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ALERT MEMORANDUM

COVID-19 in Q2 Reporting – What the SEC is Looking For

July 1, 2020

On June 30, 2020, SEC Chairman Jay Clayton moderated a virtual roundtable titled “Q2 Reporting: A Discussion of COVID-19 Related Disclosure Considerations.” He was joined by Corporation Finance Director Bill Hinman and a high-powered panel, who commented on what they hope issuers will disclose about the impact of COVID-19 and a wide range of other topics.

The roundtable follows a succession of recent statements from the SEC about what issuers should be addressing. In this memo, we will summarize some themes from the roundtable and highlight a few key points about preparing disclosure in these uncertain times.

In a separate memo published today, we explore some challenges companies face in seeking to quantify the effects of COVID-19 on their financial performance. We have also attached as Annex A to this memo a practical checklist of disclosure topics an issuer should consider in considering whether it has adequately addressed COVID-19 in its second-quarter disclosures.

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The panel for the June 30 Roundtable was well placed to speak about what investors wish for from corporate disclosures in these difficult times. They were:

- Gary Cohn – now a venture capitalist, Mr. Cohn was director of the National Economic Council in 2017-18, and previously Chief Operating Officer of Goldman Sachs.
- Glenn Hutchins – Mr. Hutchins is a leading figure in private equity, chairman of North Island and co-founder of Silver Lake Partners
- Tracy Maitland – Mr. Maitland is the founder and Chief Investment Officer at investment management firm Advent Capital Management.
- Barbara Novick – a co-founder and the Vice-Chairman of BlackRock, Ms. Novick oversees its investment stewardship team.

Following are some themes from their discussion of particular interest to reporting companies.

SEC guidance

The panelists praised the disclosure guidance emanating from the Division of Corporation Finance, and particularly the lists of questions for issuers contained in Disclosure Topics No. 9 (March 25) and No. 9A (June 23). A compendium of those questions is attached to this memo as Annex B, and a list of SEC guidance on COVID-related disclosures is attached as Annex C. Director Hinman told the panel that the staff of Corporation Finance would review disclosures after second-quarter reports are filed and highlight model disclosures on emerging issues.

Several panelists called on the SEC to take more action to make disclosures standardized and mandatory, in a range of areas including forward-looking information and human capital management.

Forward-looking disclosures

All the panelists called for more forward-looking disclosures. Several expressed disappointment about issuers withdrawing guidance and limiting themselves to reporting historical performance.[1] Recognizing that issuers cannot know how the current crisis will play out, they suggested that issuers should be able to identify a range of alternative scenarios and be transparent about their possible impact.

Addressing the reticence of issuers to provide forward-looking disclosures, Chair Clayton and Director Hinman said, as they have in the past, that the SEC "does not expect to second-guess" forward-looking disclosures that are made in good faith. Hinman emphasized that a test of good faith would be whether information that is made public is consistent with what is used internally and with the board of directors. This general outlook, while welcome, will of course not prevent private litigants, or authorities including the SEC itself, from challenging disclosures in the future.

Resilience and adaptability

The panelists emphasized that companies should consider what they have learned from the crisis about their resilience and adaptability, emphasizing supply chain management, community engagement and human capital. They suggested that resilience would be essential to an issuer's future prospects in addressing not only COVID-19 but also challenges like climate change and diversity.

Human capital and social issues

The panelists emphasized the importance of disclosures on human capital issues, including how in these times of crisis companies have addressed the interests of their employees and customers and their communities. They highlighted the current societal crisis, and several said that if not for COVID-19, social justice and diversity would be the top concern of boards of directors today. They asked companies to take the initiative to provide additional disclosures on the steps they are taking on these topics, and several asked the SEC to require more disclosure in these areas.

[1] Mr. Hutchins said that only 49 of the S&P 500 issuers currently have outstanding guidance. A study published on June 26 by FACTSET gives that figure for second-quarter guidance and also reports that 183 of the S&P 500 have withdrawn full-year guidance. The Wall Street Journal reported on June 28 that more than 40% of the S&P 500 have withdrawn guidance.

