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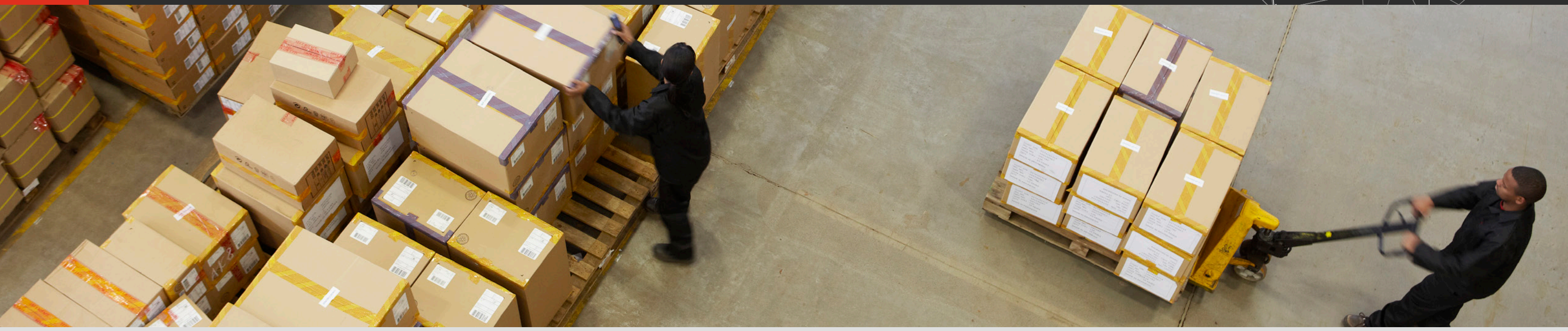
Responding to COVID-19: Considerations for corporate boards



As Coronavirus (COVID-19) continues to spread as a global pandemic, the business community is feeling unprecedented impacts. From concerns over employee well-being to massive supply chain disruptions to gyrating stock prices, businesses are experiencing a range of implications. Now more than ever, boards of directors need to be proactive and agile, and they need to respond with strong leadership. Since there are numerous strategic, operational and policy concerns impacting both the short and long term, boards will want to immediately consider the following issues.

Business

Employee well-being. First and foremost, companies need to address their employees' well-being. They need to address workforce safety and consider how to ramp up and sustain remote working capabilities. The communication strategy needs to be factual, authentic and timely.

Impact on strategy. Considering the board's responsibility for risk and strategy oversight, boards will want more frequent communications with management on the impact of COVID-19 on operations and the execution of strategic initiatives. In particular, they will want to have additional discussions about the need to pivot in light of current circumstances, changes to capital investment strategies, supply chain issues, workforce planning and cost reduction efforts.

Transactions, opportunism and activism vulnerability. If your company is currently in the midst of a transaction, access to information for diligence and pricing will be challenging. But while the deals market is uncertain, there will continue to be a very robust activism landscape. Lower equity valuations, once stabilized, may present an opportunity for hedge fund activists to take positions in companies that were less attractive to them at higher valuations. The board will want to ensure management has considered how the decline in the equity markets could expose any such vulnerabilities, and understand the mitigation techniques available. To the extent a company desires to take advantage of lower valuations and pursue a transaction, the board should consider the risks associated with uncertain outcomes and potential diligence barriers.

Share repurchases and dividends. With the global equity markets in extreme flux, boards will want to look closely at current share repurchase programs. As equity valuations decline, some companies are considering modifying their approach to share repurchases. The timing of share repurchases is always challenging and directors will want to carefully think through these decisions considering company-specific facts and circumstances. Boards may also want to look at the company's current dividend policy. The challenging economic environment and liquidity concerns may have companies considering whether to make changes.

Supply chain. Supply chains continue to be disrupted in different ways. Some companies have excess supply or capacity, while others have shortages. Most companies did not have supply chain risk sensing tools, and had not modeled scenarios to deal with an event like we are now experiencing with COVID-19. Many are in triage mode, and the ability to balance supply with demand may be impacted for months to come.

In the short term, boards should be asking whether there is sufficient liquidity for supply chain operations. They should also ask whether the company is proactively managing relationships with key suppliers and customers, some of whom may have contracts with "most favored" clauses. There may also be potential supply disruption insurance coverage gaps given "force majeure" and related caveats that management will need to track. And extraordinary supply chain expenses need to be carefully documented for insurance/tax purposes.

In the medium term, boards will want to probe whether the company's supply chain risk assessment and scenario modeling tools need to be upgraded. Boards should also be asking whether increasing workflow automation could mitigate future risk and if the supply chain operating model needs to be revisited.

