



Remediation and restatement: Responding to financial reporting issues with purpose

As the saying goes, even the best-laid plans often go awry.¹ Polling during a recent Deloitte webcast revealed just that. We asked our audience of company executives whether their organizations had significantly revised or remediated their financial processes in the past 12 months. Nearly 60% said yes. What's more, more than half said they expected to do so again in the next 12 months.²

As we noted in the first installment of this two-part series, few companies operate under the assumption that they may have to remediate their financial processes. But as our poll indicates, most will likely confront such a scenario at some point. If a remediation situation does occur, what can the company do to emerge successfully? We'll go over key action items in a moment. First, let's

unpack some of the accounting and financial reporting issues that are often present when the need for rework arises.

Understanding the triggers

In Part 1, we reviewed some examples of business conditions that can have a destabilizing effect on the company. Another way to understand what triggers a remediation is by looking at the types of errors that can occur. Common ones include:

- Misapplication of complex accounting rules, such as those for acquisitions and divestitures, investments, revenue recognition, and income taxes

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- Recognition errors, meaning failure to identify an accounting event in a timely manner
- Misclassifications in the income statement and balance sheet or related to classification of cash flows (e.g., investing, financing, or operating within the statement of cash flows)
- Areas involving estimates and valuation, such as project accounting, impairment of long-lived assets, and contingencies
- Equity transactions, like convertible securities, incentive compensation, and accounting for warrants in special-purpose acquisition companies

Finally, companies must continuously assess the sufficiency of their internal controls. Shifts in technology, regulation, and other business conditions require a new risk assessment and—potentially—new or changed controls to address those risks. Failure to keep pace can result in remediation needs.

Swinging into action

Even the most proactive of companies can find themselves in a remediation situation. When that happens, the recommendation is to act quickly and methodically.

Create a plan. Set up tools and a process for status tracking and reporting, then assign resources while making sure to allow enough time for each workstream. Don't forget to make communications part of the plan.

Assess your resources. Get sufficient people involved internally and externally, including specialists or third-party help if needed.

Evaluate the misstatement. Investigate the nature and cause while considering risks in adjacent areas. Determine the amount and extent of the restatement, including the impact on account balances and other areas within financial statements. Finally, make the adjustments.

Determine why internal controls failed. Identify the control deficiencies, focusing on the root cause, and prepare a control deficiency assessment with an eye to developing a remediation plan. Keep in mind that the root cause may affect other controls and processes, including some that don't directly relate to the area being remediated.

Communicate. Execute the communication plan. Bring the company's auditors and board of directors along on the journey with frequent updates. Meanwhile, proactively manage communications to other stakeholders, such as investors, regulators (including the Securities and Exchange Commission), and banks.

Leading causes of remediation

A Deloitte survey of public companies found that material weakness and regulatory inquiries are, by a wide margin, among the *least* likely reasons for remediating financial processes in the next 12 months.² Here's the breakdown:



48%

Implementation of new technologies (ERP implementation, automation, cloud, controls for remote work)



23.8%

Changes to accounting standards and related adoption work to comply with them



6%

Material weakness or significant deficiency remediation



5%

Inquiries from regulators

Complete the reporting. A public company has requirements to make filings timely and for other significant events (think a departure of officers or nonreliance on previously issued financial information). Once those are determined, prepare the restated financials, including disclosures within the financial statement and internal control over financial reporting, and file the amended documents. Follow up with additional external communications as appropriate.

Repair and improve. Determine the key learnings from the event, along with opportunities for improvement (including ways to upskill staff). Identify other areas of similar risk, then update internal controls and the company's response framework. Beyond that, consider steps for continuous improvement.

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Finding the opportunity in adversity

In a rapidly evolving business environment like the one we have today, companies face an elevated risk of needing to consider restating financial statements, along with remediating processes, technology, and internal controls. An effective way to deal with this risk is to mitigate it by actively monitoring for change and putting a well-thought-out response framework in place.

Should the need for remediation occur, the priority can be to reach resolution as soon as possible and keep whatever caused it from happening again. That's where the action steps we outlined come in. It also helps to view the setback as an opportunity to systematically improve processes and data. By putting the two together, monitoring the business environment and building a culture of continuous improvement, the accounting organization can become more resilient to change, reducing the likelihood that other remediations may become necessary later on.

Endnotes

1. Adapted from Robert Burns, "[To a Mouse](#)," November 1785.
2. Deloitte, "[The need for speed in financial governance: Mitigating the risks of misstatements](#)" webcast, April 27, 2021. During the webcast, 1,040 executives were polled about the factors driving their organizations to remediate financial processes in the next 12 months.

Contact us



Pam Duzik
Partner, Audit & Assurance

Deloitte & Touche LLP
+1 402 997 7115
pduzik@deloitte.com



Sean Torr
Managing Director, Risk and Financial Advisory

Deloitte & Touche LLP
+1 615 259 1888
storr@deloitte.com



Matthew Burley
Partner, Audit & Assurance

Deloitte & Touche LLP
+1 720 264 4866
mburley@deloitte.com



Matt Hurley
Senior Manager, Risk and Financial Advisory

Deloitte & Touche LLP
+1 615 313 4365
mhurley@deloitte.com

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