Fundamentals for Compliance and Oversight in the Time of COVID-19

JULY 2020

by Jeffrey Matthews

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The only thing that is certain is uncertainty. The only thing that is constant is change. Have those phrases ever been more applicable than now, during a global pandemic? "Uncertainty" can cause accountants and compliance professionals major anxiety and ulcers. Those professionals are held to practice standards in which the level of uncertainty must be measured as precisely as possible. And while historical performance can be a good indicator for future performance, is that still applicable in the current landscape? Here's a recap of the current environment.

As the effects of the COVID-19 crisis raged across the world, the United States saw an initial drop in the stock market of 27%, to its low point on March 23. Unemployment rates ballooned to more than 28%. In April, U.S. small businesses, and some larger national companies, received much needed financial aid under the Paycheck Protection Program (PPP). By April 27, two waves of PPP loans worth a combined $530 billion provided relief to businesses. Panic arose, as the funds were initially deemed too restrictive in terms of purpose and expiration dates. Then, civil unrest at the end of May resulted in more shutdowns just as businesses were reopening.

With more economic challenges on the horizon, revisions were made to the PPP at the end of May, resulting in the PPP Flexibility Act. Economists predicted a further depression, and the official U.S. unemployment rate continued to rise in May. And just like that, things changed.

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The world learned on June 5 that the U.S. unemployment rate had actually improved, and that jobs were added. It was, as economist Chris Rupkey emailed the Washington Post, the "biggest forecast miss of our life." Resulting expectations of a swift economic recovery have sent stocks flying. But then, fears of a relapse sank them yet again a few days later.

Does that mean the U.S. is on the road to recovery or, has the American economy already recovered in record time? It has been reported that the Great Depression in the 1920s lasted 15 months. The Great Recession in 2008 lasted 18 months. Is history still our best predicate? Will the U.S. face a second wave of contamination much like the economists' recent miss, and have healthcare professionals also over-estimated the future impact of COVID-19? The truth is that no one knows which direction the economy will go. Views differ on which form the recovery will take, and length of the journey the U.S. will travel to get there. For accounting and compliance experts, that question is causing some sleepless nights. Sadly, bad actors can view this as an opportunity to exploit the uncertainty through fraud and misconduct and take advantage of what some define as "free money."

The U.S. Treasury Department has realized the potential for some organizations to misuse funds, and it recently announced the government will audit all PPP loans over $2 million before offering any loan forgiveness. Unfortunately, some businesses are thinking twice about applying for needed funds for fear they may inadvertently run afoul of compliance rules and be left with a heavy fine—or worse—once the crisis ebbs.

The good news is that there are steps accounting and compliance teams can take now, despite all of the uncertainty, to prepare businesses to maximize loan forgiveness later.

Staying Organized and Being Proactive Will Save Money and Protect Reputation

In the rush to throw businesses a lifeline amid an unprecedented crisis, government guidance was initially very general, and rules have evolved since then. For all the PPP's good intentions aimed at keeping businesses solvent and their employees on payroll, the Program is fraught with risk for misunderstanding and even abuse.

A business of any size should lean on experts to tell them exactly how to confirm the accuracy of the information used in the application (if it is not too late). Experts can also advise companies on how they can and cannot use funds, how expenditures must be reported, and why. Some small businesses may not be aware of how far back the government can go in reviewing financial records to assess the loan's eligibility for forgiveness later. Moreover, for companies not accustomed to receiving government funding or being subject to potential audits, now is the time to bring in an external expert—if only on a monthly basis—to review funding use guidelines and expenditures to prevent misuse. Most importantly, experts can help guide business owners through the forgiveness process once normalcy has returned.

Compliance often comes with a price tag. But for those who think compliance is expensive, try non-compliance. That price for violations can be insurmountable.

Opportunities for Fraud Are Apparent

As we learned from the Troubled Asset Relief Program (TARP) designed to address the subprime mortgage crisis in 2008, compliance is not always black and white. Failure to navigate regulatory gray areas can have significant consequences.

