June 25, 2020

SEC Staff Supplements Its COVID-19 Disclosure Guidance

The SEC and its staff continue to monitor how companies are disclosing the effects and risks of COVID-19 on their business, results of operations and financial condition. On June 23, 2020, the SEC's Division of Corporation Finance supplemented its previous guidance, highlighting additional disclosure considerations for companies preparing for the second quarter reporting cycle. This Alert summarizes key aspects of the staff's additional guidance.

CF Disclosure Guidance Topic No. 9A

The staff's latest guidance supplements its earlier guidance issued in March (which we discussed in this previous Ropes & Gray Alert). The staff continues to encourage 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.

Operations, Liquidity and Capital Resources

The guidance acknowledges that many companies have made and are in the process of making changes to their operations, including a transition to remote work, adjustments to supply chain and distribution processes, and suspending or modifying certain functions to comply with health and safety guidelines. A company should consider the extent to which these adjustments have a material impact on its operations and financial condition and disclose this information to investors.

A company also should ensure "robust and transparent" liquidity and capital resources disclosures that inform investors how the company is dealing with short- and long-term liquidity and funding risks. The staff observed that, in response to COVID-19, companies have undertaken a range of financing activities – such as drawing down credit facilities, accessing public and private capital markets, implementing supplier finance programs and negotiating new customer payment terms – that may involve novel terms and structures. While many companies have disclosed such activities in earnings releases, the staff is encouraging companies to evaluate whether MD&A disclosure also is warranted.

The guidance contains a list of questions for companies to review when assessing disclosure of the effects of COVID-19. These questions, which we reproduce on **Annex A**, provide a helpful checklist of items companies should consider when preparing MD&A for this quarter. The list focuses on liquidity and capital resources matters, including subsequent events and known trends and uncertainties.

Government Assistance – The CARES Act

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) includes loans and tax relief. Companies should evaluate the short- and long-term impact of any such federal assistance when drafting MD&A. Companies should provide the required U.S. GAAP disclosures related to any assistance received under the CARES Act, including the accounting principles followed and the methods of applying those principles if they materially affect financial condition, cash flows or results of operations and related disclosures. The guidance highlights additional disclosure considerations about the impact of any federal assistance on a company's financial condition, short- and long-term liquidity and critical accounting estimates and assumptions (see **Annex A**). In addition, the guidance indicates that the staff will not object to a company accounting for a forgivable Paycheck Protection Program loan as either (1) debt pursuant to ASC 470, or (2) as a government grant by analogy to IAS 20, provided certain conditions are met (e.g., it is probable that the registrant will meet the terms for forgiveness of the loan).

Going Concern

When evaluating the impact of COVID-19, a company should consider whether conditions and events, taken as a whole, raise substantial doubt about the company's ability to meet its obligations as they become due within one year after the issuance of the financial statements. The guidance includes questions about a company's going concern assessment and MD&A disclosure (see **Annex A**).

Importance of High-Quality Financial Reporting in Light of COVID-19

On the same day, the SEC Chief Accountant Sagar Teotia issued a public statement regarding the continued importance of high-quality financial reporting and emphasized the vital role of the audit committee in its oversight of a company's financial reporting. In his statement, Mr. Teotia acknowledges that many companies have been required to make significant judgments and estimates to address a variety of accounting and financial reporting matters in light of COVID-19 and urges companies to ensure that these significant judgments and estimates are disclosed in a manner that is understandable and useful to investors. He also reminds companies that they should consider the effect of any operational changes due to COVID-19 on their internal controls over financial reporting and disclose any material changes in their filings. In addition, Mr. Teotia highlighted that auditors have a separate responsibility to evaluate an entity's ability to continue as a going concern.

SEC Roundtable on Second Quarter Reporting

The SEC recently announced that Chairman Clayton will moderate a roundtable entitled, "Q2 Reporting: A Discussion of COVID-19 Related Disclosure Considerations," which will be webcast on the SEC's web site on June 30, 2020 at 4 p.m. ET.

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If you would like to learn more about the issues in this Alert, please contact your usual Ropes & Gray attorney.

ANNEX A

Disclosure Considerations that Companies Should Consider Regarding Their Operations, Liquidity and Capital Resources

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 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 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 is the short- and long-term impact 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?

Government Assistance – 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 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

- 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?