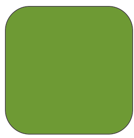

RISK MANAGEMENT AND COVID-19: BUSINESS RESILIENCY RECOMMENDATIONS

The COVID-19 pandemic has cemented the internal auditor as a critical player in business to help anticipate and mitigate the effects of unexpected catastrophes and their impact on business survival.

JAMES HENRY DUNNE AND PETER HARRIS

Increased risk due to the COVID-19 pandemic caused many business entities throughout the world to reassess their risk management strategies for identifying and addressing risk. Unfortunately, the effects of COVID-19 have been paralyzing to many business entities, particularly small businesses, which has resulted in debt and bankruptcy.

This article will first define risk and review various risk types. The risk management process will then be presented, followed by a discussion of the unique challenges COVID-19 introduces to the business community, and recent court decisions impacting risk transfer. We will then examine the internal auditor's role in the risk management process. Finally, we will conclude with lessons learned from COVID-19 and recommendations to ensure greater business resilience.

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Risk and risk management defined

Risk is defined by The Institute of Internal Auditors (IIA) as the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood. This definition considers risk in a tone that can only have a negative impact on an organization's objectives. According to The IIA, risk management is a process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.[1] Other definitions of risk, such as financial risk, also consider the possibility of gain one can realize from undertaking an investment. Any metric of risk definition requires the proper management of risk on the part of the organization's senior management.

Risk classification: Four types of risk

The accounting community has traditionally defined risk as a potential harm that can negatively impact the goals of a business.

In addition to The IIA's definition of risk as having an impact on organizational goals, the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) "Internal Control — Integrated Framework," which includes risk assessment as part of the internal control process, also considers risk as having only a potential negative impact on a company's goals. A reason for this is that the accounting community isolates risk as an operational type of risk only; from this perspective, risk can only result in a negative consequence. This perspective can also be seen from the external auditor's financial report, which provides an opinion, at a reasonable assurance level, as to the adequacy of a company's reported financial statements. However, if the financial statements are not materially correct, the audit opinion will be adverse, which means that they are not fairly presented. Traditionally, risk was defined in this fashion as companies were focused only on losses. For example, companies were interested in protecting their properties from catastrophic events, such as fire, and protecting themselves from product liability litigation and auto liability. In today's global, technological, and advanced business environment, risk has evolved to include a much greater number of risks that a company faces, as well as the interrelationship of type of risk in a company setting.

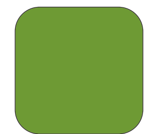
For example, in today's rapid technological environment, cyber risk has become a focal point of risk. A cyber security breach may give rise to an operational risk, hazard risk, legal risk, and a reputational risk. This type of risk can be costly to a company not only from possible litigation with its customers, but also from reputational risk, which would impact the company long after the breach. Additionally, a cyber risk can affect several divisions across an organization, such as the IT department, marketing department, and legal department. This illustrates the need to apply an enterprise risk management approach to risk analysis and not isolate risk to a departmental level only.

In an enterprise risk management approach, which is applied in today's business environment, risk is seen from a company's perspective as a whole rather than its individual units. The enterprise risk management approach has led to the classification of risk into four separate categories, which include: hazard risk, operational risk, financial risk, and strategic risk.

Hazard risk. Hazard risk (also termed insurable risk) has traditionally been the standard for the definition of risk. Hazard risk encompasses the loss of an asset due to a hazard such as a fire, hurricane, theft, earthquake, mold, volcano, or other similar occurrences. In a hazard case scenario there is no possibility of a gain, only a loss or no impact. For example, if an office building has the potential of a fire risk, the best-case scenario is that there is no fire, in which case there is no gain or loss to the owner. A fire, however, can devastate the financial position of the owner.

Operational risk. Operational risk is often associated with the accounting profession's definition of risk and it involves risk related to a company's employees, processes, and/or systems. Internal auditing is an independent function that evaluates the efficiency and effectiveness of a company's resources, adequacy of their financial reporting, and their employees' compliance with laws, regulations, and company guidelines. Clearly, this type of risk can only be one of loss with no possibility for gain or, in a best-case scenario, a no-loss situation. For example, if a company's employees follow required regulations, then there is no gain by this result, whereas regulations not followed will result in losses to the company in terms of fines, civil penalties, or criminal prosecution. Similarly, if the production line produces products that do not conform to company standards, litigation can follow due to the danger these products cause the public. Operational and hazard risks can overlap, as in a case where an employee in the accounting division embezzled funds from a company. In this situation, the company's accounting department had an operational breakdown that resulted in a hazard loss. Additionally, operational risk may be caused by multiple organizational divisions. If the embezzlement was also due to a breakdown in the company's IT system, then the IT department and the accounting department would be accountable for this loss.

