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Impact of COVID-19 on Quarterly Reporting; New Statement from SEC Chairman and Director of Division of Corporation Finance

Considerations for U.S. Public Companies Preparing for Their First Earnings Cycle Since the Onset of the COVID-19 Pandemic

SUMMARY

The evolving impact of COVID-19 will be a key focus for public companies as they prepare to report financial results for the first quarter of 2020. For companies with a December 31 fiscal year, this will be the first reporting cycle since the onset of the COVID-19 emergency around the globe. COVID-19 and the unprecedented measures taken by governmental authorities worldwide in response to the pandemic, including government-mandated closures, stay-at-home orders and extraordinary actions to stabilize markets and mitigate recessionary pressures, have affected, and will continue to affect, economic and financial market conditions globally, as well as the operations, financial results and prospects of companies across virtually all industries and geographies. The importance of the upcoming earnings cycle and related disclosure considerations was highlighted in a statement released on April 8, 2020 by the SEC Chairman, Jay Clayton, and the Director of the Division of Corporation Finance, William Hinman.[1]

Consistent with the SEC's continued call to public companies to report on the impact of COVID-19 in a timely manner and to focus on forward-looking information,[2] in the April 8 statement, Chairman Clayton and Director Hinman urged public companies "to provide as much information as practicable regarding their current financial and operating status, as well as their future operational and financial planning" related to COVID-19. In particular, they emphasized the importance of forward-looking disclosure regarding an issuer's operational and financial affairs during this uncertain time, and stated that "we would not expect

good faith attempts to provide appropriately framed forward-looking information to be second guessed by the SEC."

Although the COVID-19 pandemic presents a unique set of fact-specific challenges for each issuer, this memorandum highlights general topics issuers should consider as they prepare for upcoming earnings announcements, quarterly reports or other public disclosures. This memorandum focuses on considerations for U.S. domestic issuers, but many of the considerations addressed are also applicable to foreign private issuers with securities listed on United States securities exchanges, and foreign private issuers which are not SEC-reporting companies but may be considering undertaking exempt securities offerings (such as pursuant to Rule 144A) in the United States. We addressed additional disclosure considerations for banking institutions in our memorandum to clients dated April 6, 2020, available here.

DISCLOSURE CONSIDERATIONS

As public companies prepare to release first quarter earnings, they should consider carefully how COVID-19 has affected their business and the environment in which they operate, including any effect on their disclosure controls and procedures and internal control over financial reporting, and the risks and uncertainties it has created or amplified. These considerations apply not only to Form 10-Q filings, but to all aspects of their earnings reporting (including earnings releases and investor calls and presentations), and issuers should have consistent messaging across communications and disclosures.

Importantly, for virtually all companies, it is not business as usual this reporting cycle. Business continuity plans have been activated with work-from-home arrangements in place for a substantial number of employees in the United States and other jurisdictions. As a result, many companies are experiencing logistical and operational challenges that affect financial reporting and many companies have sought to address these challenges by accelerating reporting work to complete the work necessary for timely reporting. If, despite appropriate preparations, a company is unable to meet its first quarter filing deadline, the SEC has granted a limited extension, which is discussed in more detail below.

A. DISCUSSION OF IMPACTS

Assessing and disclosing the impact of COVID-19 will be an individual exercise for each company. All public companies, however, should focus on providing disclosures that will help investors evaluate the current and expected impact of COVID-19 through the eyes of management. As noted above, the SEC has emphasized the need to provide investors and market participants with appropriate information during this critical time of volatility and uncertainty in our markets and broader economy.[3] Issuers are encouraged to dampen speculation by disclosing how they are affected by and how they are responding to COVID-19 as early as practicable.[4]

Chairman Clayton and Director Hinman's statement also noted that due to COVID-19 "historical information may be substantially less relevant" and investors are "thirsting to know where companies stand today and, importantly, how they have adjusted, and expect to adjust in the future, their operational and financial affairs to most effectively work through the COVID-19 health crisis." These disclosures may include the financial impacts resulting from company efforts to protect workers or, where an issuer receives financial assistance under COVID-19-related federal or state programs that has "materially affected," or is "reasonably likely to have a future material effect upon, financial condition or results of operations," disclosure regarding the nature, amounts and effects of such assistance.

With respect to specific disclosure items, on March 25, the SEC issued guidance ("Disclosure Guidance Topic No. 9") addressing the impact of COVID-19 on disclosure and other securities law obligations.[5] Our memorandum to clients, dated March 30, 2020, summarizing Disclosure Guidance Topic No. 9 is available here. In Disclosure Guidance Topic No. 9, the SEC posed a series of questions for issuers to consider as they work through their disclosure regarding the evolving impact of COVID-19. These questions include how the COVID-19 pandemic:

- impacts financial condition and results of operations;
- affects capital and financial resources, including liquidity;
- affects assets and the ability to timely account for those assets;
- results in material impairments or material increases in allowances or charges;
- adversely affects the ability to maintain operations, including internal control over financial reporting and disclosure controls;
- affects demand for products or services;
- impacts supply chain or methods of distribution; or
- impacts operations as a result of constraints on human capital and productivity.

