COVID-19 Risks

Key risks arising from a pandemic

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BACKGROUND

Many CPA members wear several hats, including performing strategic planning, risk management, scenario modelling and financial reporting functions. The COVID-19 pandemic has placed significant focus on each of these disciplines as organisations respond, recover and re-create themselves in the face of turbulent economic, social and financial times. It has shone a light on organisations' resilience and agility, with significant learning opportunities arising in business continuity planning and risk management capabilities and resources.

This briefing explores some key risks arising from the pandemic which accountants, risk managers and other executives who are on boards or advisers to boards should consider irrespective of size, nature and complexity of business.

KEY RISKS

An essential task of the board is to clearly define and communicate the risk appetite of their organisation. Additionally, the latest ASX Corporate Governance Principles and Recommendations state that the board should satisfy itself that their organisation is operating with due regard to the risk appetite set by the board, at least annually.

The unique set of COVID-19-related impacts presents the perfect storm for organisations. Traditional risk probabilities and consequences can merge and escalate rapidly to give rise to threat levels well outside normal risk appetites.

Significant financial and non-financial risks include:

- loss of sales revenue
- supply chain disruption
- changes to business operations
- impact on contractual arrangements
- compliance obligations with new rules

Key risks arise from disruption to operations, finances and health of employees. A sustained effect on work, workplaces and workers is a critical issue for all organisations, as although these matters are catastrophic for some, they already represent opportunities for others.

Even though these concerns may have already been critical for some individuals and organisations, they may now also present opportunity for competitive strategic change for others.

IMPACTS OF A PANDEMIC

While there are many instances of organisations facing crises, the COVID-19 pandemic may be unique due to the scale of the below simultaneous impacts:

Global impact

The virus has rapidly infected people across the world.

Borders have been closed or travel restricted in many countries and states.

Financial impact

Governments, communities, organisations and individuals have been hit hard by sudden fall in demand for products and services, forced closure of businesses and loss of work

Health impact

Death rates, hospitalisation and infection rates differ widely between countries as their governmental response has differed in speed of response and isolation measures imposed

Operations impact

Supply chain failures, closure of offices, technology impacts of working from home, together with increased risk of fraud, corruption, theft and cyber attacks have limited the ability for some organisations to carry out business

OPERATIONAL RISK

Disruption of factory operations, offices and workplace processes can lead to an inability to manufacture or assemble products for sale. Supply chains have been dramatically affected including by the closure of many suppliers' own factories. Thus shipping and transportation have been impacted and availability of raw material and goods for resale have been delayed for an unknown duration.

From a purely economic view, many organisations have until now chosen to import products from overseas as well as holding minimum just-in-time inventories to maximise operational efficiency, reduce costs and maximise profits. However, during global disruption to operations, this strategy has resulted in significant operational risk. Balancing the need to optimise costs with achieving a necessary level of operational resilience during supply chain interruptions, must be considered to mitigate the risk to the disruption to operations.

Often goods and services are sourced largely from the single lowest cost provider with the assumption that service and product quality will implicitly meet the minimum expectations of the buyer. Those organisations that have alternative sources of supply from multiple suppliers in different geographical locations are likely to have reduced their supply chain risks relative to others.

Many organisations have been forced to close offices or operate with reduced employee numbers during the pandemic. Many have had an unexpected sharp rise in employees working from home. While some businesses evolved their offices to open-plan layouts, hot-desking and allowing employees to work from home prior to the pandemic, others have retained the traditional office as the sole place of work. When forced to work from home, standard work practices can be affected. This can include obtaining physical signatures on documents for approvals, or accessing files and documents not stored electronically.

Fraud is a significant area of risk during these times. While most employees can be trusted and should be treated as both trustworthy and reliable, the disruption to work practices might be seen by some as an opportunity for taking shortcuts in standard processes. Some employees may not properly observe operational and financial controls. Reduced hours and reduced pay may also tempt some individuals to engage in dishonest actions, which often start with small breaches going undiscovered in the early stages. A policy of zero tolerance and strong action against those found to have been engaged in fraud can be effective in sending a powerful message to the wider organisation. Equally, corruption is potentially more likely to occur when opportunity and pressure are at play.

