

SEC Issues Supplemental Guidance for COVID-19 Disclosures

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COVID-19 has presented unprecedented challenges for public companies, not just as to its effects on their business but also on how to provide adequate and timely disclosures. At the outset of the pandemic, the Securities and Exchange Commission ("SEC") acknowledged these challenges and on March 25, 2020 the Division of Corporation Finance ("CorpFin") issued CD Disclosure Guidance Topic No. 9, giving guidance on its views regarding disclosure and other securities law obligations that companies should consider. To provide additional assistance, CorpFin on June 23, 2020 issued CF Disclosure Guidance Topic No. 9A, providing supplementary guidance regarding operations, liquidity and capital resources companies should consider with respect to business and market disclosures related to COVID-19. Also on June 23, 2020, the SEC's Office of the Chief Accountant ("OCA") issued a statement on the continued importance of high-quality financial reporting for investors in light of COVID-19. As the quarter ended June 30, 2020 is the first full reporting period affected by the pandemic, it is important that companies focus on this guidance when preparing their next quarterly filings.

Topic No. 9A

CorpFin emphasized that it will continue to monitor disclosures, which should allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management. An investor should be able to understand how management and the Board of Directors are analyzing the impact of COVID-19 on the company's operations and financial condition, including liquidity and capital markets. Because the pandemic is not static, companies must be proactive and revise and update their disclosures as circumstances change.

With regard to a company's operations, the guidance noted that companies have made and are in the process of making a wide range of adjustments in response to the pandemic. These include a transition to telework, supply chain and distribution adjustments and suspending or modifying operations to comply with health and safety guidelines to protect employees, contractors and customers. These actions may have an effect that would be material to an investor's investment or voting decision and companies must carefully consider making appropriate disclosures.

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In addition to its impact on a company's operations, COVID-19 has significantly impacted the financial markets. As a result, companies are undertaking a diverse and sometimes complex range of financing activities, which may include obtaining and using credit facilities, accessing public and private markets, implementing supplier finance programs and negotiating new or modified customer payment terms. The guidance emphasizes the importance of a company providing robust and transparent disclosures as to how it is dealing with short- and long-term liquidity risks, especially if these activities present new risks or uncertainties. Although some of these disclosures may have been made by companies in their earnings releases, CorpFin encourages companies to evaluate whether this information is sufficiently material and should be included in the company's MD&A. The guidance also provides a list of questions, which are included below, to help companies analyze their specific facts and circumstances and their individual disclosure obligations.

The recently adopted Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") also presents disclosure challenges to companies. Recipients of assistance under the CARES Act must consider the short- and long-term impact of that assistance on their financial condition, results of operations, liquidity and capital resources as well as the related disclosures and critical accounting estimates and assumptions. The guidance also provides helpful questions to consider regarding the CARES Act, which are included below.

Because of the effects of the pandemic on companies and the financial markets, CorpFin highlighted in the guidance the need for management to 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 issuance of the financial statements. If there is such substantial doubt, or if the substantial doubt is alleviated by management's plans, appropriate disclosures should be provided. Additional questions for purposes of a company's MD&A disclosure are provided, as set forth below.

Office of Chief Accountant Statement

The OCA reiterated its prior statements as to the importance of high-quality financial reporting in light of the significant impacts of the pandemic. The OCA emphasized that participants in the financial reporting system play an important role in the functioning of the markets and in the collective national efforts to mitigate the COVID-19 pandemic. The OCA noted that these times of heightened uncertainty increased investors' needs for decision-useful information. The virus has increased each company's need to make significant judgments and estimates in connection with different accounting and financial reporting matters. To help assuage a company's concerns, the OCA noted that it does not object to well-reasoned judgments and estimates by companies, as long as they are disclosed in an understandable manner useful to investors and that the resulting disclosure reflects and is consistent with a company's specific facts and circumstances. Strong internal accounting controls are basic to high-quality, reliable financial reporting. Their effectiveness, however, may be affected by changes in operations caused by the pandemic, such as working

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remotely. Such changes may increase the risks of material misstatements, which then must be disclosed in a company's periodic filings.

As with CorpFin, the OCA urges management to consider, in each reporting period, including interim periods, whether relevant conditions and events, taken as a whole, raise substantial doubt about the entity's ability to continue as a going concern. If substantial doubt does exist, management should consider whether its plans alleviate such substantial doubt, and make appropriate disclosures, including of management's plans to alleviate the doubt. Additional disclosure is necessary if, after consideration, management's plans do not alleviate the substantial doubt.

Finally, the OCA provided a reminder of the important role played by audit committees and stated that the need for the oversight provided by audit committees is as critical as ever.

Questions to Consider by Companies in Evaluating COVID-19-Related Disclosures

As stated above, CorpFin provided helpful questions for companies to consider when evaluating their disclosure obligations. These questions are set forth below in their entirety.

Operations, Liquidity and Capital Resources

- 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 are 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

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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 are the short- and long-term impacts 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?

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The CARES Act

- 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 could materially change a prior critical accounting estimate? What accounting estimates were made, such as the probability that a loan will be forgiven, and what uncertainties are involved in applying the related accounting guidance?

A Company's Ability to Continue as a Going Concern

- 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?

Both CorpFin and the OCA state that their guidance is not a rule, regulation or statement of the SEC, has not been approved by the SEC and has no force of law - however, these statements, in particular the suggested questions, provide very beneficial insight and direction for companies to follow when considering the effects of the pandemic and their ongoing disclosure obligations.

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