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Center *for*
Board Effectiveness

Special Edition

Audit Committee *Brief*

Audit committee priorities in the current quarter and beyond

The *Audit Committee Brief* focuses on the timely coverage of issues and insights important to audit committees. Questions, comments, or suggestions should be directed to centerforboardeffectiveness@deloitte.com.

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Financial reporting during the first quarter of the coronavirus disease 2019 ("COVID-19") pandemic was challenging for most companies. Reporting for the second quarter promises to be even more so given the prolonged impact of the pandemic. As companies continue to grapple with the implications of managing operations remotely, supplier disruptions, government assistance, and more, audit committee oversight will be critical to applying lessons learned thus far to the current quarter. Continued challenges around financial reporting, risk oversight, critical audit matters ("CAMs"), and compliance and fraud risk could impact the audit committee's focus. Therefore, it may be an opportune time for audit committees to reassess their processes and practices to confirm they support the current and future demands of the committee.

Financial reporting

The SEC Division of Corporate Finance and the Chief Accountant both released statements on disclosure considerations during the COVID-19 pandemic and the importance of high-quality financial reporting, respectively. In their respective communications, both the Division of Corporate Finance and Chief Accountant continued to emphasize that forward-looking, high-quality, timely, and decision-useful information on the finances and operations of companies continue to be of utmost importance to the efficient operations of the capital markets. The statement from the Chief Accountant also underscored the importance of the audit committee's role in oversight of internal control over financial reporting as well as the independent auditor and external audit process. The Chief Accountant also summarized the issues addressed through consultations over the last quarter and specifically highlighted the financial reporting implications of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), debt modifications, hedging, consolidation, business combinations, lease concessions, revenue recognition and income taxes.[1]

A recent Deloitte *Financial Reporting Alert*, COVID-19 and Financial Reporting Trends — Accounting for the Pandemic in the Current Quarter, encouraged companies to take a strategic look at what are likely to be the most common hot topics for the current reporting period. Audit committees should be aware of and be prepared to engage with management and the independent auditor on these topics. Below are some key topics and questions for audit committees to consider around financial reporting:

Forecasts

Companies are likely to continue to face challenges in developing assumptions and estimates for assessing the recoverability of nonfinancial assets (including goodwill), determining the realizability of deferred tax assets ("DTAs"), and assessing their ability to continue as a going concern. Below are key questions for audit committees to consider with respect to forecasting:

- How often is management revisiting forecasting and updating assumptions, especially those that may be industry-specific?
- How is management determining what new information will affect the forecast models, and are sensitivity analyses being performed using different scenarios?
- How is management identifying assets that may be impaired, and how are they being tested for impairment?
- Has management assessed the company's ability to realize deferred tax assets before their expiration, and are they adjusted when necessary? Are there any forecasted future losses to factor into the realizability assessment?
- How has management determined if the company is a going concern, and how has the current environment been considered? How has management engaged with the independent auditor on going concern considerations?

Modifications to contractual agreements

Many companies have modified contracts in anticipation of the prolonged impact of COVID-19. Changes to existing contractual arrangements may raise accounting questions about whether such changes should be accounted for prospectively or at the time of change. Below are key questions for audit committees to consider:

- Are any alternative models being used in the accounting analysis for any lease modifications? Is the company providing the appropriate disclosures related to material concessions granted or received?
- Is the company providing any relief to mitigate the effects of pandemic in the form of, for example, price concessions, discounts on future goods and services, extended payment terms, or opportunities to terminate agreements without penalties? If so, does this constitute revision of a revenue contract and how will the company account for that?
- How will changes to existing loans be treated? Will modifications need to be made? For example, will changes to existing loans be accounted for as a troubled debt restructuring, a modification, or an extinguishment, all of which have specific individual disclosure requirements?

Collectability

Companies may have collectability problems as a result of widespread business disruptions, financial difficulties, and liquidity issues. Concerns related to collectability extend beyond simply estimating how much cash will be collected. Below are key questions for audit committees to consider:

- How is the company conducting its collectability assessment?
- Does management have concerns about the amount of revenue that can be recognized as a result of collectability concerns about new, in-process, or fully completed customer contracts? If so, how have those concerns been communicated?

Restructuring, disposal costs, and government assistance

The pandemic's prolonged impact has led companies to take proactive measures to sustain operations, such as seeking government assistance or other forms of relief and contemplating various restructuring activities. Below are key questions for audit committees to consider:

- Has management taken actions to reduce headcount or eliminate facilities and equipment? If the company

[1] https://www.sec.gov/news/public-statement/teotia-financial-reporting-covid-19-2020-06-23.

had to take these actions or may do so in the future, what is the financial impact and timing of those potential costs or liabilities?

- Has the company appropriately determined the accounting guidance and policies to apply to any government assistance received? Is the company providing the appropriate disclosures related to acceptance of government assistance?
- Will the company need to record insurance recoveries associated with, but not limited to, suspended operations, event cancellations, costs associated with increased medical claims, asset impairments, or shareholder litigation? If so, has the timing of recording insurance recoveries, their presentation, and the required disclosures been discussed?

