

Board and audit committee oversight of COVID-19 pandemic response and recovery

From April 14 to April 30, 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 two earlier special editions of *ViewPoints* based upon similar meetings from March 24–April 11. This third special edition synthesizes discussions about two issues and offers questions for reflection.¹

- **Charting the path to a ‘new normal’ as employees return to work**
- **Assessing supply and demand uncertainty as companies restart their businesses**

Charting the path to a ‘new normal’ as employees return to work

Audit committee chairs stressed the importance of focusing on employees as companies look to reopen. For many, the first step is creating a plan to allow workers to come back to company locations safely. Audit chairs also emphasized that as companies emerge from the pandemic-induced crisis, they will not return to business as usual but rather to new business models, policies, and practices.

Health and safety are at the forefront of restart decisions

Restarting operations can only begin when a workplace is widely perceived as safe. Audit chairs stressed that each company must make its own decision about when it is safe to reopen. One said, *“The decision to reopen a plant or office will be affected by the government actions, but we will be constrained more by what we think is the right choices to make sure our employees are safe, make sure our organization remains healthy, and we don’t create a community problem by acting too quickly.”* Another shared a detailed approach to reopening, *“We have discussed a phased approach to bring workers back in on a region by region basis, as allowed. We are looking at different buckets of employees: those deemed essential, those whose productivity may be compromised, and people on important projects while considering their personal situations – are they sick? Are they a caregiver? Do they have school-aged kids? – it’s a staggered approach.”* In some cases, boards or management teams are retaining outside

advisors with deep expertise in areas like epidemiology to help them think through the implications of reopening locations.

As employees return it is fundamental that companies put protocols in place to protect them. Audit chairs who serve on the boards of companies whose business have remained open shared some observations. One said, *“To keep our manufacturing plants operating, we split our staff into an A and B team, each operating on two-week cycles, to avoid having the entire staff become contaminated at once.”* Another added, *“We’ve installed smart thermometers that immediately inform management of an employee’s condition, and everyone has to be checked before entering. In the early days everyone cooperated. Now, though, as we get out of the immediate crisis mode, privacy issues have surfaced.”*

Employee health and wellbeing goes beyond just physical protection. One audit chair discussed the challenges for working parents, who have lost their typical support structures. Another said, *“The lack of camaraderie affects everyone.”* One shared an approach that has received positive feedback, *“We have weekly meetings so teams have their support groups; we get open-ended questions going every which way, sometimes emotionally. And we get constant communication from leadership. People need to see executives’ faces and get assurance that everything will be OK.”*

Corporate leaders are aware that uncertainty will remain for some time. Several said that they assume that company operations would not stabilize until the end of 2021. One audit chair said, *“We think this is a process that is going to happen very slowly over the course of several months. There will be restrictions on how we run our business, how many people can be in stores, how our employees interact with customers. It’s going to alter large aspects of how we operate.”* Another suggested that companies prepare for the possibility that locations may have to open and close on a rolling basis: *“One of my companies has already been through two plant shutdowns but fortunately the company has also restarted the plants. Companies need to figure out how to shut down and restart repeatedly because it’s going to happen inevitably.”*

The success of remote work creates prospects for reshaping the way companies do business

Audit chairs continue to be impressed by the transition to remote work. One said, *“The best news and biggest surprise to me was how quickly we’ve adjusted to this bizarre set of circumstances. Our ability from an audit point of view to close digitally and audit effectively was stunningly positive and amazing. Credit to those who put their shoulders into it.”*

Due to this success, directors expect some *“rethinking of how the work gets done and the necessity of coming to the office.”* Most see remote working as a lasting trend. An audit chair said, *“Something we had always worried about with work from home was productivity and efficiency and those have really turned out to be non-issues. So, as we go back to normal, we will consider more flexibility there and allow some to continue with remote work.”* Some audit chairs

added that, as their companies project remote working conditions, they are reassessing their commercial real estate needs.

Questions remain, however, about how the model will fare over longer periods. One audit chair said, *“Part of the reason it has worked so well is that people had the culture, history, and relationships to allow for a successful transition. Can it work going forward?”* Another raised questions about whether the pace that employees are keeping during the crisis is sustainable: *“I’m proud of how our first quarter close went, it was flawless. But we need to be aware of fatigue on the team. We should stay close to the team to make sure they have the resources that they need.”*

As temporary work-from-home arrangements are prolonged, audit chairs said that it is critical to identify and manage the associated risks. One said, *“Of course we have to watch our internal controls as remote closes persist in 2020.”* The rise of remote work has also made it more difficult for information technology (IT) teams to manage cybersecurity risk. An EY expert said, *“Three months ago, IT workers would have been able to identify the normal baseline of online activity but today, it’s a challenge to monitor and detect what may be strange behavior, opening ample opportunities for criminal actors to penetrate networks and exfiltrate data undetected.”*

Boards are also evaluating changes beyond those related to the workforce. Technology has been an accelerator of many of these innovations. One audit chair said, *“Our customers are already accustomed to digital processes and this event accelerated a lot of things we were trying to do to get paper out of the system.”* Another added, *“We were seeing changes in customer behavior, so we adapted to fit their needs. Going forward, customers may have less income and that would cause us to change our business model as well.”* According to a third, the crisis has *“unleashed a tremendous wave of innovation. We are getting creative about new services. We’ve been presented with a very unique opportunity to fast-forward five years into the future. Boards are trying to think this through and take advantage of these opportunities without exposing our teams to excessive risk.”*

Questions to consider:

- ? What steps are your companies taking to ensure the health and safety of employees as you restart businesses and reopen company locations?
- ? Are your companies considering permanent changes to work practices as a result of the lessons learned from the pandemic? What risks are you considering as you contemplate making permanent changes?
- ? Has the pandemic allowed your companies to consider new business models or accelerate business model changes that were already in the works? What opportunities have you discovered as a result of the crisis?

