ARTICLE

Impact of COVID-19 on Year-End Financial Reporting:

Considerations for Controllers and Chief Accounting Officers

The COVID-19 pandemic continues to be, first and foremost, a public health emergency of enormous proportions. The humanitarian cost to our communities, our country and the world is vast.

As we work together to address the threat to personal and public safety from the pandemic, companies face significant challenges to manage through the volatility, placing additional pressures on the finance and accounting function. Business implications, such as achieving revenue goals, adjusting costs, moving to a mobile workforce, managing supplier continuity, maintaining liquidity and forecasting future performance all need to be addressed.

Further, healthy internal controls over financial reporting are critical, and stakeholders expect timely, accurate and transparent financial information now more than ever. Companies that are comprehensively evaluating the impact of the crisis on their accounting, disclosures and internal controls are best placed to provide timely information to address these challenges and will be prepared for the upcoming year-end reporting and audit cycle.

To properly prepare for the year-end audit and financial reporting requirements, controllers and CAOs should proactively address four areas outlined, as follows.

I. Financial Statement Audit

Preparing for a financial statement audit in a primarily remote environment will require additional planning and more frequent communication with auditors, which may pose unique challenges. Organizations should prepare for these challenges by evaluating the increased risks in their financial reporting during the period, determining the ability to assist the auditors in performing procedures virtually, and preparing supporting documentation in advance to reduce time or information delays.

While pressure may not exist to meet prior earnings estimates, it may exist for companies to keep up with industry and peer performance during the period. This may result in increased risks to the effectiveness of internal controls over financial reporting in 2020. Companies should be aware of those added risks as they perform their risk assessment. Those risks should be communicated to the auditors during the planning stages of the audit.

Companies will need to consider the auditors' ability to perform procedures virtually. Controllers should determine whether they are able to perform a walkthrough test of internal controls, or how auditors will complete physical inventory counts. The answer may require a creative approach. For example, auditors may be able to rely on inventory observations conducted via the use of live video streams or on alternative observation dates with added analytical procedures to reduce the risk of misstatement.

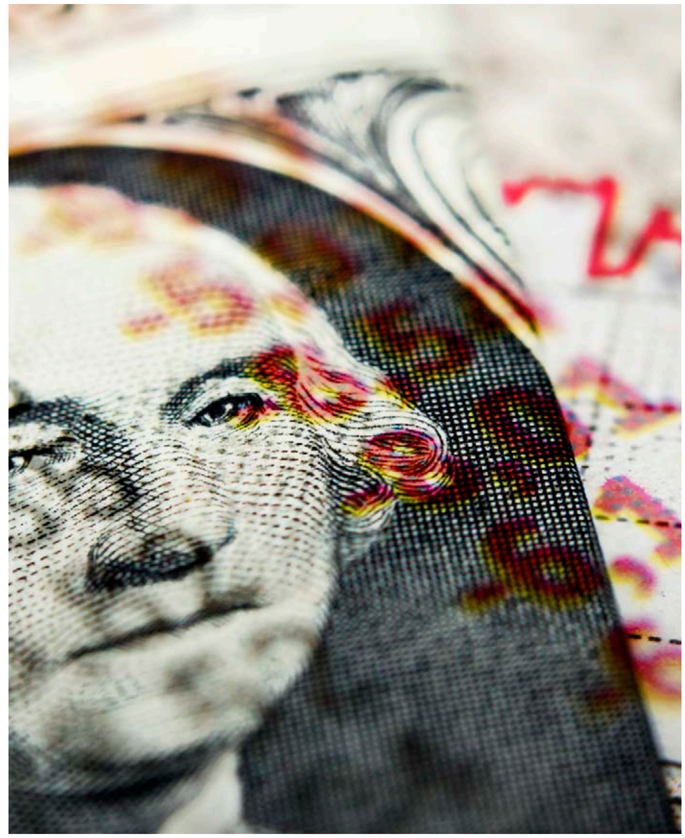
Lastly, accounting functions need to be proactive to prepare and share supporting schedules and other information with auditors as soon as possible to ensure a timely audit.

