



BDO'S CORPORATE GOVERNANCE ALERT

# AUDIT COMMITTEE CONSIDERATIONS: COVID-19 GUIDANCE FROM SEC AND PCAOB

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As audit committees, management and auditors continue to wrestle with practical challenges of accounting, reporting and disclosing impacts of COVID-19, the SEC staff and PCAOB have issued recent guidance based on their observations and engagement. We have summarized some of the significant takeaways and provided such guidance and our insights as a series of questions for audit committees to consider in executing financial reporting responsibilities and ensure audit quality.

The SEC and PCAOB are both closely monitoring the issues raised by COVID-19 as they relate to on-going audits of financial statements and timely reporting by public companies and impacts on investors and global capital markets. In response, they have each begun to issue various guidance and, in certain circumstances, relief to both public companies and auditors with the goal of continuing to provide high quality financial statements that investors and capital markets can rely on. Much of this guidance has been captured by recent BDO publications and programming, including but not limited to BDO's [COVID-19 – Accounting, Reporting and Other Related Considerations](#) publication along with our April 2020 webinar [COVID-19: Accounting, Reporting and Other Considerations for Boards](#). Below we highlight the significant takeaways for consideration as companies and their auditors address uncertain and unique challenges to annual and interim financial accounting and reporting. These are further complemented by specific questions we suggest audit committees give consideration to in their oversight roles. For evolving information and insights, we encourage you to check in often to [BDO's COVID-19 Resource Center](#).

## RECENT REGULATORY GUIDANCE COVERED IN THIS ALERT

- ▶ 4/3/2020 – [SEC Chief Accountant Statement on the Importance of High-Quality Financial Reporting in Light of Significant Impacts of COVID-19](#)
- ▶ 4/2/2020 – [PCAOB COVID-19: Reminders for Audits Nearing Completion Spotlight](#)
- ▶ 4/2/2020 – [SEC Chair Clayton's Statement – Investors Remain Front of Mind at the SEC...](#)
- ▶ 3/31/2020 – [SEC CD&Is on COVID-19 Filing Relief](#)
- ▶ 3/25/2020 – [SEC Extension of Conditional Exemptions from Reporting and Proxy Delivery Requirements](#)
- ▶ 3/25/2020 – [SEC Corporation Finance Disclosure Guidance: Topic No. 9](#)

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## PCAOB COVID-19: AUDIT REMINDERS

The PCAOB recently issued a [Spotlight](#) aimed at auditors but informative to audit committees and management about PCAOB expectations involving COVID-19 considerations as applied to audits of financial statements that are nearing completion, but we believe the reminders further serve for planning and interim period audit work as well. The Spotlight recognizes the variability in breadth and scale of individual company responses to COVID-19 along with the difficulties that auditors may encounter in fulfilling their due professional care and exercising professional skepticism under existing auditing standards.

### Identifying, Assessing and Responding to Risks of Material Misstatement

#### Risk Assessment

Risk assessment, including fraud risk, should be occurring throughout the audit process. As a result of economic effects of COVID-19, emerging risks or changes to the magnitude or likelihood of identified risks may have changed. Changes to incentives, increased pressure on management, changes to internal controls or potential increased ability for management override of controls need to be considered and factored into on-going risk assessments. This, in turn, may dictate needed changes to audit strategy and planned audit procedures as well as types of audit evidence that may need to be examined.

#### Ability and Timeliness in Obtaining Sufficient and Appropriate Audit Evidence

Additionally, stay in place and travel restrictions leading to new and unfamiliar widespread remote working conditions may make access and ability to timely obtain and evaluate the sufficiency and appropriateness of audit evidence difficult due to:

- ▶ Limited availability of, or access to, company personnel;
- ▶ Delays by management in responding to auditor's inquiries; or
- ▶ Challenges in access to, or communicating with, other auditors – particularly in multi-location audits

Furthermore, evidence may need to take new forms. Examples of where this may be particularly challenging include examining evidence that is in "copy" versus "original" form or not being able to perform physical observations of inventory and PP&E.

