October 2020

Deloitte.

Center for Board Effectiveness

On the audit committee's agenda

Audit committee challenges and priorities in the upcoming quarter and beyond

Introduction

Does it feel like Groundhog Day? On a personal level, it may feel like each day blends into the next, and many of us find ourselves waiting for the current conditions to pass so things can get back to normal. But companies can't simply take a wait-and-see attitude. They need to respond quickly to the change in the business landscape, both internally (e.g., forecasting, systems, and process) and externally (e.g., communication with stakeholders, go-to-market strategies). It's not only about how long the current environment will last, but how to position the company in the current environment and prepare for the "new normal." If companies stay the course and don't evolve during the pandemic, they are likely to fall behind competitors.

Audit committees have a critical role in helping companies evolve and thrive in this environment. To provide effective oversight and help company executives navigate these challenging times, audit committees need to ask direct, targeted questions of management to understand what alternatives were considered and chosen in addressing key issues. Audit committees should be aware of issues that are top of mind, trending, and ongoing, as well as the tension points, challenges, and alternative solutions associated with those issues.

Top of mind

Forecasting: This continues to be the single most challenging area for most companies in the COVID-19 environment. In addition to the business implications of forecasting, significant accounting judgments—such as potential impairments and going concern considerations—are driven by forecasts. Audit committees may want to ask management questions such as:

- Are multiple scenarios considered in the forecasting process, and how are those scenarios weighted?
- Does management believe the company will return to the pre-COVID level of operations? If yes, how does the timing of that recovery compare with external economic indicators? What are the key drivers influencing the company's recovery?
- Is data from the 2008 financial crisis being used to benchmark the timing and pattern of recovery from the current pandemic? Has management carefully considered the differences between the two economic periods?
- What "new normal" conditions or future trends are included in the forecast assumptions?
- Does the company have automated forecasting abilities that help remove bias and support frequent, real-time reforecasting as circumstances change?

Communication with stakeholders: Given the uncertainty inherent to the current environment, effective communication with stakeholders is of even greater importance. The call for enhanced transparency has come from both investors and the SEC,[1] which is encouraging disclosures that help investors understand how management and the board are analyzing the current and expected impact of COVID-19 on the company's operations and financial condition. Questions audit committees may want to ask include:

- Is the accounting treatment and financial reporting presentation for unusual transactions related to COVID-19 appropriately disclosed?
- Does the company describe how it is addressing short- and long-term liquidity and funding risks?
- In considering the use of non-GAAP measures, has the company considered what costs might be part of the "new normal" and how certain non-GAAP adjustments may impact comparability in the future?

Internal controls: Although aspects of the internal control environment may have changed during the pandemic, the Sarbanes-Oxley Act's requirement for effective internal control over financial reporting (ICFR) has not changed, and regulators continue to emphasize the importance of ICFR. Accordingly, companies should not lose sight of what is appropriate for maintaining effective ICFR in the context of common practices for dealing with the pandemic. Audit committees may want to ask:

- How is the company planning to address physical inventory counts? Has management considered the views of its regulators and coordinated its approach with the company's auditors?
- Has the company evaluated whether there is an appropriate segregation of duties in light of changes in job responsibilities or personnel?
- Has the company seen an increase in attempted cyber attacks, and has management reviewed cyber risk controls in the context of a remote workforce?

Trending

The continuing pandemic has created a number of additional issues for many companies. Some are revisiting stock compensation plans, while others are evaluating their real estate footprints, considering modification of certain financial instruments, and assessing their eligibility for the Employee Retention Credit.[2] It may be appropriate for audit committees to ask:

- Have stock awards been modified, and if so, what analysis has been performed to evaluate the related impact on compensation expense?
- Has the company reassessed its volatility assumption when valuing new stock awards in light recent market volatility?
- Is the company considering abandoning property? Has the company evaluated the accounting consequences if subleasing the property in the future remains a possibility?
- Has the company considered the accounting ramifications of modifying debt awards to transition away from LIBOR when that modification is combined with one that could affect the amount or timing of contractual cash flows?
- Have lenders evaluated whether there are new or continued indicators that a debtor may be experiencing financial difficulties even though that debtor is not in payment default due to a "payment holiday?"
- Has the company evaluated the eligibility criteria and developed an appropriate analysis to support application for the Employee Retention Credit?

Ongoing

Although some issues related to COVID-19 can be characterized as ongoing, that categorization is not intended to diminish the significance or pervasiveness of the matter. For example, audit committees should ask questions such as:

- Has the company updated its impairment analyses?
- Has there been any significant restructuring activity?
- Has the company modified any significant contracts, particularly contracts with customers and leases?
- Has the company received and appropriately accounted for any government assistance or insurance recoveries?

---

1 See CF Disclosure Guidance Topic No. 9, Coronavirus (COVID-19), and CF Disclosure Guidance Topic No. 9A, Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources.

2 See Summary of employer payroll tax relief for additional information.

Concluding thoughts

Audit committees should remain highly engaged with their companies' management and auditors in what continues to be a virtual work environment for many. This may necessitate more frequent communications than had been the case before the pandemic. Taking a proactive approach to discussing issues with the company's management and auditors allows the audit committee to provide the necessary oversight of financial reporting, the system of internal controls, and the audit process.

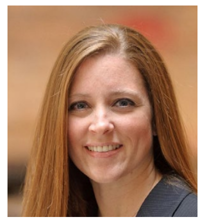
For more information on these financial reporting and accounting challenges, read COVID-19 Financial Reporting Trends: Different News or More of the Same?

Authors

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

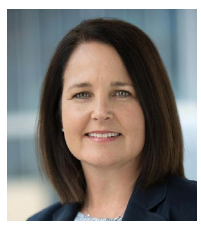
Krista Parsons
Managing Director and
Audit Committee Programs Leader
Center for Board Effectiveness
Deloitte & Touche LLP
kparsons@deloitte.com

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

MAKING AN IMPACT THAT MATTERS *since 1845*

About the Center for Board Effectiveness
The Center for Board Effectiveness helps directors deliver value to the organizations they serve through a portfolio of high quality, innovative experiences throughout their tenure as board members. Whether an individual is aspiring to board participation or a veteran of many board experiences, the Center's programs enable them to contribute effectively and provide focus in the areas of governance and audit, strategy, risk, innovation, compensation and succession. For more information, contact us at centerforboardeffectiveness@deloitte.com

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.