GLOBAL TRANSACTION ADVISORY GROUP

Capital Markets & Accounting Advisory

Top 10 Accounting & Financial Reporting Considerations

As the global markets react to the effects of the novel coronavirus (COVID-19), there are a number of pervasive financial reporting considerations that companies will need to consider. While we recognize that the repercussions from the pandemic are rapidly unfolding, A&M's Capital Markets & Accounting Advisory (CMAA) team highlight a list of the Top 10 key accounting and financial reporting issues to consider in the current environment.

U.S. regulators and standard-setters are actively engaged in addressing the rapidly emerging financial reporting challenges as a result of COVID-19, including those arising from new accounting standard implementation and additional guidance on certain of the following topics.

1. **Receivable, inventory, and loan – reserves –** Companies will need to reassess the reasonableness of reserve balances, given the deteriorating economic outlook, asset price declines, and the rapid and widening spread of COVID-19 which is expected to result in overall credit quality deterioration, especially for those companies in the most vulnerable sectors.

2. **Asset impairments (goodwill, intangible assets, PP&E) –** Companies need to evaluate whether ongoing events have caused certain assets such as goodwill, intangible assets and PP&E to be impaired. The impact from a combination of falling consumer demand, supply-chain disruption, and financial market volatility has likely impacted estimates of future cash flows and earnings.

   Although most assets are generally tested annually for impairment, the current economic environment requires more frequent analysis of whether these assets are recoverable. For example, revisions in the remaining amortization period of finite-lived intangible assets may be necessary, or net PP&E balances may be overstated, because of idle or vacant facilities.

3. **Capitalization of manufacturing overhead –** Manufacturing companies may face unusually low production levels in the current environment. Accounting guidance dictates that fixed overhead should be applied to inventory based on normal capacity. As a result, these companies may need to expense a portion of fixed manufacturing overhead immediately through earnings, rather than capitalize it into the cost of inventory.

4. **Debt agreement modifications –** Companies experiencing high exposure to earnings volatility may face liquidity pressures and be required to renegotiate or restructure their debt agreements. The accounting for debt modifications is complex and requires careful analysis to determine if the modification results in a gain or loss on extinguishment or represents a troubled debt restructuring. Furthermore, covenants may be renegotiated with lenders, which could lead to potential additional reporting requirements (e.g., new targets) and require further accounting analysis. The FASB continues to work with banking regulators to clarify guidance on this topic.

5. **Revenue Recognition –** Management may need to reconsider any variable consideration it had estimated under new revenue recognition rules (ASC 606) prior to the Covid-19 outbreak. For example, to the extent management had estimated volume-based incentives and recognized those amounts in revenue, those estimates may need to be re-evaluated if sales volumes are significantly reduced in the current business environment.

   Moreover, ASC 606 requires that for revenue to be recognized, collectability from a customer should be probable. This criteria determines whether a contract even exists. To the extent that current market dynamics add greater uncertainty about collectability because of declining customer credit profiles, further analysis may be required to determine if revenue should be recognized. Time will tell how these implications will be handled in practice.

6. **Hedging relationships –** Companies should consider the impact that existing market volatility has on derivative hedging relationships. This volatility could affect the ability to hedge interest rate, foreign currency and commodity exposures. To the extent there is on-going displacement in the broader market, this could have implications for accounting and financial reporting as well as liquidity.

Recent accounting guidance has permitted companies to test hedge effectiveness on a qualitative basis but requires companies to still assert that facts and circumstances have not changed and the hedging relationship continues to be highly effective. This assertion may become increasingly difficult to make in the current market environment .To the extent disallowed, mark-to-market accounting may be required.

7 **Loss contingencies/insurance recoveries –** Companies will need to consider the potential for loss contingency accruals and possible recoveries from business interruption insurance related to matters such as extended periods of suspended operations. The accounting for these matters requires significant judgement and is subject to differing timing/triggers for recognition or disclosure.

8 **Stock options –** Companies that have equity-based awards that vest based on achieving performance conditions such as earnings targets will need to carefully reassess the probability of achieving those targets. Because the expense related to awards with performance obligations is only recognized when it is probable that the performance conditions will be met, companies with performance awards may need to adjust their current accounting. Also, companies may consider modifying performance obligations or extending the term for options that are out-of-the money because of a significant decrease in share price. Modifying equity-based awards may result in the recognition of additional expense.

9 **Subsequent events –** Companies should consider the impact of the current economic disruption on operations and whether the effects require disclosure as a subsequent event. Companies should evaluate information which may have become available after the balance sheet date but before the issuance of their financial statements, including supply chain disruption, cancellation of significant orders, collectability concerns, and other material events.

10 **Going Concern analysis –** Working capital deficiencies, negative operating cash flows, and potential financing difficulties will likely put pressure on a company's assessment of its ability to continue as a going concern. The heightened uncertainty around the implications of economic disruption is likely to cause issues with developing reasonable support for a company's plans to address these critical matters. This could further impact a company's response to how it expects to comply with its financing agreements and meet debt service requirements over a one-year time horizon after the date financial statements are issued.

SEC registrants will have additional matters to address and several meaningful disclosures to consider. In a recent joint statement, the SEC and PCAOB has reminded companies to work with their audit committees and auditors to "ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances", including enhancing the following:

- **Assessing the impact of COVID-19 on risk factors**
- **Quantitative and qualitative disclosures about market risk**
- **Description of the business**
- **Various other filing considerations**
- **MD&A**

A&M's Capital Markets & Accounting Advisory (CMAA) team is here to help and address any questions you may have.

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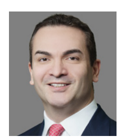

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