COVID-19's Impact on Accounting Concepts — Estimates and Assumptions, Going Concern and Subsequent Events

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Lynn Fountain

Lynn Fountain has over 38 years of experience spanning public accounting, corporate accounting and consulting. 20 years of her experience has been working in the areas of internal and external auditing and risk management. She is a subject matter expert in multiple fields including internal audit, ethics, fraud evaluations, Sarbanes-Oxley, enterprise risk management, governance, financial management and compliance.

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Agenda

- Overview the current “accounting” implications of the ongoing pandemic
- Evaluate why accountants should pay attention to their financial reporting estimates as well as cash flow estimates.
- Examine the concept of going concern and how COVID-19 has impacted that assessment.
- Explore the impact of COVID-19 on subsequent events.
- Finding additional resources in CCH® Accounting Research Manager®

Impacted Topics

There continue to be many accounting and FR issues that should be on the radar of accounting professionals. These include (but are not limited to):

Forward looking cash flow estimates	Impairment testing and recoverability of impairment of assets	Indefinite lived intangible assets other than goodwill and Long-Lived Assets	Accounting for financial assets: • Inventory, • Equity method investments, • **Revenue Recognition**
Leases	Goodwill	Subsequent Events	Going Concern
Disclosures	**Internal Control for Financial Reporting**	Exist or Disposal Costs	Loss Contingencies
Future Operating Losses	Insurance Recoveries	Government Grants	

Bolded topics have been discussed in recent lunch and learns.

POLLING QUESTION

Which topic would you like to be covered during next month's Lunch & Learn webinar?

A. Inventory, goodwill and asset impairment testing
B. Forward looking cash flow estimates
C. Indefinite lived intangible assets other than goodwill
D. Exit and disposal costs and loss contingencies

Financial Reporting and Cash Flow Estimates

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Cash Flow

- In June 2020, the SEC released disclosure guidance on considerations regarding operations, liquidity and capital (https://www.sec.gov/corpfin/covid-19-disclosure-considerations)
- This guidance covered cash flow estimates. The SEC has stated:
  - We continue to encourage companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management and to proactively revise and update disclosures as facts and circumstances change. These disclosures should enable an investor to understand how management and the Board of Directors are analyzing the current and expected impact of COVID-19 on the company's operations and financial condition, including liquidity and capital resources.

Developing Estimates

- We are in unprecedented times and research is key.
- All financial statement preparers are encouraged to arm themselves with the most accurate and time sensitive knowledge when preparing information for financial statements
- But how is that even possible when considering estimates?
  - Isn’t part of the estimating process utilizing management judgment.
  - A lot of it also involves subjectivity.
- Yes, but the key is using the most accurate and time sensitive information to support those estimates.

Developing Estimates *(cont'd)*

- Entities face inherent challenges in developing reliable estimates.
  - Estimates based on factors that have significantly changed in the current landscape cause difficulty when determining estimates.
- Let's review a few factors that may related to considerations needed for certain estimates.

Estimate Considerations

When considering the impact on Cash Flow, consider:

- How is overall liquidity and outlook evolving?
- To the extent COVID-19 is adversely impacting revenues, are impacts material to **sources and uses of funds**, and the **materiality of any assumptions** about the magnitude/duration of COVID's impact on revenues.
- Are any decreases in cash flow from operations having a material impact on liquidity position and outlook?

Estimate Considerations *(cont'd)*

- Have revolving lines of credit been assessed or raised capital?
  - Disclosures should provide investors with a complete discussion of your financial condition and liquidity.
- Have COVID impacts affected the ability to access traditional funding sources on reasonable similar terms available in recent periods?
  - Have additional collateral/guarantees/equity been provided to obtain funding?
- Has a change (potential change) to credit rating impacted the ability to access funding?

Estimate Considerations *(cont'd)*

- Have customer terms been altered (extended payment terms/refund periods)?
  - Have those actions materially affected your financial condition or liquidity?
- Have other contractual arrangements been modified to revise terms that may materially impact financial condition, liquidity, capital resources?
- Are supplier finance programs being relied on, (SC financing, structured trade payables, reverse factoring, or vendor financing), to manage cash flow?
  - Have these arrangements had a material impact on the Balance Sheet, Statement of Cash Flow, or short term and long-term liquidity and if so, how?

Estimate and Cash Flow Actions

- The pandemic is causing volatility in financial markets, threatening businesses and challenging management teams.
- Focus on the following areas to position your business for what's coming next and to properly evaluate your cash flow estimates and needs:
  - **In a volatile/slowing economy, get an immediate handle on cash needs.**
    - Take a critical view of operations, review existing cash flow processes and understand how potential disruptions may affect liquidity.
    - Evaluate cash requirements on a frequent and routine basis.
    - Ensure reliable and timely information when developing estimates.