Communication with stakeholders

A recurring theme of financial reporting issues associated with COVID-19 is the need for robust and transparent disclosure and communication. In its recent statement on disclosure considerations, the SEC's Division of Corporate Finance emphasized the importance of robust disclosures that provide a transparent look at how the pandemic impacts the company's operations and financial position.[2] Given the sustained impact of the pandemic, the audit committee will likely need to discuss with management how the company can provide timely updates to investors regarding the pandemic's current and future effect on the company. Below are key questions for audit committees to consider:

- Has management communicated any necessary changes to disclosures within the financial statements or other parts of their SEC filings, in particular, risk factors, MD&A, description of the business, disclosure controls and procedures, and internal control over financial reporting?
- Has the presentation of non-GAAP measures been reviewed to confirm they are not misleading? Are the most directly comparable GAAP measures also presented with equal or greater prominence? Is a quantitative reconciliation between the non-GAAP and GAAP measures presented?
- In light of the pandemic, the inputs and assumptions used in developing forecasts and other critical accounting estimates will be an increased area of focus along with the selection of any new accounting policies. Have the inputs and assumptions been reviewed with management and the independent auditor? What process will be used to determine the selection of new accounting policies?

Other audit committee priorities

Risk oversight

The risks companies are facing are likely evolving in this environment. Audit committees should double down on understanding management's process around identifying and assessing strategic and emerging risks. Once those key risks are identified, the board, audit committee, and other committees that oversee each of the key risks should include time on their agendas to hear from members of management that are responsible for those risks. Below are key questions for audit committees to consider:

- How is management continually identifying and assessing emerging risks, and how are those being communicated to the audit committee?
- How are external risks that can disrupt the company's strategy being sensed? How are those emerging risks being considered in the risk framework?
- Are key risks appropriately allocated across the board and its committees for oversight?

Critical audit matters

Audit reports for large accelerated filers included a new section addressing CAMs last year, and other public companies will see the same in 2020. Some of the challenges noted above, especially those associated with forecasting, may impact CAMs reported by auditors in 2020. Audit committees should be discussing potential CAMs with their auditors before the end of the year. Below are key questions for audit committees to consider:

- What factors are auditors considering when identifying CAMs for the 2020 audit?
- How do auditors expect CAMs to change from last year?
- How do the auditor's communications regarding CAMs compare to management's disclosures regarding the same matters?

Compliance and fraud risk, including whistleblower programs

Both the SEC and the Department of Justice ("DOJ") have made public statements on these topics in recent weeks. The SEC reported[3] receiving record levels of whistleblower reports since people have been working at home, and they've been issuing record level awards to whistleblowers. Audit committees should continue to understand how whistleblower programs work. Below are key questions for audit committees to consider:

- How are whistleblower complaints collected? How do employees and other stakeholder know how to lodge a complaint?
- What is the nature of the complaints being received? Are there trends (by topic, business unit, level, etc.) that need to be examined?
- How are complaints being resolved?

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2 https://www.sec.gov/corpfin/covid-19-disclosure-considerations.

3 https://www.wsj.com/articles/tips-to-sec-surge-as-working-from-home-emboldens-whistleblowers-11591003800.

The DOJ's statement on corporate compliance programs is meant to assist prosecutors in making informed decisions around a company's compliance program when misconduct occurs. The statement includes questions for prosecutors to ask around the compliance program's design and implementation. Those questions could be relevant for boards and audit committees to consider as they oversee such programs.

Audit committee processes and practices

Audit committees have been navigating how to effectively execute their oversight responsibilities during this challenging and evolving environment. Several practices have been adapted with respect to meetings and engagement.

Meeting format

Once the pandemic hit and people began working remotely, boards and audit committees had to quickly adapt to that environment as well. Audit committees seem to have adjusted well to obvious changes – like virtual meetings. Additionally, there have been opportunities for boards and audit committees to consider how meetings are organized and executed to make sure they are as effective as possible. Below are key questions for audit committees to consider:

- Does time allocated to the board and committee meetings need to shift to allow for more full board discussions of the COVID-19-related risks?
- Should a board sub-committee be created to oversee the risks associated with COVID-19 and the economic downturn, allowing the standing committees to maintain their focus on other topics?

Prioritization

Many audit committee chairs have been reassessing the way their time is spent in meetings. Regardless of how the meeting structure has changed, prioritizing the agenda has been key for the committee's effectiveness. Audit committee chairs should consider taking a step back to reevaluate what's top priority. Simply following a previously created annual calendar or last quarter's agenda may not allow the committee to focus on the right topics. Some audit committee chairs have pushed topics that aren't top priority to later in the year or to consent agendas to allow more time for some of these critical discussions.

Materials

Many committees have reviewed meeting materials when considering ways to enhance effectiveness. Some companies are sharing more memos or narratives with pre-read materials; these provide committee members a bigger picture view and allow the members to come better prepared with questions. It can also provide a way to stay informed in between meetings.

Some committees are providing more written questions to management before meetings. This doesn't mean that questions are limited to those provided in advance, but it may help management come more prepared to discuss what's important to the audit committee and allow for more robust discussions.

Other communications

In addition to the shift in how audit committees are communicating with each other and with management, many companies have increased the frequency of communications between the audit committee and management, the independent auditor, and other advisors—both formally and informally. Companies are leveraging technology to facilitate many of these discussions. Audit committees should consider how technology can help enhance effectiveness going forward, but companies should consider any related risks to leveraging those technologies.

Audit committees have quickly adapted to this challenging environment and have adopted ways to operate virtually while allowing for agility as situations change. Continuing to stay informed of financial reporting issues and other topics impacting the role of the audit committee will remain critical through 2020 and beyond. Additionally, audit committees should consider if the current environment provides opportunities to modify how they operate as they focus on executing their responsibilities effectively.

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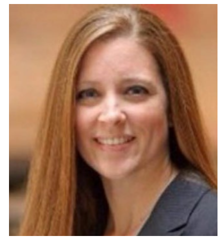

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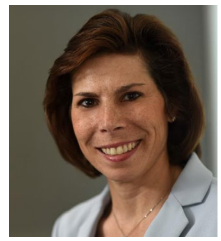

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