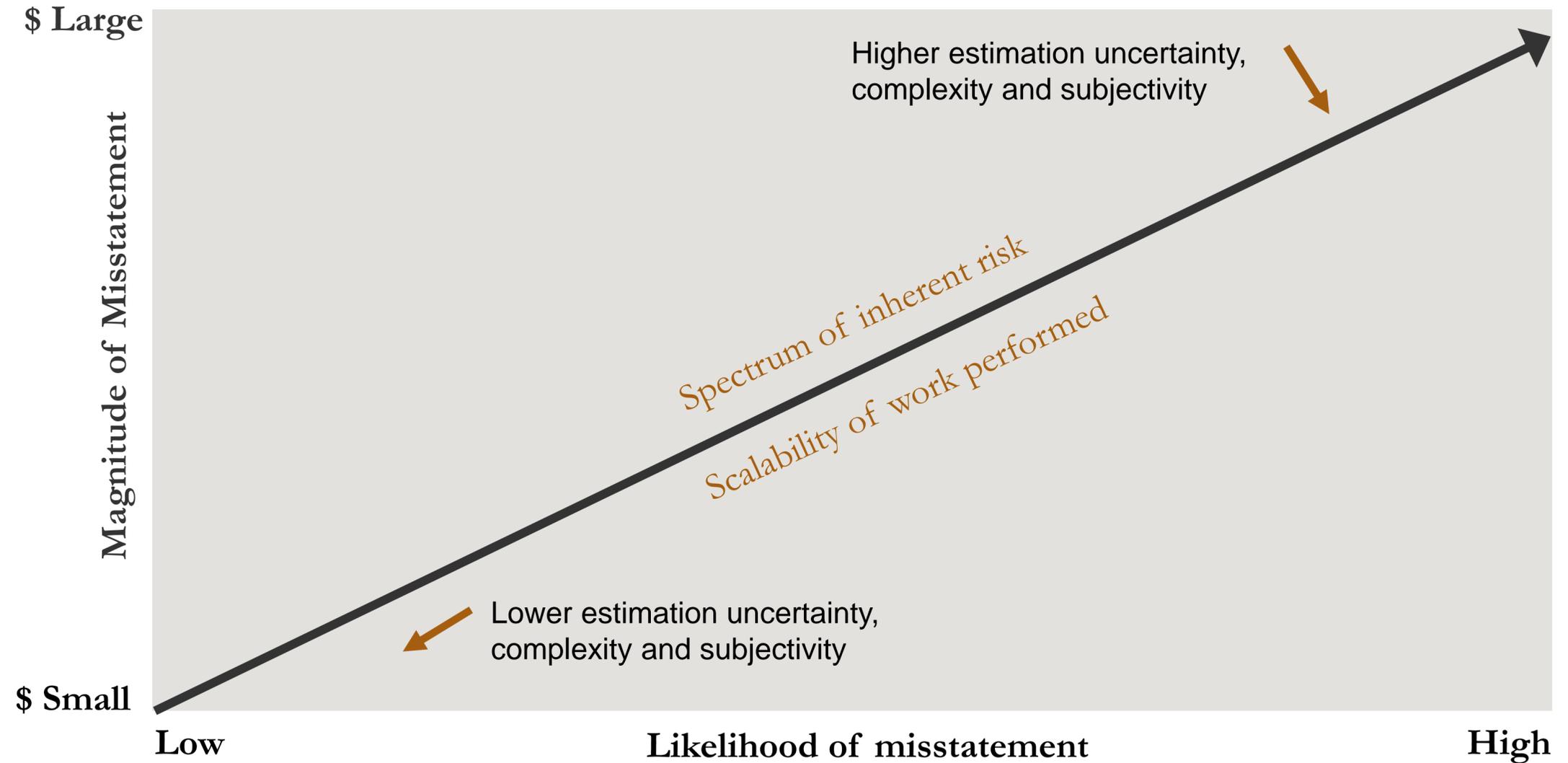
# ACCOUNTING ESTIMATES (CAS 540)

NEW CONCEPT OF SCALABILITY TO RECOGNIZE THE SPECTRUM OF INHERENT RISK

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>• More emphasis on the need for the auditor to exercise professional skepticism.</li> </ul>	<ul style="list-style-type: none"> <li>• Perform audit procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory.</li> <li>• Carefully consider all information obtained and whether it corroborates or contradicts your judgments and decisions regarding accounting estimates.</li> </ul>	<ul style="list-style-type: none"> <li>• The auditor may increasingly challenge aspects of how you derive your accounting estimates.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

