

June 24, 2020

SEC Staff Issues Additional COVID-19 Disclosure Guidance

In March, we reported on the issuance by the Staff of the Division of Corporation Finance (the “Staff”) of CF Disclosure Guidance Topic No. 9 (“CF-9”) (available [here](#)) setting forth its views regarding disclosure and other securities law obligations that reporting companies should consider in respect of COVID-19 and related business and market disruptions. On June 23, the Staff issued CF Disclosure Guidance Topic No. 9A (“CF-9A”) (available [here](#)), which supplements CF-9 and addresses operations, liquidity and capital resources disclosures reporting companies should consider with respect to business and market disruptions related to COVID-19. Concurrently, the SEC Chief Accountant Sagar Teotia on behalf of the Office of the Chief Accountant (“OCA”) issued a separate public statement (available [here](#)) on financial reporting in light of COVID-19. We are updating our March alert to cover CF-9A and the Chief Accountant’s public statement (the “OCA Statement”).

CF Disclosure Guidance Topic No. 9A; OCA Statement

The Staff notes that, as result of COVID-19-related market disruptions, reporting companies have made, and continue to make, adjustments to the ways in which they operate, which adjustments may have a material impact on reported results. These adjustments can range from work-from-home arrangements, to modifications of supply chain and distribution arrangements, to back-to-work arrangements in a significantly changed environment. The Staff also notes that reporting companies are undertaking a range of financing activities, which may involve departures from historical methods of raising capital, including the use of novel and potentially more complex funding structures. The Staff encourages reporting companies that are addressing in earnings releases the manner in which they are dealing with short- and long-term liquidity and funding risks to consider whether, in light of potential materiality, these risks should also be included in the MD&A.

Operations, Liquidity and Capital Resources, Generally

The Staff sets out the following questions for consideration:

- What are the material operational challenges that management and the board are monitoring and evaluating? How and to what extent has the company altered its operations to deal with these challenges, including challenges related to employees returning to the workplace? How are the changes impacting, or reasonably likely to impact, the company’s financial condition and short- and long-term liquidity?

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- How is the overall liquidity position and outlook evolving? To the extent COVID-19 is adversely impacting revenues, are the impacts material to the sources and uses of funds and what assumptions are being made about the magnitude and duration of COVID-19's impact on revenues? Are any decreases in cash flow from operations having a material impact on the liquidity position and outlook?
 - Has the company accessed revolving lines of credit or raised capital in the public or private markets to address liquidity needs? Are disclosures regarding these actions and any unused liquidity sources providing investors with a complete discussion of the company's financial condition and liquidity?
 - Have COVID-19 related impacts affected the company's ability to access its traditional funding sources on the same or reasonably similar terms as were available in recent periods? Has the company provided additional collateral, guarantees or equity to obtain funding? Have there been material changes in the cost of capital? How has a change, or a potential change, to the company's credit rating impacted the ability to access funding? Do financing arrangements contain terms that limit the company's ability to obtain additional funding? If so, is the uncertainty of additional funding reasonably likely to result in liquidity decreasing such that the company would be unable to maintain current operations?
 - Is the company at material risk of not meeting covenants in its credit and other agreements?
 - If management includes metrics, such as cash burn rate or daily cash use, in its disclosures, is management providing a clear definition of the metric and explaining how it 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?
 - Has the company reduced its capital expenditures and if so, how? Has the company reduced or suspended share repurchase programs or dividend payments? Has the company ceased any material business operations or disposed of a material asset or line of business? Has the company materially reduced or increased human capital resource expenditures? Are any of these measures temporary and, if so, how long does management expect to maintain them? What factors will management consider in deciding to extend or curtail these measures? What is the short- and long-term impact of these on the company's ability to generate revenues and meet existing and future financial obligations?
 - Is the company able to timely service its debt and other obligations? Has the company taken advantage of payment deferrals, forbearance periods or other concessions? What are the concessions and how long will they last? Does management foresee liquidity challenges once those accommodations end?
 - Has the company altered terms with its customers, such as extended payment terms or refund periods, and, if so, how have those actions materially affected financial condition or liquidity? Did the company provide concessions or modify terms of arrangements as a landlord or lender that will have a material impact? Has the company modified other contractual arrangements in such a way that the revised terms may materially impact financial condition, liquidity and capital resources?
 - Is the company relying on supplier finance programs (also known as supply chain financing, structured trade payables, reverse factoring or vendor financing) to manage cash flow? Have these arrangements

had a material impact on the 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 the company or any subsidiary provide guarantees related to these programs? Does the company 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 the company?

