Board and audit committee oversight of corporate responses to the COVID-19 pandemic

From March 30 to April 9, 2020, Tapestry Networks convened a series of virtual meetings with the audit committee chairs of more than 100 large US public companies, to discuss how boards and audit committees are responding to the COVID-19 pandemic. EY experts and senior leaders joined the audit chairs in these meetings.

Tapestry Networks published a special edition of *ViewPoints* on March 30 based upon similar meetings from March 24–26. This second special edition builds on concepts addressed in the first, synthesizing discussions about four trends and offering questions for reflection.[1]

- **Liquidity and financial reporting continue to be front of mind for audit committees**
- **Boards expect action against increasing cyber threats**
- **Companies face a range of difficult workforce choices**
- **Board oversight remains a balancing act**

Liquidity and financial reporting continue to be front of mind for audit committees

Given the sharp economic effects of the global pandemic, companies are focused on preserving liquidity. Audit chairs shared elements of these efforts:

- **Digging into the details of cash flow scenarios.** As one audit chair put it, *"We are managing the business for cash flow as opposed to earnings."* Audit committees are receiving real time, even daily updates on cash. An audit chair said, *"We are doing a lot of scenario planning and looking at proformas from management every two weeks, as changes are moving rapidly. Our finance team has shared three recovery scenarios with the audit committee, and we are tracking the different cash flows that would come from each of them."* Another member discussed using technology to help with forecasting: *"We are using predictive analytics to try to understand our clients' ability to pay us, by sector."* No matter how robust the modeling, supply chains are struggling and the need to preserve liquidity measures make cash flow predictions difficult. One audit chair said: *"We are beginning to see customers quote force majeure as a way of not paying us. We have our legal team on it but it's a dynamic to watch for."* Another suggested that tensions with both suppliers and customers will only get worse: *"So far, levers have not been pulled hard on either side. In another few weeks all levers will be pulled hard."*

- **Companies continue to assess credit options.** Taking on discretionary debt is a difficult decision. Audit chairs shared a range of perspectives about the topic. One reported a *"raging debate"* about it. Another, however, stressed, *"No one ever drowned in a sea of liquidity."* Audit chairs discussed how important it was to conduct due diligence on credit agreements to avoid any surprises when dealing with banks. An audit chair stressed, *"Be sure to look at material adverse change clauses in your credit agreements."* Another added, *"Many credit facilities have a prohibition against hoarding cash, so there might be a condition that says to draw down your revolver you have to have at least or not more than X amount of cash."*
- **Boards are reconsidering planned dividends.** Slower cash flows and forward uncertainty are leading to reduced or suspended dividends. One audit chair said, *"We decided to suspend the dividend through year-end, so that we can gain more clarity. We found that many other companies, especially in the consumer, retail, and real estate industries, have also suspended dividends."* Another described an alternative solution, *"We're looking to pay 80% of our dividend in stock rather than cash."*

Audit chairs also shared experiences of their companies' closing the first quarter remotely, as well as questions they are debating about corporate reports and disclosures.

- **Will companies report their financial results on time?** Audit chairs were impressed by their teams' ability to close the quarter despite the many challenges of remote working. While the SEC has offered extensions for filings due before July 1, most audit chairs expect their companies to file first-quarter reports on time. One audit chair suggested planning for inefficiency: *"It's hard to estimate how much extra time is needed, but we're assuming a 30% loss in productivity across the finance function. Develop a process and a timeline that people understand so you can sense early if there's something going haywire."*
- **How are firms thinking about forward-looking guidance?** Audit chairs also discussed the prudence of withdrawing or revising guidance. One said there was no other option but to withdraw guidance: *"If your year has changed so materially, I think you're under obligation to have a release and a filing to note that material things have happened and that the board is engaged. Our view was that there we had no option: we were obligated to withdraw guidance."* Another put it bluntly: *"Guidance is a thing of the past right now."* An EY expert suggested companies could rethink their approach to guidance, offering an example: *"One company did something novel. They came out with one set of guidance based on the economy rebounding in third quarter, another for a fourth quarter rebound, and another for no recovery until 2021. This was very well-received by investors."*

Questions to consider:

? How are your audit committees working with management to understand cash needs? Do your companies have clear processes for deciding whether and when to take on new debt?

- ? Are your companies planning to issue first quarter filings on time? What steps are they taking to plan for any inefficiency in the work of the finance function?
- ? Have your companies withdrawn guidance? How are they communicating forward-looking projections to investors and other stakeholders?

Boards expect action against increasing cyber threats

The pandemic is creating fresh opportunities for bad actors, including company insiders, adversary nations, and criminal groups, all of whom seek to exploit the distractions and disruptions associated with a rapid shift to remote working. As EY's Pete Cordero explained, working outside the physical scrutiny of colleagues reduces the effect of subtle social controls, potentially resulting in insider activity that goes undetected for weeks or months. Even well-intentioned employee actions, such as printing documents at home, can become a dangerous form of data leakage.

Companies are also more vulnerable to attackers as they rush to increase cloud computing capacity, rely more on insecure video tools, and introduce devices to company networks without adequate end-point protection. These problems go beyond corporate boundaries; as an audit chair noted: *"You can do everything you can with your own workforce, but you have all these issues with your suppliers as well."*

In response, companies are considering a range of measures to adjust for the new working environment. These include deploying secure technologies—video conferencing tools that include end-to-end encryption, for example—and ensuring that all systems are patched in a timely manner. As companies consider furloughs or layoffs, audit chairs noted the importance of effective coordination between HR and IT to monitor information transfers and enforce proper adjustment of access controls.

