SEC's COVID-19 Supplemental Guidance Reinforces the Importance of High-Quality Financial Reporting

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On June 23, 2020, in light of the ongoing global COVID-19 pandemic, the Securities and Exchange Commission's (SEC) Division of Corporation Finance released CF Disclosure Guidance: Topic No. 9A (the ***Supplemental Guidance***), which supplements CF Disclosure Guidance Topic No. 9 (the ***Original Guidance***). The Supplemental Guidance provides the Division's additional views regarding operations, liquidity, and capital resources disclosures that companies should consider with respect to business and market disruptions due to the COVID-19 pandemic.

In the Original Guidance, the Division addressed disclosure requirements, trading on insider information and reporting earnings, and financial results in light of COVID-19. The Supplemental Guidance provides companies additional considerations to assist their evaluation of COVID-19 related effects and generate robust, forward-looking disclosures.

In the Supplemental Guidance, the Division reiterates that it continues to monitor companies' disclosures of the impacts and risks of the ongoing COVID-19 pandemic on their businesses, financial condition, and results of operations. As with the Original Guidance, the Division urges companies to actively revise and update disclosures to help investors assess the actual and future impact of COVID-19 through the lens of management. The Division notes that "[t]hese disclosures should enable an investor to understand how management and the Board of Directors are analyzing the current and expected impact of COVID-19 on the company's operations and financial condition, including liquidity and capital resources."

The Division addresses three general topics in the Supplemental Guidance:

1. Operations, Liquidity, and Capital Resources

Companies have had to make a broad range of material operational changes in response to the effects of the pandemic, including the transition to remote-work, supply-chain and distribution adjustments, and changes related to health and safety guidelines to protect employees, contractors and customers, including in connection with transitions back to the workplace. The Supplemental Guidance notes that companies should carefully consider their obligation to disclose such substantial changes to investors. In addition, the current economic climate has pushed many companies to undertake a wide range of financing activities, such as obtaining new credit facilities, accessing public and private markets, and negotiating new or modified financing programs. Since the new financing tools may include novel terms and structures, the Division urges companies to provide transparent disclosures about their plans to manage short- and long-term liquidity and funding risks, especially pertaining to new risks faced by their businesses. The Division notes a potential discrepancy about these disclosures being included in earnings releases but not included in Management's Discussion and Analysis (***MD&A***), and advises that companies consider whether to include these disclosures, in light of their potential materiality, in MD&A.

See Appendix A for a list of questions the Division believes companies should consider when assessing their specific situation in the context of the ongoing COVID-19 pandemic.

2. Government Assistance – The CARES Act

Many companies have been receiving financial assistance and tax relief under the Coronavirus Aid, Relief, and Economic Security Act (***CARES Act***) in the form of loans, deferred or reduced payments, and possible refunds. The Division recommends that companies receiving federal assistance should consider the short and long-term effect of that assistance on their financial condition, operations, liquidity, capital resources, appropriate disclosures (*e.g.* MD&A and U.S. GAAP disclosures), accounting estimates and assumptions. Appendix A also includes questions the Division believes companies should consider with respect to financial assistance and tax relief under the CARES Act.

3. Ability to Continue as a Going Concern

Companies should evaluate whether the total economic effects of COVID-19 raise substantial doubt about their ability to continue as a going concern. If the adverse impact of the pandemic raises 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, the Division advises that management should provide appropriate disclosures in the financial statements and outline any plans to alleviate such doubt, as required by U.S. GAAP. Appendix A includes questions the Division believes companies should consider with respect to MD&A disclosures related to a company's ability to continue as a going concern.

4. Additional Information

As it did in the Original Guidance, the Division again emphasizes that companies should consider the impact of COVID-19 on other disclosures, including disclosure controls and procedures (***DCP***) and internal control over financial reporting (***ICFR***). The Division also refers to the SEC Chief Accountant Safar Teotia's Statement on the Continued Importance of High-

Quality Financial Reporting for Investors in Light of COVID-19 with respect to accounting and auditing matters related to COVID-19 (the ***June OCA Statement***).

The June OCA Statement on the Continued Importance of High-Quality Financial Reporting

In conjunction with the Division's Supplemental Guidance, the Office Chief Accountant (***OCA***), issued the June OCA Statement regarding the importance of high-quality financial reporting in the context of COVID-19. The June OCA Statement expands and supplements the April OCA Statement released by the OCA on April 3, 2020. In particular, the June OCA Statement focused on:

1. Significant Estimates and Judgments

As noted in the April OCA Statement, many companies had to make important judgments in accounting and financial reporting matters. The June OCA Statement urges companies to ensure that significant judgments and estimates are disclosed in a manner that is "understandable and useful to investors, and that the resulting financial reporting reflects and is consistent with the company's specific facts and circumstances."

2. Disclosure Controls and Procedures and Internal Control over Financial Reporting

The June OCA Statement emphasizes the importance of robust internal accounting controls to high-quality, reliable financial reporting. Some companies have adopted, or are adapting, their financial reporting processes as they respond to the changing environment. These changes may include consideration on how controls operate or can be tested and if there is any change in the risk of the control operating effectively in a telework environment. In addition, changes to the business and additional uncertainties may result in additional risks of material misstatement to the financial statements in which new or enhanced controls may need to be implemented to mitigate such risks. The June OCA Statement reminds companies that if any change materially affects, or is reasonably likely to materially affect, an entity's ICFR, such change must be disclosed in its Quarterly Report on Form 10-Q for the fiscal quarter in which it occurred (or the Annual Report on Form 10-K, in the case of the fourth quarter).

3. Ability to Continue as a Going Concern

The June OCA Statement reminds companies that 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 one year after the issuance of the financial statements. In instances where substantial doubt about a company's ability to continue as a going concern exists, management should consider whether its plans alleviate such substantial doubt and make appropriate disclosures to inform investors. Such disclosures should include information about 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, and management's plans that alleviated substantial doubt. If after considering management's plans substantial doubt about a company's ability to continue as a going concern is not alleviated, additional disclosure is required.

In addition, the June OCA Statement also states that although an auditor's 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, the 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. The June OCA Statement reminds auditors that after performing such procedures, to the extent the auditor determines 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 company and its audit committee.

4. Vital Audit Committee Role

The June OCA Statement reiterates the key role that audit committees play in the financial reporting system through their oversight of financial reporting, including ICFR and the external, independent audit process. The OCA intends to continue to be proactive in engaging with audit committee members to understand current market developments as well as to solicit their perspectives on improving the oversight of financial reporting.

Appendix A

Operations, Liquidity, and Capital Resources Questions

- *Operational Challenges.*

- 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?

- *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?

- *Accessing Capital*.

  - 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?

- *Changes to Accessing Capital*.

  - 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?

- *Covenants*.

    - Are you at material risk of not meeting covenants in your credit and other agreements?

- *Metrics*.

    - 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?

- *CapEx and Human Capital*.

    - 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?

- *Debt Servicing*.

    - 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?

- *Customers*.

    - 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?

- *Suppliers*.

    - 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?

- *Subsequent Events*.

  - 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?

CARES Act Financial Assistance and Tax Relief Questions

- *Loan Impacts*.

  - 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?

- *Tax Relief*.

  - 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?

- *New Material Accounting Estimates or Judgments*.

    - 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?

<u>Going Concern MD&A Disclosure Questions</u>

- *Substantial Doubt*.

    - 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?

- *Company Plans to Address Going Concern*. What are your plans to address these challenges? Have you implemented any portion of those plans?

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