QUESTIONS TO CONSIDER AS THE AUDIT APPROACHES

1. Does a secure channel of communication exist to share documents and information between the company, board of directors, and auditors or other external parties?
2. Has management performed an assessment to identify key risks in their financial reporting for 2020 as a result of COVID-19? Have these been addressed and communicated to the auditors?
3. Have existing internal controls been altered to address all new business models, as well as the shift to a remote workforce? Has the operating effectiveness of these controls been tested? Have new controls been implemented and their operating effectiveness tested during 2020?
4. Has the company considered if experts need to perform additional procedures for this year’s financial statement audit or that they may experience delays in completing those procedures (*e.g.*, valuation, tax experts)?
5. Can internal control walkthroughs or other procedures that are typically performed on-site (*e.g.*, inventory counts) be performed virtually?

II. Financial Statement Disclosures

In conjunction with preparing for the financial statement audit, companies will need to assess many potential U.S. GAAP disclosure requirements, including loss contingencies, risks and uncertainties, asset disposals, debt covenant modifications or waivers, subsequent events and going concern.



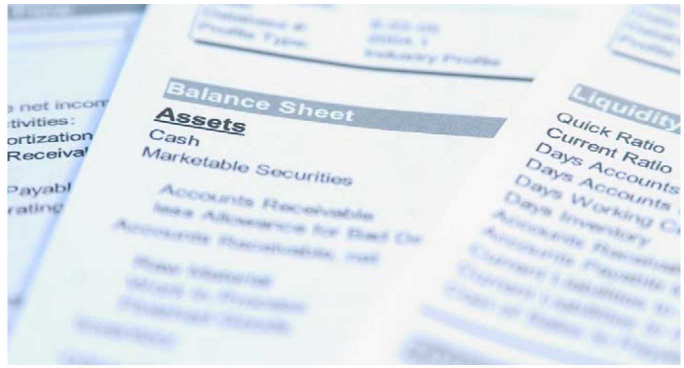
Worthy of specific mention is consideration of the effect of COVID-19 on the company’s going-concern assessment. Reforecasted cash flow projections may be needed for the going-concern assessment, with assumptions that consider the impact of prolonged facility closures causing significant delays or other disruptions, risk of collectability on outstanding accounts, and reduced demand for products or services.

Additionally, many organizations received certain benefits in 2020 that were atypical. These benefits may be a result of the CARES Act, including the receipt of loans, tax benefits or relief from GAAP requirements, which should be disclosed in the financial statements.

Further, with respect to non-GAAP financial measures, companies may need to decide whether to break out “COVID-related” costs. Consideration should be given to ensure that appropriate disclosure is included in regulatory filings to sufficiently define these costs. Registrants should be prepared to describe whether the costs or adjustments are directly related to COVID-19 and whether any new adjustments are likely to be recurring (see Regulation S-K, Item 10(e)).

QUESTIONS TO CONSIDER AS THE AUDIT APPROACHES

1. Did the company receive any atypical benefits during 2020? If so, have these items been disclosed?
2. Did the company dispose of any assets during 2020 that may have been a result of changes in business operations due to COVID-19? If yes, consider whether the asset disposal qualifies as held-for-sale asset disposal under ASC 360[1] or one which could be classified as an exit or disposal activity under ASC 420.[2]
3. Is the company considering presenting any non-GAAP adjustments for COVID-related costs?



III. Estimates and Reserves

Adverse events such as COVID-19 may trigger the need to prepare an impairment analysis. In these cases, many companies will need to reevaluate the inputs used in impairment models for assets, particularly with respect to expected future cash flows. Impairment issues can take many forms, including:

— **Goodwill and Intangible Assets**
Assessment of impairment for goodwill and indefinite-lived intangibles in accordance with ASC 350[3], as well as finite-lived intangibles in accordance with ASC 360.[4]

— **Trade Receivables**
Evaluation of historical loss rates to determine if and how they differ from what is currently expected over the life of current trade receivables (on the basis of current conditions and reasonable and supportable forecasts about the future).

— **Inventory**
Assessment of excess and obsolete inventory reserve requirements in accordance with ASC 330.[5]

— **Held-to-Maturity Debt Securities**
Assessment of reasonable and supportable forecasts required to support revisions of estimated impairment losses resulting from changes in market conditions.

— **Fixed Assets**
Assessment of impairment in accordance with ASC 360[6] that may result in recording an impairment charge and/or a change in useful lives.

