June 25, 2020

SEC Issues Additional COVID-19 Disclosure Guidance

Division of Corporation Finance Provides Additional Disclosure Guidance for Reporting on the Impact of COVID-19 and the Office of the Chief Accountant Issues Statement on the Importance of High-Quality Financial Reporting in Light of COVID-19

SUMMARY

On June 23, the SEC issued additional guidance ("Disclosure Guidance Topic No. 9A") setting forth further views of the Division of Corporation Finance regarding operations, liquidity and capital resources disclosures that companies should consider with respect to business and market disruptions related to COVID-19. Disclosure Guidance Topic No. 9A supplements Disclosure Guidance Topic No. 9, which provided the Division of Corporation Finance's initial views on disclosure and other securities law obligations that companies should consider with respect to COVID-19, and is discussed in our memorandum to clients dated March 30, 2020, available here. On the same day, the Office of the Chief Accountant of the SEC issued a statement ("June OCA Statement") regarding the importance of high-quality financial reporting in light of the significant impacts of COVID-19 and its role in the functioning of markets and efforts to mitigate COVID-19. Disclosure Guidance Topic No. 9A and the June OCA Statement reflect the SEC's continued emphasis on robust public disclosure regarding the impacts of COVID-19, which is also discussed in our memorandum to clients dated April 9, 2020, available here.

DISCLOSURE GUIDANCE TOPIC NO. 9A

Disclosure Guidance Topic No. 9A provides guidance on additional disclosure considerations for public companies regarding COVID-19, focusing on the impact of COVID-19 on a company's operations and financial condition, including liquidity and capital resources, and on disclosures regarding government assistance and a company's ability to continue as a going concern. Disclosure Guidance Topic No. 9A encourages companies to provide disclosures that allow investors to evaluate the impact of COVID-19 through the eyes of management and to proactively revise and update disclosures based on changes in facts and circumstances.

A. OPERATIONS, LIQUIDITY AND CAPITAL RESOURCES

Disclosure Guidance Topic No. 9A observes that companies have undertaken, and are in the process of making, a diverse range of operational adjustments in response to the effects of COVID-19, which may be material to an investment or voting decision and consequently should be disclosed to investors. Those adjustments may include a transition to telework; supply chain and distribution adjustments; and suspending or modifying certain operations to comply with health and safety guidelines, including in connection with a transition back to the workplace. Companies are also undertaking a diverse and sometimes complex range of financing activities in response to COVID-19, which may include novel terms and structures. Companies should provide robust and transparent disclosures about how they are dealing with short- and long-term liquidity and funding risks, particularly to the extent efforts present new risks or uncertainties to their business. Where companies have been making these disclosures in their earnings releases, the SEC staff encourages companies to evaluate whether any of the information, in light of its potential materiality, should also be included in MD&A.

Disclosure Guidance Topic No. 9A provides a series of questions for companies to consider in connection with their disclosure obligations:

- What are the material operational challenges that management and the Board of Directors are monitoring and evaluating? How and to what extent have you altered your operations, such as implementing health and safety policies for employees, contractors, and customers, to deal with these challenges, including challenges related to employees returning to the workplace? How are the changes impacting or reasonably likely to impact your financial condition and short- and long-term liquidity?
- How is your overall liquidity position and outlook evolving? To the extent COVID-19 is adversely impacting your revenues, consider whether such impacts are material to your sources and uses of funds, as well as the materiality of any assumptions you make about the magnitude and duration of COVID-19's impact on your revenues. Are any decreases in cash flow from operations having a material impact on your liquidity position and outlook?
- Have you accessed revolving lines of credit or raised capital in the public or private markets to address your liquidity needs? Are your disclosures regarding these actions and any unused liquidity sources providing investors with a complete discussion of your financial condition and liquidity?
- Have COVID-19 related impacts affected your ability to access your traditional funding sources on the same or reasonably similar terms as were available to you in recent periods? Have you provided additional collateral, guarantees, or equity to obtain funding? Have there been material changes in your cost of capital? How has a change, or a potential change, to your credit rating impacted your ability to access funding? Do your financing arrangements contain terms that limit your ability to obtain additional funding? If so, is the uncertainty of additional funding reasonably likely to result in your liquidity decreasing in a way that would result in you being unable to maintain current operations?
- Are you at material risk of not meeting covenants in your credit and other agreements?

