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CAQ COVID-19 Resource

Key Auditor and Audit Committee Considerations

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The COVID-19 pandemic and the related market conditions create many new uncertainties for public companies, auditors, and audit committees. As Securities and Exchange Commission (SEC) Chair Jay Clayton recently recognized, the continuing operation of the US capital markets is an essential component of the US's response to, and recovery from, COVID-19. This resource is intended to provide high-level financial reporting considerations for auditors and audit committees as certain audits near completion, quarterly reviews are occurring, and during planning for 2020 audits.

This resource is intended as general information and should not be relied upon as being definitive or all-inclusive. The CAQ encourages audit firms and audit committees to refer to the rules, standards, guidance, and other resources in their entirety.

KEY AUDIT IMPLICATIONS

For audits nearing completion, the PCAOB issued [COVID-19: Reminders for Audits Nearing Completion Spotlight](#). The Spotlight reminds auditors of their obligation to comply with PCAOB standards and rules, and other applicable regulatory and professional requirements. All auditor opinions need to be supported by sufficient appropriate evidence that provides a reasonable basis for those opinion(s).

In particular, the Spotlight focuses on:

1. Risk assessment

Auditors are reminded that the process to identify, assess, and respond to risks of material misstatement is not discrete but rather a continual and iterative one. As part of the evaluation of whether sufficient appropriate audit evidence has been obtained, auditors are required to evaluate the appropriateness of their initial risk assessments. Auditors may need to challenge or revise previous risk assessments in light of the COVID-19 crisis for certain financial statement areas, including disclosures (see more details below). Further, processes and controls may be affected by necessary changes to business processes in light of circumstances such as travel restrictions, or as a result of remote working

arrangements. Auditors may need to design and perform new procedures, or modify previously planned procedures, to test new or modified implemented controls.

2. Audit Committee Communication

Auditors are reminded, among other things, that significant changes to the planned audit strategy or the significant risks initially identified, and the reasons for such changes are required to be communicated to the audit committee. Such changes could include specific matters as a result of the COVID-19 crisis including significant changes management made to the process used to develop critical accounting estimates or significant assumptions, matters related to the auditor's evaluation of the company's ability to continue as a going concern, or significant difficulties encountered during the audit.

3. Auditor's Report

While the COVID-19 crisis may not itself be a Critical Audit Matter (CAM), it may be a principal consideration in the auditor's determination as to whether one or more CAM(s) exist and may also affect how CAMs were addressed in the audit. Additionally, the significance of the impacts of COVID-19 may warrant including additional elements in the auditor's report, such as

explanatory language or an explanatory paragraph when there is substantial doubt about the ability of the company to continue as a going concern.

4. Quality Control Considerations

Firms may modify policies and procedures related to engagement performance to support engagement teams addressing challenges as a result of the COVID-19 crisis. For example, such policies and procedures may include, among other things, adding or re-emphasizing requirements for consultations.

KEY ACCOUNTING AND DISCLOSURE IMPLICATIONS

Accounting and financial reporting implications of COVID-19 may require companies to make significant judgments and estimates. Certain judgments and estimates can be challenging in an environment of uncertainty. As noted in the [statement](#) by the SEC Chief Accountant, the Office of the Chief Accountant (OCA) has consistently not objected to well-reasoned judgments that entities have made, and OCA will continue to apply this perspective.

Auditors should consider how recent events and changes in circumstances due to the COVID-19 crisis may impact financial reporting. The following list, while not exhaustive, includes certain accounts and disclosures that may be impacted and some questions for auditor and audit committee consideration.

1. Impairments

a. Long-lived asset impairment (ASC 360)

- + Are there indicators of impairment of long-lived assets such as equipment, buildings, or finite-lived intangible assets? If yes, consider if events have triggered the need for an impairment test.
- + Are held-for-use assumptions of long-lived assets still appropriate? If the company changes its assertion about an asset group and concludes it meets the held-for-sale criteria, the order of impairment testing differs.

b. Goodwill impairment (ASC 350)

- + Are there indications that it is more likely than not that goodwill or an indefinite-lived intangible asset is impaired? If yes, an interim impairment test is required.

2. Investments

a. Marketable securities and available-for-sale assertions for a public business entity with a fiscal year end beginning after December 15, 2019 (ASU 2016-13)

- + Is management's assertion to hold investments to maturity still appropriate?
- + Have credit losses been appropriately recorded?

b. Equity method investments (ASC 323)

- + Are there indicators that the carrying amount of equity method investments (including in joint ventures) might not be recoverable? If yes, investments are required to be reviewed for impairment.

3. Income taxes (ASC 740)

a. Deferred tax valuation allowance

- + Has forecasted future taxable income in the carryback or carryforward period changed?
- + Has the auditor considered the requirements of ASC 740 and the effect on the interim reporting period?

b. Indefinite reinvestment assertion

- + If applicable, can the company continue to assert its intent and ability to indefinitely reinvest foreign earnings if their operations in such countries have been affected by current market conditions?
- + If the company changes its reinvestment assertion during an interim period, has the auditor considered the requirements of ASC 740 and the impact of accounting for deferred tax accounts?