Liquidity. Companies will need to take a close look at their future cash flows. Companies that might have already been close on operating cash forecasts or debt covenants will need an immediate plan of action. Depending on the industry, companies will see lower revenue resulting in less cash flow, delayed receivable collection, the need to pay payables faster to support key suppliers or related issues. Cash flow management will require close scrutiny in the months to come.

Tax policy and Washington

Rapidly evolving circumstances and engagement. President Trump and Congress are responding to this rapidly developing situation with specific proposals that warrant careful review by boards and management teams. Additional legislative and administrative measures are likely to be developed. Companies should be prepared to engage with policymakers to ensure that issues and proposals affecting their business operations and employees are carefully considered.

National emergency declaration and disaster tax relief. On March 13, President Trump declared a national emergency to address COVID-19. The President's declaration instructs the Treasury and the IRS to provide relief from tax filing deadlines to individuals and businesses. On March 18, the IRS released IRS Notice 2020-17, which provides taxpayers with a 90-day deferral of tax payments. Individuals will be able to defer up to $1 million without interest or penalties; corporations will be able to defer up to $10 million. In a March 20 social media post, Treasury Secretary Steven Mnuchin announced a delay in the tax filing deadline from April 15 to July 15. He noted that "All taxpayers and businesses will have this additional time to file and make payments without interest or penalties." As of this writing, IRS guidance had not yet been released.

Legislative relief. On March 18, President Trump signed into law legislation to provide relief for families and communities affected by COVID-19 and additional funding for tests and other measures to prevent the spread of the virus. The law requires certain employers (businesses with less than 500 employees) to provide expanded emergency family and medical leave. It also establishes a new business tax credit for certain employer-provided paid leave benefits through the end of 2020. The law also provides funding for emergency unemployment compensation and food assistance for certain individuals.

Additional financial stimulus measures. Administration officials and Congressional leaders are discussing options for additional stimulus legislation to respond to the economic effects of the COVID-19 virus. On March 19, the Senate Republicans released a draft bill which includes numerous tax provisions to support individuals and corporations. Some of the key corporate tax stimulus provisions include delay of certain tax deadlines, temporary modifications to net operating loss carryback and limitation rules, temporary modification of interest limitation rules and delay of payment of employer payroll taxes and estimated corporate tax payments.

Some of the non-tax business provisions include billions of dollars of funding for small business loans and loans to passenger airlines, cargo carriers,and other impacted industries. This legislation still needs to be passed by the Senate and considered by the House. Both the House and the Senate are scheduled to recess beginning April 6 for a two-week period, but the congressional schedule may be revised as events warrant.

Financial reporting

Financial reporting operations. As business continuity challenges escalate, companies may experience issues with "closing their books" on a timely basis. Subject to certain conditions, the SEC has provided companies that are unable to meet filing deadlines due to COVID-19-related circumstances with an additional 45 days to submit certain disclosure reports that would otherwise have been due between March 1 and April 30, 2020. Audit committees should be aware of potential workforce issues, both domestically and internationally, and the company's ability to meet original or modified deadlines. Ensuring that internal controls are still functioning effectively, even if only virtually, should be a continual focus.

The SEC has not yet indicated whether it will extend the filing deadline relief to filings due after April 30, 2020 (e.g., March 31, 2020 Form 10-Qs). The SEC has indicated that it is closely monitoring the situation and may, if necessary, further extend the time period during which this relief applies. The SEC has urged companies that need additional assistance to contact the SEC staff.

Check in with internal and external auditors and other significant third-party service providers. Audit committees will want to ensure that internal and external auditors, and other significant third-party service providers, have a plan to continue working virtually during this time. They will want to be aware of global considerations, such as the location of centralized service centers and the efforts needed from significant component audit teams. Other significant third-party service providers that provide support related to quarterly closes or other activities should also be investigated.

Earnings guidance. With widespread economic impact on financial performance, companies have already begun modifying or withdrawing their earnings guidance and other projections. Communicating timely any material matters—even if the company does not yet have all of the details—is critical.

Judgments and estimates. As companies focus on closing out their quarter, they will need to make judgments and estimates related to financial reserves, liquidity and potential impairments. Given the fluid nature of this situation, this will be challenging. A company's current financial performance or estimates of future earnings may be significantly affected by the loss of a significant supplier or customer whose own operations are impacted by recent events. The guidance for goodwill and intangibles requires that an impairment test be performed when a triggering event occurs. When an impairment assessment is required, management should update the assumptions and cash flow forecasts used to reflect the potential impact of COVID-19. Audit committees need to focus on making sure that conclusions are balanced and based on appropriate assumptions.

