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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 59
April-May 2020

This Update summarizes recent developments relating to public company audit committees and their oversight of financial reporting and of the company's relationship with its auditor.

In This Update:

SEC Leadership Offers More COVID-19 Disclosure and Financial Reporting Guidance

On April 8, SEC Chairman Clayton and William Hinman, Director of the Division of Corporation Finance, released a statement on the impact of COVID-19 on public company disclosure. The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19 (Joint Statement), gives special emphasis to the role of forward-looking information concerning how company operations and financial condition may change because of the COVID-19 fight.

Several days earlier, on April 3, the SEC's Chief Accountant, Sagar Teotia, issued a statement on how the Office of the Chief Accountant (OCA) is responding to COVID-19. In Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19 (OCA Statement), Mr. Teotia notes that in "these challenging times, investors and other stakeholders need high-quality financial information more than ever" and highlights specific areas of accounting judgment that may be impacted by the COVID-19 reporting environment. As discussed in SEC Provides Public Companies with COVID-19 Filing Deadline Relief and Guidance on the Financial Reporting Effects of the Virus, February-March 2020 Update, the SEC's Division of Corporation Finance has also released pandemic disclosure guidance.

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Joint Statement

In the Joint Statement, Chairman Clayton and Director Hinman emphasize that companies should make disclosures that respond to investor interest in "(1) where the company stands today, operationally and financially, (2) how the company's COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress." The balance of the Joint Statement is devoted to a more detailed discussion of these points and includes several observations relevant to audit committee oversight of financial reporting and disclosure.

- Earnings Reports and Analyst Calls*.* Typically, the information provided in quarterly earnings statements and calls with analysts and investors is predominately historical. This quarter, however, "historical information may be substantially less relevant." Instead, investors and analysts want to know "where companies stand today and, importantly, how they have adjusted, and expect to adjust in the future, their operational and financial affairs to most effectively work through the COVID-19 health crisis." Chairman Clayton and Director Hinman urge public companies "to provide as much information as is practicable regarding their current operating status and their future operating plans under various COVID-19-related mitigation conditions" in earnings releases, analyst calls, and other communications. "Detailed discussions of current liquidity positions and expected financial resource needs would be particularly helpful to our investors and markets", along with information concerning COVID-19's impact on operations, "including as a result of company efforts to protect worker health and well-being and customer safety." Further, if government financial assistance has, or is likely to have a material effect on its financial condition or results of operations, the company "should provide disclosure of the nature, amounts and effects of such assistance."

- Forward-Looking Disclosure**.** Under the current circumstances, providing forward-looking information regarding future operating conditions and resource needs may be difficulty, and companies may be tempted to "resort to generic, or boilerplate, disclosures that do little to inform investors of company-specific status, operational strategies and risks." The Joint Statement encourages companies and their advisers to make all reasonable efforts to convey meaningful information that "provides investors a level of insight that allows them to see the key operational and financial considerations and challenges the company faces through the eyes of management."

  The recommendation that companies provide forward-looking information is driven by three considerations: "(1) the information will benefit investors, (2) market digestion of the information will benefit the company, and (3) the broad dissemination and exchange of firm-specific plans for addressing the effects of COVID-19 under various scenarios will substantially contribute to our nation's collective effort to fight and recover from COVID-19." The more confidence investors and markets have in a company's strategy, the more willing they will be to provide credit and other financing to the company. Further, "coordination across workers, firms, investors and governmental officials will be critical to successfully emerge from this fight. The exchange of forward-looking information is essential to that coordination. * * * This increased confidence and understanding reduces risk aversion and facilitates action."

- Investor Protection, Market Integrity and Legal Risk. The Joint Statement also reminds companies of the risks associated with selective dissemination of material nonpublic information. Companies should "practice good corporate hygiene" with regard to such information and "are well served when the type of information we outlined above is held closely until disclosed, and, when disclosed, is broadly disseminated." On the other hand, the Joint Statement recognizes that many companies are cautious about forward-looking statements and estimates. In an effort to provide comfort with respect to legal risk, the Joint Statement says that, "[g]iven the uncertainty in our current business environment, we would not expect to second guess good faith attempts to provide investors and other market participants appropriately framed forward-looking information."