4. Inventory valuation (ASC 330)
 - + Is the valuation allowance for inventory obsolescence appropriate?
 - + Have unplanned work stoppages affected inventory costing?
5. Debt modifications and loan covenants (ASC 470 and ASC 310)
 - + If applicable, do additional financing or amended terms of existing debt agreements meet the definition of debt modifications or extinguishments?
 - + Have any debt covenants been violated? If yes, have accounting and disclosure requirements been considered?
6. Restructuring and other employee related accruals
 - + Have exit or disposal activities been accounted for accurately (ASC 420)?
 - + Have leasing arrangements changed (ASC 842)?
 - + Have employee benefits changed that may require accrual?
 - + Have employees been terminated such that postemployment benefit obligations have been incurred (ASC 420, ASC 712, and ASC 715)?
7. Foreign currency - Intercompany transactions of a long-term investment nature (ASC 830)
 - + When intercompany foreign currency transactions are of a "long-term investment" nature, foreign currency transaction gains and losses are reported in other comprehensive income rather than through income during consolidation. If applicable, can the company continue to assert an intercompany transaction(s) is of a "long-term investment" nature, such that settlement is neither planned nor anticipated in the foreseeable future?
 - + Has a company reassessed its liquidity needs or planned restructuring or relocation of foreign operations such that settlement could be impacted?
8. Other auditing considerations include but are not limited to:
 - + Fair value measurements
 - + Insurance recoveries
 - + Effects on contracts and commitments including revenue and leases
 - + Hedge accounting
 - + Provisions, allowances, and loss contingencies
 - + Ability to continue as a going concern
9. Disclosure considerations
 - + The SEC's Division of Corporation Finance issued [guidance](#) on March 25, 2020 providing current views regarding disclosure and other securities law obligations that companies should consider with respect to COVID-19 and related business and market disruptions. Auditors should consider the implication to financial statement disclosures, including but not limited to loss contingencies, risks and uncertainties, subsequent events, management's discussion and analysis, risk factor disclosures, and non-GAAP financial measures.

KEY AUDIT COMMITTEE CONSIDERATIONS

In executing their oversight responsibilities, both of the year-end annual Form 10-K and related audit, if not yet complete, or the interim quarterly report on Form 10-Q, audit committees may want to consider the following:

1. Has the COVID-19 crisis impacted the financial reporting process and controls? Have employees or auditors been working remotely? Has the audit or interim review by auditors been affected?
2. Have business conditions affected the company's financial position and results of operations? How has management considered the impact of COVID-19 on the valuation of accounts, including asset impairment, allowances, restructuring charges, or other expenses? How have significant

estimates and assumptions changed? How has management communicated such changes and executed related controls?

3. Is COVID-19 expected to materially affect the demand for the company's products or services? How has management considered the impact of COVID-19 on contracts including revenue and leases? How has management communicated the impact of COVID-19 on long-term projections and assertions?
4. Is COVID-19 impacting the company's liquidity and capital resources? How has management communicated the impact of COVID-19 on financing arrangements, including debt covenants? Have related accounting and disclosure requirements been considered?
5. Have there been changes to the company's use of non-GAAP financial measures? If yes, what is the rationale for such changes and are disclosures compliant with SEC regulations?
6. Have material corporate events occurred triggering a requirement to issue a Form 8-K?
7. Has the company considered whether to apply for assistance under the CARES Act (or other government relief programs)? If yes, what conditions of that relief might have disclosure and financial reporting consequences?

OTHER RESOURCES

- + [SEC Division of Corporate Finance Disclosure Guidance: Topic No. 9 \(March 25, 2020\)](#)
This guidance provides the Division of Corporation Finance's current views regarding disclosure and other securities law obligations that companies should consider with respect to COVID-19 and related business and market disruptions.
- + [Deloitte Financial Reporting Alert 20-2: Financial Reporting Considerations Related to COVID-19 and an Economic Downturn](#)
This Financial Reporting Alert discusses certain key accounting and financial reporting considerations related to conditions that may result from the COVID-19 pandemic as well as various industry-specific considerations.
- + [EY Technical Line - Accounting and reporting considerations for the effects of the coronavirus outbreak \(March 31, 2020\)](#)
This publication addresses accounting and financial reporting considerations for affected companies, including income tax accounting considerations related to the CARES Act that was enacted on 27 March 2020 and considerations relating to internal control over financial reporting and disclosures in filings with the Securities and Exchange Commission.
- + [KPMG Quarterly Outlook \(March 2020\)](#)
This Quarterly Outlook summarizes the impact of COVID-19 and other accounting and financial reporting developments potentially affecting companies in the current period or near term.
- + [SEC Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19 \(April 3, 2020\)](#)
A statement from Sagar Teotia, Chief Accountant discusses the robust and longstanding financial reporting system in place, including the accounting, disclosure, and auditing models that will help address recent challenges.
- + [PwC In depth No. Us 2020-02 FAQ on accounting for COVID-19 and market volatility \(April 2, 2020\)](#)
This In depth answers specific questions about a range of topics, including the different models and triggering events for impairment assessments of tangible, intangible, and financial assets; the accounting for the impact on taxes, revenue recognition, inventory and debt, and considerations related to internal control over financial reporting.
- + [PCAOB COVID-19: Reminders for Audits Nearing Completion \(April 2, 2020\)](#)
This Spotlight is intended as a reminder that adherence to PCAOB standards takes on added importance as investors depend now, more than ever, on the integrity of financial statements.

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WE WELCOME YOUR FEEDBACK

Please send comments or questions to info@thecaq.org