NEW CONCEPT OF SCALABILITY TO RECOGNIZE THE SPECTRUM OF INHERENT RISK



**The higher the assessed risk, the more persuasive the audit evidence needs to be!**

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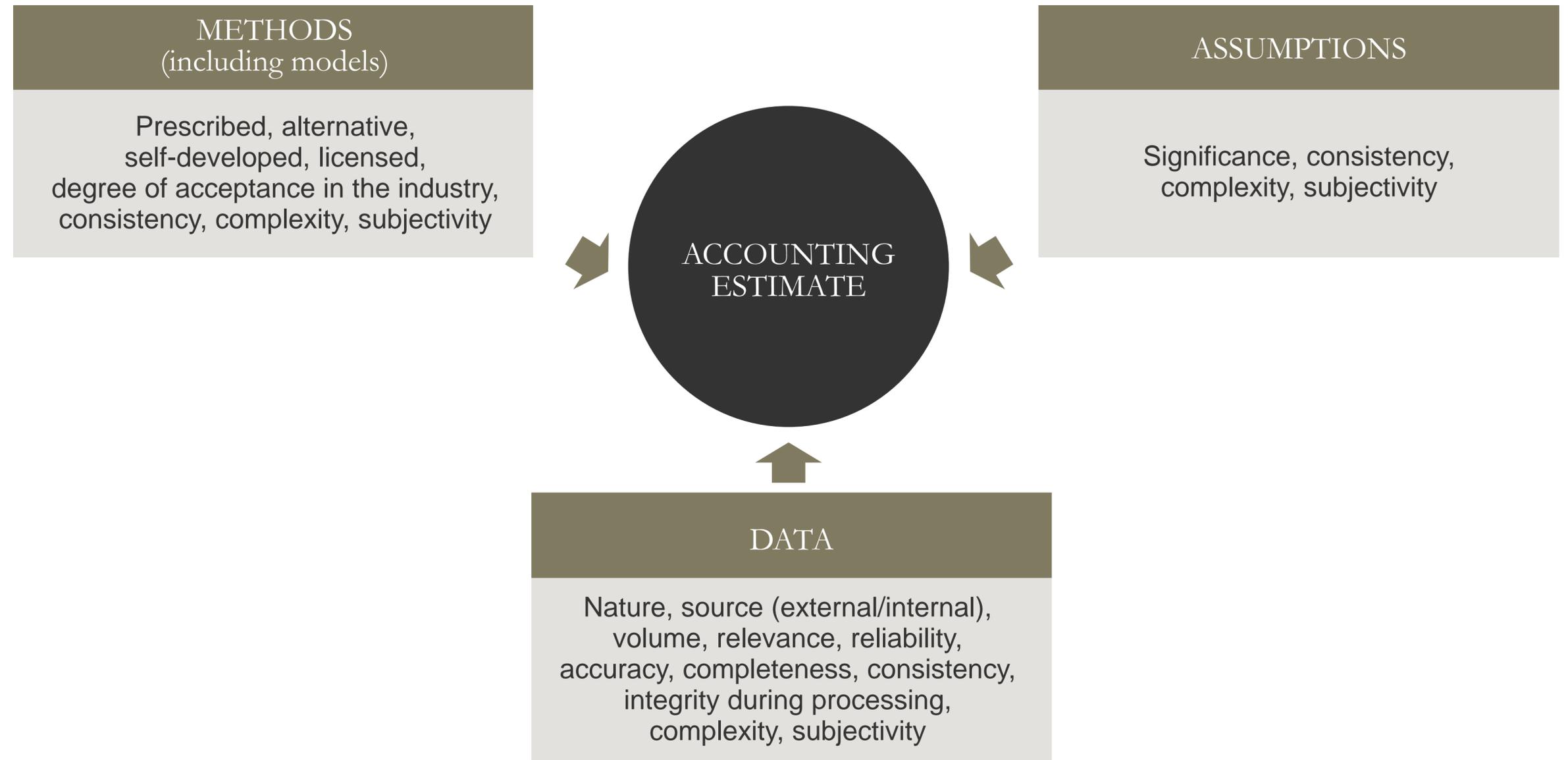
# ACCOUNTING ESTIMATES (CAS 540)