OCA Statement

The OCA Statement discusses various pandemic-related activities of the SEC's Chief Accountant. Two points are particularly relevant to financial reporting oversight.

First, the OCA Statement recognizes that the COVID-19 crisis may require companies to make difficult accounting judgments and estimates. It states that areas in which these challenging judgments and estimates may arise include: fair value and impairment considerations; leases; debt modifications or restructurings; hedging; revenue recognition; income taxes; going concern; subsequent events; and adoption of new accounting standards (e.g., the new credit losses standard]). Like the Joint Statement, the OCA Statement stresses the important of these types of disclosures and states that "OCA has consistently not objected to well-reasoned judgments that entities have made, and we will continue to apply this perspective."

Second, the OCA Statement notes that the Coronavirus Aid, Relief, and Economic Security (CARES) Act allows certain financial institutions to temporarily defer compliance in their financial reporting with two FASB standards – the new standard applicable to the measurement of credit losses (the current expected credit loss standard, referred to as CECL -- see CAQ on CECL: Help for Audit Committees on Oversight, May-June 2019 Update) and a standard governing troubled debt restructuring. Questions have arisen as to whether the SEC would view the financial statements of institutions that take advantage of the CARES Act relief as prepared in accordance with generally accepted accounting principles (GAAP). The OCA Statement says that the SEC will accept such financial statements: "For those entities that are eligible for, and elect to apply [the CARES Act accounting suspension], the staff would not object to the conclusion that this is in accordance with GAAP for the periods for which such elections are available."

Comment: Because of the unique and unforeseen circumstances in which companies now find themselves, companies are likely to face both new demands for predictive disclosure and new challenges in preparing such disclosure and making related accounting judgments. The Joint Statement and the OCA Statement highlight these issues and underscore the importance of forward- looking disclosure. Although assurances from senior SEC officials that the Commission will not second-guess "good faith attempts" to provide "appropriately framed forward-looking information" and will not object to "well-reasoned accounting" accounting judgments are helpful, this remains an area in which companies should use care. Even if the SEC declines to challenge a forward-looking statement or accounting judgment that proves incorrect, companies may still be exposed to private litigation. See, e.g., Accounting Class Action Numbers Continue to Grow in this Update.

Audit committees may want to discuss with management whether forward-looking statements conform to the requirements of the various liability safe harbor provisions under the federal securities laws and to focus particularly on the reasonableness of assumptions that underlie predictive disclosures and accounting judgments. In most circumstances, it is prudent to document the basis for such assumptions and the process by which they were selected and considered.

PCAOB Wants to Hear About "Initial Experiences" With CAM Reporting

The staff of the Public Company Accounting Oversight Board is conducting an "interim analysis" of how auditors responded to the new critical accounting matter (CAM) disclosure requirements and whether and how investors are using CAM communications. As part of this project, the PCAOB is seeking to hear from audit committees and financial statement preparers.

As described in earlier Updates (see, e.g., PCAOB Shares its Initial Observations on CAMs on CAMs, November-December 2019 Update), in 2017 the PCAOB adopted a new standard that requires the auditor's report to include CAM disclosure. A CAM is any matter arising from the audit of the financial statements that was (1) communicated or required to be communicated to the audit committee, (2) relates to accounts or disclosures that are material to the financial statements, and (3) involved especially challenging, subjective, or complex auditor judgment. The auditor's report must identify each CAM, describe the principal considerations that led the auditor to determine that the matter was a CAM, describe how the auditor addressed the CAM in the audit, and refer to the financial statement accounts or disclosures related to the CAM. For large accelerated filers, CAM reporting took effect for audits of fiscal years ending on or after June 30, 2019. CAM reporting will become effective for audits of most other public companies for fiscal years ending on or after December 15, 2020.

In Request for Comment: Interim Analysis of Critical Audit Matter Requirements (April 17, 2020), the PCAOB invites comments on "stakeholders' initial experiences with CAMs." The Board's request includes nine questions. Three questions are addressed to investors, analysts, and other financial statement users and five are addressed to preparers, audit committee members, and auditors. The preparer/audit committee/auditor questions are:

- Have preparers and audit committees experienced any changes in the financial reporting process as a consequence of CAM communications in the auditor's report? For example, has the communication of CAMs led to changes in controls or practices around financial reporting and disclosure? Did CAM communications result in any reconsideration of, or changes to, disclosures management made in company filings (e.g., notes to the financial statements, critical accounting estimates, MD&A, or risk factors)?

