May 9, 2022

SEC Staff Highlights Review of Disclosures Pertaining to Russia's Invasion of Ukraine

SEC Division of Corporation Finance Publishes Sample Comment Letter Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues

INTRODUCTION

Russia's invasion of Ukraine has had and may continue to have far-reaching impacts on the businesses of SEC-reporting companies. Companies impacted include those which: (i) have assets, operations or human capital resources located in Russia, Ukraine or Belarus, (ii) invest in those areas or hold securities that trade in those areas, (iii) are entangled in the legal and regulatory uncertainty surrounding the invasion, or (iv) rely on goods or services sourced in Russia, Ukraine or Belarus or are impacted by supply chain disruptions as a result of the invasion (including potential cybersecurity risks and other indirect operational or supply chain challenges faced by businesses with no physical operations in Russia, Ukraine or Belarus). Companies must consider how such direct or indirect impacts should be disclosed in their periodic reports to the SEC.

To assist SEC-reporting companies in assessing their disclosure obligations, the SEC recently published a "Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues" (the "Sample Letter").[1] The Sample Letter reinforces the obligation of SEC-reporting companies that are impacted by Russia's invasion of Ukraine to update their financial statements[2] and consider how these matters affect management's evaluation of disclosure controls and procedures, management's assessment of the effectiveness of internal controls over financial reporting, and the role of the board of directors in risk oversight of any action or inaction related to Russia's invasion of Ukraine, including consideration of whether to continue or to halt operations or investments in Russia and/or Belarus.[3]

SEC SAMPLE COMMENTS FOR COMPANIES

In addition to broad guidance that businesses should "evaluate whether they have been impacted by matters characterized as potential risks" and update their disclosure accordingly, the Sample Letter provides a more specific illustrative sample of comments that may be applicable to a wide range of issuers. The illustrative sample comments address a wide range of elements within a company's disclosure framework – general disclosure, cybersecurity, MD&A, non-GAAP measures, disclosure controls and procedures, and internal controls over financial reporting.

- **General:** Issuers with a material portion of their operations or assets located in Russia, Belarus or Ukraine should describe the direct or indirect impact of Russia's invasion of Ukraine on their business (or, if the impact is not material, explain why). Such disclosure should include: (1) the impact of sanctions, regulatory approvals, or export or capital controls; (2) the reaction of stakeholders, including investors, employees, and customers; and (3) the implications if Russia or another government were to nationalize any assets or operations. Issuers should also describe the role of the board of directors in overseeing risks related to Russia's invasion of Ukraine, including with respect to cybersecurity, sanctions, employees, supply chain issues, and risks associated with ongoing operational or investment (or divestment) decisions.
- **Risks Related to Cybersecurity:** Issuers should disclose any new or heightened risks of potential cyberattacks by state actors and discuss any actions taken to mitigate such risks.
- **MD&A:** Issuers should update their management's discussion and analysis to disclose, to the extent they have been materially impacted by Russia's invasion of Ukraine: (1) any known trends or uncertainties[4] that have had or are reasonably likely to have a material impact on cash flows, liquidity, capital resources, cash requirements, financial position or results of operations; (2) any required enhancements to critical accounting estimate disclosure related to, among others, the impairment of assets, valuation of inventory, allowance for bad debt, deferred tax asset valuation allowance or revenue recognition;[5] (3) any import or export bans on any products or commodities sold by or used in the issuer's business;[6] and (4) the impact of supply chain disruptions or operational challenges on business segments, products, lines of service, projects or operations.[7]
- **Non-GAAP Measures:** Any non-GAAP adjustments relating to, *e.g.*, lost revenue, revenue recognition or expenses must be in compliance with Regulation G[8] and be responsive to Questions 100.04 and 100.01 of the Division's C&DI for Non-GAAP Financial Measures.[9]
- **Disclosure Controls and Procedures:** To the extent applicable, issuers should describe the impact of Russia's invasion of Ukraine on the effectiveness or design of disclosure controls and procedures, including the impact on their conclusion of the effectiveness of disclosure controls and procedures as of the end of the relevant reporting period.
- **Internal Controls Over Financial Reporting:** To the extent applicable, issuers should disclose any changes to internal controls over financial reporting as a result of Russia's invasion of Ukraine (or any indirect impacts, such as supply chain disruptions) that have materially affected or are reasonably likely to materially affect their internal controls over financial reporting.[10]