Disclosure Guidance Topic No. 9 also calls upon issuers to examine whether they have experienced challenges in implementing continuity plans, or whether travel restrictions and border closures are expected to affect operations and a company's ability to achieve business goals. While not exhaustive, the questions serve as a helpful starting point as issuers and management work through the impact of COVID-19 on their quarterly and other disclosure obligations. Issuers should also consider the effect of any new U.S. or international laws or regulations resulting from the COVID-19 pandemic, such as the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act").

Over the course of the last several weeks, the impact of COVID-19 on companies globally has expanded dramatically. Given the rapidly unfolding pandemic, it remains to be seen whether the pace of changes or developments with respect to COVID-19 will be maintained or accelerate over the next several weeks during which many issuers will report quarterly results. In all cases, issuers will need to ensure that their procedures are sufficient to identify and assess developments and impacts through the filing date of their

Form 10-Q in order to satisfy disclosure requirements, including those regarding subsequent events for financial statement purposes and Management's Discussion and Analysis ("MD&A") disclosure.

Given the ongoing, changing and uncertain situation, it may be difficult for companies to accurately assess or predict the broad effects of COVID-19 on their business and operations, and, in many cases, the actual impact will depend on factors beyond a company's control and knowledge at the time they are making disclosure. As a result, disclosure addressing the impact of COVID-19 will necessarily include forward-looking statements based on assumptions and expectations of future events, and issuers should be encouraged to disclose those assumptions and expectations and will want to update and refine their disclaimers for forward-looking statements under the safe harbors of the Private Securities Litigation Reform Act of 1995 ("PSLRA") in connection with these disclosures. Chairman Clayton and Director Hinman's statement emphasized the importance of these forward-looking statements to investors and, given the uncertainty in the current business environment, recognized the potential litigation and liability concerns from making these statements and encouraged companies to avail themselves of the protections under the PSLRA.

Chairman Clayton and Director Hinman's statement also encouraged issuers to provide "meaningful," rather than boilerplate, forward-looking information — "information that provides investors a level of insight that allows them to see the key operational and financial considerations and challenges the company faces through the eyes of management." The statement encouraged companies to "consider the broad frameworks of some of the [forward-looking health and welfare] strategies that have been suggested, how following those strategies may affect their operations and whether that analysis would be of material interest to investors."

B. MD&A

One of the principal areas where issuers will need to consider addressing the impact of COVID-19 is in the MD&A. The MD&A is intended to provide both a historical analysis of the issuer's financial condition and results of operations and an analysis of known events, trends and uncertainties that are likely to impact the issuer's future financial condition and results of operations. The MD&A should address the questions posed by Disclosure Guidance Topic No. 9, to the extent applicable, to allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management. The discussion should include how COVID-19 has impacted an issuer's financial condition and results of operations, and how management expects COVID-19 could impact future operating results and near- and long-term financial condition. For example, Chairman Clayton has urged companies seeking federal relief to disclose information regarding their capital needs and future plans, to the extent they are able to do so.

The MD&A must identify and analyze known events, trends and uncertainties that will, or are reasonably likely to, have a material effect on financial condition or operating performance. Issuers should assess whether the impact of COVID-19 presents known events, trends or uncertainties that are reasonably likely to have a material impact on its financial condition or operating performance. In evaluating known events, trends or uncertainties, SEC guidance provides that issuers must first determine whether the trend or uncertainty is reasonably likely to come to fruition, and if so whether the event, trend or uncertainty is reasonably likely to have a material effect on the issuer's financial condition or results of operations. The standard of "reasonably likely" is a lower threshold than "more likely than not" but a higher threshold than "remote."[6]

Trends and uncertainties related to COVID-19 may include, but are not limited to:

- declines in revenue due to decreased demand for an issuer's products or services;
- disruptions in an issuer's operations, production, supply chain and distribution capability;
- increases in costs due to the adverse impact of COVID-19 on an issuer's supply chain or its workforce;
- longer-term effects on an issuer's operations, including from changes in customer behavior;
- increased cost or diminished access to capital and funding resources;
- an issuer's ability to service debt or meet other financial obligations;
- changes in laws or regulations as a result of COVID-19;
- asset impairment (including goodwill and deferred tax assets); and
- whether management expects COVID-19 to impact future operations differently than how it affected the current period.

Discussions should include the effects of these uncertainties on key metrics for the issuer, as well as any potential mitigation efforts and the effects of those mitigation efforts. Given the economic and financial disruptions COVID-19 has caused globally, and the highly uncertain nature of future developments, we expect most issuers will disclose future uncertainties relating to one or more financial or operational metrics in their MD&A disclosure.

C. RISK FACTORS

Form 10-Q requires issuers to include any material changes from risk factors previously disclosed in their Form 10-K. Accordingly, issuers should evaluate whether their prior risk factor disclosure accurately addresses the currently known and anticipated risks presented by COVID-19. Given the rapid developments of the COVID-19 pandemic, prior general pandemic or specific COVID-19 risk disclosure in an issuer's most recently filed Form 10-K will likely need to be updated to address the increasingly far-reaching and significant effects of COVID-19. As a result, issuers should evaluate whether COVID-19 presents heightened or new risks that are not adequately addressed by existing risk factors, or that otherwise warrant further disclosure.