- Have CAM communications had any impact on how audit committees approach their role and responsibilities?

- Have auditors or preparers experienced any changes in a specific audit because of CAM requirements? For example, were there changes to the nature, timing, or extent of audit procedures performed on matters identified as CAMs, not because of changes in circumstances but because of CAM requirements?

- Did CAM requirements lead to changes in communications between auditors, audit committees, or preparers? For instance, were there changes in the nature or frequency of communications during the audit process? Did audit committee members ask more or different types of questions? Was there more focus on matters that were identified as CAMs?

- Based on your experience as a preparer or auditor, what were the most significant activities that led to CAM-related costs? First, please describe each activity, including any preparatory activities (e.g., pilots or dry runs). Next, please estimate the total costs related to CAM requirements in hours (and external spend, if applicable) for each of those activities for each calendar year from 2017-2019 and the period January-April 2020, distinguishing, to the extent possible, between costs related to preparatory activities and costs related to recurring activities. Finally, for any activities that will be recurring, state whether you believe the costs will increase, decrease, or not change for each activity in future years. (The question includes examples of auditor and preparer costs.)

- From your perspective as an auditor or preparer, at which stages of the audit process did most of your activities related to CAMs occur? Did the majority of your effort occur before or after the company's fiscal year end? What factors contributed to the timing of your efforts related to CAMs?

The response deadline is June 15, 2020, and comments will be publicly available on the Board's website.

Comment: In approving the CAM requirement, the SEC indicated that it expected the PCAOB to engage in monitoring to determine whether the new disclosure had unintended consequences or unanticipated costs. The PCAOB seems to be taking post-implementation monitoring seriously. The recent request for comment is only the opening phase of its efforts to gather information about the costs and benefits of CAM reporting. Audit committees and financial reporting managements that have experience with CAM reporting – either as large accelerated filers or as a result of the "dry run" CAM reporting process that most accounting firms conducted – should consider providing the PCAOB with their views and experience, whether favorable or unfavorable, and particularly if they believe that changes in the requirement are appropriate. As emphasized in the request, information regarding costs would be particularly helpful.

CAQ Releases Key COVID-19 Auditor and Audit Committee Considerations

On April 8, the Center For Audit Quality released [CAQ COVID-19 Resource: Key Auditor and Audit Committee Considerations.]() This publication, which provides high-level pandemic-related financial reporting considerations for auditors and audit committees, addresses three topics – key audit implications, key accounting and disclosure implications, and key audit committee considerations. Each is summarized below.

Key audit implications.

The CAQ notes that, on April 2, the PCAOB released a document entitled [COVID-19: Reminders for Audits Nearing Completion](). In this statement, the PCAOB provides "important reminders" to auditors with respect to audits that are nearing completion during the disruptions stemming from COVID-19 and "reminds auditors of their obligation to comply with PCAOB standards and rules, and other applicable regulatory and professional requirements." The CAQ reiterates four issues highlighted by PCAOB:

- Risk Assessment. Auditors may need to revise their risk assessments. Further, controls may be affected by changes to business processes, such as travel restrictions or remote working arrangements. Auditors may need to design and perform new procedures, or modify previously planned procedures, to test new or modified implemented controls."

- Audit committee Communication. Significant changes to audit strategy or significant risks must be communicated to the audit committee. These could include changes to management's process "to develop critical accounting estimates or significant assumptions, matters related to the auditor's evaluation of the company's ability to continue as a going concern, or significant difficulties encountered during the audit."

- Auditor's Report. The COVID-19 crisis may affect the auditor's determination of CAMs and how CAMs are addressed in the audit. COVID-19 impacts may also warrant including additional elements in the auditor's report, "such as explanatory language or an explanatory paragraph when there is substantial doubt about the ability of the company to continue as a going concern."