Financial risk. In a climate of global trade and Wall Street market-developed investment products, financial risk has grown and become a fundamental threat



THE ENTERPRISE RISK MANAGEMENT APPROACH HAS LED TO THE CLASSIFICATION OF RISK INTO FOUR SEPARATE CATEGORIES, WHICH INCLUDE: HAZARD RISK, OPERATIONAL RISK, FINANCIAL RISK, AND STRATEGIC RISK.

to many businesses. Financial risk can provide an organization with huge upside profits as well as significant losses. The use of derivative products has also led to the possibility of no gain or loss from financial products. Currency risk, interest rates, liquidity, market, and political risks are examples of investment risk. For example, if a U.S. company opens a business in Europe, the company is now exposed to currency risk. This action may either produce positive financial results to the company or negative financial results.

THE FIRST STEP IN ANY RISK MANAGEMENT PROCESS IS TO DEFINE THE ORGANIZATION'S RISK APPETITE, OR THE LEVEL OF RISK A COMPANY IS WILLING TO ACCEPT.

Strategic risk. Strategic risk involves actions taken that will impact the long-term operations of an organization. A tobacco company, for example, has potential legal liability as well as a continued slowdown in demand for their product, which can affect their long-term viability. Strategies to address these factors may include an acquisition of a non-related tobacco company and/or making their product safer. Another example would be if a U.S. auto manufacturer opens up a business in Cuba; there is a risk that the government may close the company and repossess all its assets. However, there is a possibility that the company will profitably sell their cars and generate significant revenue in the Cuban market. Strategic risk, which also analyzes the technological and regulatory effects of a company, can be beneficial or detrimental to a company. Companies that survive for long periods of time make strategic decisions that are profitable, whereas companies that do not survive long-term have made strategic decisions resulting in losses. It is important to note that inaction on the part of management is not a viable option, and if strategic decisions are not implemented, a company would be overrun by its competitors.

The risk management process

The IIA defines risk management as a process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.[2]

The first step in any risk management process is to define the organization's risk appetite, or the level of risk a company is willing to accept. This is established by the board of directors and implemented by senior management. Risk appetite may be high, which means that the company will undertake high levels of risk to meet its goals, whereas a low-risk appetite will entail low levels of risk-taking. In our previous example, an auto manufacturer initiating business in Cuba would imply a high-risk appetite level. It is important to note that adhering to a company's risk appetite level in no way guarantees success. The risk appetite is different among each organization and dependent on its board of directors.

Once the risk appetite is established, the following are five essential steps of the risk managements process.

Identify risks. Risks that companies face have to be identified from a vast universe of potential risks they can be exposed to in their business operations. Unfortunately, the risk identification process often identifies risks that the company or others in the industry have already experienced. This methodology results in companies overlooking many potential risks that they may not have experienced. For example, pandemic risks were overlooked by many organizations prior to the COVID-19 catastrophe. In addition, the financial crisis of 2008, resulting from toxic securities, was a risk overlooked by most U.S. banks, insurance companies, and financial institutions. In today's complicated business environment, proper risk identification is difficult and may require the additional use of outside risk experts to produce the most comprehensive risk analysis possible.

Analyze the risks. Risks are analyzed from a two-dimensional aspect that includes the likelihood of the event/risk occurring and the impact the risk may have on the organization. Likelihood is the probability of an event occurring, whereas impact is the dollar effect of the event occurring. A fire may have a low likelihood of occurring; however, the occurrence of a fire would have a high impact on a company. A small theft of inventory from a department store may have a high likelihood of occurrence, but it would have a small impact. Many risks, such as liability losses for a manufacturer of a dangerous product, do not have limits for potential loss but need to be quantified nonetheless by basing the

risk on a maximum probable loss amount, as opposed to a maximum possible loss amount.

