RIVERON
PREPARE FOR CHANGE

# ASK THE EXPERTS WEBINAR

***Audit Readiness: Preparing for an Audit Unlike Any Other***

**October 1, 2020**

# PRESENTERS

## Michael Cahill

*MANAGING DIRECTOR*

**Expertise:** IPO readiness, audits, SEC reporting, financial reporting, project management, mergers and acquisitions, and due diligence

## Melissa Dennis

*MANAGER*

**Expertise:** Income tax accounting (ASC 740), tax planning, sales and use tax, tax diligence, and domestic and international restructuring

## Jeff Kranzel

*MANAGING DIRECTOR*

**Expertise:** New accounting standard implementation advisory, GAAP conversions, deal structuring, and other transaction accounting matters

## Matt Tepfenhart

*DIRECTOR*

**Expertise:** Adoption of new accounting standards, member of internal Expert Network on technical accounting matters, carve-out financial statements, completion of closing and opening balance sheets, financial diligence and conversions from cash to accrual basis of accounting

## Matt Wray

*DIRECTOR*

**Expertise:** Adoption new accounting standards, audit, audit support and readiness, SOX controls, technical accounting support, accounting errors, restatements, IPOs and buy-side support

## KEY REMINDERS AND CPE

- Riveron webcasts – past and upcoming
- CPE Information
  - Actively participate for the duration of the webinar
  - Respond to 3 of the 4 polling questions
  - On demand video is not eligible for 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
- You will receive a follow up email including:
  - Access to this webinar recording and slide deck
  - The ability to join our *Ask The Experts* mailing list to receive information on future webinars and events
  - Presenter contact info

# 2020 AUDIT READINESS: IMPACTS OF COVID-19

1. Goodwill impairment testing
2. Workforce actions
3. Going concern assessment
4. Complex financing transactions
5. Tax impact of COVID-19 related activities and regulations
6. Virtual audit procedures
7. Lower materiality thresholds and scoping
8. Leaner accounting teams

# Polling Question 1

What approach did you take to consider goodwill impairment last year?

A. Qualitative

B. Quantitative

C. We don’t have goodwill

D. What’s goodwill?

# IMPAIRMENT

# GOODWILL IMPAIRMENT ANALYSIS

## Impairment assessments can be prepared before year-end

- Performed annually or when there is a triggering event.
  - Consider whether the market response to COVID-19 is a triggering event for your company
  - Performing the annual test before year-end can alleviate pressure during the audit cycle
    - Many companies elect to perform their annual test as of October 1

## There are two approaches to testing impairment: Quantitative and Qualitative

| QUALITATIVE TEST | QUANTITATIVE TEST |
|---|---|
| This approach is optional and allows management to evaluate relevant items such as macroeconomic conditions, overall performance of the company, and changes in key personnel to assess whether the fair value of a reporting unit is less than it’s carrying amount.<br>► Many companies have relied on this testing approach in recent history. | This approach requires calculating fair value of reporting units and comparing the fair value to the carrying amount. An impairment loss must be recorded if the fair value is determined to be less than the carrying amount.<br>► Due to the volatility and uncertainty of the current economic environment, many companies will be required to adopt this approach.<br>► The quantitative test will require a significant increase in analysis and documentation required and will be new for many management teams. |

# IMPAIRMENT CONSIDERATIONS FOR THIS AUDIT CYCLE

## Many private companies have relied on the qualitative approach in recent years

Will the business be able to meet the "more likely than not" threshold required to rely on a qualitative assessment?

What factors will be required to perform a quantitative analysis?

- Documentation of potential triggering events and economic factors
- Valuation method applied - Income Approach, Market Approach, Cost Approach
- Discount rate used

What are the tax impacts when calculating and recording an impairment loss?

## Start planning now:

Consider testing impairment during the interim period

- Determine the approach and inputs that will be used
- Begin having conversations with auditors on the selected approach and documentation