When drafting risk factors, issuers should avoid describing mitigation efforts except to the extent that the disclosure is necessary to contextualize the effects COVID-19 has had on an issuer's business and relates to such mitigation efforts potentially being ineffective, insufficient or adverse to the issuer's results of operations or business. For example, if an issuer discusses the activation of its business continuity plan and implementation of work-from-home arrangements for its workforce as a result of the COVID-19 pandemic, the discussion should focus on how continued operation under its business continuity plan and remote working present ongoing risks. Issuers should also consider noting in any risk factors that the situation is still developing and that the extent of the COVID-19 impact is unpredictable and depends on a number of factors outside the issuer's control.

Recent SEC enforcement actions highlight the need for issuers to discuss the risks they face in specific terms and to describe accurately any actual incidents that have occurred or risks that have manifested. For example, the SEC brought an enforcement action against Mylan NV in late 2019 because Mylan, among other things, disclosed in its risk factors that a governmental authority "may" take a contrary position regarding the classification of the EpiPen as a generic drug on Mylan's Medicaid submissions even though the authority had already informed Mylan that the drug had been misclassified.[7] This followed an enforcement action against Facebook earlier in 2019 alleging that Facebook described risk factors associated with the use of customer data as prospective and hypothetical even though those risks had already come to fruition.[8] Accordingly, any new or updated risk factors related to COVID-19 should not describe risks as purely hypothetical if they have actually affected an issuer.

In supplementing and updating existing risk factors, companies may consider the applicability of the following risks, among others:

- ***Customer Demand.*** The current and future impact on customer demand for products and services, including the impact of consumer illness or quarantine, government actions such as mandated closures, stay-at-home orders and travel restrictions, event cancelation or postponement, and shifts in demand as a result of financial hardship, loss of consumer income, or future uncertainty.
- ***Production, Supply Chain and Distribution Disruption and Delay.*** The impact to supply chains or methods of distribution, including disruption resulting from the closure of manufacturing facilities, warehouses or distribution centers; the loss or disruption of essential manufacturing and supply elements such as raw materials or finished products; labor shortages; transportation disruptions; or the loss of other production and distribution capability, and the costs and consequences of disruption.
- ***Adverse Economic Conditions.*** The impact of prolonged negative economic conditions on the issuer and its customers, counterparties, employees and other third parties.
- ***Inability of Key Personnel to Perform Their Duties.*** The impact of work-from-home policies instituted in response to COVID-19 and mandates from state and local governments to close all non-essential businesses, including potential loss of productivity and increased cybersecurity risks, as discussed in more detail below.
- In addition, certain age groups, which may include senior executive officers and members of an issuer's board of directors, appear to be at higher risk for COVID-19's most serious health impacts. Issuers should consider the adequacy of contingency plans and any potential risks that key employees and/or members of the board of directors are incapacitated or otherwise unable to perform their duties for an extended period of time. If an issuer has a senior executive or director

who has become incapacitated, general disclosure that this may happen will likely not suffice and issuers should consider updating the risk factor to reflect events that have occurred.[9]

- ***Business and Travel Disruptions.*** As noted above, many issuers have implemented work-from-home policies for a number of personnel and suspended business travel. Issuers should address whether they have implemented, or may implement, these measures, and should consider the impact of these policies on business operations, including any increased costs such as costs incurred to implement necessary operational changes, and risks of prolonged or material business interruption.
- ***Disruption of Growth and Strategic Plans.*** The spread of COVID-19 may materially adversely affect an issuer's ability to implement plans for growth and expansion, including delaying the construction or improvement of new facilities such as stores, offices or factories as a result of government-mandated shutdowns, labor shortages or negative results of operations; delaying or canceling plans for acquisitions, expansions or entry into new markets; or delaying significant capital expenditures. Issuers should also consider whether any delay or disruption to growth or strategic plans could increase the costs of executing those plans or could continue to have an adverse impact once the COVID-19 pandemic has passed.
- ***Liquidity and Access to Capital.*** Many issuers face increased credit and liquidity risks as a result of reduced cash flow, volatility in financial markets, increased cost or diminished access to capital and funding sources, and decreased ability to service debt or meet other financial obligations. Issuers may be aware of a high risk of financial covenant defaults under credit agreements or other liquidity sources, and the related risks of any such default should be discussed. Issuers should evaluate their liquidity and credit risks to determine if they face heightened risks that are not adequately disclosed, including the risk of default.
- ***Cybersecurity.*** Many issuers face increased cybersecurity risks due to the number of employees that are working remotely in regions impacted by stay-at-home orders. Increased levels of remote access create additional opportunities for cybercriminals to exploit vulnerabilities, and employees may be more susceptible to phishing and social engineering attempts due to increased stress caused by the crisis and from balancing family and work responsibilities at home. Cybercriminals may also prey on fears about COVID-19, and take advantage of the current environment in which legitimate information regarding COVID-19 is being frequently and widely disseminated, such as by including malware in emails that appear to include documents providing legitimate information for protecting oneself from COVID-19. In addition, technological resources may be strained due to the number of remote users. Issuers should evaluate their cybersecurity risks in light of these issues and update their existing risk factors for any material changes or developments.[10]
- ***Reliance on Vendors and Other Companies.*** Many issuers rely on vendors and other third parties to provide critical systems and services. Issuers should consider whether COVID-19 presents heightened or novel risks with respect to continuity of critical services. These risks include the possibility of closure or business interruption. In addition, the definitions of essential services vary by state and may result in some vendors not being able to work from their offices. Stay-at-home orders in other countries may impose stricter requirements. For example, India has instituted a widespread mandate by which nearly all commercial and private establishments are required to close for a period of 21 days, which could have a significant impact on call centers and other services that issuers may outsource to India. Issuers should consider their existing risk factors and whether they face heightened risks of business interruption that are not adequately disclosed.
- ***Fluctuations in Stock Price.*** Risk factors for many issuers generally note that stock prices may fluctuate and can be affected by a number of factors. Issuers should evaluate the impact of COVID-19 on their stock price and whether risk factors adequately address significant and potentially precipitous changes in price. Decreases in stock prices could have other impacts that are often addressed in risk factors, such as loss of WKSI status, ability to meet listing requirements and susceptibility to activist activity or takeover offers.