OBJECTIVES-BASED  
WORK EFFORT  
REQUIREMENTS  
DIRECTED TO  
METHODS, DATA  
AND ASSUMPTIONS

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>• Audit work effort based on the selected approach(es) (testing management’s process, developing own estimate, subsequent events), including a more detailed understanding of the significant matters considered in making key judgments and decisions affecting accounting estimates.</li> </ul>	<ul style="list-style-type: none"> <li>• Revised requirements that are more directed at the components of an accounting estimate:               <ul style="list-style-type: none"> <li>- methods (including models), assumptions and data,</li> <li>- the auditor’s understanding and documentation of key elements of the entity and its environment,</li> <li>- the linkage of audit procedures to the assessed risks, and</li> <li>- significant judgments related to the determination of whether the accounting estimates and related disclosures are reasonable.</li> </ul> </li> </ul>	<p>You may:</p> <ul style="list-style-type: none"> <li>- receive more focused requests on each of these matters.</li> <li>- wish to consider retaining experts to assist with the related work.</li> <li>- consider documenting key judgments and decisions in anticipation of auditor requests. Such documentation is likely to provide a basis for more efficient and effective discussions between you and the auditor.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

OBJECTIVES-BASED  
WORK EFFORT  
REQUIREMENTS  
DIRECTED TO  
METHODS, DATA  
AND ASSUMPTIONS



# ACCOUNTING ESTIMATES (CAS 540)

OBJECTIVES-BASED  
WORK EFFORT  
REQUIREMENTS  
DIRECTED TO  
METHODS, DATA  
AND ASSUMPTIONS

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>• More detailed written representations.</li> </ul>	<ul style="list-style-type: none"> <li>• Required to request written representations from you regarding the reasonableness of the methods, significant assumptions and the data used in determining the accounting estimates, including the related disclosures.</li> <li>• Required to consider the need to obtain your representations about specific accounting estimates, including in relation to the methods, assumptions, or data used.</li> </ul>	<ul style="list-style-type: none"> <li>• You may receive requests for new or changed representations compared to previous years.</li> <li>• Therefore, you may wish to ask the auditor to let you know as soon as practicable the details of the written representations they will request from you.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

OBJECTIVES-BASED  
WORK EFFORT  
REQUIREMENTS  
DIRECTED TO  
METHODS, DATA  
AND ASSUMPTIONS

Your auditor may ask for written representations on:

- 

Whether the methods, significant assumptions and the data used are appropriate
- 

All relevant information has been taken into account
- 

Application consistency
- 

Reflect management's intent and ability
- 

Complete disclosures
- 

Specialized skills or expertise applied
- 

When applicable, no subsequent event requires an adjustment

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# ACCOUNTING ESTIMATES (CAS 540)

## ENHANCED DISCLOSURE REQUIREMENTS

WHAT DOES THIS MEAN?	IMPACT ON AUDITOR	IMPACT ON MANAGEMENT
<ul style="list-style-type: none"> <li>• More emphasis on auditing accounting estimate disclosures in the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• In particular, the sufficiency of disclosures regarding estimation uncertainty may receive more scrutiny.</li> </ul>	<ul style="list-style-type: none"> <li>• If the auditor determines the risk of material misstatement is higher for certain disclosures, the work effort will increase, which in turn will impact how much, and the type of, information you will need to provide the auditor.</li> </ul>

# ACCOUNTING ESTIMATES (CAS 540)

## HOW DO YOU...

BE PREPARED  
TO ANSWER THE  
FOLLOWING  
QUESTIONS FROM  
YOUR AUDITOR!



control your accounting estimation process?



account for regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks related to prudential supervision?



make those responsible for deriving or changing your accounting estimates aware of relevant significant transactions, conditions or events?



identify the need for, and apply, specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's expert?



review the outcome(s) of previous accounting estimates and respond to the results of that review?



identify and comply with the relevant requirements in the applicable financial reporting framework regarding your accounting estimates and related disclosures including how they are affected by complexity and your judgment?

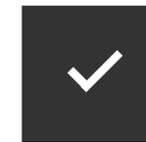
# ACCOUNTING ESTIMATES (CAS 540)

## HOW DO YOU...

BE PREPARED  
TO ANSWER THE  
FOLLOWING  
QUESTIONS FROM  
YOUR AUDITOR!



identify and address risks related to accounting estimates through your risk assessment process?



describe in your financial statements matters related to your process for deriving your accounting estimates, and matters related to the degrees of estimation uncertainty underlying your accounting estimates?



identify relevant methods (including models), assumptions and data and the need for changes in them and from those identified, select those to apply?



ensure there is oversight and governance in place over management's financial reporting process relevant to accounting estimates?



