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Financial reporting 2021 playbook

Guidance and tactics for success

PREPARE NOW FOR 2021'S FINANCIAL REPORTING CHALLENGES

In 2020, COVID-19 upended business as usual in myriad ways, including how companies approached financial reporting. Finance leaders scrambled to adapt to virtual work environments, not to mention new reporting considerations due to pandemic-related government assistance, an uptick in contract modifications, cash flow concerns, and asset valuation and impairment issues.

The challenges are far from over. Finance leaders need to carefully navigate 2020 reporting challenges and then quickly pivot to 2021 to understand how financial reporting will evolve further and what hot button issues are on the radar this year. High-quality financial reporting has never been more important for enterprises and small businesses alike. To thrive in the new year, organizations must be agile and quick to embrace the new normal.

What finance leaders need to know in 2021

This playbook offers a guide to reporting success in 2021. It outlines big-picture strategies for leaders to adopt and identifies lessons learned from 2020 that can aid execution in the new year. It also details important accounting guidance applicable to both the 2020 year-end close and 2021, covering topics from asset impairment to government assistance and financial reporting for modifications.

Read on to learn how to close out 2020 strong and prepare for 2021's financial reporting challenges and opportunities.

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SEVEN FINANCIAL REPORTING CHALLENGES IN 2020

Better reporting in 2021 starts with learning from 2020. Finance leaders must grasp what made 2020 financial reporting complex and consider how to institutionalize lessons learned.

Indeed, the past year tested the financial reporting abilities of organizations of all sizes. As COVID-19 forced organizations into survival mode, they depended more than ever on forecasts and reporting for visibility into vital details about cash flows and profitability. These forecasts fed into some of the critical financial reporting exercises performed by finance teams, including assessing the impact of changes to customer contracts and borrowing arrangements, performing going concern assessments, and assessing assets for impairment.

"When 2020 began, organizations were conducting business as usual, finalizing budgets and business plans, and devising strategies for how to optimize reporting or improve their close process," says Sean Prince, a managing director at Crowe. "But when COVID-19 arrived, all those plans went by the wayside. The world changed drastically, and there was an injection of economic uncertainty that continues to vex organizations."

New challenges and reporting complexities hit teams in waves. Read on to learn more about seven areas that made 2020 so difficult.

1. Uncertainty and difficulty in forecasting

With their business models in jeopardy, many companies desperately needed better forecasts of future cash flows and financial performance, which became difficult to generate. In part, the economic situation kept changing with a major market crash during the first shutdown, followed by brief signs of recovery in June.

Added to this cloud of economic uncertainty were the unknowns arising from political changes, which together made estimating cash flows and the value of key assets very difficult. Businesses that struggled with forecasting even in a good year realized the essential importance of improving this in-house skill. Most businesses had to revamp their forecasting processes to incorporate multiple forecasts with varying recovery scenarios and struggled to determine the probability of each one.

2. Cascading effects on reporting

"So many other reporting elements are based off of your cash flow forecasts, and when those become uncertain, they create a cascade of other reporting impacts," says Matt Schell, a partner at Crowe. For example, forecasted cash flows are used in a number of analyses and uncertainty in forecasting can create ongoing question marks about impairments, the fair value of assets, and an organization's ability to continue as a going concern. Finance teams wrestled with these uncertainties and dependencies.

3. Missing and imperfect data

With lower confidence in long-range forecasts, organizations shifted focus to the shorter term, working to gain clarity and more detailed insights on their situation, day by day and week by week. Finance leaders demanded more specific insights on cash flows. Team members sought access to more granular or new data and sometimes discovered that their systems and processes needed to change.

4. Greater scrutiny into reporting

In 2020, going concern assessments, asset valuations, and asset impairment analyses required a greater level of precision. Financial reporting was scrutinized in greater detail by finance leaders, who also recognized that auditors would require more thorough documentation behind the numbers. Some organizations discovered that their documentation needed significant improvement.

5. Unfamiliar accounting guidance

"In years when the economy was strong, finance teams might not have needed to pay as much attention to issues such as contract modifications or asset impairment, and they might have lacked detailed knowledge of the relevant accounting guidance. In contrast, in 2020, accountants spent hours researching through the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) to learn the correct approaches or find the right accounting model," says Ryan Walker, who works in accounting advisory services at Crowe.

They also needed to keep themselves up to date regularly as guidance evolved, such as when FASB helpfully simplified its lease modification guidance for COVID-19-related lease concessions or the American Institute of Certified Public Accountants issued helpful guidance on several government assistance programs.