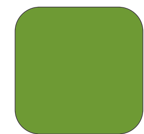
Methods to address the risks. Risks are primarily handled by the following mechanisms: risk control measures, risk financing measures, and risk exploitation measures.

Risk control is a method to either reduce the likelihood of an event occurring or reduce its impact if the event occurs. Some examples include a fire sprinkler, which will reduce the impact of a fire loss; a defensive driving course, which is aimed to reduce the frequency of accidents occurring; and a pit bull in a household, which will reduce both the likelihood of a theft as well as the impact of a theft in the event a thief attempts to enter a home. Risk control measures include the following:

1. Risk avoidance actions are taken to avoid the risk. For example, a company may have concerns about entering a new market or introducing a new product. A risk avoidance action would be to not enter the new market or introduce a new product. Risk avoidance should be followed in cases where both the likelihood and the impact of losses are high. Risk avoidance decisions do not create company value; rather, they are aimed to avoid losses.
2. Risk reduction actions are taken to reduce the likelihood and/or severity of a loss. These measures should be taken when the likelihood and the impact of the loss is not extreme, neither too high nor too low. The effect of these measures is to reduce the likelihood and/or impact to an acceptable risk level. Risk control measures require companies to take actions and are implemented by the use of preventive and detective controls.
   - Preventive controls are internal controls set by a company to prevent a negative occurrence. For example, public companies are required to have internal controls in place to provide reasonable assurance that the financial statements are materially correct. A preventive control to meet this requirement is best handled by the proper segregation of duties among employees who authorize transactions, receive the asset, have custody of the asset, record the transaction, pay/collect cash, and reconcile the asset with the accounting records. Preventive controls are based on reducing the likelihood of a negative event occurring.
   - Detective controls are controls that identify a problem once it has occurred. This is aimed at limiting the impact once a negative event occurs. Reconciliations and variance analysis are examples of detective controls.

Risk financing measures are taken to address how the company will pay for the risk. These will apply when the company transfers the risk to a third party or if the entity chooses to retain the risk. Risk financing measures include risk transfer, contractual transfer, risk retention, and risk transfer with loss retention treatment.

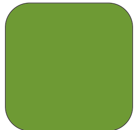
1. Risk transfer is the transfer of risk to a third party, often an insurance company. The cost of risk transfer to an insurer will exceed the cost of retention because the third-party insurer has to recover the expected cost of insurance, plus the administrative costs it incurs, plus a profit amount in its pricing. This exceeds the insurance cost of the inherent risk. However, despite this extra cost, there are many situations where transfer is prudent given certain risk characteristics. A low likelihood coupled with a high impact type of loss is ideal for risk transfer. For instance, this is why we insure our homes for a fire hazard.
2. Contractual transfer is another risk transfer technique that consists of contractual transfer of risk between parties. A business may lease physical space from a landlord and a party to the agreement may agree, as a term of the lease, to accept a potential risk. For example, a landlord of a space in an area struggling economically with no other prospects for a tenant may agree to accept a contingency clause in the lease that, if a specific event were to occur, would enable the tenant to opt out or accelerate the lease end date. One common example of the contingency clause is when restaurants negotiate that if they are denied a liquor



RISK FINANCING MEASURES ARE TAKEN TO ADDRESS HOW THE COMPANY WILL PAY FOR THE RISK.

license by their state liquor authority, they can opt out of the lease. This is necessary because in some states, the restaurant cannot even apply for a liquor license without having a signed lease in place. Another example may be when a retail shop seeks to lease space in a newly built mall and negotiates that if the main anchor store of the mall does not open within a specific time window, the shop can either have a reduced rent until the anchor store opens or exercise the alternative to opt out of the lease.

3. Risk retention is a situation whereby the entity will pay for the loss out of its own funds. Cases where the company has good loss experience data, and hence a predictable pattern of losses, coupled with a high likelihood and low impact losses, are suited for loss retention.
4. With the combination of risk transfer and loss retention treatment, companies often transfer a certain amount of risk beyond some acceptable self-retention amount as a way of reducing costs (insurance premiums) and limiting risk beyond some predetermined threshold. A deductible plan is a type of risk transfer/risk retention plan whereby the company will assume the loss up to a given deductible and have the insurer pay for amounts above this deductible amount. The advantages of this strategy are that the insurance premium cost will be lower and the company now has an incentive to better control their risk while potentially reducing cost even further. Additionally, the company limits its loss risk past a certain threshold. This threshold/deductible implicitly represents the risk appetite level that the board of directors has established.