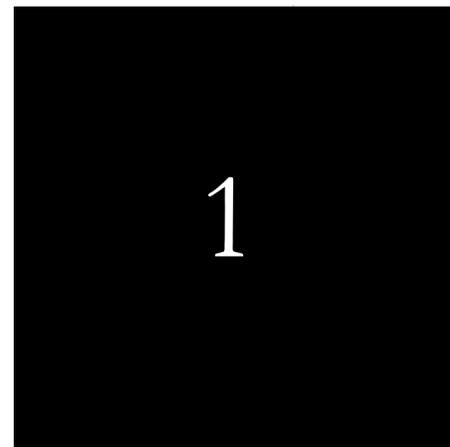
address the degree of estimation uncertainty in selecting your final point estimates?

### 3. PART 2 – COVID-19 IMPACT ON FINANCIAL STATEMENTS



# COVID-19 IMPLICATIONS – VALUATION OF ASSETS ACCOUNTS RECEIVABLE

WHAT TO  
CONSIDER WHEN  
DETERMINING  
YOUR ALLOWANCE?



Are there any indicators of impairment:

- Change in repayment terms
- Customers in financial difficulty
  - Any missed payments?
  - Have customers indicated they will have difficulty making payments?



Are insured accounts receivable still insured or have conditions changed?



Historical payment trends may no longer be relevant in determining an appropriate allowance

# COVID-19 IMPLICATIONS – VALUATION OF ASSETS INVENTORY

WHAT TO  
CONSIDER WHEN  
DETERMINING  
YOUR PROVISION?

**COVID-19 may cause the net realizable value of certain inventories to decrease below cost.**

Has the market price or demand for the inventory decreased?

Can inventory items with a limited life be sold in a timely manner? Will these inventories have to be discounted?

Were some orders cancelled? Will it be feasible to sell these items to another customer?

If demand has decreased and inventory will have to be held for an extensive period, are there significant storage costs (e.g., warehousing)?

For work-in-process, are there supply chain or other difficulties that may affect the ability or the cost to complete production?

# COVID-19 IMPLICATIONS – VALUATION OF ASSETS ACCOUNTS RECEIVABLE AND INVENTORY

## WHAT TO EXPECT FROM YOUR AUDITORS?

The auditor will perform the same procedures **but:**

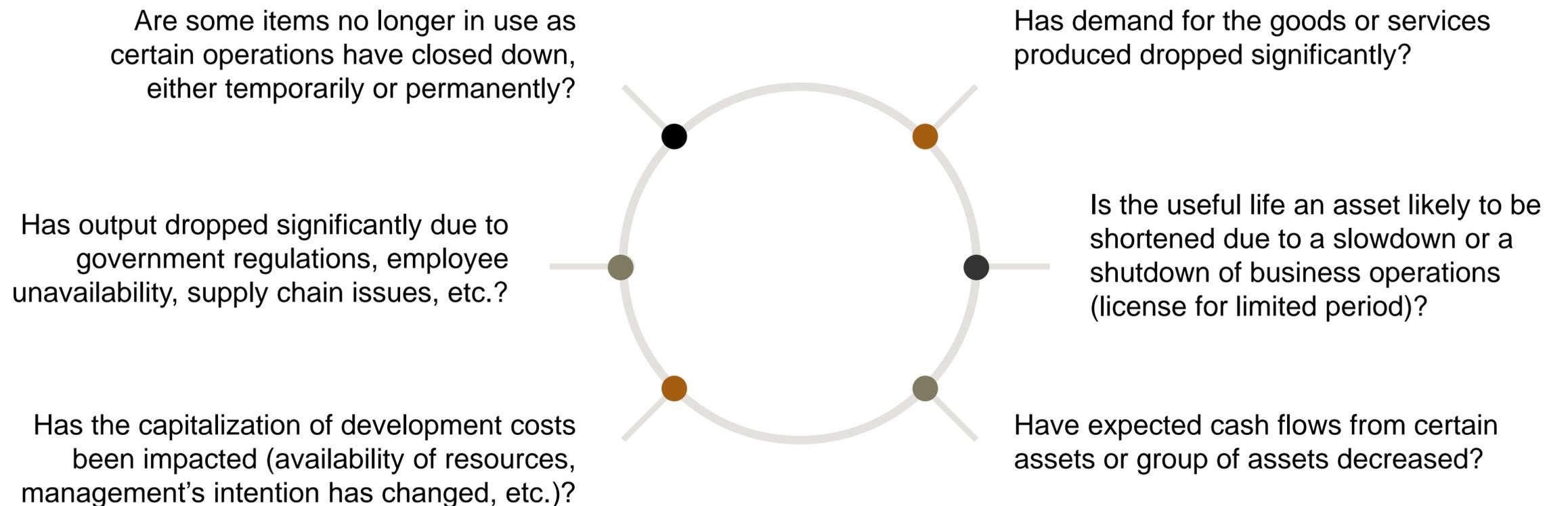


Past history may no longer be appropriate!