- ***Other Impacts on Financial Condition.*** A prolonged pandemic may have a number of effects on issuers' financial condition. Fluctuations in the issuer's stock price and cash flow projections as a result of COVID-19 could require the revision of certain accounting estimates and judgments such as those related to the valuation of goodwill, long-lived assets and deferred tax assets, which could have a material adverse effect on an issuer's financial position and results of operations.
- ***Business Interruption Insurance.*** Many issuers maintain business interruption coverage. Policies, however, may not cover interruptions caused by COVID-19. Issuers should consider the costs of potential business interruptions and whether some or all of the costs may be offset by the issuer's insurance coverage. If policies do not cover interruptions caused by COVID-19 or otherwise do not adequately cover material losses, issuers should consider disclosing those facts in their risk factors.
- ***Credit Ratings.*** Credit rating agencies have mentioned COVID-19 as a factor in a number of cases where an issuer's credit rating was downgraded or placed on credit watch. Issuers should consider whether there is a material risk that COVID-19 and other factors could result in a credit downgrade and whether such risk is adequately disclosed in its risk factors.
- ***Risks Related to Environmental, Social and Governance ("ESG") Issues and Reputational Risk.*** In recent years, investors have increased their focus on ESG matters and demanded more robust ESG practices from companies. Issuers should consider possible risks, including the potential for reputational harm if the issuer is viewed as responding slowly or inappropriately to COVID-19, such as by failing to implement appropriate measures for employees or not adequately providing accommodations to customers.
- ***Risks Related to Legal and Regulatory Response.*** Certain issuers may be adversely impacted by legal and regulatory responses to concerns about COVID-19 and related public health issues, including through government mandates regarding production or operations; commandeering of factories, supply chains or other facilities to support the COVID-19 response; government mandates for extension of insurance coverage and benefits beyond the policy language to cover COVID-19; or government requirements to modify existing contracts such as for the suspension of payments or moratorium on actions. Issuers should be sure to evaluate risks related to any recent legislation or regulatory action, including risks arising from the CARES Act.
- ***Suspension of Share Repurchases.*** Issuers should consider the need for risk factor disclosure with respect to the suspension or termination of share repurchases. Many issuers have announced suspension of their share repurchase plans in response to COVID-19. Although these voluntary suspensions have generally been for specified periods, there is no assurance they will not be extended. In addition, there has been a focus on share buybacks in Washington, particularly for issuers that have or will take government assistance. For example, the recently passed CARES Act restricts companies that receive government assistance under certain provisions of the CARES Act from paying dividends or making any other capital distributions, including share repurchases, with respect to their common stock. Certain investors only invest in shares of issuers that pay cash dividends, so a cessation of dividend payments could prompt a rotation out of an issuer's shares, putting downward pressure on the issuer's stock price. Further, some issuers may decide to refrain from repurchases, paying dividends or making other capital distributions so as to not risk precluding future assistance should it be needed.

D. DISCLOSURE AND INTERNAL CONTROLS

Issuers generally are required to maintain disclosure controls and procedures and internal control over financial reporting, and to evaluate the effectiveness of these controls and procedures at the end of the quarter. Any change in an issuer's internal control over financial reporting during the quarter that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting must be disclosed on Form 10-Q. Additionally, the principal executive officer and principal financial officer will be required to provide certifications as to the effectiveness of disclosure controls and procedures for internal control over financial reporting.

Issuers will need to assess carefully their disclosure controls and internal control over financial reporting due to the impacts of COVID-19. The SEC has urged issuers "to work with their audit committees and auditors to ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances in meeting the applicable requirements."[11] Additionally, an issuer's team working on financial reporting should consult with the team coordinating the issuer's COVID-19 response to fully inform management and the parties involved in disclosure controls of the impact of COVID-19. For example, disclosure committees may need to meet more frequently as part of the quarterly reporting process in light of rapid changes and governmental responses to the pandemic.