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[1] https://asc.fasb.org/subtopic&trid=2155824
[2] https://asc.fasb.org/topic&trid=2175745
[3] https://asc.fasb.org/topic&trid=2144416
[4] https://asc.fasb.org/subtopic&trid=2155824
[5] https://asc.fasb.org/topic&trid=2126998
[6] https://asc.fasb.org/subtopic&trid=2155824

— **Capitalized Software**
Assessment of impairment of software development costs in accordance with ASC 985-20[7] for costs of software to be sold, leased or marketed, or in accordance with the internal use software guidance.

— **Fair-Value Measurement**
As in past periods when transactions were not orderly, such as during the 2007-2008 credit crisis, the current volatility in the economy and financial markets will likely present challenges in determining the appropriate inputs to fair-value measurements in accordance with ASC 820[8] for assets and liabilities such as investments and certain financing obligations.

QUESTIONS TO CONSIDER REGARDING ESTIMATES AND RESERVES

1. When calculating Current Expected Credit Losses (CECL) under ASC 326[9], as applicable, has the company updated the inputs that may have changed during 2020 which affect the total forecasted value of expected losses?
2. Have impairment analyses been performed on the company's intangible and tangible assets (*e.g.*, goodwill, receivables, inventory, fixed assets, capitalized software) using updated inputs that may have changed the assets carrying value as a result of COVID-19? Have those asset impairments been disclosed in the financials?
3. Do business changes (facility closures, risk of collectability on accounts receivable, reduced orders, etc.) resulting from COVID-19 impact cash flows that affect the company's ability to continue as a going concern? Has this been disclosed?

IV. Restructuring and Other Pandemic-Related Costs

Business changes from the effects of COVID-19 may have impacted cash flows significantly, and as a result, companies may have needed to restructure certain parts of their business to continue to operate during 2020. The resulting restructuring may include reducing operating expenditures, such as facilities in use and the size of the workforce. Reducing operating expenditures may also include debt restructuring, supplier rationalization, lease termination costs, dealing with workforce termination benefits, and other unexpected costs. Organizations should be cognizant of the accounting requirements for recording and disclosing restructuring or other costs.

QUESTIONS TO CONSIDER REGARDING PANDEMIC COSTS

1. Did COVID-19 result in the need to terminate employees? If so, consider whether the termination fees qualify as a one-time arrangement under ASC 420[10] or an ongoing benefit arrangement under ASC 712.[11]

[7] https://asc.fasb.org/subtopic&trid=2197796
[8] https://asc.fasb.org/topic&trid=2155941
[9] https://asc.fasb.org/topic&trid=82887179
[10] https://asc.fasb.org/topic&trid=2175745
[11] https://asc.fasb.org/topic&trid=2197446

2. Did COVID-19 result in the need to terminate leases? Is the company considering the change in lease termination guidance as a result of the updated lease guidance in ASC 842?[12]

3. Did COVID-19 affect the company's cash flows significantly enough to trigger debt covenants or result in any debt modification? The company should consider the specific accounting impacts of the following instances.

   — **Debt Modification vs. Debt Extinguishment**
   Assessment of whether an amendment to a debt arrangement should be treated as a debt modification versus a debt extinguishment in accordance with ASC 470-50.[13]

   — **Troubled Debt Restructuring**
   Assessment of whether a debt restructuring meets the criteria for troubled debt restructurings in accordance with ASC 470-60.[14]

   — **Balance Sheet Classification**
   Assessment of how covenant violations, covenant waivers, post-balance sheet refinancing transactions and subjective acceleration clauses affect short-term vs. long-term debt classification.

Additional FTI Resources

For additional information to consider as year-end financial reporting approaches, please refer to the following FTI articles and webinar:

— **COVID-19 Impacts on Accounting, Disclosures & Internal Controls**

— **Applying the Right Accounting Model for Pandemic-Related Changes in Workforce & Asset Leases**

— **4 Key Risk Areas for Accounting & Financial Reporting in 2020**

— **COVID-19 Pandemic-Related Compliance, Financial Reporting & SEC Enforcement Considerations**

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[12] https://asc.fasb.org/topic&trid=77888249

[13] https://asc.fasb.org/subtopic&trid=2208699

[14] https://asc.fasb.org/subtopic&trid=2208729

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