- Quality Control Considerations. Firms may modify their engagement performance policies and procedures because of COVID-19. For example, this may include additional consultation requirements.

Key accounting and disclosure implications.

The CAQ lists the following accounts and disclosures that may be impacted by the COVID-19 crisis and suggests some questions for auditor and audit committee consideration regarding each. These accounts and disclosures, with examples of the suggested questions, are:

1. Impairments. Consider whether there are indications that either long-lived assets (e.g., equipment, buildings, or finite lived intangible) or goodwill are impaired. Are held-for-use assumptions of long-lived assets still appropriate?

2. Investments. For marketable securities, is management's assertion that it intends to hold investments to maturity still appropriate? Have credit losses been appropriately recorded? Are there indicators that the carrying amount of equity method investments might not be recoverable?

3. Income taxes. For the deferred tax valuation allowance, has forecasted future taxable income in the carryback or carryforward period changed? As to foreign earnings, can the company continue to assert (if it has in the past) its intent and ability to indefinitely reinvest foreign earnings?

4. Inventory valuation. Is the valuation allowance for inventory obsolescence appropriate? Have unplanned work stoppages affected inventory costing?

5. Debt modifications and loan covenants. Do any additional financings or amended terms of existing debt agreements meet the definition of debt modifications or extinguishments? Have any debt covenants been violated?

6. Restructuring and other employee related accruals. Have exit or disposal activities been accounted for accurately? Have leasing arrangements changed? Have employee benefits changed that may require accrual? Have employees been terminated such that postemployment benefit obligations have been incurred?

7. Foreign currency - Intercompany transactions of a long-term investment nature. Can the company continue to assert that an intercompany transaction is of a "long-term investment" nature? (When intercompany foreign currency transactions are of a "long-term investment" nature, foreign currency transaction gains and losses are reported in other comprehensive income rather than through income.)

8. Other auditing considerations. Other considerations may include fair value measurements, insurance recoveries, effects on contracts and commitments including revenue and leases, hedge accounting, provisions, allowances, and loss contingencies, and ability to continue as a going concern.

9. Disclosure considerations. Auditors and audit committees should consider the SEC Division of Corporation Finance March 25, 2020 guidance regarding disclosure and other securities law obligations with respect to COVID-19. See SEC Provides Public Companies with COVID-19 Filing Deadline Relief and Guidance on the Financial Reporting Effects of the Virus, February-March 2020 Update.

Key audit committee considerations.

The CAQ suggests that audit committees may also want to consider the following five sets of issues:

1. Has the COVID-19 crisis impacted the financial reporting process and controls? Have employees or auditors been working remotely? Has the audit or interim review by auditors been affected?

2. Have business conditions affected the company's financial position and results of operations? How has management considered the impact of COVID-19 on the valuation of accounts, including asset impairment, allowances, restructuring charges, or other expenses? How have significant estimates and assumptions changed? How has management communicated such changes and executed related controls?

3. Is COVID-19 expected to materially affect the demand for the company's products or services? How has management considered the impact of COVID-19 on contracts including revenue and leases? How has management communicated the impact of COVID-19 on long -term projections and assertions?

4. Is COVID-19 impacting the company's liquidity and capital resources? How has management communicated the impact of COVID-19 on financing arrangements, including debt covenants? Have related accounting and disclosure requirements been considered?

5. Have there been changes to the company's use of non-GAAP financial measures? If yes, what is the rationale for such changes and are disclosures compliant with SEC regulations?

6. Have material corporate events occurred triggering a requirement to issue a Form 8-K?

7. Has the company considered whether to apply for assistance under the CARES Act (or other government relief programs)? If yes, what conditions of that relief might have disclosure and financial reporting consequences?

The CAQ's paper includes a list of resources (and hyperlinks) relating to the impact of the COVID-19 crisis on financial reporting and disclosure, including SEC, PCAOB, and large accounting firm publications.

Comment: The COVID-19 crisis and the related economic disruptions will require audit committees to consider a wide range of financial reporting, disclosure, and other challenges that were unanticipated only a few weeks ago. Resources to help audit committees in understanding these challenges are rapidly beginning to appear. Each company's situation is of course unique. However, the CAQ's publication, along with those issued by the major accounting firms (see the next item in this Update and What's on the Audit Committee's Agenda in 2020? Part II: COVID-19, February-March Update) provide useful checklists as audit committees grapple with these issues.