Mr. Cordero pointed audit chairs to a critical success factor: *"Ask the CISO: do you have the resources necessary to ensure a proper security posture? They'll tell you if they don't."* Resources may be strained by both the scale of the effort and by the loss of staff to illness, so security teams may need to draw on other areas in the company such as internal audit as well as on third-party vendors. Contingency planning should be continuously updated given the rapidly evolving situation. Non-executive directors, who often use personal rather than corporate equipment, can be tempting targets for bad actors, so board members should have their companies' IT teams review the security of their devices and technology configurations.

For a comprehensive set of questions to consider, please see the recent publication from EY's Center for Board Matters entitled COVID-19: Cybersecurity Risk Oversight in a New Work Environment.

Companies face a range of difficult workforce choices

As the COVID-19 crisis continues to play out, companies and boards are being forced to make important workforce decisions, often with incomplete information.

Cash flow declines are driving furloughs and layoffs

Boards are assessing employee retention scenarios as the crisis continues. Conditions are especially difficult for companies that have had to close large portions of their business. An audit chair described the situation at a retailer: *"We had been paying all the staff fully up until now. But as the lockdown extends beyond what people expected a few weeks ago, we are moving to furlough. We will continue to pay benefits, but no salaries."* Others described similar decisions, noting that their boards are in close contact with management about events that would trigger a furloughs or layoffs. One explained, *"We looked at each scenario and decided what actions we could take in that case. No final decisions were made, but a lot of things got put on the table."*

Executive and director pay actions

In many cases, senior executives and non-executive directors are foregoing compensation during the crisis. Several audit chairs said that their boards have given up the cash portion of their fees, in some cases redirecting it to employee assistance plans. Many executives are taking substantial pay cuts, either while the business is substantially impacted or for all of 2020. An audit chair said, *"Executives took a 50% cut in salary and the board took a 50% cut in the cash portion of its retainer."* Another mentioned cuts ranging from *"30% on average for C-suite to 100% for the CEO."*

Directors were also interested in how their peers are thinking about compensation metrics and targets in this challenging environment. While executives may be working harder than ever to keep the company afloat, macroeconomic forces make it unlikely that they will meet targets set before the scale of the crisis was apparent. One audit chair said, *"Our view is no structural changes to bonuses, but the plan may reflect a new reality."* Another suggested, *"We may divide the year into two halves, given the lack of clarity from a financial planning perspective."*

Repurposing internal audit to assist with critical frontline tasks

Audit chairs discussed the disruption that the crisis has created in the work of internal auditors. Some spoke of working with chief audit executives to make wholesale changes to annual audit plans that have become unfit for purpose. Others reported that they are reassigning internal audit staff to areas such as cybersecurity and IT teams, while deferring less pressing audit priorities. One said, *"Ten people from internal audit were seconded to work on security controls. We want to make sure that people working from home are secure and encrypted."*

Repurposing internal audit to assist with critical frontline tasks

Repurposing internal audit also takes pressure off functions, like finance, that are under inordinate pressure. Many of internal audit's typical functions remain important, members said, like checking employee safety, fraud, vendor controls, and cyber and IT controls. One audit chair said that in dealing with fewer staff, *"It might be a time to capitalize on big data and artificial intelligence. You can get more done with fewer people."*

Companies are aware, however, that reassigning internal audit staff to other work might create a requirement for different people to audit that work down the road. An audit chair explained that *"we want to make sure that people working from home are secure and encrypted; when we go back and audit that, we will have to find external people who pass the objectivity test."*

Questions to consider:

- ? How are your companies determining when to furlough employees or make layoffs?
- ? Are your boards implementing pay cuts for senior management or non-executive directors?
- ? How has the crisis changed the work of your internal audit functions? Have any internal audit professionals been reassigned?

Board oversight remains a balancing act

Boards continue to explore how best to provide oversight at a time when management teams are working around the clock. Many are receiving frequent updates–daily in some cases—and most are holding weekly virtual meetings. The flood of information, from financial and market data to the number of employees who are ill, creates the need for frequent touchpoints along multiple axes. One audit chair said, *"I've seen inconsistency in how board members are communicating with management. Directors want to provide oversight and ask questions but it's important not to create unnecessary additional work."* Another stressed, *"Now is an important time for directors to understand the difference between what you want to know and what you need to know to do your job effectively."*

Audit chairs suggested several ideas for enhancing board oversight. One said, *"We have a set time every week for the CEO to provide updates to the board. Knowing that is coming prevents directors from dialing the CEO on a whim."* In another case, an audit chair discussed participating in management's crisis response committee: *"The committee was set up not just for this but as part of normal business continuity. It includes senior management leaders across the business. I am the designee for the board as audit committee chair. We meet every week and try to keep it to 45 minutes. It helps to get together regularly. I can update the rest of the board."* Boards are considering where to allocate oversight of risk related to the pandemic, though most audit chairs said that their companies are managing the crisis at the full board and delegating specific issues to existing committees as appropriate.

Questions to consider:

- How are your boards receiving updates from management during the crisis? How do you balance the need to provide oversight with the risk that you create incremental work for busy managers?
- How are your boards delegating oversight responsibilities during the crisis? Could an ad hoc committee add value?

Endnotes

[1] *ViewPoints* reflects the use of a modified version of the Chatham House Rule whereby names of participants and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from these virtual meetings.