ANNEX A – Impact of Covid-19 – Second-Quarter Reporting Checklist

Disclosure on Operational Matters

— Principal categories for companies to consider include reopening measures, safety measures, continuing restrictions on operations, supply chain management and human capital matters.

— The SEC staff has been calling for detail on these matters, and investors have indicated significant interest as well.

— Companies should consider whether this disclosure is best included in the Form 10-Q, the earnings release, the earnings script or slides, or in some other manner on the corporate website.

Financial and Accounting Issues

— Quantification of COVID-19 impacts has been encouraged by the SEC staff and investors, but raises questions of risk and compliance with the rules on non-GAAP financial measures (see our separate memo on quantification of COVID-19 impacts).

— Companies should consider the extent to which an outlook or guidance can be provided:

- Despite more clarity from having a full quarter of results reflecting the pandemic, many companies may still not be comfortable issuing guidance for the full year or future quarters.
- Consider whether forward-looking information about expectations for potential continuing impacts to key line items (e.g., revenue) can be supported.
- Consider disclosure about alternative scenarios or a range of outcomes.
- Consider other qualitative information that can be provided to help investors understand key trends.
- Any forward-looking information should be clear about assumptions and should be consistent with information presented internally and to the board of directors.

— A number of accounting issues may be more material or further developed in the second quarter, and therefore ripe for disclosure, including:

- Valuation of assets and related issues (impairment of long-lived assets, loans and loan loss reserves, etc.).
- Going concern.
- Subsequent events (in a continuing volatile environment, disclosure of events beyond the end of the quarter may be required).
- Special issues for financial institutions (e.g., suspension of troubled debt restructuring treatment and capital impacts).

— Carefully consider disclosures on liquidity and funding, including COVID-19 impact on:

- operating cash flows.
- spending (e.g., capital expenditures, dividends, share repurchases).
- access to and changes in types of funding sources.
- Issues related to loan agreement and other covenant compliance.

Risk Factor Disclosure

— Consider risk factors included in first quarter Form 10-Q and whether they should be further updated.

— Forward-looking statements language should also be considered for updates to the identification of meaningful cautionary statements.

Process, Governance and Other Matters

— Identify any impact of COVID-19 on internal control over financial reporting (ICFR) and disclosure controls and procedures (DCP).

- Implement necessary additional procedures to counteract any control issues.
- If material, include disclosure of those changes in Form 10-Q controls section.
- Be sure to include auditors in discussions of controls.

— Ensure that COVID-19 disclosures are consistent with information otherwise provided to the audit committee and the board of directors.

— Where COVID-19 disclosures are a departure from prior practice, ensure that they are subject to DCP to the same extent as other disclosures.

— Consider second quarter disclosures, and in particular any new COVID-19 related disclosures, in light of any potential future securities offerings, including:

- Are there particular disclosures underwriters will expect to see?
- Will the auditors be able to provide comfort on new COVID-19 financial information?
- Are there any potential answers to underwriter due diligence questions that might be helpful to reflect in Form 10-Q?

ANNEX B – Impact of COVID-19 – SEC Questions For Issuers to Consider

Division of Corporate Finance, CF Disclosure Guidance: Topic No. 9A (June 23, 2020)

General COVID-19 Considerations For Issuers

1. 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?

2. 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?

3. 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?

4. 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?

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

6. 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?

7. 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?

8. 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?

9. 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?

10. 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?

11. 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?

Considerations Regarding Government Assistance

12. How does a CARES Act 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?

13. 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?

14. 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?

Considerations on the Company's Continuation as a Going Concern

15. 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?