#### Performance and Consultation Matters

Additional issues that auditors may need to overcome in modifying audit work plans or designing new audit procedures include:

- ▶ Ensuring appropriate supervision of inexperienced staff – enhancing direction and/or modifying nature and extent of review of their work
- ▶ Increasing involvement of more senior/experienced engagement team members – particularly related to complex issues
- ▶ Increasing involvement of current or new subject matter experts and specialists
- ▶ Developing alternative work plans/procedures, including leveraging technology, when using other auditors
- ▶ Changing policy requirements related to consultations related to judgments and conclusions most likely to be affected by uncertain COVID-19 issues
- ▶ Changing scope of engagement quality reviews when considering the nature of significant judgments being made by engagement teams related to COVID-19 issues

#### Effect on the Financial Statements that May Affect the Audit

As indicated in our recently released [COVID-19 – Accounting, Reporting and Other Related Considerations](#) and in SEC guidance discussed elsewhere in this publication, some of the more likely financial statements areas that will be impacted significantly by COVID-19 include:

- ▶ Subsequent events
- ▶ Going concern
- ▶ Asset valuation, including impairment triggers and related assessments
- ▶ Accounting estimates, including fair value measurements
- ▶ Revenue recognition, including effects of contract modifications
- ▶ Leases
- ▶ Hedging
- ▶ Income taxes, including tax valuation allowances
- ▶ Provisions, allowances, and loss contingencies
- ▶ Debt modifications or restructuring
- ▶ Debt covenants, other regulatory ratios, and minimum net capital requirements for broker-dealers
- ▶ Disclosures, including those pertaining to risks and uncertainties, and liquidity-related disclosures.

### Effect on Financial Reporting Processes and Controls that May Affect the Audit

COVID-19 may necessitate changes in company controls related to business process and financial reporting controls. Consideration will need to be given to risks arising from changing existing or developing new controls, particularly in light of drastically changed work environments, including lack of segregation of duties or lack of effective monitoring controls. This will require documentation by management of changes and likely will prompt the need for auditors to reassess internal control testing procedures and design to allow for additional inspection and reperformance if observing real-time operations is not possible.

### Audit Committee Communications

Auditors are reminded to provide, and audit committees should be expecting, robust communications about the following required communications:

- ▶ Significant changes to identified risks or planned audit strategy and scope and the reasons for such
- ▶ Matters related to significant accounting policies, practices and estimates and the auditor's evaluation of the quality of the company's financial reporting, particularly any significant changes to critical accounting estimates or significant assumptions, the reasons for such and the impact on the financial statements
- ▶ Control related matters – e.g., significant deficiencies or material weaknesses
- ▶ Difficult or contentious matters for which the auditor consulted outside the engagement team and are relevant to the oversight of the financial reporting process
- ▶ Matters related to the auditor's evaluation of going concern
- ▶ Significant difficulties encountered in the audit

### Auditor's Report Considerations

The auditor's report may be further impacted by the auditor's determination to include an emphasis of matter paragraph, explanatory language or going concern language as COVID-19 circumstances warrant.

Additionally, COVID-19 effects should also be part of the auditor's assessment of critical audit matters (CAM). While COVID-19 crisis may not itself be a CAM, it may be a principal consideration in the auditor's determination as to whether one or more CAM(s) exist and may also affect how CAMs were addressed in the audit.

### PCAOB INSPECTION RELIEF

On March 23, 2020, the PCAOB provided audit firms with an opportunity to avail themselves of a 45-day relief period, in full or in part, from inspections. The PCAOB has indicated it expects to fully resume inspections on May 11, 2020.

### SEC COVID-19 RELIEF AND REPORTING GUIDANCE

A [statement](#) released by SEC Chairman Jay Clayton indicated that the SEC is actively monitoring the interplay between "the health and safety crisis" and "the recognition that the continuing, orderly operation of our markets is an essential component of our national response to, and recovery from, COVID-19." SEC Chief Accountant Sagar Teotia further [indicated](#) that as we face unprecedented national challenges "investors and other stakeholders need high-quality financial information more than ever. The proper functioning of our capital markets depends on a regular supply of high-quality financial information that enables investors, lenders, and other stakeholders to make informed decisions."

### Accounting Judgments and Estimates

The following highlight some of the areas recognized by the SEC that may involve significant accounting judgements and estimates in reaction to the evolving and dynamic nature of COVID-19:

- ▶ Fair value and impairment considerations
- ▶ Leases
- ▶ Debt modifications or restructurings
- ▶ Hedging
- ▶ Revenue recognition
- ▶ Income taxes
- ▶ Going concern
- ▶ Subsequent events
- ▶ Adoption of new accounting standards (e.g., CECL)

The Office of the Chief Accountant (OCA) reminds issuers that it will not object to well-reasoned judgments being made by entities and the OCA remains available for and encourages consultation.

### Working with Auditing and Accounting Regulators and the Audit Profession

The SEC is having ongoing dialogues with both the FASB and PCAOB, the U.S. regulatory bodies, and internationally with the IASB and the Monitoring Group, with respect to the impact of COVID-19. Additionally, the SEC continues to meet regularly with the larger audit firms, including BDO, to keep informed on accounting and auditing issues that are arising related to COVID-19 and how that may impact financial reporting.

