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COVID-19: Corporate governance and reporting

KPMG Board Leadership Centre

In a joint statement, the Financial Conduct Authority (FCA), the Financial Reporting Council (FRC) and the Prudential Regulation Authority (PRA), identify a series of actions, designed to protect the capital markets by ensuring the continued flow of information to investors.

Here we summarise the guidance for companies, which covers advice for both corporate governance as well as reporting responsibilities.

Highlights from the joint statement[1]

While unprecedented and extreme, the impacts of the COVID-19 pandemic are likely to rebound sharply once social restrictions are lifted. In the meantime maintaining the communication of accurate and timely information to investors is vital.

Users of financial statements are encouraged to take into account the unique set of circumstances arising, which might result in uncertainty, delays and an increase in modified audit opinions.

In particular, given the common goal that the financial system should be a source of strength for the real economy, lenders are encouraged to take account of these circumstances when responding to covenant breaches.

> *"The package of measures today is designed to give [companies and their auditors] the ability to consider the impact of Covid-19 more comprehensively in the light of government and other responses and provide markets and investors with the information they need to make informed decisions"*
>
> David Rule
> Executive Director of Supervision at the FRC

Guidance for companies

Unprecedented uncertainly over companies' immediate prospects are compounded by disruption to management and governance processes which would typically be there to support them in times of operational difficulty.

The FRC highlights key areas of focus for boards seeking to maintain strong corporate governance, and offers guidance on some of the most pervasive issues around corporate reporting preparation.

Corporate governance

In such times the need for clear and decisive leadership based on reliable information is more crucial than ever. Meanwhile disruption to working practices makes this harder than ever.

Change is inevitable in the face of disruption so the key priority for boards must be to ensure plans are in place to protect the core areas of corporate governance from likely issues:

Management information flows may be disrupted. Do you have a solution to maintain or complement the missing information? This is important for current reporting requirements as well as for inevitable reactivation of the business.

Risk management and internal controls systems may become unworkable. Are the gaps easily identifiable? Are mitigating controls an option? If you are relaxing controls is there additional monitoring in place?   Is there a plan for the reinstatement of the status quo?

The payment of proposed dividends may no longer be 'appropriate'. Remember that there must be sufficient reserves at the time of payment not only at the time of proposing a dividend. Further, even were there sufficient reserves, directors must consider whether the payment of a dividend is appropriate given the likely operational and capital needs of the company.

Cash flow demands will be well outside of the forecast. Do you have a group structure which facilitates speedy channelling of cash? Do you have unleveraged financing facilities that you can lean on?

[1] http://www.frc.org.uk/about-the-frc/covid-19/covid19-joint-statement-26th-march-2020

External Reporting

The ability to communicate with investors on their priorities (liquidity, viability and solvency) may be inhibited. While you won't be able to predict the extent of the impact of COVID-19 you will be expected to articulate the anticipated outcomes of possible impacts on your specific business.

Do you have a relationship with investors which enables transparent conversations? Have you been historically clear on assumptions and judgements providing a basis for presenting the impact of current circumstances?

While COVID-19 impacts all businesses the implications will be different for each of them. The strategic report needs to reflect the specific impact to the business and the planned mitigation. Do you have the capacity to deliver the mitigation plan? And the resources to withstand the effects which will remain?

Whatever your business, your employees may be the most valuable resource you have. Stakeholders, including investors, are always interested in the workforce, but never more so than in times of crisis. At such times, capacity is fundamental to delivery but pushing employees too far may create retention issues down the line when corporate memory is crucial. Have you clearly articulated how your employees are being retained and supported?

The assertions within the viability statement may feel much harder to make, but they remain crucial. The FRC reassures boards that having a 'reasonable expectation' of the company's viability during the current emergency would naturally carry a much lower level of confidence than at other times; being clear on specific circumstances and the degree of uncertainty is important; and qualifications and assumptions should be called out in the statement. Are you making your disclosures fuller in line with the more complex situation?

When the determinations around going concern are necessarily more presumptive, increased disclosure is key. The FRC expects an increased number of 'material uncertainties' disclosures, and reminds boards that when assessing whether material uncertainties exist, they should consider both the uncertainty and the likely success of any realistically possible mitigation. These assessments are naturally significantly more difficult given the uncertainties around the impact and duration of the COVID-19 pandemic and the associated international response. Further, the FRC clarifies that even where boards conclude that there is no material uncertainty requiring disclosure, if this conclusion required the application of significant judgement, then this judgement should be disclosed.

The lack of consensus view on assumptions over the path of the COVID-19 outbreak and response is not a reason to shy away from making and disclosing your own assumptions. As with viability and going concern statements, the FRC encourages disclosure of judgements made when applying accounting policies, irrespective of any narrow interpretation of the requirements. For example, does an estimate for the duration of social distancing measures impact materially on an accounting estimate and therefore require disclosure? Or perhaps the magnitude or certainty of government support available?

How much of the impact of COVID-19 is adjusting versus non-adjusting requires judgement. Consider the reporting date; the specific operations; and the particular events under consideration. Does the event shine a brighter light on conditions existing at the year end or did conditions change thereafter?

COVID-19 is generally considered to be non-adjusting for December year ends. Material non-adjusting events require disclosure. Can the financial effect on the company be estimated for disclosure? Or a range of estimated effects? In the absence of any quantitative estimate, a qualitative description should be provided.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

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