- If you include metrics, such as cash burn rate or daily cash use, in your disclosures, are you providing a clear definition of the metric and explaining how management uses the metric in managing or monitoring liquidity? Are there estimates or assumptions underlying such metrics the disclosure of which is necessary for the metric not to be misleading?
- Have you reduced your capital expenditures and if so, how? Have you reduced or suspended share repurchase programs or dividend payments? Have you ceased any material business operations or disposed of a material asset or line of business? Have you materially reduced or increased your human capital resource expenditures? Are any of these measures temporary in nature, and if so, how long do you expect to maintain them? What factors will you consider in deciding to extend or curtail these measures? What is the short- and long-term impact of these reductions on your ability to generate revenues and meet existing and future financial obligations?
- Are you able to timely service your debt and other obligations? Have you taken advantage of available payment deferrals, forbearance periods, or other concessions? What are those concessions and how long will they last? Do you foresee any liquidity challenges once those accommodations end?
- Have you altered terms with your customers, such as extended payment terms or refund periods, and if so, how have those actions materially affected your financial condition or liquidity? Did you provide concessions or modify terms of arrangements as a landlord or lender that will have a material impact? Have you modified other contractual arrangements in response to COVID-19 in such a way that the revised terms may materially impact your financial condition, liquidity, and capital resources?
- Are you relying on supplier finance programs, otherwise referred to as supply chain financing, structured trade payables, reverse factoring, or vendor financing, to manage your cash flow? Have these arrangements had a material impact on your balance sheet, statement of cash flows, or short- and long-term liquidity and if so, how? What are the material terms of the arrangements? Did you or any of your subsidiaries provide guarantees related to these programs? Do you face a material risk if a party to the arrangement terminates it? What amounts payable at the end of the period relate to these arrangements, and what portion of these amounts has an intermediary already settled for you?
- Have you assessed the impact material events that occurred after the end of the reporting period, but before the financial statements were issued, have had or are reasonably likely to have on your liquidity and capital resources and considered whether disclosure of subsequent events in the financial statements and known trends or uncertainties in MD&A is required?

B. GOVERNMENT ASSISTANCE

The Coronavirus Aid, Relief and Economic Security Act ("CARES Act") provides financial assistance to companies in the form of loans and tax relief in the form of deferred or reduced payments and potential refunds. Disclosure Guidance Topic No. 9A encourages companies receiving governmental assistance, including foreign companies receiving assistance from their home country, to consider the short- and long-term impact of that assistance on their financial condition, results of operations and capital resources, as well as the related disclosures and critical accounting estimates and assumptions.

Questions provided by the SEC staff for companies to consider include:

- How does a loan impact your financial condition, liquidity and capital resources? What are the material terms and conditions of any assistance you received, and do you anticipate being able to comply with them? Do those terms and conditions limit your ability to seek other sources of financing or affect your cost of capital? Do you reasonably expect restrictions, such as maintaining certain employment levels, to have a material impact on your revenues or income from continuing operations or to cause a material change in the relationship between costs and revenues? Once any such restrictions lapse, do you expect to change your operations in a material way?

- Are you taking advantage of any recent tax relief, and if so, how does that relief impact your short- and long-term liquidity? Do you expect a material tax refund for prior periods?
- Does the assistance involve new material accounting estimates or judgments that should be disclosed or materially change a prior critical accounting estimate? What accounting estimates were made, such as the probability a loan will be forgiven, and what uncertainties are involved in applying the related accounting guidance?