### Auditor Independence

Auditors and audit committees are reminded that the OCA remains focused on auditor independence in these unprecedented times and are not letting down their guard with respect to such.

### Filing Relief

In response to the COVID-19 crisis and practical issues outlined above, the SEC issued an Order providing a temporary 45-day grace period to extend filing of Exchange Act reports due through July 1, 2020. In order to take advantage of this conditional relief, issuers must furnish a Form 8-K by the later of March 16, 2020 or the original reporting deadline, which includes the following information:

1. A statement that the registrant is relying on the Order;
2. A brief description of the reasons why the registrant cannot file on a timely basis;
3. The estimated date the registrant expects to file;
4. If appropriate, a risk factor explaining the impact of the coronavirus on the registrant's business (if material); and
5. If the reason the registrant is unable to file relates to a person other than the registrant, the Form 8-K must include an exhibit signed by that person containing the specific reasons why that person is unable to provide its opinion, report, certification, etc.

The due date for annual or quarterly reports for companies that receive an extension pursuant to the Order will be 45 days after the filing deadline for the report. Those companies will be permitted to rely on the grace period in Exchange Act Rule 12b-25 to receive additional time to file the report (fifteen calendar days for an annual report and five calendar days for a quarterly report). Companies that take advantage of the extension permitted by the Order or the grace period permitted by Rule 12b-25 will still be considered current and timely Exchange Act filers for purposes of Form S-3 and Form S-8 eligibility.

The Order also provides relief from the proxy and information statement delivery requirements for those delivering materials to the affected areas.

### Other Practical Reminders – Insider Trading and Timeliness of Information

The SEC further reminded companies of their disclosure obligations under Federal Securities Laws:

- ▶ If a company has become aware of a coronavirus related risk that would be material to its investors, it should refrain from engaging in securities transactions with the public. Additionally, companies should take steps to prevent directors, officers, or other insiders from initiating such transactions until investors have been appropriately informed about the risk.
- ▶ Companies should disseminate material information related to the impact of the coronavirus broadly and on a timely basis. Previous disclosures may need to be revisited or updated.
- ▶ Companies providing forward-looking information or known trends and uncertainties regarding the coronavirus in an effort to keep investors informed can avail themselves of the safe harbor in Section 21E of the Exchange Act.

## CORPORATION FINANCE COVID-19 DISCLOSURE GUIDANCE

On March 25, 2020, the SEC's Division of Corporation Finance issued Disclosure Guidance Topic No. 9, reflecting current staff views regarding disclosure and other securities law obligations that companies should consider with respect to COVID-19 and related business and market disruptions.

Corp Fin recognizes the difficulty to assess or predict with precision the broad effects of COVID-19 and that the actual impact depends on many factors beyond a company's control and knowledge. However, it further recognizes that the effects COVID-19 has had on a company, what management expects its future impact will be, how management is responding to evolving events, and how it is planning for COVID-19-related uncertainties can be material to investment and voting decisions.

This requires a delicate balance and disclosure of COVID-19 risks should be considered relative to MD&A, the business section, risk factors, legal proceedings, disclosure controls and procedures, ICFR and the financial statements.

Disclosures related to COVID-19 will be, by nature of the developments, be facts- and circumstances-based and should be tailored and specific to a company's situation, including how management responds.

Below highlights illustrative questions for companies to be considering with respect to their disclosures:

### Questions for CFOs/Audit Committees in considering present and future impacts of COVID-19 specific to their company including, but not limited to:

- ▶ Financial condition and results of operational impacts
- ▶ Impact on capital and financial resource and liquidity needs and sources
- ▶ Expected impact on assets on the balance sheet, including fair-value assets
- ▶ Anticipated material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets, investment securities), allowance for credit losses, restructuring charges, etc.
- ▶ Remote work arrangement impacts on operations, systems and controls
- ▶ Business continuity plans and associated costs
- ▶ Impact on demand for products and services
- ▶ Impact on supply chain or methods to distribute products or services
- ▶ Impact of constraints or other impacts on your human capital resources and productivity
- ▶ Impact of travel restrictions and border closures ability to operate and achieve business goals

The SEC encourages companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management, and that companies proactively revise and update disclosures as facts and circumstances change. Much of this information may be considered "forward-looking" information based on assumptions and expectations regarding future events and fall under the safe harbor protections within the Securities and Exchange Acts.

Management and auditors should be working together and keeping the audit committee (and board) aware of any challenges they foresee in dealing with accounting and reporting complexities resulting from COVID-19 impacts. The SEC further reminds companies not to be 'selective' in what they chose to disclose. This includes providing any non-GAAP disclosures to adjust for or explain the impact of COVID-19. The staff guidance provides examples of permissible and nonpermissible use of non-GAAP measures.

