SEC Issues Additional Guidance on COVID-19 Disclosure Considerations

July 13, 2020 Bruce Newsome, Rosebud Nau

PRACTICES Corporate, Capital Markets and Securities

On June 23, 2020, the Division of Corporation Finance of the Securities and Exchange Commission ("SEC") issued CF Disclosure Guidance: Topic No. 9A, supplementing its previous guidance to provide disclosures companies should consider including in Management's Discussion and Analysis ("MD&A") in light of the many changes companies have made and the uncertainties they face due to the effects of the novel coronavirus ("COVID-19") pandemic. Reporting companies with a December 31 fiscal year-end should review this guidance as they are preparing their upcoming quarterly reports.

The SEC suggested a variety of questions for a reporting company to consider as it analyzes its disclosure obligations. These questions address the following considerations, among others:

Operations.

- Any material operational challenges that management and the Board of Directors are monitoring and evaluating;
- Changes to operations already implemented; and
- The effect of those changes on the company's financial condition and short- and long-term liquidity.

Liquidity.

- The materiality of the impact of COVID-19, if any, to the company's sources and uses of funds;
- The materiality of any assumptions the company has made about the magnitude and duration of COVID-19's impact on its revenues; and
- Any material impact of a decrease in cash flow from operations on the company's liquidity position and outlook.

Financing Arrangements.

- If the company has accessed revolving lines of credit or raised capital in the public or private markets to address its liquidity needs;
- Whether COVID-19 has affected the company's ability to access its traditional funding sources; and
- Whether the uncertainty of additional funding is reasonably likely to affect the company's ability to maintain current operations.

Risk of Default.

- Whether the company is at a material risk of not meeting covenants in its credit and other agreements;
- Whether the company can timely meet its debt and other obligations; and

- Whether the company has taken advantage of available payment deferrals, forbearance periods, or other concessions and, if so, the terms of those concessions, and the liquidity challenges the company may face once those accommodations end.

Financial Metrics. If the company includes metrics, such as cash burn rate or daily cash use, in its disclosures, the company should include the following:

- A clear definition of such metric;
- An explanation of how management uses the metric in managing or monitoring liquidity; and
- Estimates or assumptions underlying such metric if necessary for the metric not to be misleading.

Reductions in Capital Expenditures.

- Whether the company has reduced or suspended capital expenditures, share repurchase programs or dividend payments, ceased or disposed of any material business operations, material assets or lines of business, or materially reduced or increased its human capital resource expenditures; and
- If so, whether these measures are temporary, the expected duration, the factors the company will consider in deciding to extend or curtail the measures, and the expected short- and long-term impact of these reductions on the company’s ability to generate revenues and meet existing and future financial obligations.

Contractual Obligations.

- Whether the company has altered contractual terms with its customers, suppliers, landlords or other parties; and
- If so, the material effects of such actions on the company’s financial condition, liquidity, and capital resources.

Cash Flow Management. If the company is relying on supplier finance programs, such as supply chain financing, structured trade payables, reverse factoring, or vendor financing, to manage its cash flow, the company should include the following:

- The materials terms of such arrangements; and
- Whether such arrangements have had or are expected to have a material impact on the company’s balance sheet, statement of cash flows, or short- and long-term liquidity.

CARES Act. If the company has received financial assistance under the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), the company should include the following:

- The material terms of the financial assistance; and
- The impact of that financial assistance on the company’s financial condition, liquidity, and capital resources.

Ability to Continue as a Going Concern.

- If there are any conditions and events that, taken as a whole, raise substantial doubt about the company’s ability to continue as a going concern; and
- If so, the company’s plans to address those challenges.

In addition, the SEC has reminded companies that COVID-19 may materially impact other disclosures, such as disclosure controls and procedures and internal control over financial reporting.

Also on June 23, 2020, in conjunction with the guidance from the Division of Corporation Finance discussed above, the SEC's Office of the Chief Accountant ("OCA") issued a statement regarding the importance of high-quality financial reporting in light of the effects of COVID-19, supplementing its previous statement from April 3, 2020. Among other topics, the OCA discussed certain matters relating to audit and accounting disclosures, including the following:

Significant Judgments and Estimates. Companies should ensure that significant judgments and estimates are well-reasoned and disclosed in a manner that is understandable and useful to investors, and the resulting financial reporting reflects and is consistent with the company's specific facts and circumstances.

Internal Controls. Companies are reminded to disclose any changes that materially affect, or are reasonably likely to materially affect, internal control over financial reporting in the report for the fiscal quarter in which the change occurred, including, as follows:

- These changes may include changes made to how controls operate or can be tested or the risk of the control not operating effectively in a telework environment; and

- Changes to the business and additional uncertainties in the present environment may result in additional risk of material misstatement to the financial statements, and new or enhanced controls may need to be implemented to mitigate such risks.

Ability to Continue as a Going Concern. Management and auditors should evaluate the company's ability to continue as a going concern. When conditions and events, taken as a whole, raise substantial doubts about the company's ability to continue as a going concern, the company should disclose:

- The principal conditions giving rise to the substantial doubt;

- Management's evaluation of the significance of those conditions relative to the company's ability to meet its obligations;

- If applicable, management's plans that alleviated the substantial doubt; and

- Additional disclosure in the event management's plans do not alleviate the substantial doubt.

For further information, please contact a member of the Haynes Boone Capital Markets and Securities practice group.