



Center for Board Effectiveness

On the audit committee's agenda

Year-end accounting and financial reporting considerations: Questions for audit committees to consider

Introduction

The current business and economic landscape is unprecedented. With little to no warning, companies have had to adjust to a variety of challenges, including supply chain disruptions, government-mandated shutdowns, implications of the CARES Act, working remotely, and more. While companies have managed through these challenges for the past several months, this year-end close may be like no other as those issues continue to evolve and new challenges

arise. This continued uncertainty in the business environment, combined with increasing the complexities and risk, will require a high degree of judgement as companies approach the year-end reporting cycle. Not surprisingly, audit committee oversight will be critical. In fulfilling their governance role, audit committees may want to discuss management's approach and conclusions to 10 common topics during the year-end reporting cycle.

1) Forecasts and related impairment analyses

- Have forecasts and applicable impairment analyses been appropriately updated through year-end?
- Have multiple recovery scenarios been contemplated, and how are those scenarios utilized for forecasting and impairment testing purposes?
- How are cumulative historic losses, as well as projected losses (within different jurisdictions), contemplated in the recoverability of deferred tax assets?

2) Going concern

- Has management reassessed potential liquidity and working capital shortfalls, potential diminished demand for products or services, and contractual obligations?
- How has management considered potential government assistance?
- How have management's current plans and the ability to effectively implement such plans been considered in the going concern analysis?

3) Internal controls

- Have changes in transaction flow and processes resulted in a change in the design and monitoring of controls? And, if so, how has management ensured controls have been appropriately redesigned?
- Have changes in job responsibilities given rise to a change in controls, and how has management ensured appropriate segregation of duties in light of any such changes?
- Have cyberattacks increased, and have applicable controls been reassessed?
- Has management considered the existence of new and/or increased opportunity as it relates to fraud risk?

4) Government assistance and insurance proceeds

- Has management reassessed applicable provisions (including eligibility criteria) of the CARES Act (or similar government programs) and any related interpretations?
- Has management updated its evaluation of insurance claims (e.g., business interruption insurance, loss recovery, lost profits)?

5) Financial instruments

- How has management evaluated the creditworthiness and default risk related to customers—particularly in situations in which customers have been granted “payment holidays” or other types of relief?
- What are the key factors, assumptions, and estimates management has used in determining fair value?
- Has management evaluated the transition away from the use of the London Interbank Offered Rate (LIBOR) and the related potential accounting impact?
- Has management reassessed the accounting for qualifying cash-flow hedges of forecasted transactions that have been delayed due to COVID-19? Specifically, has management reassessed the probability of such transactions still occurring and the appropriateness of recording any gains or losses on such qualifying cash-flow hedges outside of earnings?

6) Revenue and lease contracts

- Has management reassessed or revised estimates of variable consideration expected to be received under contracts with customers (e.g., refunds, concessions, rebates, discounts)?
- In estimating variable consideration for new and more recent contracts, how has management considered any recent practice related to price concessions in determining the amount of revenue to be recognized?
- Has the potential deterioration of its customers' financial position resulted in management reassessing whether it is probable that the company will collect any remaining consideration under contracts for future goods and services?
- Has the company made a policy election (as provided by the FASB) regarding how to account for lease concessions resulting directly from COVID-19, and if so, was the appropriateness of applying the policy election evaluated?

- Has rental space been abandoned, and if so, has management updated its assessment regarding the potential sublease of the rental space in its accounting analysis?
- Has management reassessed whether partial lease payments (“short payments”) represent concessions or if the original enforceable lease obligation remains in effect?

7) Employee benefits

- As it relates to defined benefit plans, has management reassessed the various assumptions used to measure both its obligations and assets and the potential related accounting impacts (e.g., overall decline in fair value of plan assets, valuation of plan assets that do not have an active market, discount rate used to value obligations)?
- Has management reassessed the probability that stock awards containing performance targets will be issued and the related impact on compensation expense?
- How has management considered recent market activity when evaluating the expected volatility assumption utilized for purposes of valuing recent and new stock option issuances?

8) Restructuring activities

- Has management reassessed the timing of expense recognition for continuing or new furlough arrangements, including factors such as the company’s past practice with similar programs, the direct or indirect benefits the company may receive from the furloughed employees, the duration of the furlough arrangement, etc.?
- Has management evaluated whether and to what extent recent employee terminations have created a “past practice” to consider in accounting for “new” similar termination arrangements?

9) Stakeholder communications

- Has management reassessed its disclosures for unusual transactions (e.g., proceeds received under the CARES Act, impairment charges, restructuring charges, allowance for credit losses)?
- How has management considered the disclosure considerations issued by the SEC (CF Disclosure Guidance Topic Nos. 9 and 9A) specific to COVID-19 (e.g., liquidity and capital resources, known trends and uncertainties, business continuity plans, consumer demand, supply chain matters)?

- What disclosure-related changes are management considering as a result of the recently issued SEC guidance related to the description of the company’s business (Regulation S-K Item 101) and risk factors (Regulation S-K Item 105)?
- What new disclosures related to certain emerging areas of interest (e.g., Brexit, LIBOR transition, cybersecurity) are management considering?

10) Subsequent events

- How has management considered subsequent events resulting from COVID-19 that are macroeconomic in nature and may have a pervasive impact on estimates in the company’s financial statements?
- How has management considered the potential subsequent event accounting and reporting associated with the provisions and related interpretations of the CARES Act?

Concluding thoughts

While the year-end financial reporting process is a busy time for companies, this year will present unprecedented challenges for management, including highly judgmental and complex accounting issues, changes in work processes, and more. In executing their governance and oversight responsibilities, audit committees may want to not only discuss the above-listed issues with management, but also proactively serve as a sounding board and resource to help management navigate the current financial reporting landscape.

Authors



Eric Knachel
Partner
Audit & Assurance
Deloitte & Touche LLP
eknachel@deloitte.com



Krista Parsons
**Managing Director and
Audit Committee Programs Leader**
Center for Board Effectiveness
Deloitte & Touche LLP
kparsons@deloitte.com

Contact us



Carey Oven
National Managing Partner
Center for Board Effectiveness
Chief Talent Officer, Risk & Financial Advisory
Deloitte & Touche LLP
coven@deloitte.com



Maureen Bujno
**Managing Director and
Audit & Assurance Governance Leader**
Center for Board Effectiveness
Deloitte & Touche LLP
mbujno@deloitte.com



Audrey Hitchings
Managing Director
Executive Networking
Deloitte Services LP
ahitchings@deloitte.com



Debbie McCormack
Managing Director
Center for Board Effectiveness
Deloitte LLP
dmccormack@deloitte.com

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