# Polling Question 2

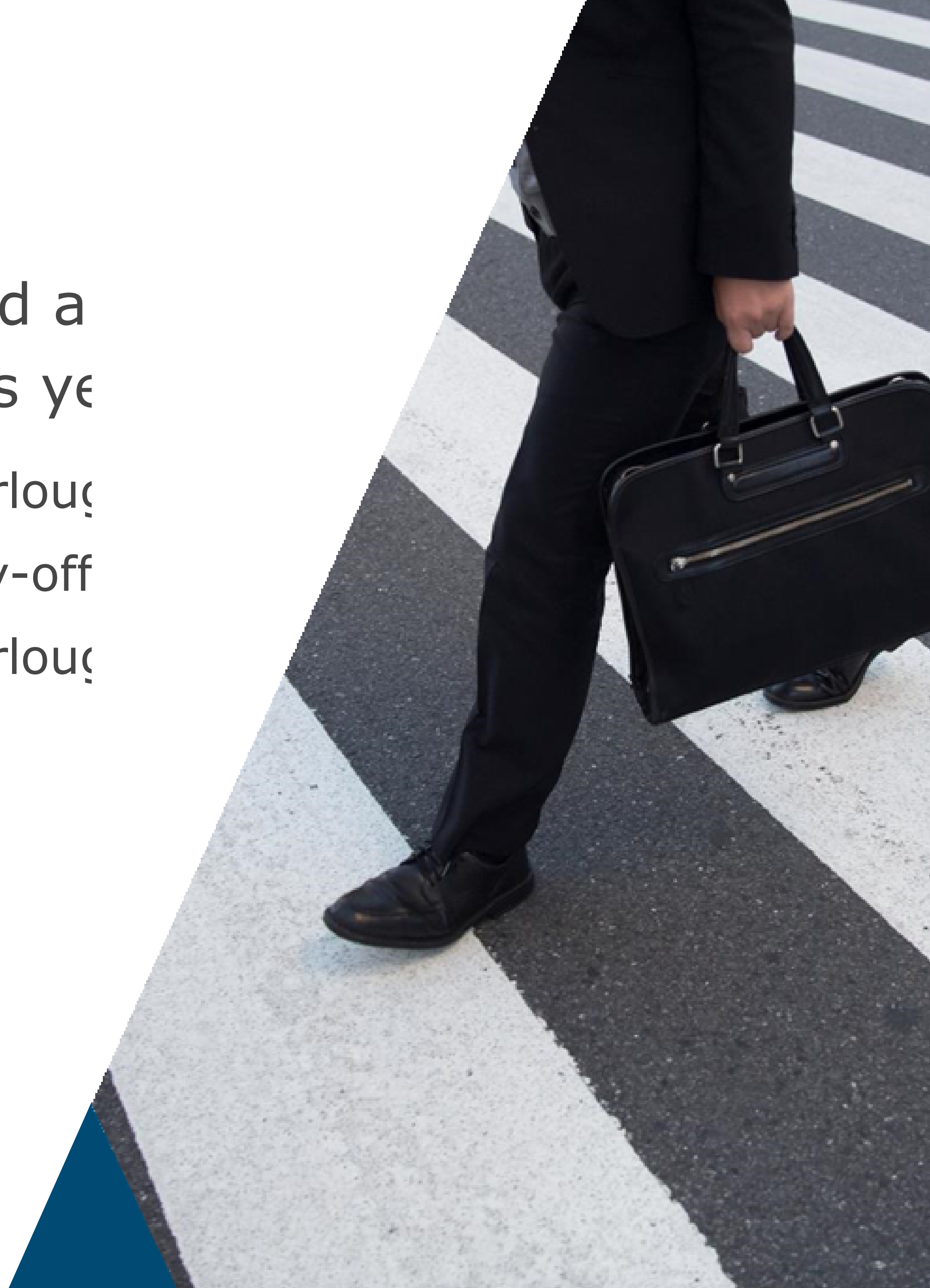
Has your company faced a workforce reduction this ye

A. Yes – we experienced furloug

B. Yes – we experienced lay-off

C. Yes – we experienced furloug and lay-offs

D. No



# WORKFORCE ACTIONS

# IMPACTS OF WORKFORCE ACTIONS

**Many companies have seen workforce reductions through terminations and furloughs**

The uncertainty of the impact of COVID-19 led many companies to adopt cost-cutting initiatives, including temporary or permanent reductions in workforce via terminations or furloughs, which result in differing accounting treatments.

**There are three main types of workforce actions:**

| | |
|---|---|
| **VOLUNTARY TERMINATIONS** | ▸ An employee makes the choice to leave on their own accord.<br>▸ Recognize benefits offered in exchange for voluntary termination as expense when employee irrevocably accepts the offer and amount can be reasonably estimated. |
| **INVOLUNTARY TERMINATIONS** | ▸ Includes lay-offs or firings. This is the choice of the employer and can be for cause or without cause.<br>▸ Contractual termination or other benefits (severance): Recognized when it is probable that the employee will be entitled to the benefit and the amount can be reasonably estimated.<br>▸ One-time termination benefits: Recognized immediately or ratably (if period of future service is more than 60 days). |
| **FURLOUGH ARRANGEMENTS** | ▸ Typically requires an employee to take mandatory time off with no pay or a pay decrease, and/or continuation of some fringe benefits. The timeframe of a furlough may be known or unknown. |

