FEATURE


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COVID-19: STRATEGY AND TACTICAL DECISIONS

By Naresh Srinivasan, CPA, MBA

When we rang in the new year 2020, no one would have predicted the situation we all are in today. The global economy has come to a screeching halt and every industry has been affected. Some sectors have been heavily impacted while others to a lesser extent.

There have been numerous research papers published and predictions being made on the outcome. The truth, however, is the path of COVID-19 and the socio-economic response over the next few months is still very uncertain.

We are living in unprecedented times and what matters is what we do now! Put aside the five-year strategic plan that you finalized a few months ago. There is a famous quote by William Durant: "Forget past mistakes. Forget failures. Forget everything except what you're going to do now and do it." There is only the here and now. Organizations must focus on that and act swiftly.

Strategies

Many companies' executive leadership teams are taking quick, reactive cost-cutting measures. Finance leadership can provide valuable data analytics and information to the board/executives to implement a strategy that is designed to focus on the short-term strategies and the long-term impacts (keeping in mind the new normal that will emerge) of COVID-19 and detail out the tactical decisions for implementation. Following are some essential elements to consider.

1. Your people and your customers or clients: Your number one priority should be the health and safety of your employees and your customers or clients. Adjust your work environment and shift to accommodate the changing needs of your customers or clients, while working to protect employees.

2. Implement CRO Support: Businesses may need a Chief Restructuring Officer (CRO), who will work with management, the board and external stakeholders to help navigate the organization through any restructuring.

3. Preserve cash and optimize profitability: Cash is the life blood of an organization. Take decisive and timely actions to preserve cash and maximize liquidity. The challenge will be to maximize "free cash flow" during a period in which revenues and profits will be down by reducing capital expenditures and managing costs. Execute actions quickly to reduce both variable and fixed costs.

4. Have courage to re-position: Develop and implement a restructuring plan. If you sit idle, you will probably get run over, so re-size the business and re-build your business model to achieve target profitability at lower revenue and be stronger on the other side of the crisis.

5. Institutionalize new ways of working: Use technology and lessen dependence on travel for meetings. Shift permanently to shorter planning cycles and more frequent review of key performance indicators (KPIs).

Tactical Elements

Following are some essential elements to consider from a tactical standpoint.

1. Initiate a regular communications plan with key stakeholders.

2. Swiftly source the necessary personal protective equipment (PPE) and provide guidance on how to operate safely under the current conditions, including personal hygiene and social distancing.

3. Track the impact on the financials for reporting and clarity. Consider treating COVID-19 as a project to record in your ERP at the lowest level possible (GL account level, invoice level) transactions impacted due to the pandemic. This will help facilitate reporting for clarity to stakeholders; for example, the company spent $x during the quarter on PPE.

4. Your workforce is one of your main assets. Have empathy and the courage to do the right thing. In most organizations, labor cost is one of the largest components of expenses. However, don't just have a kneejerk reaction to cut x% of the workforce. If employees see that you used all means before you considered a RIF/severance and were able to save jobs, they will understand it better and the trust component skyrockets. As an example, a path to take might be:

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- Freeze new hires and see if the new hire workload might be absorbed by the existing workforce;
- Cancel bonus payments, especially those that are discretionary;
- Consider temporarily stopping company match on retirement accounts; e.g., 401k;
- Temporarily freeze pay increases;
- Take pay cuts, starting at the executive level; the higher the pay grade, the higher the pay cut percentage. If there are some employees close to the minimum wage level, ensure that you don't violate any federal/state laws with a pay cut that would put them over the line.
- Consider furloughing employees;
- Review your temporary and contractor workforce; if there is no choice but to reduce your workforce, this category more than likely comes ahead of your permanent workforce and might prove less expensive from a severance/cash outflow perspective.

5. Evaluate options to defer or minimize outbound cash flow through extending or renegotiating payment terms with your vendors.

6. Evaluate options to maximize the inflow of cash through enticing early payment options for the customer (e.g., through guaranteed services and supply) or factoring your receivables.

7. Restructure debt agreements and obtain waivers in debt covenants.

8. If your company is in a strong cash position, use this time to shore up your supply chain by buying more raw materials or making advance payments in return for preferential access to resources at a discounted rate.

9. Adopt a new remote workforce environment. Make remote work a permanent option for roles that allow it. Use collaboration tools to help drive clarity on ownership, responsibility and accountability of tasks. Reduce your real estate footprint.

10. Change HR/compensation policies. Maybe consider having different compensation levels for jobs that are done remotely vs. on-site.

11. Consider freezing or minimizing your capital expenditures. This will help your free cash flow.

12. Review your assets for impairment, as well as classifying them as idle assets. These idle assets will stop the clock on the depreciation expense, consequently favorably impacting operating earnings.

13. Review your contractual commitment from a leverage standpoint. Most contracts have a force majeure clause that might need to be invoked provided the non-performing party establishes that it could have performed if the force majeure event had not occurred. Having said that, this clause could have been worded differently for different companies, so without a specific reference to a pandemic, a force majeure clause will probably not apply.

14. More than likely, you have a brick and mortar office that is leased. Work with your landlord/lessors on rent concessions due to COVID-19. The Financial Accounting Standards Board (FASB) and Securities and Exchange Commission (SEC) recently came out with practical and timely guidance that can be applied to the accounting for rent concessions (free rent) and rent deferrals (e.g., don't pay now but pay later).

This method will allow you to record the benefit in the same month it's received However, only modifications that meet specific criteria are eligible. As an example:

- Eligibility: Eligible leases are those for which the concession is COVID-19 related and the changes to the lease do not result in a substantial increase to the rights of the lessor or the obligations of the lessee.
- Original lease entries are unchanged and recorded as normal. This way, the asset and liability continue to amortize on the balance sheet like they normally would.
- Rent concessions (free rent) are recorded as a credit to variable rent expense in the free rent period.
- Rent deferrals are recorded as negative variable rent expense in the free rent period and positive variable rent in the period paid, essentially recording the expense on a cash basis. For example, assume we have a 12-month lease at $100/month and the lessor says we do not have to pay the first six months, but have to pay double the rent in the last six months to make it up. The P&L would show $0 expense the first six months and $200/month in expense in the last six months.

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Other Considerations

There is a new accommodation from the SEC that allows registrants to reconcile non-GAAP measures to provisional GAAP amounts if they haven't completed their accounting measurements due to the effects of the COVID-19 pandemic.

Registrants can quantify and discuss other effects of COVID-19 on their operations or their financial condition as long as they don't adjust GAAP measures to reflect what their performance or condition would have been without those effects.

The SEC has stated it believes that a registrant should disclose only non-GAAP financial measures that are consistent with how management and the board are analyzing the current and potential effects of the COVID-19 pandemic on the registrant's financial condition and operating results. Accordingly, a registrant should not present a non-GAAP measure "for the sole purpose of presenting a more favorable view of the company," the SEC staff said. (**Editor's Note:** Please see the CPE article "Key Performance Indicators and Non-GAAP Measures" in this issue of *Today's CPA* for more information on this topic.)

Preparing for the New Normal

The finance team's primary responsibility now is to help guide the organization through the worst of the crisis. Don't focus on the long term. Once the dust settles on current events, there is an opportunity for the finance team to use these experiences to make necessary changes for the new normal.

For many companies and firms, the current pandemic may spell doomsday. However, for others it might mean new opportunities and successes. The critical point is that businesses that position themselves for success in the short term, and implement their tactical-level decisions swiftly, will be the ones that will succeed in the long run.

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