THE COVID-19 PANDEMIC IS A CLEAR EXAMPLE OF SENIOR MANAGEMENT NEEDING TO RE-ADDRESS ITS RISK MANAGEMENT PROCESS.

Risk exploitation seeks to maximize the use of risk by the possibility and opportunity to produce positive results, such as increases in net income, increases in market share, new product development, and entering a new market segment. Risk exploitation is associated with financial and strategic risks only, as the potential for gain exists. For example, company A may pursue acquiring company B, which will enable company A to grow its market share, cut duplicative costs, and increase its unit selling price. Another example of a risk exploitation opportunity amidst the COVID-19 pandemic is obtaining a Paycheck Protection Program loan, with the goal of forgiveness. The low interest rate environment resulting from COVID-19 has created an opportunity for companies to refinance at a much lower interest rate, thus creating a risk exploitation opportunity (related to financial risk).

Implement chosen risk method. The method identified to address risk (mentioned previously) ultimately needs to be implemented by senior management. Implementation will usually require joint workings between divisional managers and senior management and the interworking of many different company divisions. It is also important that implementation be timely.

Monitor and start the process again. Risk management processes should be monitored through ongoing management activities, separate evaluations, or both. This ensures that the risk measures are being properly followed. Further, the monitoring process will also serve as a control measure to identify the need for alterations in the risk management process due to changes in the business environment. These may include, for example, technological, competitive, and/or regulatory changes, which are always occurring and can impact the company and its risk management decision-making. The COVID-19 pandemic is a clear example of senior management needing to re-address its risk management process. This will require revisiting the entire organizational risk management process and making the needed adjustments in their risk management policies in response to a pandemic.

Business impact and legal decisions related to risk transfer and COVID-19

Due to the unprecedented stress on business survival in many different industries across the globe, the COVID-19 pandemic has forced a broad swath of industries to confront the reality that no matter how effective an organization was in identifying potential risk factors that could adversely impact a business or industry and how they manage those risks, the impact of long-term restrictions and shutdowns to non-

essential businesses were mostly unforeseeable through any reasonable forecast attempting to manage risk based on past history.

The COVID-19 pandemic has caused businesses to react to an unforeseen variable of federal and local governments imposing restrictions that have crippled their profitability. These restrictions include the number of patrons permitted to enter their establishment, limitations on hours of operations, types of service permitted (restaurant outdoor-only seating, take-out and curbside delivery, and limited or no indoor dining), and government-mandated lockdowns where essentially no retail business can be transacted (for businesses deemed "non-essential"). From general contractors being limited by the number of crew members permitted to work on a jobsite to appointment-only entry into retailers with extreme limitations on capacity of patrons at any one time, limiting losses and operating in as cost-effective a manner as possible to approach breakeven has been the strategy for survival for these organizations to outlast the impact of the pandemic.

Many businesses have sought relief through their business interruption insurance policies that they purchased prior to the pandemic as part of their risk management strategy with the belief that they were transferring or limiting risk. Since the pandemic was a risk that most companies overlooked, along with the prolonged shutdowns and shelter-in-place mandates by state and federal governments, many businesses felt that the profound adverse impact of COVID-19 on their sustainability was part of the "catastrophic event" portion of their business interruption policies. Countless companies have argued that that they had indeed transferred the risk of the pandemic by paying premiums for these policies.

Many businesses filed claims with their respective insurance carriers. The initial position of carriers was that COVID-19 and the threat of its spread do not constitute "direct physical loss," which is commonly found in all policies, under risk insurance and first-party property insurance coverage. Insurers successfully argued that the COVID-19 virus is not a direct physical loss or damage to the insured property and even if it were, exclusions for viruses or bacteria bar coverage. Due to this position, businesses responded by moving forward in courts to litigate against insurers. While decisions have varied, the legal decisions handed down by courts initially trended in favor of the insurers. Courts were reading insurance policies narrowly and were thus dismissing claims related to the virus for lack of tangible alteration to business property.