# ACCOUNTING FOR FURLOUGH ARRANGEMENTS

## The details of the furlough arrangement will impact the accounting treatment

| Type of Benefit | Example | Employment Status | Timing of Liability/Expense Recognition | |
|---|---|---|---|---|
| **Vests or accumulates** | **Retirement benefits, vacation days** | ► N/A<br>► Employment status does not impact treatment | ASC 710 | ► Accrued when the costs are **probable**, and the amount can be **reasonably estimated**. |
| **Does not vest** | **Sick leave, medical benefits** | **Active Status**<br>► Employee is required to perform duties during furlough period<br>► Employee must stand ready to return to work while receiving benefits | ASC 710 | ► Costs are recognized **as incurred** during the furlough period |
| | | **Inactive Status**<br>► Employee is not rendering service to employer but has not been terminated<br>► Eligible for unemployment<br>► Can seek other employment while receiving benefits<br>► Job uncertainty has been communicated to employee | ASC 712 | ► Accrued when costs become **probable** and the amount can be **reasonably estimated**<br>► If liability is not probable and cannot be reasonably estimated, recognize expense **as incurred** |

# GOING CONCERN

# GOING CONCERN – A REFRESH ON THE STANDARD

- ASC 205-40 changed the going concern assessment from an audit standard to a management accounting issue. Although this has not typically been a concern for most businesses in recent history, the volatility of the current economic environment is expected to have an impact on the emphasis placed on going concern.
- Management is required to evaluate an entity's ability to continue as a going concern during the look-forward period, which is generally one year after the date the financial statements are issued or available to be issued.
- This analysis requires management to establish a base case, supported by specific assumptions and forecast drivers to predict the results in the look-forward period.
- A sensitivity analysis should be prepared to evaluate scenarios that could prove to become a reality in the next 12 months.
  - Perform an analysis based on macroeconomic assumptions and industry or business-specific reactions to specific change drivers.
- Consider the entity's ability to meet all obligations under their contractual arrangements in the look-forward period (e.g. debt covenants, acceleration clauses).
- If substantial doubt is raised, document mitigating plans that are in place to alleviate the going concern risk.

# PREPARING A GOING CONCERN ANALYSIS

## Many companies have not prepared a detailed analysis in previous years

- Management teams have relied on business profitability, both historic and expected, and have not been required to perform a thorough going concern analysis in recent history
- The uncertainty and volatility in the markets as a result of COVID-19 has changed the landscape and predictability of results for nearly all industries to some degree. These uncertainties, which may be material, could cast doubt on a company's ability to operate under the going concern basis.
- Audit firms will have mandatory going concern risk reviews, with key focuses on the following:
  - Forecasting liquidity
    - How will an entity be able to support itself and make good on its obligations in the near term (12 months out)?
  - The ability to meet all contractual obligations in the look-forward period
    - Will the business be able to meet the required thresholds to comply with all obligations?
  - Management's plan to alleviate any identified substantial doubt and if the plan has been implemented

**Management can begin to consider the going concern now by identifying inputs to liquidity forecasts and plans to address potential risk.**

# FINANCING TRANSACTIONS

# COMPLEX FINANCING TRANSACTIONS

## COMPANIES ARE SEEKING NEW WAYS TO MANAGE LIQUIDITY IN AN UNCERTAIN ECONOMIC ENVIRONMENT

- With the timing of economic recovery slower than expected and additional government support uncertain, many companies have undertaken complex financing transaction to raise cash and manage liabilities.
- Types of financing transactions undertaken include:
- Debt & equity issuances
- Loan modifications
- Invoice financing and factoring arrangements

## MANAGEMENT CONSIDERATIONS

- Consider the impact of the transaction before entering the arrangement to ensure that the desired accounting treatment is achieved
- Consider the impact of this transaction on current debt covenant requirements and other ratios
- Engage with auditors early to ensure that the appropriate level of documentation is being maintained and to avoid audit delays

# COMPLEX FINANCING TRANSACTIONS

## APPLYING ASC 470

- The first step in accounting for any debt modification is to determine whether the modification represents a troubled debt restructuring (TDR)
  - TDR: Debtor must be experiencing financial difficulties and lender must have granted a concession
    - If assets or equity are transferred to settle debt, a gain is recognized for the excess of the carrying amount over the fair value of the assets or equity interest
    - If terms are modified, change is accounted for prospectively
    - Undiscounted future cash payments of the new terms < the carrying amount, gain recognized
- When a debt modification does not qualify as a TDR, determine if it is a debt extinguishment
  - An extinguishment occurs when present value of future cash payments is at least 10 percent different than those of the original debt
  - Modifications and extinguishments result in different balance sheet and income statement impact

