SEC Staff Issues Additional Guidance on COVID-19 Disclosure

June 25, 2020

On June 23rd, the staff of the SEC's Division of Corporation Finance issued new **Disclosure Guidance Topic No. 9A** reflecting the staff's current views regarding disclosure that companies should consider in light of disruptions related to COVID-19. The new guidance supplements the **previous guidance** issued by the staff in March and specifically addresses disclosure as it relates to operations, liquidity, and capital resources. The staff issued the guidance on the same day that the SEC's Office of the Chief Accountant (OCA) issued a **statement** on the continued importance of "high-quality" financial reporting in light of COVID-19.

CF Disclosure Guidance: Topic No. 9A

As a general matter, the guidance "encourage[s] companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management and to proactively revise and update disclosures as facts and circumstances change." In an effort to aid that disclosure, the guidance includes a detailed list of questions for companies to consider when preparing disclosure, some of which are included below.

Operations, Liquidity, and Capital Resources

The guidance serves as a reminder to consider if any of the adjustments made by a company in response to COVID-19 (such as a transition to telework, supply chain and distribution adjustments, and suspending or modifying certain operations) have had a material effect on the company. In addition, companies that have undertaken financing activities in response to the crisis should also provide "robust and transparent" disclosure about short- and long-term liquidity and funding risks, particularly to the extent efforts present new risks or uncertainties to their businesses. Examples of these activities include obtaining and utilizing credit facilities, accessing public and private markets, implementing supplier finance programs, and negotiating new or modified customer payment terms. While some companies are including some of this information in their earnings releases, the guidance reminds companies to evaluate whether any of this information should be included in its MD&A as well.

The guidance lists a number of questions that a company should consider in evaluating its disclosure obligations, including, but not limited to, the following:

- *Operations.* What are the material operational challenges that management and the Board of Directors are monitoring and evaluating? Considerations include changes to operations, such as new health and safety policies for employees and others and the impact of such changes on financial condition and short- and long-term liquidity.
- *Liquidity*. To what extent is COVID-19 adversely affecting revenues? Considerations include whether such impacts are material to sources and uses of funds, as well as the materiality of any assumptions made about the magnitude and duration of COVID-19's impact on revenues, and any decreases in cash flows that have a material impact on liquidity position and outlook.
- *Credit.* A company should consider whether disclosure regarding accessing lines or credit, raising capital and any unused liquidity sources are necessary for a complete discussion of its financial condition and liquidity. Other considerations include: COVID-19-related impacts on access to traditional funding sources on the same or similar terms as were available in recent periods; requirements of additional collateral, guarantees, or equity to obtain funding; material changes in cost of capital; impact of any change to credit rating; and ability to service debt. Is the uncertainty

of additional funding reasonably likely to result in liquidity decreasing in a way that would result in being unable to maintain current operations? Is the company at material risk of not meeting covenants in its credit and other agreements?

- Customer payment terms: If the company has altered terms with its customers, such as extended payment terms or refund periods, or modified terms as a landlord, consider if those actions have materially affected financial condition or liquidity.
- Supplier finance programs: If the company is relying on any supplier finance programs to manage its cash flow, consider if these arrangements have had a material impact on the balance sheet, statement of cash flows, or short- and long-term liquidity. Considerations include subsidiary guarantees of these programs and any material risk if a party to the arrangement terminates it.

- *Capital Expenditures.* Has the company reduced capital expenditures, reduced or suspended share repurchase programs or dividend payments, ceased any material business operations, or disposed of a material asset or line of business? Considerations include: material reductions or increases in human capital resource expenditures; whether these measures are temporary in nature; and the short- and long-term impact of these reductions on the ability to generate revenues and meet existing and future financial obligations.
- *Metrics*. If the company includes metrics such as cash burn rate or daily cash use in its disclosures, it should provide a clear definition of the metric and explain how management uses the metric in managing or monitoring liquidity. Consider whether there are estimates or assumptions underlying such metrics the disclosure of which is necessary so as not to be misleading.
- *Subsequent events*. Companies should assess the impact of any material events that occurred after the end of the reporting period, but before the financial statements were issued, that might have an impact on liquidity and capital resources.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

The guidance also addresses disclosure relating to federal assistance. Companies receiving such assistance should consider the short- and long-term impact of the assistance on their financial condition, results of operations, liquidity, and capital resources, as well as the related disclosures and critical accounting estimates and assumptions. Questions to consider include:

- *Loans.* The impact of a loan on the company's financial condition, liquidity and capital resources. Consider the material terms and conditions of any assistance received, including the ability to comply; any conditions limiting the company's ability to seek other sources of financing; restrictions, such as maintaining certain employment levels, that might have a material impact on revenues or income from continuing operations or to cause a material change in the relationship between costs and revenues.
- *Tax relief.* If the company is taking advantage of any recent tax relief, how does that relief impact short- and long-term liquidity? Consider any material tax refund for prior periods.
- *Accounting estimates.* Consider whether the assistance involves new material accounting estimates that should be disclosed or materially change a prior critical accounting estimate including uncertainties are involved in applying the related accounting guidance.

Ability to Continue as a Going Concern

The guidance encourages management to consider whether conditions and events raise substantial doubt about the company's ability to meet its obligations as they become due within one year after the issuance of its financial statements. Management should provide the appropriate disclosure in the company's financial statements and consider disclosure in the MD&A when there is substantial doubt about the company's ability to continue as a going concern or the substantial doubt is alleviated by management's plans. The company should consider the following questions regarding the 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, including a default on outstanding obligations or labor challenges?
- Consider discussing any plans to address these challenges.

OCA Statement on Financial Reporting in Light of COVID-19

The OCA statement, issued the same day as the guidance, provides additional considerations for companies when considering financial reporting issues related to the impact of COVID-19. The statement reminds companies to disclose any significant judgments or estimates made in connection with COVID-19-related issues in a manner that is understandable and useful to investors, and to ensure that the resulting financial reporting reflects and is consistent with the company's specific facts and circumstances. In addition, if any changes made to financial reporting and disclosure controls procedures, including those relating to a telework environment, materially affects a company's internal control over financial reporting, it must be disclosed. The statement also reiterates that management should consider whether relevant conditions and events, taken as a whole, would impact a company's ability to continue as a going concern. In a case where such doubt exists, disclosure is required. Finally, the statement reminds companies that the OCA has processes in place to provide staff views on the application of U.S. GAAP and International Financial Reporting Standards to complex, unique or novel issues.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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