

LEGAL UPDATES

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# A Summary of Recent Additional SEC Guidance on Disclosure, Financial Reporting, and Accounting Practices in Light of COVID-19

On June 23, 2020, the Division of Corporation Finance of the U.S. Securities and Exchange Commission (SEC) further supplemented its previous guidance to assist public companies in navigating the disclosure challenges brought on by the coronavirus (COVID-19) pandemic. Below, we summarize this guidance and explore issues that companies should consider in their compliance and disclosure processes during the COVID-19 crisis.

## **Division of Corporate Finance Issues Further Disclosure Guidance Focused on Management Discussion and Analysis of Operations, Liquidity, and Capital Resources in Light of COVID-19**

On June 23, 2020 the SEC Division of Corporation Finance (Division) issued Disclosure Guidance: Topic No. 9A which supplements its previously issued Disclosure Guidance Topic No. 9 (covered here). The guidance highlights key considerations that public companies should focus on in making disclosures related to the impact of COVID-19 and the Coronavirus Aid, Relief, and Economic Security (CARES) Act on the company's financial condition, results of operations, liquidity, and capital resources, as well as related impacts on a company's ability to continue as a going concern. The Division's guidance does not prescribe specific disclosures; instead, it poses a series of questions designed to elicit targeted, company-specific disclosures based on management's assessment of the company's current situation.

The Division is aware that in recent months companies have had to take unprecedented measures in light of COVID-19 that may have had a material impact on their operations and financial condition. Developments such as

shifting to a work-from-home or telework stance, changing health and safety protocols, relying on supply chain financing, or extending payment windows may qualify—alone or in the aggregate—as material changes in a company’s operations or financial condition that management may be expected to discuss in MD&A. The Division again stressed the principles-based application of these disclosure requirements and urged management, when drafting MD&A disclosures, to consider the following questions (as detailed in the guidance):

What material operational challenges are management and the Board monitoring and evaluating?

How and to what extent have you altered operations, such as implementing health and safety policies for employees, contractors, and customers, to deal with challenges, including 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?

Have you accessed revolving lines of credit or raised capital in the public or private markets to address liquidity needs? Are your disclosures regarding these actions and any unused liquidity sources providing investors 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 or any of your subsidiaries provided additional collateral, guarantees, or equity to obtain funding? Have there been material changes in your cost of capital, or impacts due to a change in your credit ratings? 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? Are there estimates or assumptions underlying such metrics that must be disclosed for the metric not to be misleading?

Have you reduced your capital expenditures, and if so, how? 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?

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 supply chain financing, structured trade payables, reverse factoring, or vendor financing, to manage your cash flow? Have these arrangements materially impacted your balance sheet, statement of cash flows, or short- and long-term liquidity?

Have you fully assessed the impact of material events that could impact your liquidity or capital resources which occurred after your most recent balance sheet date, but before financial statements are issued, to ensure proper disclosure of subsequent events or known trends and uncertainties?

Furthermore, companies receiving federal assistance under the CARES Act are expected to consider the short- and long-term impact of that assistance on their financial condition, results of operations, liquidity, and capital resources, as well as the related disclosures and critical accounting estimates and assumptions. Some CARES Act specific questions to consider include:

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 as a result of changes to permitted carrybacks of net operating losses (NOLs) or other material tax impacts?

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?

Finally, management is expected to consider whether recent events 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 (including interim period financial statements). Where there is substantial doubt about a company's ability to continue as a going concern or the substantial doubt is alleviated by management's plans, management should provide appropriate disclosures in the financial statements, in accordance with the requirements of FASB ASC Topic 205-40-50, and consider whether the MD&A disclosures adequately disclose the extent and prevalence of the challenges giving rise to the doubt, and management's plans to address these challenges.

### **SEC Chief Accountant's Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19**

Sagar Teotia, the SEC's Chief Accountant, issued a statement on June 23, 2020 highlighting the challenge that COVID-19 presents for public companies' auditing and accounting functions, echoing and expanding on points raised in his statement from April 3, 2020 (covered here). The Chief Accountant's new statement reiterates how the impacts of COVID-19 may require companies to make significant judgments and estimates in their disclosures and addresses the continued importance of high-quality financial reporting in these uncertain times and the efforts that the SEC's Office of Chief Accountant (OCA) has undertaken to continue promoting this goal.