TECHNOLOGY RISK

Working from home is likely to mean that more employees will use personal devices, which may be less secure than corporate devices. Insecure virtual private networks, or applications previously only available inside offices now being accessed remotely, create a bigger attack surface for cybercriminals to attempt to identify and exploit vulnerabilities.

While the advent of cloud computing and mobile computing have enabled many organisations to operate systems remotely, there are still a significant number of businesses that have failed to implement these solutions across all their corporate applications.

The ‘paperless office’ was first postulated decades ago but has only been fully realised by a limited number of organisations. Those organisations with digital processes that don’t allow parallel use of paper forms have been well-positioned during a pandemic. Robotic process automation, together with mobile apps, have the potential to deliver significant productivity improvements for organisations and provide a strong platform for continuing business operations where workforces are operating from non-traditional locations.

Cloud computing has reduced the reliance on computing hardware located and maintained within corporate offices. By utilising public clouds, organisations effectively outsource processing power, storage and networking infrastructure to large purpose-built facilities run by global organisations. This drives down costs and leverages reliability, flexibility and automation of technology services at scale.

Cybersecurity and data privacy are key risks for all organisations today, yet during a crisis such as the current pandemic, additional risks emerge. Employees and teams may be distracted with the significant business disruption and fail to apply the same level of cyber awareness as they do during normal operations.

IT teams may be pressured to provide services to remote users quickly, to enable business to continue without appropriate safeguards in place to support connections outside the corporate firewall.

Password-sharing, emailing secure documents and utilising insecure personal storage solutions may be more likely during significant disruption.

There may be additional pressure on boards to allow management to operate outside the approved cyber risk appetite to ensure operations can continue and customers can be serviced. Boards must be highly cognisant of recent strict data privacy laws, especially regarding sharing, storage and retention of data including with service providers and across borders.

FINANCIAL RISK

The simultaneous global, health, financial and operational impacts of pandemics significantly increase the risk of financial instability and insolvency. Board and their advisers will be key players in identifying and mitigating these risks. There is an urgent imperative around managing cash flows. Some argue that launching a 'cash war room' to focus on this critical task, might be considered.[1]

Some key actions to identify risks include:

- Updating cash flow forecasts
- Updating financial statements
- Conducting scenario analysis
- Keep reviewing costs and updating forecasts

Some key actions to mitigate risks include:

- Stopping all non-essential cash outflows
- Understanding and accessing any government assistance
- Promoting online sales and/or other alternative cash inflows
- Considering asset divestitures
- Renegotiating debt facilities and covenants
- Evaluating the need for pre-emptive equity raising
- Promptly seeking professional advice, say for example, in relation to risk of insolvency

Mitigating operational, technology, human and other risks brings costs to the organisation. Boards need to weigh the costs and benefits to the organisation, to determine which risks should be eliminated and those risks to be mitigated. Robust financial modelling of risks and their impacts is a critical part of making these determinations.

HUMAN RISK

One of the biggest changes resulting from the COVID-19 pandemic is the rise of working from home. While many organisations have been prepared for this change to the work environment, some have not. Organisations that were not prepared needed to address questions such as: How will team members best communicate with each other? How will systems and information be securely accessed from remote computers and devices? How will work be effectively monitored and managed?

[1] McKinsey & Company: The CFO's role in helping companies navigate the coronavirus crisis

While videoconferencing seems like a simple solution, not all employees working remotely might have appropriate ergonomic workspaces, desks, chairs and lighting, devices with webcams or high-speed internet access.

Even where technology rises to the challenge, working from home is different to working from an office. Informal interactions that are often integral to innovation and psychological well-being do not readily occur. Equally, workplaces at home are not always designed for corporate work, with interruptions from household members and the psychological impact of being at home impacting productivity and job satisfaction.

HR teams, executives and boards have a duty of care for the well-being of employees and must ensure the desired culture permeates consistently throughout the organisation. This can present a challenge when most workers are physically disconnected.

Communication is key and many organisations have implemented daily team meetings via videoconference and introduced support systems such as chat groups, dedicated to providing support and advice for remote workers.

