CPA
Practice Advisor

COVID-19

6 Proactive Practices To Prepare Your Clients For 2022

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Risk mitigation is a foundational concept in most business schools, MBA and Master of Accounting programs, yet as much as it's drilled in the psyches of students and accountants alike, the reality is most businesses are woefully underprepared for risks. While 2020 may have given us a one in 100-year event, one only has to look at the recent past to see other events that caught businesses ill prepared–exposing the deficiencies in businesses' risk mitigation strategies.

According to a survey by Gartner Inc., only 12 percent of businesses responded that they felt prepared. As with all hard learned lessons, and with CPAs often serving as valuable financial advisors, it is critical to urge clients to learn from the past when planning for the future. With the first quarter of 2021 behind us, these six proactive practices can enable you to start now to prepare your clients' businesses for 2022.

1. Understand That Catastrophic Events Can And Will Happen

The 2008 financial crisis, the 2001 Fukushima Nuclear Disaster, the 9/11 terrorist attack and the Dot-Com Crash of 2000 are all considered Black Swan events. Black Swans are events that were unforeseen and thought virtually impossible yet still happened. For those counting, that makes four virtually impossible Black Swan events in the past 20 years. While we can never know the specificity of future Black Swan events, we can ascertain the certainty the future of such events. And, due to their severe consequences, we should therefore seek to structure businesses' risk management strategies to mitigate its impact.

As we saw with COVID-19, and other Black Swan events, those businesses that employ strong risk management strategy, not only survived, but in some instances, thrived. Those businesses that did not put a premium on risk management, did not fare well.

2. Develop A Business Continuity (AKA Interruption) Plan

When your client's business or corporation is faced with disaster, how will they keep up day-to-day operations? Preventing disruption is key since any interference with daily business activity means lost revenue and reduced profit. However, despite the business disruption crises bring, 51 percent of organizations across the world do not have a business continuity plan according to a study based on Mercer's Business Responses to the COVID-19 Outbreak Survey. While some business continuity plans can be complex and lengthy, the critical point is to establish a risk management strategy that will address the impact of unforeseen events, a decrease in revenue, cash flow and liquidity. Although it's late in the game to develop one now to address the pandemic, now is the time to start planning for the next crisis.

The ideal business continuity plan should assess all business risks by utilizing a risk assessment review, and, most importantly, to address such risks with corresponding mitigating strategies. By employing this approach, the business will be in a much-improved position to withstand the effects of the next stress scenario.

3. Make Insurance With Customized Policy Language A Decisive Component Of Your Risk Management Strategy

Being blind-sided by risks does not bode well for businesses. This is especially true for small and mid-market businesses. Unlike their Fortune 1,000 brethren, they lack access to credit and capital markets, are often geographically concentrated and tend to have concentrated revenue streams. This increases the chances of small to mid-market businesses going bankrupt. In fact, according to the Small Business Administration, 40 percent of small businesses affected by natural or human-caused disaster never reopen their doors.

This is one reason why only 30 percent of family-owned businesses never survive into the second generation—and over 100,000 business small business didn’t survive COVID-19. Most business owners or management teams would agree they could have benefited from more insurance with policy language customized for their business. COVID brought to light not only risks that were uninsured or underinsured, but also risks that a business owner thought one had coverage for, only to find out the un-individualized policy language excluded such coverage…such as our next point, business interruption insurance.

4. Take Into Account That Business Interruption Insurance Often Isn’t Enough

A classic example of an underinsured risk during COVID-19 was business interruption insurance. For most businesses, their business interruption coverage was only triggered if their property is damaged. Many thought they were covered for business interruption only to find out they were not. Therefore, now is the time to encourage your clients to review insurance policies and to assess their company’s risks and determine whether the risk is uninsured or underinsured and to find out what the exclusions may be and if more insurance is needed.

5. Have More Sustainable Cash Flow And Liquidity

If executive teams could have seen the future looking at 2020 and 2021, most would say they would have liked to have not only more of the right (customized) insurance, but sustainable cash flow and liquidity. During COVID, many businesses who lacked cash flow and liquidity opened credit lines found themselves struggling for survival. Government programs like SBA funding and the Paycheck Protection Plan (PPP) helped, but it still led to 800 small businesses closing each day according to a report by Yelp between April and September 2020.

6. Consider Captive Insurance

One approach to a risk management strategy that addresses both the need for more (customized) insurance, cash flow and liquidity is a captive (aka private) insurance company. A captive insurance company is a licensed insurance company owned by the business or business owner that can insure against a wide array of related business risks. In 2020, many of these business risks were triggered by the COVID pandemic, that lead to supply chain interruption, loss of a key supplier or customer, subcontractor default, bankruptcy of certain counterparties and losses from governmental actions (like forced business suspension or quarantine).

Captive insurance serves as an ideal way to fill the exclusions in commercial insurance policies. It also enables businesses to increase their asset base, improve cash flow and liquidity (perilous elements – see AIG's 2007 – 2008 stock price collapse) since the premiums paid to the captive insurance company, less the claims, inure to their bottom line (not the commercial carrier). And in some cases, captive insurance companies may receive very favorable tax treatment to help them build loss reserves (and corresponding assets, cash flow and liquidity). The captive insurance company can thus ensure that a business has sufficient (customized) insurance and sufficient cash flow and liquidity to weather a crisis.

Based on the lessons gleaned from the past year, this is an ideal time for CPAs to encourage their clients to look ahead to 2022 and proactively integrate a robust risk mitigation strategy to prepare for the next "virtually impossible" Black Swan event. As stated, a risk mitigation strategy based on an increased asset base, improved cash flow and liquidity, accomplished by forming a captive insurance company, is proven strategy to prepare for the next stress scenario.

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