PwC Has COVID-19 Guidance for Audit Committees

PwC has released two publications to assist audit committees in fulfilling their responsibilities during the pandemic. COVID-19: Audit committee financial reporting guidebook discusses financial reporting, while COVID-19: Navigating core audit committee responsibilities focuses on other core audit committee functions, such as oversight of internal and external audit. A summary of each publication appears below.

COVID-19: Audit committee financial reporting guidebook

Financial reporting oversight is a fundamental audit committee responsibility. "It is important for the audit committee to set the tone and ensure management is encouraging employees to ask for more time or additional resources in order to make sure things are done the right way." PwC lists financial reporting and technical accounting issues that audit committees should consider in the current crisis. For each issue, PwC includes specific questions that the audit committee may wish to ask management. The issues are:

Financial reporting

- Closing the books and SEC filing deadlines. Companies may have difficulty closing their books on a timely basis. The SEC has provided companies that are unable to meet filing deadlines due to COVID-19 with an additional 45 days to submit certain reports due between March 1 and July 1, 2020. See SEC Provides Public Companies with COVID-19 Filing Deadline Relief and Guidance on the Financial Reporting Effects of the Virus, February-March Update. In addition, "ensuring that internal controls are still functioning effectively should be a continual focus."

- Optional deferral of CECL. The Financial Accounting Standards Board's new accounting standard on credit losses standard, which requires recognition of current expected credit losses (CECL), became effective for most SEC reporting companies for periods beginning after December 15, 2019. See CAQ on CECL: Help for Audit Committees on Oversight, May-June 2019 Update. The Coronavirus Aid, Relief, and Economic Security (CARES) Act provides an optional deferral of CECL implementation for certain financial institutions. See CAQ Releases Key COVID-19 Auditor and Audit Committee Considerations in the Update.

- Government assistance. Various forms of government assistance are available for businesses impacted by the COVID-19 crisis. Companies that accept such assistance should consider the GAAP and reporting implications. "[D]etermining the proper accounting treatment for government incentives by business entities can be challenging and will likely depend on a careful analysis of the nature of the assistance and the conditions on which it is predicated."

- Risk factors, Management's Discussion and Analysis (MD&A) including liquidity and other disclosures. The risks and impacts of COVID-19 may require disclosure in SEC filings, including in MD&A, description of the business, risk factors and legal proceedings. In risk factors, "if something has already occurred, the disclosure should no longer address the hypothetical 'risk' of it occurring. Instead, it should describe what has occurred, and then disclose what the risk now is, such as the potential for the situation to worsen." In MD&A, "companies should be disclosing, to the best of their ability, how COVID-19 could impact the company's financial performance including operations, cash flows, capital investment programs and liquidity."

Technical accounting

- Revenue recognition and receivables. "While a company may continue to sell products and services to customers impacted by disruptions caused by COVID-19, revenue can only be recognized for new sales if payment is probable. After revenue is recognized, companies should assess the need for write-offs or reserves on outstanding receivable balances."

- Impairment of goodwill, indefinite-lived intangibles and long-lived assets. COVID-19 impacts, such as changes in projected cash flows due to a decrease in demand, supply chain disruptions, delivery challenges or other events, may constitute a "triggering event" requiring an impairment assessment for goodwill and/or indefinite-lived intangibles and long-lived assets.

- Valuations. COVID-19 disruptions could affect the availability of the information used in fair value models. "Initial estimates should be updated for any delayed information that becomes available prior to the release of the company's financial statements if the information provides additional evidence about known or knowable conditions that existed at the measurement date."

- Derivatives and hedging. Companies that have cash flow hedges, such as of inventory purchases, sales or revenues, debt issuances or interest payments, may have to consider the impact of decreases in forecasted transaction volume on their financial statements. The new economic environment could also impact the ability to continue hedges or establish new hedges.

- Inventory valuation. Inventories should be measured at the lower of cost or net realizable value and should be written down unless substantial evidence exists that the net realizable value will recover before the inventory is sold. "Given the significant uncertainties associated with the current market conditions, it would be challenging for a company to conclude that prices will recover before inventory is sold."