# COVID-19 IMPLICATIONS – VALUATION OF ASSETS LONG-LIVED ASSETS

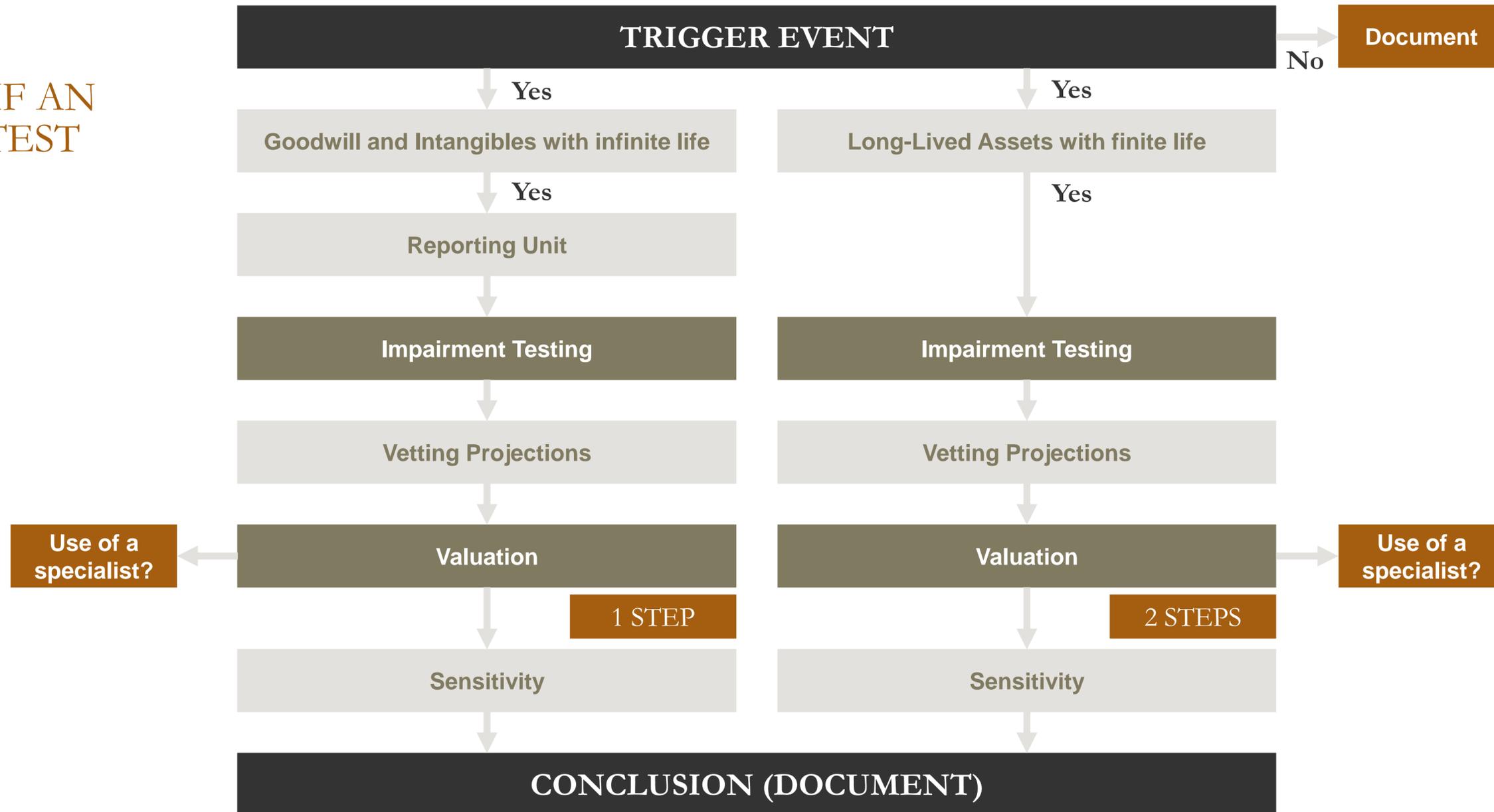
## WHAT TO CONSIDER WHEN DETERMINING IMPAIRMENT?