*Significant Judgments and Estimates.* The statement begins by reminding companies that the accounting and financial reporting implications of COVID-19 may require companies to make significant judgments and estimates in relation to their accounting disclosures, which may be uncertain and challenging in the current economic climate. The Chief Accountant emphasized that the OCA remains steadfast in its commitment not to object to significant judgments or estimates when made in a well-reasoned manner. The OCA previously indicated that forming well-reasoned judgments "typically involves a lot of effort and underscores the importance of a robust implementation process... [that] includes adequate and advance planning, a focus on contractual terms and areas of judgment, and a thorough evaluation of controls." Companies making judgments and estimates are encouraged to ensure that disclosure regarding judgments and estimates is clear and useful to investors, and produce reports that accurately represent the company's unique circumstances.

*Disclosure Controls and Procedures (DCP) and Internal Control over Financial Reporting (ICFR).* In the statement OCA emphasizes the importance of high-quality financial reporting during these times supported by strong DCP and ICFR. Like the Division, OCA understands that companies may have shifted course in recent months and notes that reporting and control programs may have needed to do the same. Changes to a company's operations—like shifting to telework—may increase the risk of material misstatements in financial statements and SEC filings. In light of this, companies may need

to adopt different DCP and ICFR to ensure continued high-quality reporting during this time. Companies are reminded that if any such changes to controls materially affect (or are reasonably likely to materially affect) a company's ICFR, such changes must be disclosed in their SEC filings.

*Going Concern.* The OCA statement also stressed that, in preparing financial statements for inclusion in a company's periodic reports, management should consider whether circumstances exist that raise a "substantial doubt about the entity's ability to meet its obligations as they become due within one year after the issuance of the financial statements." In other words, whether there is substantial doubt about the company's ability to continue as a going concern. Bolstering the Division's statement (discussed above), OCA reminded companies that where such substantial doubt exists, management must consider whether its plans alleviate such doubt and make appropriate disclosure. Such disclosure should include information about:

the circumstances giving rise to the doubt;

management's evaluation of the significance of those circumstances relative to the company's ability to meet its obligations; and

management's plans to alleviate the doubt, and the additional disclosures that are required if, after considering management's plans, such doubt is not alleviated.

Companies are reminded that U.S. generally accepted accounting principles (GAAP), specifically FASB ASC Topic 205-40-50, requires such disclosure in the notes to financial statements in addition to disclosures required by SEC rules. Furthermore, OCA reminded auditors that, while a review of interim financial information is not designed to identify conditions that indicate substantial doubt about a company's ability to continue as a going concern, auditors nevertheless have an important role to play in ensuring these disclosures conform to the requirements of GAAP when they become aware of such conditions as part of their review, including maintaining appropriate communications with both management and the company's audit committee.

*OCA Engagement with Regulators and Auditors.* In addition to the aforementioned topics, the Chief Accountant's statement addresses the following topics with respect to public company accounting, audits, and international regulators:

OCA is actively working with the Financial Accounting Standards Board (FASB) on issues related to the impact of COVID-19 and notes that the Public Company Accounting Oversight Board (PCAOB) has published information with important reminders for auditors engaged in audits nearing completion during this time.

OCA and the SEC participate in the development and implementation of reforms to the international audit-related standard-setting system, work with the International Accounting Standards Board in developing its standards and cooperate with foreign securities regulators to promote company-specific and material disclosure to investors.

OCA has an ongoing dialogue with audit committees, their members, and related organizations to promote high-quality financial reporting and emphasized the importance of high quality audit committee oversight and continuing feedback from this group of stakeholders during this time.

*Working with OCA.* The OCA has processes in place to provide staff views on the application of GAAP and IFRS to complex accounting issues and encourages companies to proactively reach out to its staff for assistance with any issues that arise with respect to their accounting practices or ability to comply with the requirements of the federal securities laws during the ongoing pandemic.

### **Contact us**

Husch Blackwell's securities law team continues to monitor the evolving situation and its implications for our clients. Should you have any questions, please do not hesitate to contact Steve Barrett, Kirstin Salzman, Rebecca Taylor, Brandon Warrington or your Husch Blackwell attorney.

### **Comprehensive CARES Act and COVID-19 Guidance**

Husch Blackwell's CARES Act resource team helps clients identify available assistance using industry-specific updates on changing agency rulemakings. Our COVID-19 response team provides clients with an online legal Toolkit to address challenges presented by the coronavirus outbreak, including rapidly changing orders on a state-by-state basis. Contact these legal teams or your Husch Blackwell attorney to plan a way through and beyond the pandemic.