The SEC's guidance in the Sample Letter provides a sample of the types of disclosure that SEC-reporting companies should be considering before submitting their next periodic filing. While the SEC's guidance will be more applicable to issuers with significant assets or operations in Russia, the Sample Letter also emphasizes that other issuers may be indirectly impacted by Russia's invasion of Ukraine in a manner that may require increased disclosure due to, for example, new cybersecurity risks, supply chain disruptions or material changes to input products or commodities prices.

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ENDNOTES

[1] U.S. Securities and Exchange Commission, "Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues" (May 3, 2022), https://www.sec.gov/corpfin/sample-letter-companies-pertaining-to-ukraine?utm_medium=email&utm_source=govdelivery.

[2] The Sample Letter notes that SEC-reporting companies may need to update their financial statements to reflect: (1) impairment of assets; (2) changes in inventory valuation; (3) deferred tax asset valuation allowance; (4) disposal or exiting of a business; (5) de-consolidation; (6) changes in exchange rates; and (7) changes in contracts with customers or the ability to collect contract considerations. *Id*.

[3] *Id*.

[4] The Sample Letter notes that trends or uncertainties may include: (1) impairments of financial assets or long-lived assets; (2) declines in the value of inventory, investments, or recoverability of deferred tax assets; (3) the collectability of consideration related to contracts with customers; and (4) modification of contracts with customers. *Id*.

[5] According to the Sample Letter, the MD&A with respect to critical accounting estimates should include: (1) descriptions of why existing critical accounting estimates are subject to uncertainty; (2) estimates and assumptions underlying certain calculations; (3) the degree to which estimates and assumptions have changed since the last assessment (including due to the effects of changes to, *e.g.*, prices, exchange rates or estimated cash flows); and (4) the sensitivity of the reported amount to the method and assumptions underlying its calculation. *Id*.

[6] Disclosure related to import and export bans should include the estimated impact on the issuer's business, taking into consideration the availability of materials, cost of needed materials, costs and risks associated with transportation and the impact on margins and customers. *Id*.

[7] Supply chain disruptions may include, among other things, (1) suspensions in the production, purchase, sale or maintenance of certain items; (2) higher costs due to constrained capacity, increased commodity prices or sourcing challenges; (3) surges or declines in consumer demand that cannot be addressed with adequate adjustments to supply; (4) the inability to source supply products at competitive prices; and (5) exposure to supply chain risks or expectations of "de-globalizing" the supply chain. *Id*.

[8] 17 C.F.R. §§ 244.100 *et seq*. Regulation G provides a set of rules and regulations in connection with the use of non-GAAP financial measures. *See also* U.S. Securities and Exchange Commission, "Non-GAAP Financial Measures" (last updated April 4, 2018), https://www.sec.gov/corpfin/non-gaap-financial-measures ("Non-GAAP Financial Measures").

[9] *See* Non-GAAP Financial Measures, *supra* note 8. Question 100.04 provides that non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. Question 100.01 provides that certain adjustments, although not explicitly prohibited, may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP measure to be misleading. *Id*.

[10] *See also* Item 308(c) of Regulation S-K, requiring a registrant to disclose any change in its internal control over financial reporting identified in connection with the evaluation of internal controls pursuant to paragraph (d) of Rule 13a-15 or 15d-15 that has occurred during the registrant's last fiscal quarter that has materially affected, or is reasonably likely to affect, the registrant's internal control over financial reporting. *See* 17 C.F.R. §§ 229.308, 240.13a-15, 240.15d-15.

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