6. New reporting and regulatory requirements

Government assistance programs such as the Paycheck Protection Program (PPP) brought new reporting and documentation retention requirements for businesses to manage. In addition, the terms and conditions of these programs have continued to change, requiring organizations to have to continually monitor for changes that might bear on financial or other reporting requirements.

Finally, businesses that have received government assistance also have had to consider the short- and long-term impact of the assistance on their financial condition, liquidity, and financial performance, as well as how to address potential funding shortfalls when the government assistance program is ultimately terminated.

7. Lack of historical context

In the past, organizations could look to previous years or similar disruptive events to find their bearings. But COVID-19 presented organizations with circumstances that, at times, upended entire business models. There was no reference to follow – not even the recession of 2007-2009.

“We have so many more unknowns going forward and no history to look back on,” says Andrea Meinardi, a partner at Crowe. “We can’t look to the previous year’s results for an answer.”

In difficult economic times, businesses need their reporting and supporting documentation to be more precise than ever, more granular than ever. They can't simply make assumptions without some sort of substantive support behind them.

Andrea Meinardi

REPORTING GUIDANCE & REMINDERS BY TOPIC

The top reporting challenges of 2020 likely will remain with us in 2021. The following charts provide a high-level overview of some of the most important financial reporting topics, with tips and reminders on how to address them in 2021. For a deeper dive into each topic, explore the links to additional resources.

DEBT MODIFICATIONS

Accounting guidance

ASC 310 (Receivables)

ASC 470 (Debt)

Refer also to the FASB staff educational paper on Topic 470 (Debt), released October 2020

Reporting overview

Debt modifications can be treated as a troubled debt restructuring (TDR), a modification, or an extinguishment, depending on the facts and circumstances of the modification. The financial statement impact and disclosures for each outcome differ.

Key reminders

The first step in a debt modification analysis is to determine whether the modification is a TDR. Failure to perform this step could result in a material misstatement. Organizations should be aware that there are differences between the ASC 310-40 and ASC 470-60 troubled debt restructuring models (for example, what constitutes a concession). Additionally, lenders may be able to bypass the TDR assessment in certain circumstances under the CARES Act or applicable regulatory guidance, but they should still closely track and disclose modification activity.

Another common area that presents challenges in accounting for debt modifications is the treatment of fees or expenses incurred in effecting a modification.

Additional resources

FAQ
Debt modifications

Webinar
Accounting for contract modifications in a COVID-19 environment

Report
Evaluating accrued interest receivable on loan deferrals and modifications

FASB staff educational paper

LEASE CONCESSIONS

Accounting guidance

ASC 842 (Leases – new standard)

ASC 840 (Leases – old standard)

Refer also to the FASB staff Q&A, released April 2020

Reporting overview

The correct accounting for lease concessions (for example, deferred rental payments) hinges on whether the concession is granted under the original terms of the lease.

If a concession is not part of the original terms of the lease, then modification accounting applies; this requires organizations to update their inputs into lease classification and possibly lease measurement.

On the other hand, if a concession is part of the original terms, the reporting entity will need to determine how to best reflect the concession in its financial statements.

Key reminders

In April 2020, the FASB staff issued a Q&A document that provides a practical expedient to simplify the accounting for COVID-19-related lease concessions.

If elected, the practical expedient allows organizations to bypass a legal review to determine if the qualifying concession was granted as part of the terms of the original lease. It also permits organizations to bypass application of the lease modification guidance, sparing the organization from having to update inputs into the lease classification assessment and from measuring the revised lease asset and lease liability.

Additional resources

FAQ
Accounting for lease concessions

Webinar
Accounting for contract modifications in a COVID-19 environment

FASB staff Q&A

FASB delay on revenue recognition and lease standards

REVENUE CONTRACTS

Accounting guidance

ASC 606 (Revenue From Contracts With Customers)

Reporting overview

For customer contracts, any changes to the transaction price or promised goods and services must be accounted for in accordance with the ASC 606 modification guidance. Modifications may need to be treated as separate revenue contracts, accounted for prospectively, or they could result in a cumulative effect adjustment to revenue, depending on the terms of the modification.

In addition, under ASC 606, organizations are required to revise their estimates of variable consideration each reporting period.

Key reminders

Organizations should establish clear communication between sales personnel and finance teams to verify that all modifications, accommodations, or price concessions – whether verbal or written – are identified and accounted for appropriately.

Organizations also should remember that not all offers to customers will be treated as modifications. In some cases, an offer may need to be treated as a marketing incentive.

Finally, organizations will need to consider how its estimates of variable consideration are affected by the economic uncertainty arising from the pandemic.

