ASK THE EXPERTS WEBINAR

Financial Close in the COVID-19 Crisis

March 26th, 2020

PRESENTERS

Keith Bown *MANAGING DIRECTOR*

Years of Experience: 17+

Expert Areas: Management reporting and analysis, IPO readiness, business combinations, audit readiness, capital markets

Industries Served: real estate, technology, hospitality, consumer services, manufacturing

Todd Follett *MANAGING DIRECTOR*

Years of Experience: 22+

Expert Areas: Accounting and Finance operations, management reporting and analysis, and post transaction integration support

Industries Served: Healthcare, technology, manufacturing, and travel and transportation

PRESENTERS

Sasha Morozova *MANAGING DIRECTOR*

Years of Experience: 14+

Expert Areas: Carve-out and pro forma financial statements, business combination and divestiture matters, IPO readiness, GAAP change and conversions

Drew Niehaus *MANAGING DIRECTOR*

Years of Experience: 16+

Expert Areas: Technical Accounting, Financing Transactions, SEC Reporting, SOX Design

Industries Served: Consumer Products, Technology, Government Contracting, Manufacturing, Service Companies, Aerospace and Defense

AGENDA

INTRO & REMINDERS

BUSINESS SUPPORT

FINANCIAL CLOSE

ACCOUNTING AND FINANCIAL REPORTING CONSIDERATIONS

Q&A AND CLOSE

KEY REMINDERS

- Riveron webcasts – past and upcoming
- 4 polling questions must be answered to obtain CPE
- If you have questions, feel free to ask in Q&A option in Zoom
- Webinar evaluation form & CPE certificate will be emailed to you
- On demand video is not eligible for CPE
- You will receive a follow up email including:
  - Access to this webinar recording and deck
  - The ability to join our Webinars Mailing list to receive future invites
  - Presenter contact info

BUSINESS SUPPORT AND FINANCIAL CLOSE

BUSINESS SUPPORT AND FINANCIAL RESILIENCY PLANNING

CFO ORGANIZATION - A STRATEGIC PARTNER IN BUSINESS CONTINUITY DECISIONS

LIQUIDITY MANAGEMENT

- Working capital optimization efforts
  - Assess A/R collections and forecast potential write-offs
  - Optimize vendor payment terms and centralize controls over A/P disbursements
- Prepare “Cash Burn” analysis (base, worst and best case)
- Analyze other liquidity sources
  - Optimize available credit options
  - Analyze debt covenant headroom
  - Monetize non-core assets

OPERATIONAL CONTINUITY & COST CONTROL

- Reforecast and refine reporting
  - Modeling scenarios and stress testing
  - Suspended or reduced business operations
  - Financial levers to pull to optimize business health
- Sales and revenue projections
  - Revenue pipeline evaluation
  - Inventory fulfillment capabilities
- Cost control
  - Optimize supply chain costs
  - Manage workforce expense
  - Minimize capital expenditures

“OUT OF NORM” REPORTING

- Increased credit default trigger analyses and modeling short term relief options:
  - Financial covenants
  - Borrowing capacity
  - Credit metrics computations
- Monitoring estimated impacts of stimulus package and other relief efforts
- Financial reporting deadline relief
- Changing income tax laws and filing deadlines

FINANCE AND ACCOUNTING MANDATE

- Real time financial information
- Expectation of accuracy and completeness
- Value-add financial and operational metrics
- Applying accounting for non-routine financial levers to forecast and scenario modeling

ANOTHER NEW CHALLENGE – "100% REMOTE CLOSE"

SHIFT IN CULTURE AND TEAM DYNAMICS

- Close process built on interaction
- "People & Safety First"
- Possible change in team composition
- Successfully executing virtual meetings
- Fostered communication

TECHNOLOGY DEPENDENCIES

- Remote access set-up
- Provide laptops, VPN's, & screen sharing tools
- Learning curve and adaption time period (login, online review, access servers, firewalls)

INTERNAL CONTROLS

- Adapt existing control documentation processes
- Centralized data retention software and access
- Electronic preparer & approver sign-offs
- Audit readiness

REMOTE CLOSE PLANNING

QUESTIONS FOR CONSIDERATION

- What has historically been done in person that will have to be redesigned for a virtual work environment?
- What normal accounting functions are at risk in a remote work environment?
- What tasks will take longer to complete in a virtual work environment?
- What new technology/team support will be required to operate successfully in a virtual environment?