Of great importance for employees who are required to continue operating in the workplace, is that that there are clear OHS protocols, particularly around social distancing, cleaning and the use of facilities and equipment. Procedures and processes must be robust, properly implemented and monitored, and subject to incident reporting to the board.

CONSIDERATIONS FOR MITIGATING KEY RISKS

Risk Area	Risk	Potential Risk Treatments
Operational	Supply chain risk	• Establish relationships with multiple suppliers being local businesses where possible • Document business continuity plans and test these regularly
	Fraud and corruption risk	• Ensure controls are in place to detect fraud and that these controls are operational during a crisis • Retain awareness of personal pressures on senior executives which might cause a lapse in professional judgment
Technology	Bring your own devices (BYOD)	• Implement multi-factor authentication (MFA) to safeguard user credentials • Implement conditional access policies to ensure devices meet basic security requirements before being granted access to corporate resources
	On-premises computing	• Consider opportunities to develop mobile apps • Consider embarking on a digital transformation and cloud migration strategy
	Increased cyber attacks	• Ensure information protection policies are in place and are effective • Review the security posture of the organisation with regard to global security standards
	Reduced cyber awareness	• Provide cyber training for users with suitably timed refreshing • Establish supervision of high-risk users and processes
Human	Mental health risks	• Ensure active engagement with all workers through team chats, videoconferences, teleconferences and regular check-ins both formally and informally • Facilitate where laws permit capacity to attend the workplace under suitably strict health and safety procedures • Provide access to employee assistance programs to support those struggling with personal issues during the crisis
	Physical risks	• Robust OHS protocols where employees are working on site • Processes around incident reporting

CRISIS MANAGEMENT AND BUSINESS CONTINUITY PLANS

Crisis management and business continuity plans should be critically evaluated and updated to reflect insights from the impact of the COVID-19 pandemic, including best industry practice in the sector.

This should include an assessment of responses that were managed well by the organisation, as well as risks and responses that were handled poorly. Plans should be updated regularly to reflect new information learned from the rapidly evolving pandemic including business and societal impacts.

It is also important that plans are adapted to any changes to the business model in response to navigating through the pandemic, as well as more fundamental structural changes to the business model in the ’recover‘ or ’reimagine‘ phase of managing the crisis.[2]

Organisations should conduct simulations around risk events and test their business continuity and crisis plans on a regular basis to understand the resilience of the organisation and employees.

Many organisations identify climate change as a continuing risk. Understanding the similarities, differences, and the associations between pandemics such as COVID-19 and the potential impacts of climate risk could also inform the revisions to crisis management and business continuity plans.[3]

In a sobering finding, a survey of 393 Australian governance and risk professionals and senior executives conducted in March 2020 revealed that almost 40 per cent of businesses are not regularly testing their risk and crisis plans. That statistic is a major concern given the current COVID-19 pandemic.[4] Similarly, only 11 per cent of businesses are running scenarios around risk events on a regular basis to test organisational response.

According to Governance Institute of Australia CEO, Megan Motto, “COVID-19 has exposed some significant gaps in many organisations’ crisis management and business plans”.

[2] CPA Australia: COVID-19 Key implications for boards
[3] McKinsey & Company: Addressing climate change in a post-pandemic world
[4] Governance Institute of Australia: Risk Management Survey 2020

CONCLUSION

The COVID-19 pandemic is unlike any other crisis in living memory. How organisations adapt to a 'new normal' is a question yet to be answered. To what extent there will be a return to old practices pre-crisis, or a shift to a radical transformation of attitudes, processes and practices, is unknown. The risks are not new, yet learnings are all around us. Some organisations will fail, others will survive and there are those who will thrive.

One thing which may change is greater acknowledgement of the value of strong risk management practices. Too many organisations, especially in the SME sector, fail to spend time adequately identifying emerging risks and leveraging the power of the discipline of risk management.

Perhaps the global COVID-19 pandemic will change the views of boards and corporate executives around the world.

And what will be the next well-known risk that catches organisations off-guard en masse?

Will it be climate change with its well-known risks and widespread agreement about the catastrophic consequences for many? How many organisations would consider themselves well-prepared? Is the COVID-19 pandemic just a dress rehearsal for the real disruption waiting to bring devastation on a global scale, or will this be a challenge for another generation?

Only time will tell.

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