Revenue recognition. The disruption in the supply chain and reduced consumer spending could have an impact on revenue recognition. A company may continue to sell products and services to customers impacted by disruptions caused by COVID-19. Not only should companies assess the need for write-offs or reserves on outstanding receivable balances, but revenue can only be recognized for new sales if payment is probable. Changes in business conduct must also be identified on a timely basis to address any guarantees, side letters or other agreements that might address coverage of loss, right of return or other aspects that need to be appropriately accounted for and disclosed.

Debt. Companies may need to seek additional financing or amend the terms of existing debt agreements due to lost revenue, uninsured losses or losses for which insurance recoveries have not yet been received. In that case, a company may seek to amend the terms of an existing debt agreement with its lenders to temporarily or permanently increase borrowing capacity, change the interest rate or modify other contractual terms. Such modifications will need to be analyzed to determine the accounting implications. Additionally, SEC registrants that enter into material direct financial obligations, including draw-downs on revolving credit arrangements, will need to make timely disclosures.

Disclosure. As the situation has developed, we have seen increased frequency and detail of disclosures related to COVID-19. Within the financial statements, companies should consider disclosure of risks and uncertainties and whether, how and when events might impact the many judgments inherent in their financial reporting, including those discussed above. Additionally, companies should evaluate whether subsequent events have occurred that require disclosure in the financial statements.

Internal control and testing. A system of controls can be rendered ineffective by people being unavailable or unable to meet responsibilities on which the system relies. Testing the effectiveness of controls is also important. Depending on the company's fiscal year end the company may have already begun or may need to begin testing internal controls in anticipation of management's annual certification of internal control over financial reporting. Travel bans and the ability to only work virtually may cause revisions to the control procedures or to testing plans or schedules. The board can ask: is management treating the effect of social distancing on the way people work as a trigger for an event-driven reassessment of business risk, control risk and the effectiveness of the related controls?

Human capital and executive compensation. We have already seen companies begin to furlough workers in industries that have a substantial hourly employee base. Compensation committees will need to think about how incentive plans may need to be changed or modified as a result. These changes could result in significant accounting implications.

Governance

Crisis management core principles. As companies work through their crisis management plans, the response should be in line with, and consider, the company's values. The crisis team should consist of a small, nimble, cross-functional team of leaders and workstreams with clearly defined ownership, roles and responsibilities. Additionally, the company should be considering all relevant stakeholders—not just the obvious ones—and communicating proactively and often. If the board has not done so already, it might want to consider implementing a standing board of directors call or communication plan to keep directors informed as this situation unfolds.

Conducting safe board and committee meetings. Considering the advice regarding reduced travel and avoiding large groups of people, companies should be prepared to conduct board and committee meetings by telephone or video conference.

Annual shareholder meetings. A number of companies have either already shifted, or are considering shifting, to a fully virtual annual shareholder meeting. Many investors have not been in favor of virtual meetings in the past, but in this particular season, it might be the prudent solution. Companies and boards will want to review the recently-issued SEC staff guidance around virtual meetings and work with their outside legal advisors regarding the required notification of shareholders, particularly if the company's 2020 proxy statement has already been issued.

Emergency board and management succession. We have already seen individuals in high-profile positions contract COVID-19. It is to be expected that these incidents will not be isolated. Boards must therefore be prepared to implement emergency temporary replacement plans should C-suite leaders become ill. Boards should also clarify their plans regarding emergency board leadership temporary replacements, with particular emphasis on the roles of board chair, lead director and committee chairs.

Tone at the top and business conduct. Additional problems tend to arise in a storm. Value statements and guidelines alone do not create an ethical culture. Boards will want to ensure that they remain focused on tone at the top and corporate culture, particularly if there are changes in the operation of internal reporting structures (like risk, HR, legal) or whistleblower systems that impact the timeliness of resolution, or reporting of, any material issues to the board. Boards should also remain cognizant of the need to conduct any internal investigations virtually.

PwC insights on COVID-19

We're operating in uncharted waters. Critical information on the characteristics of COVID-19 and its impacts on business are difficult to assess and can change overnight. PwC provides a variety of insights on how companies can focus their efforts**.**

COVID-19: What US business leaders should know
COVID-19 CFO Pulse survey
PwC's COVID-19 Navigator **-** an online, interactive tool to help organizations better understand where they are on their path toward COVID-19 preparedness and response.

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