Assessing supply and demand uncertainty as companies restart their businesses

Audit chairs shared some of their key assumptions about economic recovery. Their companies are taking a range of steps to ensure the resiliency of their supply chains amid the reality that demand will be unpredictable as anxious consumers save money rather than spending it. One said, *“There’s not much use to try to make specific assumptions because we live in such a dynamic environment. Instead of having one set of assumptions, you need several, extreme scenarios. Our worst case could be worse than we can imagine.”*

Supply chains have been resilient but may fundamentally change

As companies emerge from the initial supply chain crisis, they are turning their focus to scenario planning for the medium and longer term. Some companies are looking to the progress in Asia as a positive leading indicator. One member said, *“China gave us a blueprint for protocols for opening plants. You have to do rigorous work with the supply base to ensure we have the materials to get started. In some cases, we’re working with major competitors, who may have the same suppliers we do.”*

While many companies are on a path to restart production, audit chairs shared concerns about liquidity down the supply chain. Some expect their companies will have to take new steps to keep key suppliers afloat. One commented, *“Supply chain is something we’re very concerned about. Tier 2 and tier 3 suppliers will be the problem because they won’t have the resources from a liquidity standpoint. From a demand and liquidity standpoint, we are trying to support our suppliers as we look at a restart.”* Another whose company is about to restart manufacturing said the company benefited from stocking up on inventory just before shutting down: *“We should have enough inventory in the near term, although low-tier suppliers might prove to be an issue.”*

As more companies come back online, some audit chairs envision lasting changes to global supply chains. One noted, *“The biggest question for the board is, are supply chains going to remain globalized, or will there be retrenchment? To the extent the United States imposes boundaries around its supply chains, what are the costs of being fenced in?”* An EY expert concurred, suggesting that many companies and boards will *“take a step back to look at existing networks and what the right risk adjusted structure should be going forward. They’ll reconsider things like onshoring, near shoring, and how to get better visibility across supply chains. They’ll look for better demand sensing with intelligent forecasting and scenario planning to better pickup on signals in the future.”*

The energy sector faces a unique and difficult landscape

As demand and supply shocks have driven oil prices sharply lower, energy companies face an additional challenge. An audit chair summarized: *“The energy*

The energy sector faces a unique and difficult landscape

industry had already started this year in a precarious position; now combine that with challenges with OPEC, the Saudi and Russian reactions, and the decline in demand from COVID-19. I don't think companies have any ability to plan with any level of certainty at this moment." Some companies are expecting these challenges to continue through the end of 2020 and beyond. An audit chair said, "This is going to take a significant amount of time to work off the excess inventory that has been created and is still being created, into at least June. Some people think we'll start working it off in July, but starting is not finishing, so it's going to take a significant amount of time into 2021 before you see a crude price that starts with a '3.'" Another agreed, adding, "The disruption is expected to continue into 2021. You might see some early return to the energy markets in late 2021 or early 2022, but the reality is honestly that nobody knows."

Companies are trying to anticipate consumer and business demand

Even as manufacturing capacity begins to return, audit chairs shared their concerns about when consumer and business demand will stabilize. While their companies are planning for a return to pre-COVID demand levels somewhere between late 2020 and late 2022, audit chairs were skeptical about any firm projections on the length and severity of demand disruptions. An audit chair in the travel and leisure industry said: *"Our assumption is that travel will not really begin again until the third quarter and we are all just treading water until the September timeframe. Even then, no one predicts that travel will ramp up to its full potential until mid-2021, and no one is planning for the new normal to be anywhere near what we saw in the past."* Another shared, *"One of my companies has seen demand shift from one part of the business to another, partly due to shutdowns and partly due to stockpiling. We expect it to level out."*

As they consider potential signals, audit chairs shared that companies are focused on internal observations and metrics like changes in customer demand and activity. A member said, *"We're not keying our operational planning to macroeconomic factors like unemployment or GDP, we're looking at internal metrics."* The audit chair of a retail company noted they are focused on store openings and customer demand metrics, while a director of several technology firms said those companies are tracking metrics like the research and development spending activity among their customers.

Much like with their suppliers, companies are concerned about the financial condition of their customers and distributors. One audit chair discussed the challenge of trying to patch weak spots in the company's value chain: *"We have been doing a deep dive on our distributors – we want to understand, if they run into an issue, who are our other options in the area and do we have a relationship? Our CFO and COO have been having frequent calls with our distributors to understand how they are doing and what they need."* Those with captive consumer or business

lending groups anticipate credit portfolios continuing to suffer. One audit chair assumes “massive” credit losses for banks and other lending operations. Another said, “Credit risks, loan modifications, and other challenges in the portfolio will only get worse. Protecting liquidity and the core business is very important.”

Questions to consider:

- ? What risks are your companies considering as you assess the resiliency of your supply chains? Are your companies taking steps to sure up the liquidity of your suppliers?
- ? What assumptions are your companies making about the timeline for return to pre-crisis demand? What factors indicate that demand in your industry is on a path to return?

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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.