Estimate and Cash Flow Actions *(cont'd)*

- **Communicate with banks and lenders frequently.**
  - Understand needs for loan covenants, debt requirements or need to obtain cash flow or short-term loans and use this information in forecasts.
  - Information should be appropriately reflected in any cash flow estimates.
- **Strategically manage working capital, potentially selling inventory or minimizing new inventory purchases to generate cash.**

Estimate and Cash Flow Actions*(cont'd)*

- **Evaluate viability of customers and suppliers.**
  - Do not assume your customers are financially healthy.
    - Re-evaluate credit terms with current customers, negotiate the shortest reasonable terms, and carefully review the credit-worthiness of each new customer before extending credit.
    - Evaluate supplier base to determine if current agreements are still the most favorable for your business.
  - Continuously monitor accounts and minimize receivable collection time.
  - Negotiate favorable credit terms with suppliers.

Summary Actions

- Understand minimum cash and liquidity requirements
- Establish a robust short term cash flow forecast and run multiple scenarios
- Take actions to protect your position
- Establish a central point of control for communications.
- Develop contingency plans for accounting operations and workforce.

Subsequent Events

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Subsequent Events

SUBSEQUENT EVENT	UNDERLYING CONDITION OR EVENT	FINANCIAL STATEMENT EFFECT
TYPE 1 Recognized	Existed at balance sheet date	Recognize in the financial statements
TYPE 2 Non-Recognized	Did not exist at balance sheet date but happened later	Disclose the nature of event and range of estimated impact on financial statements. If not estimable, must disclose this fact.

Subsequent Events *(cont'd)*

- For entities with a calendar year ending December 31, 2019, or earlier, most subsequent events related to the impacts from COVID-19 will likely be Type 2, such as the following examples:
  - **Accounts Receivable** – Customer's cash flow issues and difficulty paying accounts receivable that directly result from COVID is a Type 2 event. In contrast, a condition that existed prior to COVID and existing at the reporting date is Type 1.
  - **Investments** – Subsequent market or fair value declines are Type 2 events.
  - **Asset impairments** – Most are Type 2 events although impair models under GAAP vary depending on the asset.

Subsequent Events *(cont'd)*

- **Lease modifications** – Terms affecting both parties are typically Type 2.
- **Loss contingencies** – If underlying casual event for loss contingency requirement did not occur before period end, an accrual should not be made however additional disclosure may be required.
- **Going Concern** –Take into account the effect of future cash flow projects, operating results and other facts subsequently affected by COVID, within one-year after the date the financial statements are issued.
- **Taxes** – Various provisions in CARES Act are Type 2 events. Also, COVID considerations may require reassessment of whether deferred tax assets are realizable at reporting date.

Subsequent Events *(cont'd)*

- The application of the subsequent events accounting standard ("ASC") 855-10-20 will be challenging for entities.
  - Take care to ensure that financial statements are not adjusted for events and conditions that did not exist as of the reporting date.
  - However, to prevent the financial statements from being misleading, additional information that reflects significant new events or conditions should be assessed for disclosure.

Subsequent Events *(cont'd)*

Consider:

- Are events related to the COVID (e.g., lawsuit/bankruptcy etc.) providing additional evidence about conditions existing at reporting date?
- All information that becomes available before the financial statements are issued or available to be issued should be considered in assessment of conditions on which financial statements are based.
  - Events could represent the culmination of conditions that existed over an extended period and could have existed before the reporting date.
    - Consequently, these could very well be concluded as Type 1 events.

Subsequent Events *(cont'd)*

- The pace of the spread of COVID-19 after the reporting date may not provide additional evidence about conditions existing at reporting date.
  - Judgment may be required to assess events that occurred after the reporting date to correctly distinguish between the impacts directly related to the COVID-19 and other conditions that may have existed at the reporting date.
    - Example: an employee legal matter that occurred after the Balance Sheet date may be attributable to factors that are unrelated to the COVID-19 pandemic.

Subsequent Events *(cont'd)*

- In periods ended just before and after the COVID-19 outbreak, the potential accounting implications are more extensive and may require more that is beyond just disclosure.
- Entities should assess the impact on both the recognition and measurement of any significantly affected amounts and related financial statement disclosures.

Going Concern

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Going Concern

- Entities must take careful consideration as to whether such factors raise substantial doubt about whether the entity may be able to continue as a going concern.
- In connection with preparing financial statements for each annual/interim reporting period, GAAP requires management to evaluate entity's ability to continue as a going concern.
- Management must consider whether:
  - There are conditions/events that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the interim or annual financial statements are issued
  - These conditions are able to be mitigated by management's plans.

Going Concern *(cont'd)*

- If management concludes there is substantial doubt, then disclosure in the financial statement is required, even if management's plans alleviate that substantial doubt.
- If management's plans do not alleviate substantial doubt about the entity's ability to continue as a going concern, GAAP requires management to state in the notes to the financial statement there is substantial doubt about the entity's ability to continue as a going concern within one year after the date on which the annual or interim financial statements are issued.

POLLING QUESTION

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B. Yes, I subscribed to another research service
C. No, I do not have a subscription to an accounting research service.

Additional Answers in CCH® Accounting Research Manager®

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Beth Patrick is a Solutions Consultant at Wolters Kluwer and has over 20 years' experience serving Accounting Professionals. She works with both CPA firms and Corporations sharing best practices to ensure they are utilizing CCH Accounting Research Manager to its fullest.

POLLING QUESTION

Would you like a more in-depth demo of the tools and content available on CCH Accounting Research Manager?

A. Yes

B. No

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