Audit committee chairs discuss the implications of the COVID-19 pandemic

From March 24–26, 2020, Tapestry Networks convened a series of virtual meetings with the audit committee chairs of more than 50 large, public companies across the United States, to discuss how companies, boards, and audit committees are responding to the COVID-19 pandemic. EY experts and senior leaders joined the audit chairs in these meetings.

This special edition of ViewPoints synthesizes discussions about three trends:

- Liquidity is a concern as companies face revenue and free cash flow declines
- Financial reporting work is getting done remotely
- Board oversight looks different but remains critical

Liquidity is a concern as companies face revenue and free cash flow declines

With the unprecedented and sudden slowdown in economic activity, companies are focused on preserving liquidity to fund core operations. Audit chairs discussed steps that their companies are taking to manage through the current situation.

**Ensuring access to cash before an acute need arises**

At a time when ready access to cash is critical, traditional corporate funding sources, such as commercial paper markets, have become very tight. Many companies are utilizing credit facilities with their relationship banks; there was some debate about the urgency for action in this regard. Some audit chairs supported drawing down credit lines immediately to reassure investors that companies—especially those in hard-hit sectors—have adequate cash on hand. One audit chair explained, “My companies have fully drawn their lines of credit, based on scenarios they’ve modeled and projected. They’ve also renegotiated debt level and other financial covenants with their banks to provide more headroom given declines in EBITDA.”

Others cited concerns about the banks' liquidity as the reason for a rapid drawdown. “What happens when the credit losses start piling up? I’m not worried about the optics of the company drawing down the revolver; I’m worried about us having the cash,” one said. Not all companies have immediate plans to tap their credit lines. Some audit chairs noted that banks are in a better position than they were during the financial crisis of 2008, with the Federal Reserve acting more
forcefully to support them. One said, “Large banks have very sophisticated processes around stress-testing for both capital and liquidity.”

**Halting share repurchases and assessing dividends**

A focus on preserving liquidity has led boards to reconsider whether to return capital to shareholders. Many companies are considering changes to planned share buybacks. One audit chair said, “Our discussions have been about halting or reducing the share repurchase program. Clearly now is an attractive time to buy at low prices but without knowing how long the downturn will last, we are proceeding cautiously.” Another said, “We made a collective decision to take a pause on the previously-approved buybacks.” Some companies have made cuts to dividends—or suspended them entirely—as a further step to preserve cash.

Questions to consider:

- What steps are your companies taking to ensure access to cash? What factors do your boards consider when authorizing a key decision like drawing down a revolving line of credit?
- Are your companies continuing share repurchase programs in the current environment? Are you considering changes to dividend policies? What process does your board follow to make changes to a previously approved buyback or dividend program?

**Financial reporting work is getting done remotely**

Corporate finance teams and external auditors are overcoming the unprecedented challenge of completing quarter- and year-end processes while working remotely. Overall, audit chairs expressed that this transition has been smooth, and that they have been pleased with the innovative thinking of their finance and external audit teams.

**Audit committees are keenly aware that new issues will arise**

The crisis is creating new issues both for the generation of financial reports and for the content of the reports themselves. One audit chair described the creation of a special disclosure control to inventory new disclosure issues and plan how to address them. The pandemic is complicating the financial reporting process in several ways:

- **Macroeconomic uncertainty.** Audit chairs discussed the challenges of closing the quarter amid severe economic disruption. One said, “A lot of things are unknowable, but you still have to have some opinion on accounting and financial disclosures.” In this environment, members stressed the need for enhanced risk factor analysis in management discussion and analysis section of their 10-Ks and 10-Qs. Companies and boards are also paying special attention to going concern disclosures, especially in light of possible breaches of debt covenants.

- **Valuation and impairment issues.** Market volatility makes it unusually hard to assess the fair value of tangible and intangible assets, posing obstacles to modeling cashflow for goodwill.
impairment, reassessment of contract values, and revenue recognition. Audit committees are struggling with impairment issues. One chair noted, “We had a significant drop in the stock price of one company; the comparables we could use were few. This triggered goodwill impairment and we now have to prepare all that documentation before we can release first quarter results.” Another reported that a company “lost about 50% of stock value in the first quarter. It’s going to be hard even to measure all the factors that go into goodwill.” Companies may also need to plan for the possibility that the demand for outside specialists who assist with valuation modeling and other services will skyrocket in the current environment.

- **Inventory audits.** While technology advancements have made it easier for external auditors to perform many tasks virtually, some items still require in-person verification. One audit chair said, “As a manufacturing company, validating inventory has been a challenge in this remote environment but our auditors have come up with creative solutions, like FaceTime, to execute their responsibilities. We are cautiously optimistic we will be able to close by our deadline.”

