Responding to COVID-19: Considerations for Boards of Directors

April 18, 2020

A·F·FERGUSON&Co.

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 spinning share 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.

Dividend policy. 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. 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.

Financial reporting

Financial reporting operations. As business continuity challenges escalate, companies may experience issues with "closing their books" on a timely basis. As regards any statutory return, which was required to be filed on or after March 24, 2020 under the respective provisions of the Companies Act, 2017, the Securities and Exchange Commission of Pakistan (SECP) has allowed the companies to file the same with the concerned registrar with a delay of 30 days of occurrence of any event without any additional filing fee as no penal action shall be taken for the late filing. The SECP has also assured to facilitate companies for grant of extension in filing first quarter financial statements on application sent to the SECP via email.

In addition to this all companies are allowed to recognize unrealized gain / loss arising on fair value measurement of equity Instruments classified as "Fair Value through Profit or Loss" held as at March 31, 2020 in the statement of changes in equity as a separate component of equity. However, the amount so recognized shall be treated as a charge to profit or loss for the purpose of distribution as dividends. The amount of unrealized gain or loss as at March 31, 2020 shall be charged to profit or loss along with any adjustments of fair valuation in the financial statements for the period / year ending on June 30, 2020.

Boards 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.

Check in with internal and external auditors and other significant third-party service providers. Boards 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. Other significant third-party service providers that provide support related to quarterly closures or other activities should also be investigated.

Potential impacts on profitability. With widespread economic impact on financial performance, companies have already begun modifying their earnings projections. Communicating timely any material matters to the stock exchange – 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. Boards 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 provisions 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. To combat the impact of COVID-19 and to help the businesses in payment of wages and salaries to their workers and employees and thereby support continued employment in this challenging environment, the State Bank of Pakistan has introduced a temporary refinance scheme for payment of wages and salaries to the workers and employees of the business concerns. This Scheme is expected to ease cash flow constraints of the employers and thereby avoid layoffs.

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 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. 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 are experiencing challenges due to the COVID-19 outbreak that were never predicted. Accordingly, HR&R 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. The Pakistan corporate law does not provide for any specific relaxation in requirement of board of directors meeting once in every quarter. However, the SECP has encouraged the companies to pass resolutions by the directors through circulation. The SECP has further advised the companies to prioritize public safety, while ensuring corporate compliance. Accordingly, the SECP has indicated that it shall give due consideration to all underlying circumstances while enforcing regulatory compliance.

Annual shareholder meetings. A number of companies have either already shifted, or are considering shifting, to a fully virtual annual general meeting of shareholders. 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 which are required to hold the elections of directors during these months will want to review the recently-issued SECP guidance allowing the companies to file impediment reports with the concerned registrar citing reasons for delay in holding election of directors. The SECP has allowed that all companies which are facing difficulties in timely holding AGM for the year ended December 31, 2019 are allowed general extension for a period of 30 days i.e. they can now hold AGM for the year ended December 31, 2019 on or before May 29, 2020.

Use of technology. As safety of employees is priority of the companies during COVID-19 outbreak, the companies are encouraged by the SECP to make necessary arrangements for the use of technology and related applications in order to enable them to work from home to meet regulatory compliances.

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 have a plan in events it needs to make temporary arrangements.

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.

Our insight 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. We aim to provide a variety of insights on how companies can focus their efforts.

Accounting implications of the impacts of COVID-19 – An Overview of IFRS Requirements.

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.

A. F. Ferguson & Co.,
Chartered Accountants

Karachi Office
State Life Building 1-C
I. I. Chundrigar Road
Karachi – 74000
Pakistan

Lahore Office
23-C, Aziz Avenue
Canal Bank, Gulberg 5
Lahore – 54000
Pakistan

Islamabad Office
PIA Building
49 Blue Area
Fazl-ul-Haq Road
Islamabad – 44000
Pakistan