Insurance carriers without a specific virus exclusion in their policies had mostly succeeded in their defense based on the aforementioned position that these businesses did not suffer direct physical loss. Many of the lawsuits came from hospitality businesses devastated by the pandemic. However, in recent months, litigators have embraced more creative arguments to persuade the courts to hear their cases. Given the "invisible" or "intangible" nature of an airborne virus, no matter how pervasive or deadly, and its inability to damage property physically, it is not surprising that initially the courts were reluctant to recognize COVID-19 within the existing framework.

Case law examples. The following are examples of case law after the initial onset of the pandemic that generally favored insurers.

A District of Columbia superior court judge rejected a restaurant owner's argument that COVID-19 and the governmental shutdown order satisfied the "direct physical loss" clause and issued a summary judgment in favor of the insurer, although the policy of the insured included "partial or total interruption of business" resulting "directly from loss or damage" to the insured.[3]

A California U.S. district court judge granted a motion to dismiss in favor of the insurer and against the insured restaurant owner. The judge dismissed the plaintiff's argument that the pandemic and related governmental orders met the definition of "direct physical loss" and cited case law defining physical loss as a "distinct, demonstrable, physical alteration."[4]

A Texas district court judge dismissed a barbershop case regarding "physical loss" and upheld the policy's exclusionary language regarding viruses.[5]

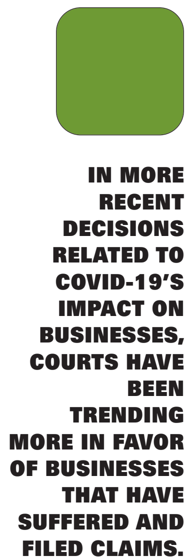
A New York U.S. district court judge denied a magazine publisher's motion, finding it failed to demonstrate damage to

THE COVID-19 PANDEMIC HAS CAUSED BUSINESSES TO REACT TO AN UNFORESEEN VARIABLE OF FEDERAL AND LOCAL GOVERNMENTS IMPOSING RESTRICTIONS THAT HAVE CRIPPLED THEIR PROFITABILITY.

its property. The policyholder's legal counsel argued "the virus exists everywhere," to which the judge responded, "it damages lungs. It doesn't damage printing presses."[6]

A landlord sought to evict Kirkland due to the COVID-19 pandemic and retailers' inability to conduct business. It was decided that Kirkland failed to explain how the governmental regulations it described as a *force majeure* event resulted in its inability to pay its rent in favor of the landlord.[7]

Early in the pandemic, as demonstrated in the cases mentioned previously, courts around the nation were mostly dismissing insurance claims by business owners. It could be argued that these businesses impacted by the pandemic did not look closely enough at their policies and incorrectly assumed that losses they suffered would be covered by their commercial policies during this unprecedented crisis. In more recent decisions related to COVID-19's impact on businesses, courts have been trending more in favor of businesses that have suffered and filed claims. Litigators representing these businesses have taken a different approach than earlier cases and argue that the "physicality" and "imminent threat" of this lethal airborne virus impacts business operations and the habitability of business properties. In counties and states where access to business properties were completely prohibited due to shutdowns, some businesses have successfully invoked the "civil authority clause" of their coverage. Courts have begun to acknowledge that what was initially regarded as an invisible threat that caused no direct physical loss is instead something that could render a business property dangerous and unusable. These positive developments, from the perspective of the insured, are worthy of consideration as auditors move forward in their risk management assessments, strategies, and legal approaches. Examples of such cases are provided in the following section.



IN MORE RECENT DECISIONS RELATED TO COVID-19'S IMPACT ON BUSINESSES, COURTS HAVE BEEN TRENDING MORE IN FAVOR OF BUSINESSES THAT HAVE SUFFERED AND FILED CLAIMS.