- **The controls environment.** Several audit chairs noted that internal control systems at many companies will require scrutiny because they are not designed for a situation where many employees are working remotely. One EY leader emphasized the importance of knowing “which control processes are changing,” recognizing that a remote close might require new and different controls, including IT access and change controls, documentation of manual controls, and segregation of duties considerations.

- **Timing.** Some audit chairs raised concerns about disruption to the timing of the close. “We have an aggressive filing timeline, but we’re focused on quality rather than speed,” one said. They discussed the importance of coordination and creating backup plans for contingencies like employee health, or unavailability due to childcare duties. Many companies and their auditors are conducting dry runs to get a realistic sense of how long it would take to accomplish the close. The SEC has issued guidance providing public companies with an extension on filings that would have been due between March 1 and July 1. Audit chairs noted that it might be necessary to move the audit committee review to allow management more time to prepare.

**Transparency is critical as conditions change**

Some companies are also issuing or considering interim disclosures to keep the markets apprised of new issues that arise as the crisis unfolds. These include:

- **Issuing Forms 8-K.** Some companies are making interim disclosures to update investors on the rapidly changing environment. “We’ve had a posture of maximum transparency. We filed three 8Ks in three weeks,” one audit chair said. An EY leader added that “the more impacted the company is by the crisis, the more we’ve seen 8-Ks filed,” but pointed out that such disclosures have to do less with specific financial projections than with general strategic discussions of the situation.
• **Updating or withdrawing guidance.** The current environment raises additional questions for companies that provide forward-looking guidance. Audit chairs’ experience confirmed this. One said, “I’ve been hearing: ‘if you have been providing guidance, don’t provide it anymore.’” Another reflected, “If you look back to the financial crisis of 2008, some big companies stopped providing guidance because they didn’t have the visibility, but they were still very viable companies.”

Questions to consider:

- How has your company managed finance and accounting matters with many members of the finance function and related groups forced – often at short notice – to work remotely?
- What steps has the company, board, external auditor, and audit committee taken to ensure a smooth remote closing of the quarter?
- What are the most important new issues that your audit committees are monitoring in the current financial reporting environment?
- Are your companies considering providing interim disclosures to update investors on the strategic implications of the crisis? Are your companies updating or withdrawing forward-looking guidance?

**Board oversight looks different but remains critical**

The realities of the pandemic have changed how companies operate. Audit committee chairs shared several ways that their boards are adapting their oversight function to respond to the crisis.

**Boards are contemplating how best to convene in a time of both crisis and social distancing**

Audit chairs noted that their boards are in regular communication as their companies manage through the crisis. In some cases, boards are primarily in listening mode, hearing updates from management; in others they are making decisions on critical issues.

In addition to special meetings, boards are contemplating how to run regular board meetings now that directors cannot participate in person. Many are rethinking the timing, agendas, and participants. One audit chair was concerned about pressure to compress the agenda of an upcoming audit committee meeting to accommodate a virtual format: “We don’t want the urgent to crowd out the important. I’m not comfortable not hearing about internal audit findings, ERM, or other things that are not deemed urgent.” Another concurred: “I’d be worried if people got things done too quickly.” Another audit chair shared an example of one board’s approach to dealing with this issue: “My company had a three-day set of committee and board meetings scheduled for April. We have decided to have the committee meetings spread out over a few days, as it’s not productive to have people sit on a conference call all day.”

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Committees are redoubling their cybersecurity oversight efforts

While cybersecurity has long been an important issue for boards and audit committees, the risk associated with a rapid, unexpected move to remote work is not lost on audit chairs. One put it bluntly: “There are bad people who will take advantage of a crisis like this.” Another discussed moving this item to the top of the agenda at a recent meeting: “My audit committees have asked for the CIO and CISO to provide a special drill down on access controls, an exacerbated risk in this remote environment.” Others stressed the importance of ensuring that their companies are providing additional education to employees so that they are aware of COVID-19 related phishing messages and malware. Audit chairs also noted that as their boards convene using virtual videoconferencing platforms, board meetings themselves could be a ripe target for cybercriminals.

Directors are an important sounding board for management

Audit chairs stressed the importance of regular communication with management throughout the crisis, including outside of board calls or meetings. One explained that board members can provide a sanity check for leaders who are pressed into making critical decisions at high speed: “Don’t underestimate how important it is for the CEO, CFO, or other executive not to get isolated. It’s critical for boards to reach out, without feeling disruptive, to be a sounding board to help give them confidence in making decisions.”

Questions to consider:

? What steps are your boards taking to provide oversight in a time of social distancing? How are you structuring board meetings when you cannot meet in person?

? What new issues are rising to the top of the board and audit committee agenda as a result of the COVID-19 pandemic?

? How are you and your fellow directors providing additional support to management as deal with the crisis? How does your board balance the need to weigh in on key issues with the potential for distracting managers from the mission at hand?

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Endnotes

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