System Dependencies

- Set-up lap-tops, remote access to ledger systems and share drives for employees
- Provide training on:
  - Remote access log-ins
  - Server access
  - Shared drives access
  - Conference and virtual team meeting tools
- Consider need for electronic documentation tools

Process Modifications

- Proactively identify workarounds for manual activities such as payables, check runs, and bank reconciliations
- Practice “Soft” remote close of "at risk tasks" for training and gap assessment
- Explore if close timeline needs to be extended due to impact on data feeds
- Develop “Remote” close calendar, identify key touch points, and critical path items
- Communicate detailed plan clearly and cross-functionally
- Schedule recurring virtual meetings

Resource Support

- Identify “key person dependencies” and outline risk mitigation plan if this resource is affected by the pandemic:
  - Cross-training
  - Back-up resources
  - Documentation of performed processes
- Clearly assign and communicate close execution accountabilities
- Consider need for additional review for new or developing employees
- Heavy emphasis on collaboration and team work

SOFT SKILLS OF REMOTE WORKING

Themes	Observations	Actions
Continuous reinforcement of important messaging	► Schools are closed and families are all home together resulting in unusual distraction and disruption ► The current situation may be unfamiliar to team members that are usually office-bound ► Messages may be lost and important information forgotten	► Reinforce deadlines and important project aspects regularly ► Break up complicated material as much as possible ► Use different mediums to communicate messages
Assess if extensions are required and discuss with team	► Decisions tend to be made faster when in-person and slower in remote environments ► Communication gaps may delay the amount of time it takes to reach consensus or to gather necessary information	► Discuss any potential needs for extending project timelines with your team and other impacted parties
Transparency becomes even more important	► Without regular face-to-face interaction, remote communication can increase the risk of miscommunication and misunderstandings	► Similar to reinforcing important messaging, be aware of the frequency of open and honest communication with team members
Try to reach out to individuals regularly if you're part of a larger team	► Team members can be distracted during conference calls ► Some may not want to speak on group calls and thus go unheard	► Be aware of this dynamic and reach out to individuals of the group to close communication gap
Build in some unstructured time into each call	► Clients that habitually begin in-person meetings or conference calls with idle chatter need to be given the opportunity to continue doing so ► Build up rapport and breaks tension	► Allow for a few minutes of organic chatter, usually at the beginning of the call ► Be cognizant of time so don't allow for content derailment (i.e. still keep calls focused)

Polling Question #1

Which has posed the greatest challenge for the accounting and finance function working through challenges presented by COVID-19?

A. Remote working environment
B. Managing special requests
C. New accounting issues
D. IT challenges

ACCOUNTING & FINANCIAL REPORTING CONSIDERATIONS

REVENUE RECOGNITION

Disruptions to your company's or your customer's operations can manifest themselves in several ways throughout the revenue recognition process

- For new customer contracts, companies should evaluate the customer's intent and ability to pay as amounts become due to evaluate whether a contract with a customer exists.
- Customer credit losses should be analyzed as part of a company's CECL assessment
  - Consider both current economic conditions and management’s expectation of future economic conditions
  - Forward-looking model of CECL will require significant judgement
- Extending customer payment terms may add a significant financing component to contracts
- Contract terminations or modifications should be identified, and the contract modification guidance should be applied.
- Companies may be experiencing disruptions in meeting certain contractual milestones that have a revenue recognition impact

REVENUE RECOGNITION

Contracts with variable consideration should be re-evaluated

- Certain contract conditions may have been previously considered perfunctory, such as performance bonuses or minimum spend
- Contract modifications may introduce variable consideration, such as volume-based rebates that companies had not previously considered
- Service level agreements may need to be re-evaluated if management believes it will be more difficult to achieve targeted metrics
- Companies updating their policies to allow sales returns should consider the impact on the estimated transaction price
- Excess capacity in the sales channel may exist which may impact revenue recognition if there is an expectation that sales will be returned

IMPAIRMENT

Effects of an outbreak can become a "trigger" to perform interim goodwill and indefinite-lived intangible assets impairment test

- Applying qualitative approach to impairment may require significant judgement and may not become feasible in current environment.
- Decline in company's stock price and market capitalization should be considered in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount.
- Impairment tests of all other assets (e.g., inventory, long-lived assets) should be completed and reflected in the carrying amount of the reporting unit prior to the completion of the goodwill impairment test

Effects of an outbreak may also lead to factors requiring impairment tests for long-lived assets

- Impairment model for long-lived assets includes 3-step approach
- Significant change in business environment will likely cause companies to move to Step 2 (recoverablity test) and 3 (measuring the amount of impairment)
- Depreciation estimates should be closely evaluated, cash flow projections in recoverability tests should also be adjusted

IMPAIRMENT

Carrying value of inventory may need to be adjusted

- Disruption in supply change and low sales volumes due to outbreak may result in adjustment to carrying value of inventory.
- Declines in net realizable value should be recorded as an expense when incurred.
- Companies with idle capacity or vacant facilities may have to recognize all overhead as expense instead of capitalizing into inventory.