In evaluating its internal control over financial reporting in light of COVID-19 and any related changes to the control environment, issuers should consider, among other things:

- how remote working arrangements have impacted the control environment, including as it relates to increased cybersecurity risks;
- how remote working arrangements, facility closures or other operational disruptions, such as the unavailability of personnel, have impacted the ability to appropriately test control procedures;
- how supporting evidentiary materials will be provided to internal and external auditors to support assessments of the effectiveness of the control environment; and
- what impediments there may be to the finance function meeting its responsibilities to prepare reliable financial statements.

Issuers may determine that it is necessary to add additional controls or processes or redesign controls in order to address these concerns and the accompanying risk of material misstatements in their financial statements. Issuers will also need to have in place effective controls for any accounting adjustment resulting from COVID-19. Any changes in internal controls, as well as any delays in closing the books for the quarter, may affect the timing of quarterly reporting and could, depending on the circumstances, give rise to a disclosure obligation in an issuer's Form 10-Q.

E. FINANCIAL STATEMENTS

In connection with preparing their financial statements, issuers should carefully evaluate the accounting areas that are likely to be affected by COVID-19 and the disclosures regarding adjustments and underlying assumptions and estimates regarding COVID-19. The SEC Chief Accountant recently issued a statement that reiterates the need for high-quality financial reporting in light of COVID-19, and encouraged issuers to contact the SEC's Office of Chief Accountant ("OCA") with questions they encounter as a result of COVID-19. In particular, the statement notes that the OCA recognizes that "accounting and financial reporting implications of COVID-19 may require companies to make significant judgments and estimates," which "can be challenging in an environment of uncertainty."[12] The OCA clarified that it will continue its pattern of not objecting to "well-reasoned judgments" that issuers make, and reiterated the importance of required disclosures of judgments and estimates. The statement also notes that the OCA "remains actively focused on independence matters in these unprecedented times." Management and board of directors should continue to consider carefully any matter that could affect auditor independence.

Some of the accounting areas that may be affected by COVID-19 include:

- ***Asset impairment.*** Issuers will need to assess whether there are indicators of impairment (such as decreased revenues, supply chain disruptions and factory or store closures), and if so perform the required impairment tests. In performing these tests, issuers will likely need to make difficult judgments about the nature of the COVID-19 disruptions, including whether such disruptions are temporary. If an asset is determined to be impaired, issuers will then need to make judgments about the recoverable amounts of the asset, which will require making judgments about the economic conditions that will exist over the remaining life of the asset.
- ***Fair value measurements.*** Where issuers are required or permitted to measure assets or liabilities at fair value, such as for the valuation of investment portfolios, such measurements should reflect market participants' views of market conditions as of the measurement date, which may be affected by COVID-19. In particular, issuers will need to consider how market participants would evaluate the effects of COVID-19 on their future expectations regarding the affected asset or liability.
- ***Debt modifications or restructurings.*** Issuers modifying the terms of their existing debt obligations or obtaining waivers from certain covenants as a result of COVID-19 will need to evaluate the accounting implications, including whether a debtor should account for a debt restructuring as a troubled debt restructuring or a debt extinguishment.[13] Issuers will also need to take into account changes in indebtedness such as draws on revolving credit facilities or defaults, and the liquidity of the issuer (see "Going concern," below).
- ***Revenue recognition.*** Issuers will need to consider how uncertainties related to COVID-19 would affect the revenue they receive under contracts, including estimates regarding expectations of variable consideration. Issuers should also take into account how the COVID-19 affects the probability of collectability and any price concessions that may be offered, as well as any modifications to such agreements.
- ***Going concern.*** Issuers will need to evaluate their ability to continue as a going concern within one year after the date of the financial statements. If disruptions from the COVID-19 pandemic, such as prolonged plant closures or liquidity issues, raise substantial doubt about the ability to continue as a going concern, issuers will need to include appropriate disclosure, including management plans to alleviate such doubts.
- ***Compensation.*** Issuers will need to account for the costs of employment benefits provided due to COVID-19, including benefits to furloughed employees and postemployment benefits for terminated employees. Additionally, issuers will need to evaluate the cost of their equity-based awards, including the effects of COVID-19 on performance conditions and the effects of any modifications to the awards.
- ***Subsequent events.*** The SEC has emphasized that issuers should consider disclosure of events subsequent to the balance sheet date in their notes to financial statements in accordance with applicable accounting standards.[14] Under US GAAP, subsequent events are either recognized subsequent events, which will require adjustment to the financial statements, or unrecognized subsequent events, which may need to be disclosed in order to keep the financial statements from being misleading. Disclosures regarding material unrecognized subsequent events should include the nature of such events and an estimate of the financial

effect or a statement that such estimate cannot be made. Issuers will need to have procedures in place to evaluate the rapid developments of the COVID-19 pandemic as subsequent events, and evaluate any disclosures that should be provided regarding the effects.