**These assets are tested for recoverability whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Consider whether COVID-19 may cause indicators of possible impairment requiring an impairment test:**



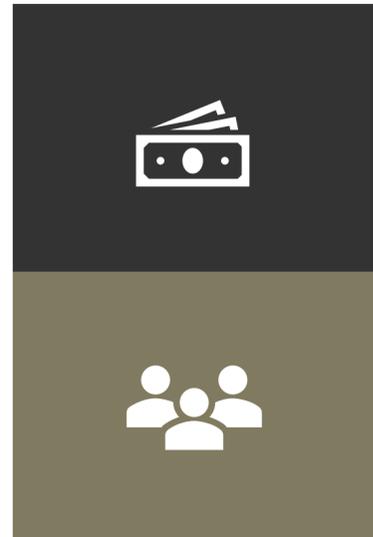
# COVID-19 IMPLICATIONS – VALUATION OF ASSETS LONG-LIVED ASSETS

WHAT TO DO IF AN  
IMPAIRMENT TEST  
IS REQUIRED?



# COVID-19 IMPLICATIONS – VALUATION OF ASSETS LONG-LIVED ASSETS

WHAT TO EXPECT  
FROM YOUR  
AUDITORS?



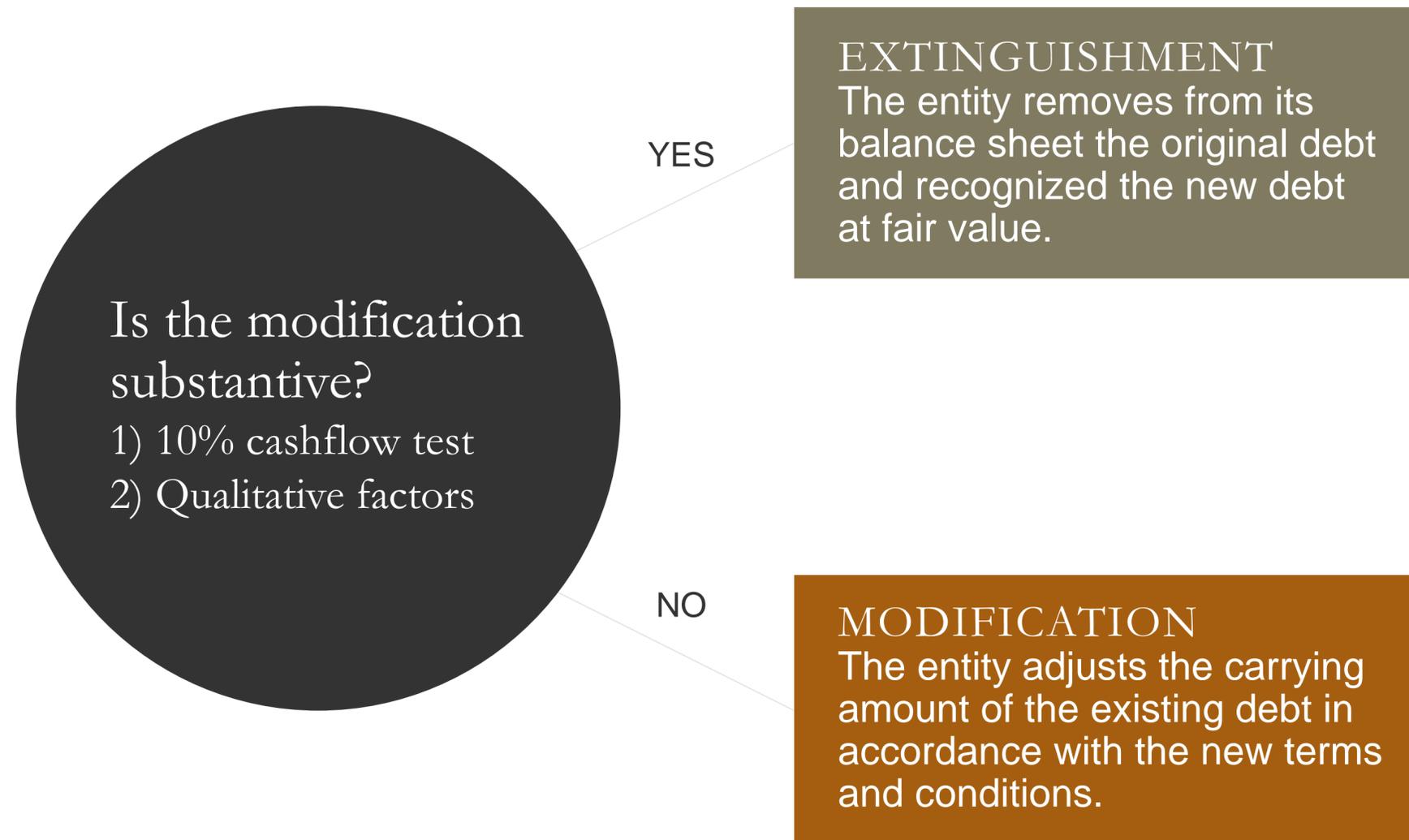
Request for projected cash flows

- Discussion of your assumptions and hypotheses
- Consider any uncertainty in both local and global markets

Request for third party valuation

# COVID-19 IMPLICATIONS – DEBT MODIFICATIONS AND COVENANT BREACHES DEBT MODIFICATION OR EXTINGUISHMENT

WHAT DO YOU  
NEED TO CONSIDER  
IN IDENTIFYING  
WHETHER A  
CHANGE IN  
THE AGREEMENT  
REPRESENTS  
A DEBT  
MODIFICATION  
OR AN  
EXTINGUISHMENT?