A North Carolina superior court judge granted a partial summary judgment in favor of a restaurant group against the insurer. The judge ruled that the definition of "physical loss" could be inferred to mean "resulting from a given cause." As of press time, this judgment is currently under appeal but is a positive development from the perspective of the business in the argument regarding the meaning of "physical loss."[8]

A Missouri district court judge denied an insurer's motion to dismiss a group of salon and restaurant plaintiffs' arguments. The judge rendered their argument sufficient to establish a relationship between COVID-19 and business interruption. The court ruled the policyholder's argument about whether the salon owner sustained a "physical loss" to their premises as a result of the government orders to prevent the spread of COVID-19 was sufficient. The judge denied the insurer's position that the losses claimed were not related to "actual, tangible, permanent, physical alteration" as specified in the policy. The judge also found that the businesses persuasively argued a causal relationship between COVID-19 and their losses: "COVID-19 particles attached to and damaged their property, which made their premises unsafe and unusable," resulting in direct physical loss to the premises and property. In addition, the businesses alleged that COVID-19 is a "physical substance," that it "live[s] on" and is "active on inert physical surfaces," and is "emitted into the air." Although the shutdown orders permitted take-out and delivery, the judge ruled that the insured's plausibly alleged access was prohibited to such a degree that coverage should be provided.[9]

A northern Illinois bankruptcy court partially sided with a restaurant that relied on the *force majeure* clause of their lease. The plaintiff stated that the Illinois stay-at-home-order constituted a government action that hindered the restaurant's ability to conduct business in its traditional manner. The bankruptcy court declined to abate the full amount of rent that the restaurant owed as it found the restaurant was not forced to completely close during the stay-at-home period, and that it could have generated some revenue by providing take-out and delivery services. Instead, the court abated the rent of the restaurant "in proportion to its reduced ability to generate revenue due to the executive order."[10]

A landlord sought to evict a Bed Bath & Beyond store due to the COVID-19 pandemic and the retailers' inability to conduct business. The court sided with Bed Bath & Beyond and permitted their fixed rent delay due to "global circumstances."[11]

Additional cases related to the inability to conduct business during the pandemic and contractual *force majeure* clauses are pending and, once decided, will be sure to provide additional insight that will impact risk management strategies moving forward.

- In *NetOne, Inc. v. Panache Destination Mgmt.,* an event contract was cancelled by the client due to COVID-19, but the event company declined to return the deposit since time was spent on event preparation.[12]
- In *Pacific Collective v. ExxonMobil,* COVID-19 shutdown orders made it impossible for a party to execute a commercial real estate closing at the time contracted. The other party sought to terminate the contract since the date for closing had passed without the party appearing to close the sale.[13]
- In *Williamsburg Climbing Gym v. Ronit Realty,* a gym attempted to abandon their commercial lease due to the pandemic, claiming that the lease was impossible for them to pay due to the impossibility of being able to conduct business.[14]
- In *W.L. Pertey Wholesale Co. v. V2 Incentives,* a wholesale grocery company is seeking to have their deposit returned by a travel company for accommodations and travel, but the travel company has only offered to reschedule the travel to a later date rather than refund the deposit.[15]

Internal auditor's role in the risk management process

IIA Standard 2120 describes the nature of internal audit activities and provides criteria for how these services can be evaluated. IIA Standard 2120 addresses risk management and states that the internal audit activity must evaluate the effectiveness of the risk management processes and contribute to its improvement.[16] Determining whether risk management processes are effective is a judgment resulting from the internal auditor's assessment that:

1. organizational objectives support and align with the organization's mission;
2. significant risks are identified and assessed;
3. appropriate risk responses are selected that align risks with the organization's risk appetite; and
4. relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.

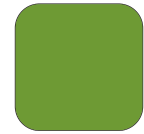
IIA Standard 2120 further states that the internal audit activity may gather the information to support this assessment during multiple engagements. The results of these engagements, when viewed together, provide an understanding of the organization's risk management processes and their effectiveness.

IIA Standard 2120.A1 states that the internal audit activity must evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the following:

1. achievement of the organization's strategic objectives;
2. reliability and integrity of financial and operational information;
3. effectiveness and efficiency of operations and programs;
4. safeguarding of assets; and
5. compliance with the laws, regulations, policies, procedures, and contracts.[17]

This standard also states that internal auditors acting in a consulting role can assist the organization in identifying, evaluating, and recommending risk management methodologies and controls to address those risks. Having a risk-based audit model and participating in the organization's risk management processes are both ways in which the internal audit activity adds value.