- Has management assessed the impact material events that occurred after the end of the reporting period, but before the financial statements are issued, have had or are reasonably likely to have on liquidity and capital resources and considered whether disclosure of subsequent events in the financial statements and known trends or uncertainties in the MD&A is required?

Government Assistance

For reporting companies that have received federal financial assistance in the form of loans and/or tax relief, the Staff sets out the following questions for consideration:

- How does a loan impact the company's financial condition, liquidity and capital resources? What are the material terms and conditions of any assistance received, and does management anticipate being able to comply with them? Do those terms and conditions limit the ability to seek other sources of financing or affect the cost of capital? Does management reasonably expect restrictions, such as maintaining certain employment levels, to have a material impact on revenues or income from continuing operations or to cause a material change in the relationship between costs and revenues? When such restrictions lapse, does management expect a change in operations in a material way?
- Is the company taking advantage of any recent tax relief and, if so, how does that relief impact short- and long-term liquidity? Does management expect a material tax refund for prior periods?
- Does the assistance involve new material accounting estimates or judgments 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?

Going Concern

Both CF-9A and the OCA Statement address the possibility that conditions and events, taken as a whole, could raise substantial doubt about a reporting company's ability to meet its obligations as they become due within one year after the issuance of the financial statements (which, for SEC purposes, is when the filing containing the financial statements is made). In each reporting period, including interim periods, management should consider whether relevant conditions and events, taken as a whole, raise substantial doubt about the company's ability to meet its obligations as they become due within the one year. Where substantial doubt about the ability to continue as a going concern exists, management should consider whether its plans alleviate the substantial doubt. The Staff provided a reminder (citing FASB ASC Topic

205-40) that the evaluation by management is to be based on conditions and events known and reasonably known at the date the financial statements are issued, and the evaluation initially should not take into consideration the potential mitigation effects of management's plans that have not been fully implemented.

Where there is substantial doubt about a company's ability to continue as a going concern (after considering management's plans) or the substantial doubt is alleviated by management's plans, management should provide the appropriate disclosures in the financial statements. This may be incremental to other disclosures (*i.e.*, in risk factors or the MD&A) in the relevant report.

The OCA Statement notes that auditors also have a responsibility to evaluate a reporting company's ability to continue as a going concern based on their knowledge of relevant conditions that exist at or occurred prior to the date of the audit report. Although a review of interim financial information is not designed to identify conditions or events that indicate substantial doubt about a company's ability to continue as a going concern, an auditor may become aware of such conditions or events in the course of performing review procedures. In such cases, the auditor should inquire with management and consider the adequacy of the relevant disclosures' conformity with GAAP. If it determines that the relevant disclosure is inadequate such that it represents a departure from GAAP, the auditor should extend the procedures, evaluate the results and communicate as appropriate with the reporting company and its audit committee.

Other OCA Statement Topics

The OCA Statement highlights OCA's inclination to not object to significant judgments and estimates to address COVID-19-related accounting and financial reporting matters that are well reasoned and disclosed in a way that is understandable and useful to investors.

The OCA Statement reiterates OCA's view of the importance of robust internal control over financial reporting ("ICFR") and disclosure controls and procedures ("DCP"). To the extent that financial reporting processes have been modified due to COVID-19, the changes may include consideration of how controls operate or can be tested and whether there are risks that the controls may not be effective in a work-from-home environment. In addition, changes to the business or additional uncertainties may trigger the need for new or enhanced controls. If any change materially affects, or is reasonably likely to materially affect, ICFR, the change must be disclosed in quarterly filings in the quarter in which it occurred (or the fiscal year, in the case of a foreign private issuer).

OCA also reiterates that, in these times of rapid change and increased uncertainty, the oversight role of the audit committee is critical in promoting high-quality financial reporting.

Finally, OCA reminds all stakeholders of the key role that auditor independence, which is a shared responsibility of the audit committee, management and the auditors, plays in ensuring the credibility of financial statements.

CF Disclosure Guidance Topic No. 9

In March, the Staff issued guidance in light of its view that the effects of COVID-19 and related business and market disruptions on reporting companies, management's expectations as to future impacts, management's responses to unfolding events and management's planning for uncertainties can be material to investment and voting decisions. The Staff noted that its rules are, in effect, principles-based and that, notwithstanding the absence of specific line item requirements, discussion of COVID-19-related matters may be necessary or appropriate in the MD&A, the business section, the risk factors, the description of legal proceedings, disclosures relating to DCP and ICFR, and the financial statements.

Disclosures need to be tailored to the specific facts of the reporting company, and they should enable investors to evaluate the current and expected impact of COVID-19 "through the eyes of management." The Staff encouraged reporting companies to proactively revise and update disclosures as facts and circumstances change. The Staff also recognized that many COVID-19 disclosures will have forward-looking elements that may be based on assumptions and expectations regarding future events.