- Accounting for insurance claims. Accounting for recoveries, or expected recoveries, under business interruption insurance policies can raise challenging issues. "Typically, a business interruption insurance recovery gain would not be recognized prior to the insurance carrier acknowledging that the claim is covered and communicating the amount to be paid to the company. Any stipulation from the carrier (e.g., "pending final review") should be reviewed to determine whether it is an indication the claim may not be realizable."

- Debt. Liquidity issues may jeopardize compliance with debt covenants, which may, in turn, affect classification of debt as current or noncurrent. Debt restructuring during a downturn raises a variety of issues, such as "whether the restructuring would be considered a troubled debt restructuring. If the restructuring is not considered troubled, it should be assessed to determine if it is a modification or extinguishment."

- Taxes. Deteriorating operating results may require a company to reassess the need for a valuation allowance on deferred tax assets and may impact the required quarterly forecast of the full-year annual effective tax rate used to compute the year-to-date income tax provision.

- Subsequent events: Companies should consider whether events after the balance sheet date, but prior to the issuance of the financial statements, need to be reflected in the financial statements.

- Going concern: "Companies impacted by COVID-19 will have to update their forecasts, and if conditions give rise to uncertainties about the ability to continue to operate (e.g., recurring operating losses), it will be necessary to make adjustments in the financial statements (e.g., record asset impairment losses) and provide disclosures to alert investors about the underlying financial conditions and management's plans to address them."

COVID-19: Navigating core audit committee responsibilities

While audit committees "will have a lot on their plates in the coming months" with respect to financial reporting oversight, they also need "to continue to focus on their other core responsibilities." PwC discusses four of these other audit committee responsibilities, as summarized below.

- Risk oversight. Audit committees "will want to understand how management is evaluating the effects of COVID-19 on the business operations and the way people work, and whether those effects trigger an event-driven reassessment of business risk, control risk and the effectiveness of the related controls." Issues audit committees should consider include whether there are "protocols in place to report, aggregate and analyze emerging risks" and whether the company could leverage "internal audit or other resources to provide assurance related to new or different internal controls."

- Internal audit oversight. Audit committees should ask management to review the annual internal audit plan. Among other things, the audit committee might ask whether internal auditor can provide assurance that the control environment is addressing any new risks, such as those "related to changes to the financial close process, changes in the supply chain, IT security related matters, etc." Internal audit might also be asked to assist in compliance with regulatory requirements related to CARES Act economic assistance.

- External audit oversight. Audit committees should understand any changes in audit procedures for review of interim financial reports as a result of working remotely. They should also learn whether the auditor performed extended audit procedures and, if so, whether those procedures required consultation outside the engagement team. The audit committee should also understand the auditor's "perspective regarding potential changes in audit risk, management's process for deriving significant estimates and impacts on internal control over financial reporting."

- Whistleblower, ethics and compliance oversight. Audit committees should continue to focus on organizational culture and should be alert to possible new types of whistleblower or ethics complaints. For example, employees working in essential businesses may have concerns about their safety. Similarly, as companies reopen, "individuals may have differences in opinion regarding their personal safety in the workplace or about traveling for business."

Comment: PwC's two publications are useful checklists of the kinds of issues that audit committees should consider as the COVID-19 crisis unfolds. Since there is likely to be considerable focus on financial reporting and disclosure challenges arising from the pandemic crisis, the reminder concerning other core functions, such as whistleblower and ethics compliance oversight, is also particularly timely.

Accounting Class Action Numbers Continue to Grow

Cornerstone Research has issued its annual report on accounting class action litigation. In Accounting Class Action Filings and Settlements—2019 Review and Analysis, Cornerstone found that, in 2019, class actions against public companies alleging accounting violations hit a new high, although the total value of settlements in such cases declined. In contrast, last year Cornerstone reported that, in 2018, the number of new accounting class actions declined slightly, while the value of settlements increased fivefold over 2017. See SEC and PCAOB Cases Against Accountants Decline, While Accounting Class Actions Near Record Highs, May-June 2019 Update. Year-to-year variations aside, accounting class action litigation against public companies is clearly flourishing.