Additional resources

FASB delay on revenue recognition and lease standards

Webinar
Accounting for contract modifications in a COVID-19 environment

EMPLOYEE AGREEMENTS AND SHARE-BASED COMPENSATION

Accounting guidance

For restructuring costs and employee terminations:

ASC 420 (Exit or Disposal Cost Obligations)

ASC 710 (Compensation – General)

ASC 712 (Compensation – Nonretirement Post-Employment Benefits)

ASC 715 (Compensation – Retirement Benefits)

For share-based compensation:

ASC 718 (Compensation – Stock Compensation)

Reporting overview

Choosing the correct accounting model for termination benefits depends on whether the benefits are part of an existing contractual agreement and whether they are offered for voluntary or involuntary terminations.

There are different types of modifications to share-based payment arrangements. The accounting for a modification will vary depending on the type of the modification and on how the shared-based payment is classified – as a liability or as equity.

Key reminders

In certain cases, termination benefits are required to be recognized over a service period if the employee is required to render substantive services prior to his or her departure.

For modifications of share-based payments, organizations will need to determine the fair value of the modified award (using current inputs) to determine the amount of incremental compensation cost to be recognized. If the original award was not expected to vest at the date of modification, the company will recognize compensation cost using the modified award's fair value.

Additional resources

Webinar
Accounting for contract modifications in a COVID-19 environment

NONFINANCIAL ASSET IMPAIRMENT ACCOUNTING

Accounting guidance

Depending on the asset type, follow impairment testing guidance and disclosure requirements under:

ASC 330 (Inventory)

ASC 350-30 (Intangibles Other Than Goodwill)

ASC 350-20 (Goodwill and Other)

ASC 360 (Impairment or Disposal of Long-Lived Assets)

To determine fair value of an asset, reference:

ASC 820 (Fair Value Measurement)

Reporting overview

Organizations must evaluate whether any nonfinancial assets have been impaired, including inventory; intangible assets; property, plant, and equipment (PP&E); and goodwill.

Correct evaluation requires close attention to the ordering of impairment testing, testing frequency, triggering events, and the specifics of each impairment model (for example, for PP&E, there is a two-step process). Measuring an impairment loss requires estimating the fair value of an asset versus its carrying amount.

Key reminders

Asset impairment analyses for 2020 and 2021 might require significantly more documentation of assumptions and management judgments than in years past.

In addition, organizations should verify that the impairment analysis is performed using the correct inputs – that is, the facts and circumstances that existed at the time a triggering event occurred or the impairment analysis was otherwise required.

Additional resources

Article
Accounting for nonfinancial asset impairment

Webinar
Triggering events and asset impairment – what you need to know

Article
How to assess – not guess – goodwill impairment caused by COVID-19

GOING CONCERN ASSESSMENTS

Accounting guidance

ASC 205-40 (Presentation of Financial Statements – Going Concern)

Reporting overview

Businesses are required to alert financial statement users about any “substantial doubt” surrounding their ability to continue as a going concern.

An evaluation of an entity’s ability to continue as a going concern is required at all interim and annual reporting periods.

Key reminders

Regardless of whether substantial doubt has been alleviated, a range of financial statement disclosures are required, such as principal conditions or events that raised substantial doubt, and management’s plans that are intended to mitigate the conditions or events.

In addition, organizations must verify that estimates and assumptions made as part of its going concern assessment are consistent with those used for other accounting conclusions.

Additional resources

Article
How to get on top of going concern assessment during COVID-19

Article
Going concern: 15 questions to ask during COVID-19

GOVERNMENT ASSISTANCE

Accounting guidance

The accounting model to apply to government assistance will depend on the form of the assistance as well any related terms and conditions. Some models that might apply include (but are not limited to):

ASC 450-30 (Gain Contingencies)

ASC 470 (Debt)

ASC 740 (Income Taxes)

ASC 958-605 (Not-for-Profit Entities – Revenue Recognition)

IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance)

Reporting overview

Stimulus legislation issued during the pandemic (such as the CARES Act and the *Consolidated Appropriations Act, 2021*) has given rise to a number of different government assistance programs, ranging from PPP loans to income tax relief.

The correct accounting model to be applied to government assistance will depend on whether the assistance falls in the scope of existing guidance and whether the organization has a preexisting accounting policy, among other considerations.

Key reminders

Significant uncertainty remains about how certain terms and conditions of several government assistance programs will be interpreted by the governmental entities providing the assistance.

In addition, recent stimulus legislation issued in December 2020 significantly changed the terms and conditions of existing government assistance programs.

Organizations must remain up to date on changes to these programs and related tax laws and how these changes will affect them. In addition, it is imperative that, beginning now, organizations document all assumptions, supporting facts, and eligible expenditures to satisfy potential regulatory reporting requirements.