Equity method investments

- Companies with equity method investments in entities that have incurred significant losses or impairments may have other than temporary impairment risk
- In addition to common impairment indicators such as declining earnings or a decline in the fair value of the investment below the carrying amount, investors should evaluate any impairments taken by the investee as a potential impairment indicator

Polling Question 2

Has your company begun any impairment evaluations in Q1?

A. Yes

B. No

C. Considering it

D. Not applicable

LEASES

Impairment Assessment of ROU assets

- Lessees – ROU assets will be subject to impairment model of ASC 360
- Lessors – For sales-type and direct financing leases, the guidance on credit losses applies
- Lessors – For operating leases, the collectability of lease payments should be evaluated under the terms of ASC 842

Rent concessions

- Accounting will depend on whether rent abatement represents an enforceable right in the original lease or whether it is negotiated separately.
- Lease modification will be accounted on a prospective basis as a reduction to lease cost (lessee) and lease income (lessor)
- If lease concession is not considered lease modification, it will be accounted as variable lease payment (reduction in variable rent).

Other impacted areas of lease accounting

- Lease reassessments, discounts rates, asset abandonment or sublease

INCOME TAXES

Income taxes

- Companies with operations in international locations should consider whether it is appropriate to continue to assert their intent and ability to indefinitely reinvest foreign earnings
- Valuation allowances should be established where deferred tax assets may not be realizable. Expected future losses are considered negative evidence.
- Estimating the annual effective tax rates: Discrete items
  - Unusual or infrequently occurring items are excluded from AETR calc and recorded in period
  - Discrete treatment: Changes in valuation allowances related to projected income from future years vs. current year

OTHER ACCOUNTING CONSIDERATIONS

Stock based compensation

- Any modification to earnings targets that trigger a stock option to vest or that impacts the probability of vesting may be considered a modification of the award requiring further evaluation and potentially additional compensation expense.

Contingent consideration

- Companies that have recently completed a business combination may have assets or liabilities associated with contingent consideration which are measured at fair value.
- Company-specific forecasts or supply chain disruptions may impact earnings, which should be incorporated into the updated fair value analysis.
- Any changes in the terms of such agreements should be incorporated into an updated fair value analysis.

Financial Transactions

- Hedges may no longer be effective, such as those related to commodity purchases
- Hedged transactions that did not occur
- If any debt was refinanced, evaluation of modification versus extinguishment may be different than historical analyses due to low interest rates

Polling Question 3

What accounting and financial reporting area do you expect to be the most challenging during Q1 close as the result of COVID-19?

A. Revenue Recognition

B. Asset impairment

C. Inventory valuation

D. Other

GOING CONCERN

The uncertainty surrounding customer demand and collectability should compel many companies to prepare a going concern analysis

- Even if long term demand is not projected to decrease, the going concern analysis focuses on one year after the date the financial statements are issued
- Supply chain disruption, prolonged plant closures, and collection concerns are key indicators
- Evaluate cash and financing options to meet debt obligations
- Liquidity problems may surface due to in inability to access credit or equity markets
- Carefully review debt covenants to determine if violations may occur. Covenants may include a provision surrounding going concern opinions from auditors
- Disclosures are required in the notes to the financial statements if management concludes substantial doubt exists

DISCLOSURE

Subsequent Events

- Type I – Events that provide additional evidence about conditions that existed at the date of the balance sheet
- Type II – Events that provide evidence about conditions that did not exist as of the balance sheet
- Outbreak related events such as losses on sales of inventory or other assets or the bankruptcy of a customer that occur subsequent to the balance sheet date may indicate a previously unrecognized loss that should be a Type I event

Loss Contingencies

- Companies must disclose a potential contingency when there is a reasonable possibility a loss has been incurred
- Must include an estimate of the possible loss or range of possible losses, or disclose no such estimate can be made

DISCLOSURE

Risks and Uncertainties

- Disclosures about certain risks and uncertainties that could significantly affect the amounts reported or the functions of the company in the near term are required
- Companies impacted by COVID-19 may be required to disclose significant estimates or vulnerabilities
  - Significant estimate disclosure should include those that are sensitive to change where the effect of the change would be material
  - Vulnerability disclosure may focus on concentrations of operations or customers that exist at the balance sheet date where the company has a risk of a near-term severe impact that is at least reasonably possible

Risk Factors

- Public companies are required to disclose any material new risks or changes in risk factors.
- Disclosure of how companies plan to address the uncertainty as a result of the outbreak is integral information for stakeholders

Polling Question 4

Have you discussed the potential for a going concern analysis with your auditor yet?

A. Yes

B. No

C. Planning on it

D. Not applicable

Q&A

ADDITIONAL RESOURCES

Related Thought Leadership

View the latest COVID-19 insights **HERE**

Additional Resources

PREPARING FOR THE NOW, THE NEXT AND THE NEW NORMAL

The NOW: A Guide to Dealing With Disruption

Contact Us

REQUEST TO SPEAK WITH A TEAM MEMBER