In preparing their financial statements, issuers should also evaluate their disclosure regarding loss contingencies. Issuers will be required to recognize loss contingencies in their financial statements where (1) information available indicates that the loss is probable and (2) the amount of the loss can be reasonably estimated. If there is a reasonable possibility of a loss contingency, but one of the above conditions is not satisfied, issuers will be required to disclose the nature of the contingency and give an estimate regarding the possible loss or range of possible losses (or state why an estimate may not be made). In many cases, given the uncertainties regarding COVID-19, it may not be possible for issuers to provide estimates regarding losses. Issuers should also consider accounting requirements regarding risks and uncertainties, including disclosure of risks and uncertainties that could significantly affect the amounts reported in the issuer's financial statements.

EARNINGS RELEASE AND EARNINGS CALL CONSIDERATIONS

A. GUIDANCE AND REGULATION FD

In light of the dynamic nature of, and the uncertainty surrounding, COVID-19, issuers that have provided guidance in the past should evaluate the appropriateness of confirming, updating or withdrawing previously issued guidance or communicating new financial guidance to the market. Determinations regarding guidance will depend on an issuer's specific circumstances, including its specific guidance policies, the kind and timeframe of the guidance it issues and the industry in which it operates, among other considerations.

As a general matter, the federal securities laws do not impose an affirmative obligation to update previously issued guidance (unless the issuer has indicated that it would update the guidance). However, in light of COVID-19, a number of issuers have determined that prior guidance is no longer accurate and have withdrawn it in advance of securities offerings or reporting their quarterly earnings, often motivated by desires to manage market expectations and facilitate discussions with analysts and investors. Issuers should also consider trends in their specific industry with respect to guidance.

With respect to facilitating discussions with analysts and investors, it is important to keep in mind the restrictions imposed by Regulation FD. Regulation FD provides that no covered person can disclose material nonpublic information ("MNPI") to market professionals or security holders unless such information is simultaneously publicly disclosed. Under Regulation FD, information is considered material if there is a "substantial likelihood that a reasonable shareholder would consider it important" or if the information "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[15] Given the far-reaching effects of the COVID-19 pandemic, discussions of COVID-19 with investors or analysts could include MNPI, especially to the extent that such discussions regarding COVID-19 would bear on previously issued guidance. Consequently, issuers with outstanding guidance need to be very careful in any discussions with analysts and investors, and as a result, many issuers have publicly updated or withdrawn previously issued guidance.

Even without guidance in place, issuers should still consider whether discussions regarding COVID-19 with analysts and investors may contain material information. The SEC has also warned that due to the dynamic circumstances of the COVID-19 pandemic, nonpublic information may hold greater value than under normal circumstances (and therefore is more likely to be MNPI, with a correspondingly greater number of employees now having access to MNPI).[16] Accordingly, issuers should evaluate their Regulation FD policies and procedures to protect against the improper dissemination of MNPI.

***Quarterly reporting*.** Many issuers will not have addressed the impacts of COVID-19 on their previously issued guidance by the time of their quarterly reporting or may have revised their guidance in connection with COVID-19 but have since determined that the updated guidance is no longer accurate. Issuers should review their guidance policies and involve their audit committee and auditors in connection with issuing guidance. Due to the uncertainties caused by COVID-19, many issuers may determine that they are unable to issue reliable guidance, in which case they should decline to issue guidance this quarter and consider withdrawing previously issued guidance. In many industries, this has been a common approach, and issuers should expect to receive questions about any new or outstanding guidance, including the underlying assumptions for that guidance. If an issuer feels that it is able to issue reliable guidance, it should consider disclosing the assumptions and expectations upon which the guidance was based and should include appropriate qualifiers such as that the guidance is "expected" or "anticipated."

In issuing any guidance, issuers should be clear that the guidance constitutes forward-looking statements within the meaning of the PSLRA and, as described above, update and refine their disclaimers for forward-looking statements accordingly. Finally, as issuers provide new guidance and engage with analysts and investors, they should be mindful of their obligations under Regulation FD.

B. NON-GAAP FINANCIAL MEASURES AND PERFORMANCE METRICS

Issuers including non-GAAP financial measures or performance metrics in their quarterly reporting (including in order to adjust for or explain the impact of COVID-19) should prepare their disclosure in accordance with Item 10(e) of Regulation S-K and Regulation G and other applicable SEC disclosure requirements, as well as SEC guidance on non-GAAP financial measures and performance metrics. Disclosure Guidance Topic No. 9 provides additional guidance on the use of non-GAAP measures in connection with COVID-19, including the ability to reconcile non-GAAP measures to estimates or reasonable ranges of GAAP results, other than in filings where GAAP financial statements are required. Disclosure Guidance Topic No. 9 also directs issuers reconciling to provisional amounts or estimated ranges to limit disclosures to those non-GAAP financial measures they use to report results to their boards of directors, reminding issuers that the SEC staff does not believe it is appropriate for an issuer to present non-GAAP financial measures or metrics for the sole purpose of presenting a more favorable view of the issuer. Additionally, Disclosure Guidance Topic No. 9 notes that issuers including key performance indicators and metrics to describe the impacts of COVID-19 should be sure to comply with disclosure requirements for such metrics, including disclosing why management finds those measures useful and how those measures help investors assess the impact of COVID-19. More information on the guidance provided in Disclosure Guidance Topic No. 9 regarding non-GAAP measures and performance metrics is included in our memorandum to clients dated March 30, 2020, available here, and more information on the SEC's guidance regarding performance metrics is included in our memorandum to clients dated February 5, 2020, available here.