# COVID-19 IMPLICATIONS – DEBT MODIFICATIONS AND COVENANT BREACHES

## COVENANT BREACHES

### WHAT HAPPENS WHEN YOU BREACH YOUR COVENANTS?

- .14 Long-term debt with a measurable covenant violation is classified as a current liability unless:
- (a) the creditor has waived, in writing, or subsequently lost, the right, arising from violation of the covenant at the balance sheet date, to demand repayment for a period of more than one year from the balance sheet date; or
  - (b) the debt agreement contains a grace period during which the debtor may cure the violation and contractual arrangements have been made that ensure the violation will be cured within the grace period;
- and a violation of the debt covenant giving the creditor the right to demand repayment at a future compliance date within one year of the balance sheet date is not likely.

# COVID-19 IMPLICATIONS – GOING CONCERN

## WHAT DOES THE HANDBOOK SAY?

When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern.

In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, **twelve months** from the balance sheet date.



Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so.

Management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

# COVID-19 IMPLICATIONS – GOING CONCERN

## HOW DO YOU PERFORM AN ASSESSMENT?



1. Evaluate whether events or conditions, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern; and
  - Will the entity be able to meet its obligations as they become due within one year of the entity's balance sheet date.

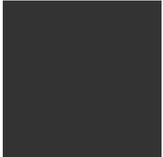


2. If so, your plans to address them;
  - Will your plans alleviate any substantial doubt about the entity's ability to continue as a going concern.

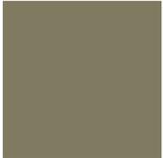
# COVID-19 IMPLICATIONS – GOING CONCERN

## HOW MIGHT COVID-19 IMPACT YOUR ASSESSMENT OF GOING CONCERN?

COVID-19 MAY  
RESULT IN THE  
FOLLOWING  
EVENTS AND/OR  
CONDITIONS THAT  
MAY CAST  
SIGNIFICANT DOUBT  
ON AN ENTITY'S  
ABILITY TO  
CONTINUE AS A  
GOING CONCERN:



Restricted ability to operate due to government-imposed restrictions



Loss of revenues



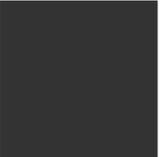
Significant drop in demand and reduced customer bases



Limited distribution channels



Labor shortages



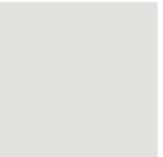
Breach in covenants



Indications of withdrawals of financial support by creditors



Inability to obtain new financing for essential new product development or other essential investments