C. GOING CONCERN

Disclosure Guidance Topic No. 9A notes that management should consider whether conditions and events, taken as a whole, raise substantial doubt about a company's ability to meet its obligations as they become due within one year after the date of the financial statements. Where there is such a substantial doubt, or the substantial doubt is alleviated by management's plans, management should provide disclosure in the financial statements, as prescribed in FASB ASC Topic 205-40 for companies reporting under U.S. generally accepted accounting principles ("GAAP"). Additionally, the SEC staff encourages companies to consider the following questions regarding the related MD&A disclosure:

- Are there conditions and events that give rise to the substantial doubt about the company's ability to continue as a going concern? For example, have you defaulted on outstanding obligations? Have you faced labor challenges or a work stoppage?
- What are your plans to address these challenges? Have you implemented any portion of those plans?

In addition to the disclosure considerations set forth above, COVID-19 may also materially impact other company disclosures such as disclosure controls and procedures ("DCP") and internal control over financial reporting ("ICFR"). Financial reporting considerations regarding DCP and ICFR and an entity's ability to continue as a going concern are discussed further in the June OCA Statement below.

Also discussed below is the key role that audit committees play through their oversight of financial reporting. The critical role of the audit committee extends beyond financial statements to the disclosures discussed in Disclosure Guidance Topic No. 9A, and the audit committee should be included in the disclosure process.

The SEC staff have emphasized that the questions for companies to consider in Disclosure Guidance Topic No. 9A, as supplementing Disclosure Guidance Topic No. 9, are intended to be illustrative and are not exhaustive. Accordingly, companies should carefully assess COVID 19's impact and tailor their disclosures based on their facts and circumstances to provide material information to investors and other market participants.

JUNE OCA STATEMENT ON FINANCIAL REPORTING

On April 3, the Office of the Chief Accountant ("OCA") issued a statement regarding the importance of high-quality financial reporting in light of the significant impacts of COVID-19. The June OCA Statement reiterates the continued importance of high-quality financial reporting as companies prepare for second quarter financial reporting and emphasizes their role in the functioning of markets and the national effort to mitigate COVID-19. The June OCA Statement highlights the following areas in connection with financial reporting:

- ***Significant Estimates and Judgments.*** Where companies have made significant judgments and estimates to address accounting and reporting matters, the OCA will continue to not object to well-reasoned judgments that companies have made. Companies should ensure that significant judgments and estimates are disclosed in a manner that is understandable and useful to investors, and that the resulting financial reporting reflects and is consistent with the company's facts and circumstances.
- ***Disclosure Controls and Procedures and Internal Control over Financial Reporting.*** Public companies have adapted, or are adapting, their financial reporting processes as they respond to the changing environment. The June OCA Statement reminds companies that if a change materially affects, or is reasonably likely to materially affect, an entity's ICFR, such change must be disclosed in the quarterly filings in the fiscal quarter in which it occurred (or fiscal year in the case of a foreign private issuer).
- ***Ability to Continue as a Going Concern.*** As described above, for each reporting period GAAP requires management to consider whether conditions and events, taken as a whole, raise substantial doubt about a company's ability to continue as a going concern. GAAP requires going concern disclosures in the notes of the financial statements, and there will likely be other disclosure requirements in SEC filings, such as in MD&A. Furthermore, the OCA notes that where, in the course of its review of interim financial information, an auditor becomes aware of conditions or events that indicate substantial doubt about a company's ability to continue as a going concern, the auditor should inquire with management and consider the adequacy of the relevant disclosures' conformity with GAAP.
- ***Addressing Complex or Emerging Issues in Financial Reporting.*** The OCA observes that, as a general matter, the complex financial reporting issues that arose during the first quarter 2020 reporting cycle were addressed effectively and timely through the existing financial reporting structure, and expects the existing financial reporting system to provide the framework for addressing such reporting issues in connection with second quarter reporting.
- ***Vital Role of Audit Committees.*** The OCA reiterates the key role that audit committees of companies play in the financial reporting system through their oversight of financial reporting, including ICFR and the external, independent audit process. The OCA stresses that in these times of rapid change and increased uncertainty, the need for the oversight role that audit committees play is as critical as ever.

As companies continue to fulfill their financial reporting obligations during this period of economic stress and heightened uncertainty, the June OCA Statement emphasizes the OCA's commitment to supporting reporting parties and its continued availability for discussion and consultation.

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