C. EARNINGS CALLS

Due to COVID-19, issuers will likely need to conduct their earnings call differently from their normal practice. As a result, issuers should begin planning for their earnings call earlier than in the normal course, even if they are not yet able to set a date for the call, and consider the implications of any changes to their normal practices and those of their vendors.

- ***Earnings calls should be Regulation FD compliant.*** Issuers must give public notice a "reasonable period" ahead of the call, which the SEC has described as notice of several days for a quarterly earnings announcement. Due to the effects of COVID-19, issuers may not be able to finalize and announce a date for their earnings release in accordance with their customary timelines, and consequently their earnings call may occur later in the process or with less notice than normal. Even if the timeline for an earnings call changes, issuers should still provide adequate notice in advance of the earnings call.
- ***Presentations should align with earnings release and overall message.*** Issuers should carefully review whether any slide decks or other materials to be presented on the earnings call accurately reflect the current state of the business in light of COVID-19. For example, issuers may normally use standard slide deck templates that are updated for each earnings call. These slide decks should have sufficient disclosure about the impacts of COVID-19 and should not inadvertently give an overly optimistic impression.
- ***Management will need to find ways to coordinate communications while working remotely.*** Due to restrictions in movement, officers may be required to join the call from different locations and without their broader team in close proximity as may be customary. This may limit their ability to communicate with one another, including in connection with answering questions from analysts. Issuers should consider ways in which team members can coordinate during the call, and implement mechanisms for team members to be easily reached during the call.
- ***Management should be familiar with any new technology well in advance of the call.*** Due to COVID-19, issuers may be using new and different technology. As a result, call participants should conduct a dry run with any new technology in advance, and issuers should prepare for any contingencies in connection with the call, such as interruptions in service or the need to postpone the call.
- ***Be prepared to address health issues of management.*** Issuers should consider the health of each of the participants in the call and other senior executives of the issuer and be prepared to answer questions on this topic from analysts. If any senior executives are unable to participate in the call due to COVID-19-related illness, issuers should consider disclosing this in advance of the call.[17]

In light of the evolving impact of COVID-19, some issuers may also consider not conducting an earnings call. While earnings calls are not required under securities laws, they are customarily part of quarterly reporting and during this time may help promote a sense of normalcy and investor transparency by demonstrating that management and other relevant parties continue to perform their normal functions despite the crisis. In addition, earnings calls frequently serve as a Regulation FD-compliant means for issuers to facilitate discussions with analysts and investors as a supplement to the disclosures made in the earnings release. If an issuer determines it will not be conducting an earnings call, it will need to be mindful of Regulation FD's prohibition on selective disclosure of MNPI in any discussions with investors and analysts.

TIMING CONSIDERATIONS

A. SEC FILING EXTENSION

In recognition of the operational and other challenges presented by COVID-19, as anticipated, the SEC recently extended the scope of conditional relief it announced earlier in March. Under the extension, issuers meeting certain conditions (discussed in our prior memorandum to clients, dated March 30, 2020, available here) may qualify for relief from some of the requirements under the Securities Exchange Act of 1934. Among other things, issuers that are unable to meet a filing deadline due to the COVID-19 crisis may receive a 45-day extension on Exchange Act reports due between March 1 and July 1, 2020 (as compared to the original March 1 to April 30, 2020 period under the SEC's March 4 order). For issuers with a fiscal year ending December 31, the Form 10-Q filing deadline would be extended from May 11 to June 25, 2020 for Large Accelerated and Accelerated Filers and from May 15 to June 29, 2020 for Non-Accelerated Filers. Even if issuers meet the requirements for the extension, they may be constrained by other agreements in availing themselves of the relief. Accordingly, issuers should review their agreements and any other obligations, particularly covenants in indentures, credit agreements and other debt agreements, to evaluate whether they impose independent deadlines on reporting that would be implicated if an issuer delayed its reporting.

B. CONSIDERATIONS FOR ISSUERS TAKING ADVANTAGE OF EXTENSION

Issuers that file their quarterly reports on a delayed basis may wish to provide information in the form of an earnings release or preliminary results announcement in advance of filing their Form 10-Q. Although such information may be preliminary, issuers have exposure under the securities laws for material misstatements or omissions in such disclosures. Issuers should therefore evaluate whether their internal control over financial reporting and disclosure controls and procedures are operating effectively to enable accurate disclosures, including with respect to key reporting metrics. To the extent that any results are preliminary, issuers should convey that information to investors, indicating how that information may change. Of particular concern would be positive information that leads investors to believe that the final reported results will be more favorable than they are. In deciding whether to report preliminary results, issuers will want to consider their confidence level in the disclosures. Issuers and their IR departments may also feel driven to report results early based on misinformation in the market as to the likely results of COVID-19 on their business. Reporting preliminary results will also provide issuers the ability to talk with analysts and investors about those results, subject to compliance with Regulation FD. As always, issuers may not convey MNPI during those discussions, but by releasing preliminary results, issuers may reduce the risk of inadvertent disclosures.