16. What are your plans to address these challenges? Have you implemented any portion of those plans?

Division of Corporate Finance, CF Disclosure Guidance: Topic No. 9 (March 25, 2020)

Considerations for Assessing and Disclosing COVID-19's Impact

17. How has COVID-19 impacted your financial condition and results of operations? In light of changing trends and the overall economic outlook, how do you expect COVID-19 to impact your future operating results and near-and-long-term financial condition? Do you expect that COVID-19 will impact future operations differently than how it affected the current period?

18. How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook? Has your 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 your sources or uses of cash otherwise been materially impacted? Is there a material uncertainty about your ongoing ability to meet the covenants of your 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? Consider the requirement to disclose known trends and uncertainties as it relates to your ability to service your 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. Do you expect to disclose or incur any material COVID-19-related contingencies?

19. How do you expect COVID-19 to affect assets on your balance sheet and your 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 U.S GAAP or IFRS?

20. Do you anticipate any material impairments (e.g., with respect to goodwill, intangible assets, long-lived assets, right of use assets, 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 your financial statements?

21. Have COVID-19-related circumstances such as remote work arrangements adversely affected your ability to maintain operations, including financial reporting systems, internal control over financial reporting and disclosure controls and procedures? If so, what changes in your controls have occurred during the current period that materially affect or are reasonably likely to materially affect your internal control over financial reporting? What challenges do you anticipate in your ability to maintain these systems and controls?

22. Have you experienced challenges in implementing your business continuity plans or do you foresee requiring material expenditures to do so? Do you face any material resource constraints in implementing these plans?

23. Do you expect COVID-19 to materially affect the demand for your products or services?

24. Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services? Do you expect the anticipated impact of COVID-19 to materially change the relationship between costs and revenues?

25. Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?

26. Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

ANNEX C – Impact of COVID-19: Regulatory Pronouncements on Disclosure

March 25, 2020: SEC Division of Corporation Finance CF Disclosure Guidance: Topic No. 9, Coronavirus (COVID-19) (https://www.sec.gov/corpfin/coronavirus-covid-19)

- Provides questions to consider when assessing and disclosing the evolving impact of COVID-19
- Provides guidance on use of non-GAAP financial measures
- Identifies challenges relating to material non-public information

April 2, 2020: PCAOB Staff Spotlight – Reminders for Audits Nearing Completion (https://pcaobus.org/Documents/COVID-19-Spotlight.pdf)

- Highlights a number of quality control considerations for auditors
- Prompts auditors to identify, assess, and respond to risks of material misstatement

April 3, 2020: SEC Chief Accountant Sagar Teotia – Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19 (https://www.sec.gov/news/public-statement/statement-teotia-financial-reporting-covid-19-2020-04-03)

- Encourages stakeholders to contact the Office of the Chief Accountant with questions they encounter as a result of COVID-19
- Stresses the importance of required disclosures of judgments and estimates in accounting and financial reporting

April 8, 2020: SEC Chair Jay Clayton and Division of Corporation Finance Director Bill Hinman – The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19 (https://www.sec.gov/news/public-statement/statement-clayton-hinman)

- Urges issuers to provide investors with as much information as practicable regarding their current financial and operating status, as well as forward-looking information about their future operational and financial planning

May 4, 2020: SEC Chair Jay Clayton – Remarks at Special Meeting of the Investor Advisory Committee (https://www.sec.gov/news/public-statement/statement-clayton-iac-2020-05-04)

- Emphasizes the need for issuers to make all reasonable efforts to disclose material information regarding the company's current operating posture in the absence of additional funding, the disruption of supply and distribution chains, and the management of health and safety for employees

June 23, 2020: Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 (https://www.sec.gov/news/public-statement/teotia-financial-reporting-covid-19-2020-06-23) (follow up statement to April 3 statement)

- Reiterates the continued importance of high-quality financial reporting in light of COVID-19

June 23, 2020: SEC Division of Corporation Finance CF Disclosure Guidance Topic 9A: Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources (https://www.sec.gov/corpfin/covid-19-disclosure-considerations)

- Provides guidance on operations, liquidity and capital resources disclosures companies should consider with respect to business and market disruptions related to COVID-19