Significant deterioration in the value of assets



Dependency on related parties for financial support

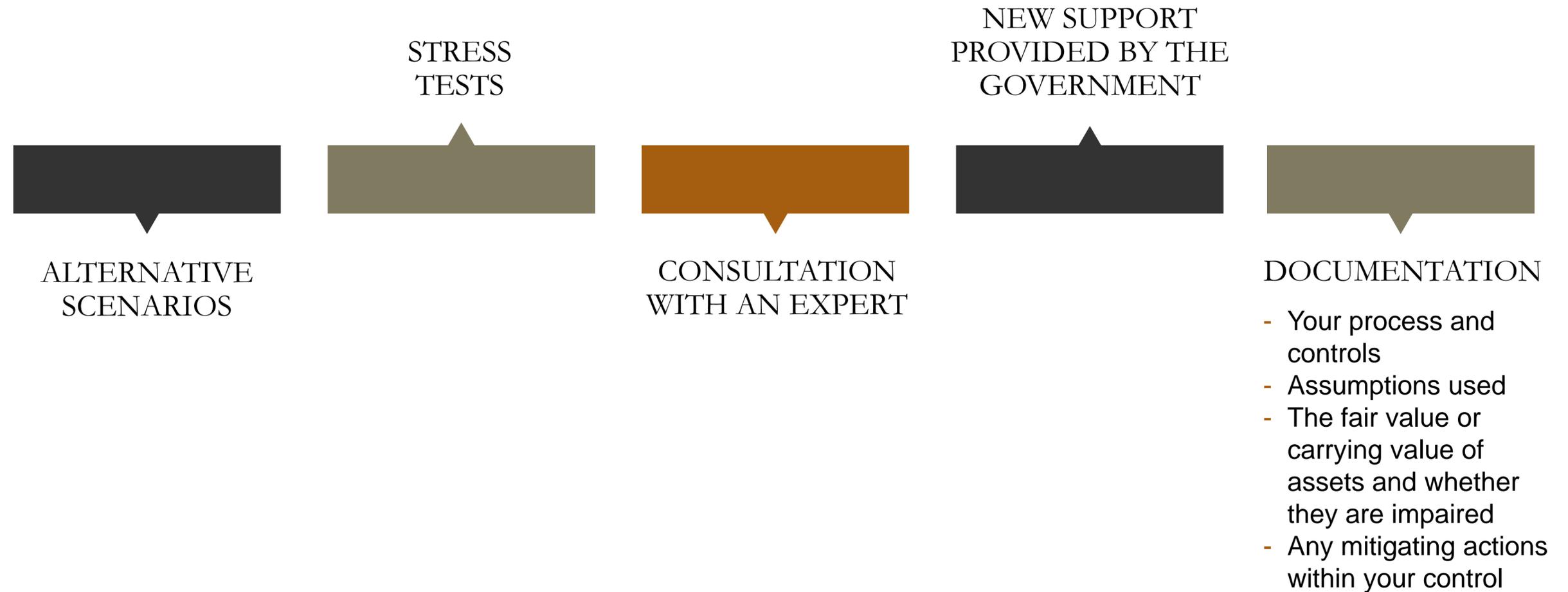
# COVID-19 IMPLICATIONS – GOING CONCERN

**HOW TO GET PREPARED:**  
WHEN YOU (OR THE AUDITOR) DETERMINES THAT AN EVENT OR CONDITION DOES EXIST THAT MAY CAST SIGNIFICANT DOUBT ON AN ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN, WHAT MAY THE AUDITOR REQUEST AND WHAT PROCEDURES WILL THE AUDITOR PERFORM?



# COVID-19 IMPLICATIONS – GOING CONCERN

**HOW TO GET  
PREPARED:**  
WHAT SHOULD YOU  
CONSIDER WHEN  
PERFORMING YOUR  
ASSESSMENT TO  
GET AHEAD OF  
THE GAME?



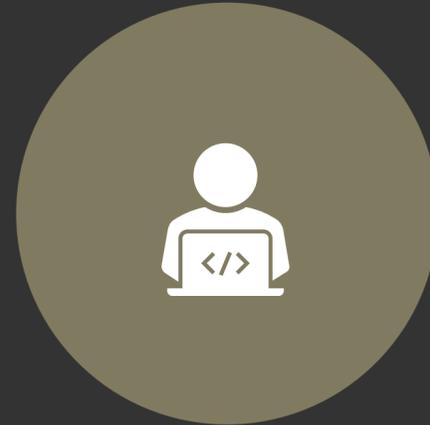
# COVID-19 IMPLICATIONS – GOING CONCERN

## WHAT NEEDS TO BE DISCLOSED?

SITUATION	IMPLICATION ON FINANCIAL STATEMENTS AND AUDITOR'S REPORT
<p>Going concern basis of accounting is appropriate but a material uncertainty exists</p>	<ul style="list-style-type: none"> <li>• In the Financial Statements:                             <ul style="list-style-type: none"> <li>- Disclose the principal events or conditions and management's plans to address them</li> <li>- Disclose clearly that a material uncertainty exists, and that the entity may not be able to realize its assets and discharge its liabilities</li> </ul> </li> <li>• In the Auditor's report:                             <ul style="list-style-type: none"> <li>- Emphasis of matter paragraph making reference to the material uncertainty note in the financial statements.</li> </ul> </li> </ul>
<p>Going concern basis of accounting is appropriate, and NO material uncertainty exists, but events of conditions have been identified</p>	<ul style="list-style-type: none"> <li>• In the financial statements: provide adequate disclosures about those event or conditions (i.e. close calls)</li> <li>• In the auditor's report: no impact</li> </ul>



CONCLUSION  
AND DISCUSSION  
QUESTIONS AND COMMENTS



NEXT WEBINAR

**From Equity to Liabilities: New Accounting Rules for  
Retractable Preferred Shares –**

May 6, 2021 at 11:30 a.m.

**Coming soon at Richter**

2021 Economic Forecast

March 24, 2021 at 11 a.m.

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THANK YOU!