Interestingly, this standard explicitly states that the internal auditor is responsible for identifying and assessing an entity's significant risks, which include pandemics, and ensuring that proper risk responses are selected and align with the organization's risk appetite. In short, the role of the internal auditor is central for the assessment, management, and monitoring of company risk within an acceptable company risk appetite level.

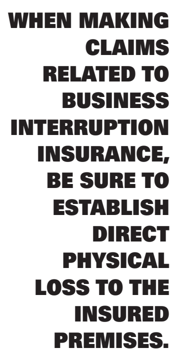


THE ROLE OF THE INTERNAL AUDITOR IS CENTRAL FOR THE ASSESSMENT, MANAGEMENT, AND MONITORING OF COMPANY RISK WITHIN AN ACCEPTABLE COMPANY RISK APPETITE LEVEL.

Recommendations for internal auditors to ensure greater business resilience

It will be necessary to re-evaluate potential risks and methods by which organizations

reduce those risks in a post-COVID-19 risk management scenario. Moving forward, organizations and internal auditors will need to consider pandemics, shutdowns, and government-mandated limits on business volume as part of their risk management plans to ensure resilience. Organizations will need to calculate risk in the decision-making process to include techniques to quantify outcomes and probabilities that address existing uncertainties in monetary value.



WHEN MAKING CLAIMS RELATED TO BUSINESS INTERRUPTION INSURANCE, BE SURE TO ESTABLISH DIRECT PHYSICAL LOSS TO THE INSURED PREMISES.

To ensure greater business resilience, internal auditors should consider the following:

1. Clarify insurance policy coverage to determine whether or not pandemic-related business interruption is part of the policy. This will necessitate a clear interpretation of what "catastrophic events" would actually include. Are "virus," "pandemic," and related terms included in coverage?
2. Be sure the insurance policy coverage includes a "civil authority clause," which covers income losses due to government closures that are not related to physical damage. In addition, clarify whether partial state and federal restriction mandates to businesses are covered.
3. When making claims related to business interruption insurance, be sure to establish direct physical loss to the insured premises. Such claims will more likely be acknowledged by insurers if businesses can demonstrate a causal link between a pandemic or other interruption and the financial health of their business. This can be accomplished by documenting losses through detailed profit and loss statements, tax returns, bank statements, expense reports, and budgets.
4. Seek shorter lease terms for physical space and/or lease agreement clauses that address pandemic-related impacts on a business. Negotiate lease agreements to anticipate risks like pandemics, civil unrest, and other *force majeure* circumstances that will prevent an organization from conducting its business.
5. Consider negotiating lease terms that allow payment of "alternative rent." Examples of alternative rent terms include if rent is based on the sales revenue of a tenant, or if the landlord provides assurance of a certain percentage of other tenant businesses on the commercial property that are open and operational.
6. Diversify an organization's supply chain to ensure availability of product and reduce the likelihood of production delays by utilizing suppliers from various regions and countries, rather than fewer suppliers from fewer geographic locations, which may expose a business to greater vulnerability during a crisis.
7. Increase the number of shareholders and/or business partners to help offset risk of loss.
8. Develop work-from-home protocols and IT systems to support these protocols if a business is forced to work remotely.
9. Develop more detailed workforce shortage plans.
10. Develop safety protocols for the workplace compliant with local health authorities.
11. Create marketing strategies to provide information for the customer about alternatives to access of products in case of a crisis.
12. Expand customer communication streams through digital and social media channels.
13. Expand business website tools to provide customers with opportunities to stay engaged with the organization and purchase products with digital payment systems as well as through third-party intermediaries.
14. Offer alternate products that expose a business to a greater likelihood of success in a stay-at-home economy.
15. Provide more automated ordering and payment systems (on-site and through apps) that offer customers ways to transact business virtually.
16. Strengthen risk data and risk-based decision support and methodology.

Conclusion

In closing, COVID-19 has paralyzed the world economy and exposed vulnerabilities in what were once considered best-practice risk management scenarios. It is clear that

having a more detailed and expansive emergency plan is essential to enable an organization to quickly react and mitigate the impact of a pandemic or other devastating catastrophe. Companies must also implement additional preventive measures to ensure greater business resilience amidst a crisis. The COVID-19 pandemic has cemented the internal auditor as a critical player in business to help anticipate and mitigate the effects of unexpected catastrophes and their impact on business survival.

NOTES

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