Questions to Consider

The Staff offered some questions for reporting companies to consider (as examples):

- How has COVID-19 impacted the company's financial condition and results of operations? In light of changing trends and the overall economic outlook, how does management expect COVID-19 to impact future operating results and near- and long-term financial condition? Does management expect that COVID-19 will impact future operations differently than how it affected the current period?
- How has COVID-19 impacted the company's capital and financial resources, including overall liquidity position and outlook? Has the cost of, or access to, capital and funding sources, such as revolving credit facilities or other sources, changed, or is it reasonably likely to change? Have sources or uses of cash otherwise been materially impacted? Is there a material uncertainty about the ongoing ability to meet covenants in credit agreements? If a material liquidity deficiency has been identified, what course of action has the company taken or proposed to take to remedy the deficiency?¹ Does management expect to disclose or incur any material COVID-19-related contingencies?

¹ The Staff suggests that reporting companies consider the requirement to disclose known trends and uncertainties as they relate to the ability to service debt or other financial obligations, access the debt markets, including commercial paper or other short-term financing arrangements, maturity mismatches between borrowing sources and the assets funded by those sources, changes in terms requested by counterparties, changes in the valuation of collateral, and counterparty or customer risk. See prior SEC guidance (available [here](#)).

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- How does management expect COVID-19 to affect assets on the balance sheet and the ability to timely account for those assets? For example, will there be significant changes in judgments in determining the fair-value of assets measured in accordance with GAAP or IFRS?
 - Does management anticipate any material impairments (*e.g.*, with respect to goodwill, intangible assets, long-lived assets, right of use assets or investment securities), increases in allowances for credit losses, restructuring charges, other expenses, or changes in accounting judgments that have had or are reasonably likely to have a material impact on the financial statements?
 - Have COVID-19-related circumstances, such as work-from-home arrangements, adversely affected the company's ability to maintain operations, including financial reporting systems, ICFR and DCP? If so, what changes in controls have occurred during the current period that materially affect or are reasonably likely to materially affect the company's ICFR? What challenges does management anticipate in the company's ability to maintain these systems and controls?
 - Has the company experienced challenges in implementing its business continuity plans or does management foresee requiring material expenditures to do so? Does the company face any material resource constraints in implementing these plans?
 - Does management expect COVID-19 to materially affect the demand for the company's products or services?
 - Does management anticipate a material adverse impact of COVID-19 on the company's supply chain or the methods used to distribute its products or services? Does management expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?
 - Will operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?
 - Are travel restrictions and border closures expected to have a material impact on the company's ability to operate and achieve its business goals?

Reporting Considerations

The Staff encouraged reporting companies to proactively address financial reporting matters earlier than usual. The Staff cited the example of needing to consult with experts to determine how the evolving COVID-19 situation may impact assets, including impairment of goodwill or other assets.

The Staff also reminded reporting companies of their obligations in respect of non-GAAP/IFRS financial measures as well as the SEC's recent guidance relating to disclosures of performance metrics (available

[here](#)). The Staff noted that, to the extent a reporting company presents a non-GAAP/IFRS financial measure or performance metric to adjust for or explain the impact of COVID-19, or changes the method by which it calculates a metric as a result of COVID-19, it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the reporting company's financial position and results of operations.

Where GAAP/IFRS financial measures are not yet available at the time of an earnings release, the Staff indicated that it would not object to reporting companies reconciling a non-GAAP/IFRS financial measure to preliminary GAAP/IFRS results that either include provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP/IFRS results.² The Staff noted that this accommodation reflects the view that non-GAAP/IFRS financial measures and performance metrics can be a useful way for management to share with the market how it and the board are assessing the current and potential impact of COVID-19 on operating results and financial condition.

The Staff cautioned that, if a reporting company presents non-GAAP/IFRS financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP/IFRS financial measures in reliance on its accommodation, management should limit the measures in its presentation to those non-GAAP/IFRS financial measures it is using to report financial results to the board. If a reporting company presents non-GAAP/IFRS financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP/IFRS financial measures, it should explain, to the extent practicable, why the line item(s) or accounting is incomplete, and what additional information or analysis may be needed to complete the accounting.

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² For example, if a reporting company intends to disclose on an earnings call its EBITDA, it could reconcile that measure to either its GAAP/IFRS earnings, a reasonable estimate of its GAAP/IFRS earnings that includes a provisional amount, or its reasonable estimate of a range of GAAP/IFRS earnings. The provisional amount or range should reflect a reasonable estimate of COVID-19-related charges not yet finalized, such as impairment charges.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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