Additional resources

Webinar
Accounting for government assistance, including PPP loans

FAQ
PPP loan accounting

Article
Navigate the accounting for government assistance

Podcast
Navigating the impact of PPP and government assistance

A GAME PLAN FOR FINANCIAL REPORTING IN 2021

Although the relevance of financial reporting topics varies by industry and circumstance, organizations can adopt six overarching strategies to help them properly close out financial reporting for 2020 and proactively embrace financial reporting in 2021.

1. Be diligent about data, documentation, and disclosures

Finance teams should expect closer scrutiny from auditors and other external stakeholders about how COVID-19 affects their businesses. Year-end financial statements must provide greater transparency than in a typical year, so more detailed and rigorous documentation and disclosures will be necessary. Teams should also make any necessary accommodations to meet any new documentation retention requirements (for example, payroll stubs to support PPP loan forgiveness).

Organizations must start early to identify and track down missing data, especially when in-person access is limited. For public companies, the Securities and Exchange Commission will expect meaningful disclosure about how the COVID-19 pandemic has impacted their business, financial condition, and results of operations.

2. Maintain consistency with estimations and assumptions

"One of the absolute and utmost important steps an organization can take is to be consistent in its estimations and assumptions across the organization," says Prince.

"If you're making one set of assumptions about cash flows for goodwill impairment testing and then using a different set of cash flow assumptions for a separate accounting issue – for example, going concern assessments – then you likely have a problem," he says. Any differences in assumptions should be justifiable and grounded on differences in models or required estimates.

3. Plan for tomorrow, today

Organizations should plan ahead and gain a clearer understanding of the tasks and challenges they will face in 2021.

"Plan early, plan often, and start now," Meinardi suggests. "If your financial statements are due the beginning of March, don't start at the end of February."

Teams should begin this process by having conversations with important parties, including auditors and regulators, who can provide answers to pertinent questions.

4. Open the lines of communication across the organization

In difficult economic times, transparency and clear communication are essential for successful financial reporting, both internally and externally. Today's reporting must be a collaborative effort across an organization. Additionally, changes in business practices due to the pandemic require most professionals to work remotely and to interact with their colleagues and advisers through innovative uses of technology to meet audit requirements.

"Open channels of communication are critical, especially in a virtual environment," says Prince. "Finance teams must be kept in the loop about business activities such as sales representatives renegotiating contracts. By maintaining clear channels of communication across various departments, finance leaders can keep tabs on financial reporting considerations while minimizing the risk of accounting oversights or errors."

5. Be ready to react and adapt to the unknown

Absolute certainty is a precious commodity in today's highly volatile environment. This shifting landscape makes everything tricky. For instance, some organizations will have to complete their financial reporting without knowing whether they'll receive forgiveness on their PPP loans, while others will have already received formal forgiveness from the Small Business Administration.

But the goal isn't to have all the answers. Rather, organizations must maintain the flexibility to adapt to evolving circumstances and continually stay abreast of a changing economic and political landscape. For example, forecasting should likely incorporate multiple forecast scenarios and should be monitored continually.

6. Review and tighten internal controls and processes

After assessing any 2020 shortcomings with internal processes and controls, organizations should take steps to improve. Internal controls will continue to play a significant role in ensuring materially correct financial statements, so finance leaders should verify that controls are appropriately designed for and implemented in the new COVID-19 environment.

2021 BRINGS A NEW NORMAL

Many U.S. companies likely will not return to pre-pandemic business practices. They have entered a new normal.

But in the new normal, many businesses can be more flexible, resilient, and able to respond more quickly to disruption. Business models rapidly evolved for a digital-only world, and digital transformation journeys accelerated to enable remote work and shift data and applications to the cloud. Along the way, businesses updated and strengthened internal processes.

Financial reporting will continue to be challenging. But in the coming months, business leaders will look for more clarity and certainty about economic recovery, including the impact of additional federal stimulus payments and the distribution of COVID-19 vaccines. These macroeconomic factors will shape the trajectory of organizations and their financial reporting obligations.

If there's anything finance leaders know for certain, it's that nothing is for certain in 2021. They'll need to draw on the lessons learned from 2020 and devise a solid game plan that emphasizes agility and preparedness.

Receive guidance from the Crowe team of financial reporting specialists

High-quality financial reporting has never been more important – or more challenging. Now and always, our advisers offer deep expertise in all aspects of financial reporting, and they bring the experience of assisting countless organizations across major industries for nearly 80 years.

For assistance with asset impairment, financial reporting for modifications, or accounting for government assistance programs, tap into our years of experience in financial reporting solutions and services.

Learn more about how Crowe can support you.

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