C. REPORTING PREPARATIONS

Regardless of their timing for reporting first quarter earnings, issuers should begin planning as early as possible and involve the relevant parties, including the audit committee and auditors, early in the planning process. Additionally, issuers should monitor for new developments that would impact their disclosures and evaluate their contingency plans to account for the uncertainties and rapid changes stemming from COVID-19.

While the topics discussed in this memorandum provide general considerations for issuers, each issuer's reporting and disclosure is unique, and therefore should be carefully tailored to its particular facts and circumstances.

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ENDNOTES

1 *See* SEC, The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19 (Apr. 8, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-hinman.

2 In a statement issued on April 2, 2020, SEC Chairman Clayton emphasized that while challenges may impact the timing of certain filings, the staff is "keenly focused on ensuring that issuers and other registrants continue to provide material information to investors, including information related to the current and expected effects of COVID-19, as promptly as practicable." *See* SEC, Investors Remain Front of Mind at the SEC: Approach to Allocation of Resources, Oversight and Rulemaking; Implementation of Regulation Best Interest and Form CRS (Apr. 2, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-investors-rbi-form-crs.

3 *See* SEC, Special Meeting of the Investor Advisory Committee (Apr. 2, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-investor-advisory-2020-04-02.

4 *See* CNBC Transcript: SEC Chairman Jay Clayton Speaks with CNBC's Andrew Ross Sorkin on "Squawk Box" Today (Apr. 7, 2020), *available at* https://www.cnbc.com/2020/04/07/cnbc-transcript-sec-chairman-jay-clayton-speaks-with-cnbcs-andrew-ross-sorkin-on-squawk-box-today.html.

5 *See* Division of Corporation Finance Disclosure Guidance Topic No. 9 (Mar. 25, 2020), *available at* https://www.sec.gov/corpfin/coronavirus-covid-19.

6 *See* Division of Corporation Finance Financial Reporting Manual, Topic 9 – Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A), *available at* https://www.sec.gov/corpfin/cf-manual/topic-9.

7 *See* SEC, Mylan to Pay $30 Million for Disclosure and Accounting Failure Relating to EpiPen (Sept. 27, 2019), *available at* https://www.sec.gov/news/press-release/2019-194.

8 *See* SEC, Facebook to Pay $100 Million for Misleading Investors About the Risks It Faced From Misuse of User Data (July 24, 2019), *available at* https://www.sec.gov/news/press-release/2019-140.

9 For more information on disclosure considerations in connection with senior executive illness due to COVID-19, see our memorandum to clients, dated March 20, 2020, entitled "Senior Executive Illness Due to COVID-19," *available at* https://www.sullcrom.com/files/upload/SC-Publication-Disclosure-Considerations-Senior-Executive-Illness-Due-to-COVID-19.pdf.

10 For a general discussion of heightened cybersecurity risks that may affect companies as a result of COVID-19, see our memorandum to clients, dated March 30, 2020, entitled "Heightened Cybersecurity Risks Resulting From COVID-19's Effects on Operations: Companies Should Be Alert to Cybercriminals Exploiting Remote Working Vulnerabilities and Interest in COVID-19," *available at* https://www.sullcrom.com/files/upload/SC-Publication-Heightened-Cybersecurity-Risks-Resulting-From-COVID-19.pdf.

11 *See* SEC, Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus — Reporting Considerations and Potential Relief (Feb. 19, 2020), *available at* https://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19.

12 *See* OCA, Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19 (Apr. 3, 2020), *available at* https://www.sec.gov/news/public-statement/statement-teotia-financial-reporting-covid-19-2020-04-03.

13 With respect to lender accounting of debt modifications, the CARES Act and banking regulators have provided for the ability for lenders to make short-term loan modifications in connection with COVID-19 without such modifications being considered troubled debt restructurings under US GAAP. *See* our memorandum to clients, dated March 29, 2020, entitled "Coronavirus Aid, Relief, and Economic Security Act," *available at* https://www.sullcrom.com/files/upload/SC-Publication-

ENDNOTES (CONTINUED)

Coronavirus-Aid,-Relief,-and-Economic-Security-Act.pdf and our memorandum to clients, dated March 22, 2020, entitled "Interagency Statement on Loan Modifications and Reporting," *available at* https://www.sullcrom.com/files/upload/SC-Publication-Bank-Regulators-Issue-Statement-on-COVID-19-Related-Loan-Modifications.pdf.

14 *See* Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus — Reporting Considerations and Potential Relief (Feb. 19, 2020), *available at* https://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19.

15 Release No. 33-7881, Final Rule: Selective Disclosure and Insider Trading (Aug. 15, 2000), *available at* https://www.sec.gov/rules/final/33-7881.htm#P110_41725.

16 *See* SEC, Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC's Division of Enforcement, Regarding Market Integrity (Mar. 23, 2020), *available at* https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity.

17 *See supra* note 9.

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