

CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES



The Integrity of Financial Reporting in an Economic Downturn

January 22, 2009

Global Economic Downturn

- The worst financial crisis since the Great Depression
- Estimated \$30 trillion of global stockmarket value wiped out in 2008
- High profile rescues and bankruptcies (AIG, RBS, Bear Sterns, Lehman Brothers, Nortel.....)
- Governments worldwide have pledged trillions in emergency measures
- The US is facing an “economic pearl harbor” (*Warren Buffet*)

Agenda

- Chairman's remarks
- Valuation issues
- Impairments
- Counterparty non-performance risk
- Going concern
- Financial statement disclosures
- Fraud risk considerations
- CPAB expectations of audit firms

Chairman's Remarks

- Economic uncertainty
- Risk assessment
- Use of estimates
- Financial statement disclosure
- Professional scepticism

Valuation Issues

- Fair value determinations will be more challenging
- Estimates need to incorporate market participant assumptions for current transactions
- Specialists will be required
- All relevant risks should be incorporated (e.g. credit risk liquidity risk, non-performance risk)
- More use of internal models

Valuation Issues

- Cashflow forecasts
 - Increased significance in current environment
 - Have market conditions and appropriate risk adjustments been incorporated into forecasts?
 - Have forecasts been stress tested?
 - Are forecasts consistent with other available information?

Valuation Issues

- Defined benefit pension plans
 - Actuarial losses
 - Return on plan assets
 - Discount rate for pension liabilities
 - Plan valuation considerations
- Stock-based compensation plans
 - Modifications
 - Increased compensation cost

Impairments

- Financial assets:
 - Accounts and notes receivable
 - Loans
 - Investments in debt and equity securities and other financial assets
 - Amendments to allow reclassifications

Impairments

- Other assets:
 - Future income tax assets
 - Long-lived assets
 - Intangible assets
 - Goodwill

Counterparty Non-performance Risk

- Counterparty non-performance risk is pervasive in current environment
- Customers
 - Collectability of receivables
 - Reduced demand
 - Customer concentration

Counterparty Non-performance Risk

- Suppliers and inventory issues
- Providers of financing
 - Refinancing debt
 - Guarantors
 - Development stage enterprises
 - Other counterparties

Counterparty Non-performance Risk

- Areas of potential risk impacting revenue recognition:
 - Rights of return
 - Bill-and-hold arrangements
 - Changes in payment terms
 - Side agreements
 - Consignment arrangements

Going Concern

- Increased risk of corporate failure
- Potential areas of focus
 - Budgets/forecasts
 - Borrowings
 - Management plans
- Disclose material uncertainties

Financial Statement Disclosures

- Fair presentation
- Measurement uncertainty
- Impairments
- Covenant violations and waivers
- Going concern

Financial Statement Disclosures

- Financial instruments
- Contingencies and guarantees
- Variable interest entities
- Economic dependence
- Subsequent events
- Non-GAAP financial measures

Fraud Risk Considerations

- Increased risk of management bias/fraud
- Economics and substance of transactions
- Areas that may be impacted:
 - Revenue recognition
 - Assumptions for significant estimates
 - Balance sheet classifications
 - Omitted or inaccurate financial statement disclosures
 - Related party transactions

CPAB Expectations of Audit Firms

- Leadership of the firm
- Audit planning
- Materiality
- Role of the engagement partner
- Role of the concurring review partner
- Modifications of audit procedures

CPAB Expectations of Audit Firms

- Consultation
- Use of specialists
- Documentation
- Reporting to audit committees
- Professional scepticism

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