Unfortunately for accountants and internal audit or compliance teams, compliance with the COVID-19 stimulus is more complicated than it was for TARP—or any other stimulus, for that matter.

During the time of TARP, only certain industries—such as banking and automotive—received government funds. With PPP, however, funds are being dispersed much more widely, which means that oversight activities will be much broader in scope.

With controversy about certain large businesses erroneously receiving PPP assistance still fresh in regulators' minds, there's likely to be strict oversight once the emergency has eased. Given the sheer size of this stimulus, government regulators are likely to be quite keen to claw back funds from companies deemed ineligible or to not forgive loans from any companies that used funds questionably once the crisis lifts. And, given a highly polarized political environment, it is uncertain exactly how oversight and subsequent investigations will be handled and where they will be applied.

During 2020, prior to the pandemic, the Association of Certified Fraud examiners studied over 2,500 fraud cases that spanned across 125 countries. Nearly half of those cases involve SMBs (companies with fewer than 1,000 employees). These are the very companies that are most likely to have received PPP loans. Lack of controls was identified as the largest internal control weakness, allowing for fraud to flourish. And unlike TARP, where usage parameters were relatively narrow, COVID-19 stimulus funds can be used in broader ways—such as for covering payroll and other overhead expenses, with precise limitations on each. This also raises the potential for misuse, whether intentional or accidental.

Accountants will need to meticulously document the use of funds by their organizations so that they can best position themselves for forgiveness. Just as important, internal compliance officers must be empowered to report potential problem areas should they arise. Internal audit teams are often stuck mitigating risks after the fact. To become more proactive, frank discussions with C-level executives, where decision-makers are educated about what is appropriate under the rules should take place. A small misstep now could have serious consequences later—such as non-forgiveness. By choosing to self-report, businesses can maintain their reputation and prevent larger regulatory issues down the road.

Keep One Eye on the "Now" and One on the Future

Every company, big or small, has experienced tremendous changes to their organization's operational environment. As such, first and foremost, strong governance is paramount. Having documented protocols, revised controls and streamlined communication guiding the new operating environment must be a priority.

With so many moving parts as a result of the crisis—from remote work to global market fluctuations—it's easy for businesses and accountants to become "distracted." Team members may face challenges beyond the workplace, such as adjusting to a lack of childcare, school closures and preparing twice as many meals as before while juggling the demands of their profession. While many professionals are well-adapted to technology and the use of multiple computing devices, other colleagues may find technology somewhat overwhelming.

They may be reluctant to rely on elements that they initially felt were fraught with risks. Nonetheless, those charged with assessing risks have to consider each end of this spectrum, and seek out mitigating strategies around the risks posed with the increased reliance on alternative computing devices (phones, tablets, personal computers, and often shared, laptops), as well as the risks associated with a lack of institutional investment and knowledge of emerging technology.

But the operational risks posed from the current crisis are only half the battle. The second half begins once the situation is addressed, funds are somewhat restored, and government oversight ramps to "normal" levels.

The first question companies should ask themselves is how transparent they want to be. Here, the perspective of an internal or outside legal counsel and that of the accounting expert may be distinct, or even at odds. The typical accounting perspective is "when in doubt, disclose," and this, in my view, should be the recommended approach for any business that participates in the Paycheck Protection Program.

There's also a strong likelihood that internal compliance teams will be overextended as a result of the crisis, so they need to balance today's emergencies with preparation for future oversight. Recognizing the need for help and adding temporary resources can help streamline oversight activities such as responding to government inquiries. This will also keep the process as stress-free as possible during what will surely be a hectic time for compliance post-COVID and ensure that companies can get their loans forgiven to the fullest extent possible.

The COVID-19 crisis is arguably one of the most unique and challenging events to ever hit the business community. By getting back to basics, accounting and compliance professionals can help their organizations weather the crisis, ensure a faster recovery, and help them emerge in the strongest financial position possible once the crisis abates.

This article was initially published in
CPA Practice Advisor in July 2020

About the Author

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