## ENHANCED DISCLOSURE REQUIREMENTS

- Disclosures include the terms of the new debt, whether the old debt was extinguished, and any gains or losses recognized

# TAX IMPACTS

# KEY TAX PROVISIONS OF THE CARES ACT

## Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

### NET OPERATING LOSSES

- 2018-2020 losses may be carried back for 5 years
- 80% limitation suspended until 2021

### INTEREST DEDUCTION

- Increased limitation for 2019 and 2020 from 30% to 50%

### AMT CREDIT

- Fully refundable

### DEPRECIATION OF QUALIFIED IMPROVEMENT PROPERTY (QIP)

- Retroactive technical correction to allow bonus depreciation on QIP

### CHARITABLE CONTRIBUTIONS

- Increased limitation from 10% to 25% for 2020

# CARES ACT & ACCOUNTING FOR INCOME TAXES

## Evaluating the realizability of deferred tax assets

| | |
|---|---|
| **INCREASED 163(J) DEDUCTIONS** | ▶ Less carryforward<br>▶ Change in attributes used |
| **NOL CARRYBACKS** | ▶ Change in tax rate<br>▶ Change in attributes used |
| **AMENDED RETURNS FOR QIP DEDUCTION** | ▶ Additional losses<br>▶ Change in attributes used |

# Polling Question 3

Has your Company began mode
the use of Deferred Tax Assets f
Valuation Allowance assessment

A. Yes – piece of cake
B. Yes, but we are still working through all these new chang
C. No – we don't even know where to begin
D. No – not applicable

# VIRTUAL AUDITS

# MOVING TO A VIRTUAL AUDIT

Proactively set meetings to discuss expected audit areas or changes in scope

Identify support that can be compiled during interim

Consider audit areas that may require remote testing or alternative procedures

Use online collaboration tools to provide support electronically

Communication and frequent touchpoints will be integral

- Agree on timeline and expectations
- Stick to the set delivery dates (on both sides)

# IMPACTS OF MATERIALITY

# IMPACTS ON MATERIALITY

## Unforeseen changes in business activity could impact the auditors' materiality threshold

- Decreased revenues and increased expenses in the current year may result in additional testing procedures, increased testing populations, and lower testing thresholds
- This could result in areas being brought into scope that have not been tested in the past, such as:

Business units (smaller locations, foreign entities)

Revenue streams

Financial statement line items and underlying accounts

Accounting systems

# HOW TO PREPARE FOR A SCOPING CHANGE

**1**

**Consider what items might be impacted**

a. Review accounts, business units, or geographies that are at or near previous scoping thresholds
b. Have conversations with the audit team early to understand scoping changes

**2**

**Review the data that is available for identified items**

a. Is the support currently available for newly in-scope items consistent with other previously audited areas?
b. Is there a specific contact in your organization with this knowledge who can prepare documentation?
c. Will additional resources or time be required to organize and provide requested support?

# LEANER ACCOUNTING TEAMS

# LEANER ACCOUNTING TEAMS

**Hiring freezes or workforce reductions, plus changes to the audit process, can have a big impact on the Accounting team**

1. Certain technical areas will have more emphasis in the coming audit cycle - Going concern, impairment, financing transactions

2. Changes in scope and materiality will increase the amount of audit procedures

3. Working virtually will make collaboration more difficult

**Consider where the team may need help and what can be done now**

# THINGS THAT CAN BE DONE NOW

**Begin preparing for the 2020 audit cycle by taking steps now:**

- ✓ Perform impairment analysis and prepare documentation
- ✓ Consider the risk of going concern and how to document those considerations
- ✓ Review potential in-scope entities and the integrity of the data
- ✓ Consider the impact of a leaner team on controls processes
- ✓ Identify any potential personnel gaps or areas where extra help may be needed
- ✓ Implement an online collaboration tool for management and the auditors
- ✓ Consider automation to streamline processes
- ✓ Begin compiling supporting documents to alleviate some pressure at year-end

## Polling Question 4

What is your biggest area of concern for this audit cycle?

A. Impairment testing

B. Going concern

C. Changes in scope

D. Working virtually

E. We feel prepared

# Q&A

# ADDITIONAL RESOURCES

## Related Thought Leadership

An Audit Cycle Unlike Any Other

Financial Reporting for Employee Termination Events

COVID-19: Understanding the Going Concern Assessment Process

COVID-19 Impairment Guide: Navigating the Testing Process

Accounting for Income Taxes Under the CAREs Act

Bursting the Corporate Debt Bubble: Tax Implications of Debt Modifications

View additional insights **HERE**

## Contact Us

REQUEST TO SPEAK WITH ONE OF OUR EXPERTS