#### The SEC and the CARES Act:

The SEC is working with market participants regarding the [Coronavirus Aid, Relief, and Economic Security Act](#) (the "CARES Act"). The CARES Act allows a limited number of entities the option to temporarily defer or suspend the application of two provisions of U.S. GAAP. These include:

- ▶ [Section 4013](#) temporary relief from troubled debt restructurings and
- ▶ [Section 4014](#) optional temporary relief from current expected credit losses

The Office of the Chief Accountant has indicated that it would not object to conclusions made by eligible companies that election of these options is in accordance with GAAP for the periods for which such elections are available.

**BDO Insight:** The CARES Act represents extremely complex legislation and the impacts on individual companies requires careful consideration. We encourage companies to be consulting with their advisors to understand both eligibility for relief provisions as well as how applying those provisions may impact the financial reporting of such activities.

## QUESTIONS FOR AUDIT COMMITTEES IN CONTEMPLATING COVID-19 IMPACTS

### Audit Specific Questions

- ▶ What unintended consequences of COVID-19 may increase incentives or pressures on management that may result in management override of controls?
- ▶ Are there changes in controls over financial reporting that need to be evaluated to ensure management certifications are adequate?
- ▶ Are we able to ensure continued proper segregation of duties and monitoring controls given changing physical work situations?
- ▶ Have any significant risks or material weaknesses been identified as a result of impacts from COVID-19?
- ▶ What changes in risk assessments have auditors determined need to be made and how will that impact the audit strategy?
- ▶ Are there known impediments – either by management or by the auditors - that may delay timely filing of financial statements? (e.g., lack of access or ability to obtain audit evidence or other information)
- ▶ What additional resources or expertise may be needed by management to properly account for judgments or estimates or changes related to circumstances brought on by COVID-19?
- ▶ What additional efforts may be required by the auditor to ensure the performance of a high-quality audit?
- ▶ Does my audit firm have the depth of or access to adequate resources to address complex accounting and auditing questions, including industry-specific matters, as they arise?
- ▶ Do my management teams, as well as my auditors, have the ability to properly supervise and direct the work of their staff and teams?
- ▶ Are there additional challenges in performing auditing procedures due to multi-geographical considerations?
- ▶ Has COVID-19 impacted circumstances that may call into question the company's ability to continue as a going concern? What are management's plans to address? How do these impact the auditor's going concern evaluation?
- ▶ Are there any auditor independence issues that have arisen with respect to COVID-19?



### Accounting and Reporting Specific Questions

- ▶ Has management adequately assessed changes in risk factors impacting our business? Are these appropriately reflected in our financial statements?
- ▶ Has management properly identified significant accounting areas where impacts from COVID-19 are likely? Has management further accounted for related income tax effects of these impacts?
- ▶ Have we properly accounted for and disclosed changes in significant estimates and judgments impacting the financial statements?
- ▶ Has management, along with the auditors, identified applicable relief opportunities with respect to the 2020 CARES Act and appropriately factored these into the accounting and reporting, including income tax effects, within the financial statements?
- ▶ Are there accounting or disclosure matters that have required significant consultations outside of the audit engagement team?
- ▶ Have the auditors and management identified significant or industry-specific matters related to the interaction of the CARES Act and GAAP or GAAS impacting our financial statements that need regulatory consultation?
- ▶ Has new information arisen regarding COVID-19 events contained in previously filed financial information that requires updating of current disclosures?

### Corporate Governance Specific Questions

- ▶ As an audit committee, how are we maintaining our education with respect to COVID-19 considerations, relief efforts and related risks and opportunities?
- ▶ Are we appropriately engaging with internal and external stakeholders and providing transparent and consistent communications about significant impacts on our business?
- ▶ Are we allocating enough time and making ourselves available to discuss critical issues as they arise with management, the auditors and the board?
- ▶ Are we keeping the full board appropriately updated as to significant challenges with respect to financial accounting and reporting?
- ▶ Are we considering responses to anticipated questions from shareholders during upcoming annual meetings?
- ▶ Is management actively and effectively engaging with lenders, customers and other stakeholders in a timely and productive manner and are the results of those engagements reflected in the financial accounting and reporting?
- ▶ Are we, as a board committee, appropriately considering additional risks that have arisen related to other stated committee responsibilities as described in our Audit Committee Charter – e.g., COVID-19 cybersecurity and data privacy risks?



## NEXT STEPS

We encourage audit committees, management, as well as our own professionals to review the guidance referenced in this guide and additional guidance anticipated to be released by regulators. We further encourage robust dialogue between our clients and our engagement teams around audit quality.

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