Cornerstone found that there were 169 securities class actions involving accounting allegations filed against public companies in 2019, nearly double the average during the past ten years, and an 18 percent increase over 2018. Accounting class actions were 42 percent of total securities law class action filings. At the same time, the total value of accounting class action settlements fell, from $4.5 billion in 2018 to $920 million in 2019. The decline in settlement value may not, however, be very meaningful. Cornerstone notes that the value of settlements "can fluctuate substantially from year to year due to the presence or absence of very large settlements." In 2019, there were no settlements exceeding $500 million and only two exceeding $100 million. Moreover, the median settlement amount rose from $9.7 million to $10.5 million.

The growth in accounting class action cases has been driven by an increase in cases challenging mergers and acquisitions on accounting grounds. Such cases have become more common, and, in 2019, 102 of the 169 new accounting cases filed were M&A-related — a 29 percent increase over 2018. These actions typically allege a failure to reconcile a non-GAAP measure to a GAAP measure and are often brought by attorneys seeking a quick settlement involving a disclosure correction and the payment of attorney's fees. See Accounting Class Actions Rise, But Settlements Fall, April-May 2018 Update. The fact that companies are inclined to settle these cases to remove an obstacle to the transaction makes them popular with the plaintiff's bar.

In 2019, 67 "core accounting cases" (i.e., cases not involving M&A transactions) were filed -- an increase of 5 percent over 2018. The stakes in such cases are increasing: Average market capitalization losses alleged in core accounting cases, as measured by the change in the defendant company's market capitalization during the class period, were $54.2 billion in 2019, roughly the same as in 2018 ($54.8 billion), but 58 percent higher than the 2010-2018 average. In two of the newly filed 2019 cases, alleged market capitalization losses were $5 billion or greater.

Restatements and internal control weaknesses are fertile ground for class action litigation. Twenty-eight percent (19) of the 2019 new core accounting cases involved restatements, and 90 percent of the 2019 restatement cases included an internal control weakness allegation; over the past 10 years, more than 75 percent of restatement cases included allegations of internal control weaknesses.

Settlements were reached in 34 accounting class actions in 2019, compared to 41 settlements in 2018. As noted above, aggregate value of settlements declined slightly in 2019, although the median settlement value increased. In addition:

- Two accounting class action settlements exceeded $100 million.

- There is a trend for settlements to involve larger companies. The median market capitalization of the 2019 settling companies was $817.6 million, well above the $635.7 million 10-year median.

- Forty-four percent of settled accounting cases in 2019 also involved an SEC enforcement action. This was the highest percentage of settled cases accompanied by SEC action since 1998.

As to the industries that attracting accounting class actions:

- As in 2018, the greatest number of 2019 cases were filed against companies in the Consumer Non-Cyclical sector (which includes biotechnology, healthcare, and pharmaceuticals). In both 2019 and 2018, the Financial sector was the second most popular defendant industry. On the other hand, cases against companies in the Technology sector (in third place last year) declined by over 50 percent in 2019.

- Companies in the Consumer Non-Cyclical sector also settled the most cases in 2019. By dollar amount, the Energy sector had the largest number of accounting case settlements.

Comment: As noted in Securities Law Class Actions are Mushrooming, But More Cases are Being Dismissed and the Survivors are Settling for Less, March 2018 Update, the risk that a public company will be named in a securities law class action is increasing, particularly for companies engaged in M&A activity. Even outside of M&A litigation, accounting issues remain a significant line of attack for the plaintiff's bar, and restatements and disclosure of internal control weaknesses are likely to attract litigation. At the same time, the cost of settling accounting cases is on a general upward trend. The best protection against litigation is diligence and care in overseeing the company's financial reporting.

The Audit Blog

I am a co-founder of The Audit Blog and blog on developments in auditing and financial reporting, on auditor oversight and regulation, and on sustainability disclosure. Occasionally, items that appear in the Audit Committee and Auditor Oversight Update also appear on the blog. The blog is available here. You can follow it @BlogAuditor on twitter or @the-audit-blog on medium.com.

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Prior Updates issued after January 1, 2019 are available here.