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COVID-19 Impacts on Accounting, Disclosures & Internal Controls

The COVID-19 pandemic is, first and foremost, a public health emergency of enormous proportions. The humanitarian cost to our communities, our country and the world is vast, and at the time of this publication, still rising.

While safety and health care threats must come first, economic concerns follow shortly thereafter, as we all seek to minimize the impact on our businesses and our economy. Companies face many unknowns regarding the ability to continue critical operations, generate revenue, manage contractual obligations, obtain access to capital and credit, and available business interruption and other insurance coverage, to name a few.

Given the significant uncertainties in today's global marketplace coupled with impacts across all geographies and industries, companies need to comprehensively evaluate the impact of the crisis on their accounting, disclosures and internal controls.

Accounting & Reporting Issues Potentially Impacted by COVID-19

Asset Impairments

Adverse events 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 & Intangible Assets** – Assessment of impairment for goodwill and indefinite-lived intangibles in accordance with ASC 350, as well as finite-lived intangibles in accordance with ASC 360.
- **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).¹
- **Inventory** – Assessment of excess and obsolete inventory reserve requirements in accordance with ASC 330.
- **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.²
- **Fixed Assets** – Assessment of impairment in accordance with ASC 360 that may result in recording an impairment charge and/or a change in useful lives.
- **Capitalized Software** – Assessment of impairment of software development costs in accordance with ASC 985-20 for costs of software to be sold, leased or marketed, or in accordance with the internal use software guidance.

Fair Value Measurement

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 for assets and liabilities such as investments and certain financing obligations, similar to past periods when transactions were not orderly, such as during the 2007-2008 credit crisis.

Hedge Accounting

The uncertainty in the current business environment may also result in the need to reassess the probability of hedged transactions occurring, which could result in the determination that hedge accounting is no longer applicable under ASC 815.

Debt Modifications & Loan Covenants

Many companies are experiencing negative impacts on operations and cash flows that could adversely impact the ability to service debt or comply with debt covenants. Such companies may need to obtain waivers for covenant violations, modify existing debt arrangements or enter into new financing arrangements. Challenging accounting and presentation issues can include the following:

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

¹ Alternatively, to the extent the Current Expected Credit Loss (CECL) guidance has not yet been adopted, evaluation and/or development of estimates of probable loss inherent in trade receivables with longer durations, based on historical loss rates and what is currently expected based on recent loss events.

² Alternatively, to the extent the CECL guidance has not yet been adopted, evaluation of other-than-temporary impairment (OTTI) for held-to-maturity (HTM) debt securities where the fair value of the HTM debt security is less than its cost



Revenue Recognition

Companies are required to estimate variable consideration at contract inception and to revisit those estimates at each subsequent balance sheet date throughout the term of the contract. In many cases, the changing business environment will require reassessments of those variable consideration estimates in accordance with ASC 606. In addition, assessments may need to be made of potential impairment of costs to obtain or fulfill a sales contract.

Insurance Recoveries

Companies are scrutinizing their business interruption and overall insurance coverage and preparing claims in light of the COVID 19 situation. Insurance recoveries give rise to financial reporting matters including recognition and disclosure of anticipated reimbursements in accordance with the ASC 450-30 gain contingencies guidance, as well as the income statement, balance sheet, and cash flow classification of any recoveries.

Bankruptcies & Restructurings

Some companies that are negatively impacted may need to restructure in order to reduce operating expenditures such as facilities and workforce, which may include asset impairments, lease termination costs and dealing with workforce termination benefits. COVID-19 is also sure to cause some companies to file for Chapter 11 bankruptcy, which involves specific accounting and financial reporting implications, both during the bankruptcy and upon emergence from bankruptcy.

Financial Statement Disclosures

Companies will need to assess many potential U.S. GAAP disclosure requirements, including loss contingencies in accordance with ASC 450-20, risks and uncertainties in accordance with ASC 275, subsequent events in accordance with ASC 855 and going concern in accordance with ASC 205-40. In addition, public companies will need to assess the timeliness, accuracy and sufficiency of disclosures around the impacts of the pandemic on their business, including in the Management’s Discussion and Analysis (MD&A) and Risk Factor sections of their Form 10-K and 10-Q filings.

Internal Controls Over Financial Reporting Implications

Companies will need to evaluate both the design and operating effectiveness of their internal controls as this pandemic changes their daily operations. For example, closures of facilities and employee absence due to responsibilities at home or illness may result in a lack of available information or ability to maintain the effectiveness of internal controls. In certain cases, this can lead to a high-risk environment where normal controls are being bypassed in order to meet governmental or customer demands. This may require implementing new controls or reliance on other mitigating controls for which the operating effectiveness has not been tested.

On top of these constraints, the regulatory demand for information is unwavering, as referenced in SEC Chairman Jay Clayton’s comments, on the SEC’s order (Release No. 34-88318) providing conditional regulatory relief, which requires registrants to “provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments.” As new or increased risks emerge, companies may need to quickly modify their controls or design and implement new ones. This may result in additional required disclosure to stakeholders, including for changes to the control environment in SEC filings.

FTI is Here to Help

The experts in our SEC & Accounting Advisory practice have decades of experience as former regulators, industry professionals and audit firm partners (including National Office) in dealing with the accounting, disclosure and financial reporting issues discussed above across all industries. Our experience, combined with our core expert rapid-response model, allows us to tailor a comprehensive approach to address the specific needs of our clients in these unprecedented times.

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