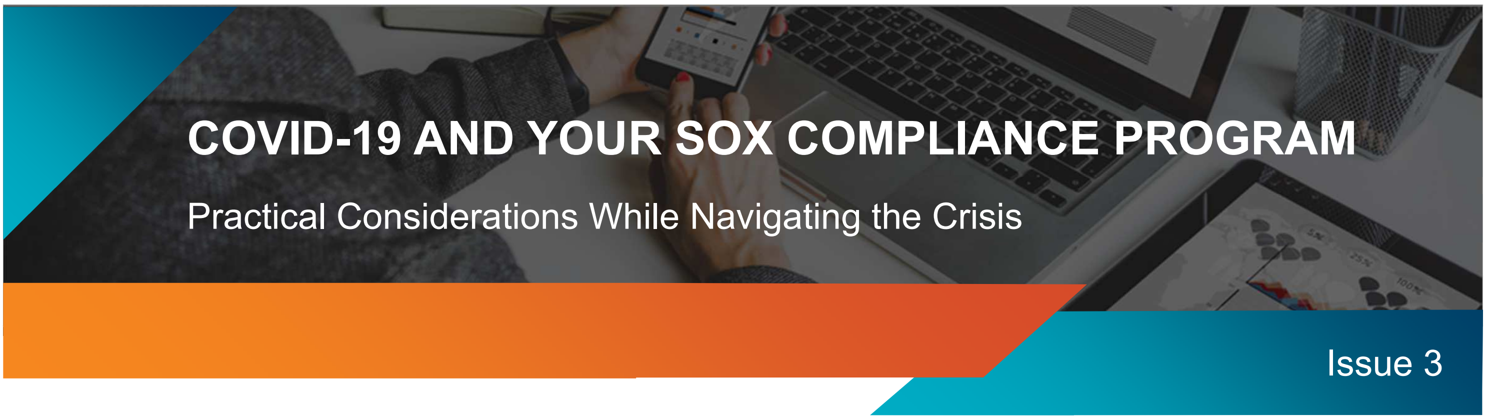

COVID-19 AND YOUR SOX COMPLIANCE PROGRAM

Practical Considerations While Navigating the Crisis

Issue 3

SOX Risk Assessment in the Time of COVID-19:

April is the traditional start of SOX risk assessment season for calendar year filers. With the 10-K and proxy filed and the Q1 close coming to completion, organizations typically kick off the next fiscal year's compliance efforts with the annual risk assessment. As we begin to navigate this season in the time of the COVID-19 pandemic, companies are facing an unprecedented velocity of change.

We offer the following practical considerations as you perform your SOX risk assessment for FY20:

1) **Historical Quantitative Inputs To Materiality Calculations May Not Be Sufficient** – While the starting point for our FY20 risk assessment may still be the final FY19 financial statements, this input will not likely be representative of what FY20 financial results will look like for any company in any industry. While forecasts may still be in the process of being re-worked, they may prove to be the more suitable starting point. Usual measures such as net income before tax are likely to be substantially lower for FY20, and even negative for some companies. In such situations, other measures such as EBITDA or revenue may need to be used and several materiality scenarios assessed to determine the level of adjustment which would impact the earnings per share measurement.
2) **New Financial Statement Elements and Locations May Come Into Scope** – With the results of the materiality calculation likely being lower than in recent prior years, there may be financial statement elements or perhaps even locations which will rise above the quantitative and qualitative measures that have typically been used to define the SOX program scope. This may require additional judgment in the risk assessment process and require planning to address these items in FY20. Risk assessment conclusions should be clearly documented and supported. Perhaps there are current monitoring controls which can be adjusted to address the risks of these new processes or locations coming into scope in FY20. If not, new controls may need to be implemented and tested in relatively short order for new scope areas. Additionally, if materiality has significantly decreased, thresholds or tolerances applied in controls, particularly for Management Review Controls, may need to be calibrated to the unique circumstances of FY20.
3) **Annual Update to Risk Assessment and Scoping May Not Be Sufficient** – The pace of change in response to the pandemic is like nothing we have seen before. Extended shelter in place requirements, changes to the definition of essential businesses, and responses by organizations to pivot from business as usual to address the emerging challenges and risk show no signs of slowing down. Risk assessments will need to be updated following Q2 and likely even more frequently as circumstances change. Organizations will need to be able to demonstrate that the SOX risk assessment and scoping is reflective of any material changes in the financial statements at the end of FY20. This new environment we are living in will push us more than ever toward real-time risk assessment rather than an annual update.
4) **Filing Status and Deadlines May Change** – The current market volatility coupled with the SEC's recent changes to the definitions of accelerated and non-accelerated filers[1] may result in changes to the filing status of a number of organizations to expand the number of 404(a) filers and reduce the need for external auditor attestation. Companies will want to educate themselves on the recent SEC updates and pay close attention to where they stand on the June 30^{th} measurement date (for 12/31 yearend filers). With the SEC also allowing for the extension of filings due between March 1 and July 1[2], and for many working remotely, it will be important to closely communicate updates to filing calendars and coordinate with Legal, Investor Relations and Financial Reporting.
5) **A Detailed Fraud Risk Assessment is Warranted** – Some organizations include the assessment of fraud risk as a component of the overall SOX risk assessment. In a period of overwhelming change as we are in today, there is a heightened risk of fraud. Just in the last couple of weeks we have seen an uptick in fraud schemes perpetrated to take advantage of the

current uncertainty at the same time as the relaxation of certain control requirements. For example, often times a dual signature is required for transactions over a certain threshold. A company may temporarily suspend the requirement for dual authorization of transactions for certain transactional levels. Or a company may extend deadlines for completion of account reconciliations. Another consideration is reaction to technology which may have been hastily deployed to a newly remote work force but perhaps without the normal diligence to ITGC coverage or with a mindset of ‘enablement’ rather than ‘restriction’ regarding user access. Organizations should consider the impact of these new exposures in a robust fraud risk assessment.

6) **Coordination with External Audit is Crucial -** As with all aspects of internal control over financial reporting, early and frequent communication with your external auditor on COVID impacts is recommended. Management should review and obtain external audit agreement with the risk assessment conclusion and practical cadence for update in FY20. Additionally, management should discuss how the timing and extent of audit procedures will be impacted and coordinate on the impact of any filing extension.

Addressing these areas early in the completion of the FY20 risk assessment will set the organization on the right course to navigate these uncertain times.

Note 1: https://www.sec.gov/news/press-release/2020-58

Note 2: https://www.sec.gov/news/press-release/2020-73