

Second Quarter Reporting — Recent SEC Guidance on COVID-19-Related Disclosure

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Key Points

The 2019 novel coronavirus (COVID-19) pandemic continues to have an impact on the operations of nearly every business and business sector. Reporting companies must evaluate how they disclose the effects of the pandemic, including in reports filed with the Securities and Exchange Commission (SEC). While many considerations from earlier in the COVID-19 pandemic (discussed in a prior Katten advisory, available [here](#)) remain applicable, it is imperative that reporting companies revisit their COVID-19-related disclosures while preparing reports and earnings releases for the second quarter of 2020 and beyond, taking into account recent comment letters and guidance from the SEC.

Specifically, reporting companies should:

- consider if prior COVID-19 disclosures reflect the current state of the pandemic, are tailored to the company's particular industry and business, and comprehensively address the ways COVID-19 has impacted or will impact the company's business, as SEC comment letters to date have focused on the lack of detail or specificity generally and in risk factor disclosure related to COVID-19;
- consider whether operational adjustments and financing activities disclosed in earning releases and on earnings calls should be included in the Management's Discussion and Analysis (MD&A) section of reports;

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- review questions raised by the SEC staff in Disclosure Guidance Topic No. 9A, which address the impact of the pandemic on a company's operations, liquidity and capital resources, as well as those the SEC staff previously raised in Disclosure Guidance Topic No. 9, to ensure issues that are material for the company are addressed in disclosures;
 - consider disclosing the short- and long-term impact of any assistance received under the CARES Act on their financial condition, results of operations, liquidity and capital resources and critical accounting estimates; and
 - consider if changes to a company's financial reporting procedures due to the pandemic materially affect, or are likely to materially affect, the company's internal control over financial reporting and should be disclosed.

SEC comment letters on COVID-19 disclosures

In its review of filings, the SEC staff has issued comment letters requesting that reporting companies provide supplemental information, revise or add to previously filed disclosures, or provide enhanced disclosure in future filings, in respect of COVID-19 pandemic-related matters. It takes time for comment letters to be made publicly available, as comment letters and company responses are made available 20 or more business days after the SEC staff completes its review of a filing. To date, more than 30 comment letters related to companies' COVID-19 disclosures on the effects of the COVID-19 pandemic have been released. The companies that have received these comment letters are not limited to any particular size or industry. These comment letters have primarily addressed the following topics:

- insufficient risk factor disclosure related to COVID-19, particularly a lack of detail or specificity;
- lack of disclosure addressing trends and uncertainties that a company has experienced or may experience due to the COVID-19 pandemic;
- lack of disclosure addressing the impact of COVID-19-related governmental measures for a particular industry;
- insufficient disclosure regarding how the COVID-19 pandemic has affected, and will affect, a company's business, specific segments and operations (closures, travel restrictions, etc.);
- lack of discussion of how COVID-19 is expected to impact a company's future operating results and financial condition; and
- focus of discussion of the impact of COVID-19 on only a single financial measure, with the SEC requesting discussion of the impact of COVID-19 on other financial statement measures to provide context, noting that a single financial measure may provide an incomplete picture.

The comment letters made available to date highlight the need for reporting companies to ensure that their COVID-19 disclosures reflect the current state of the pandemic, are tailored to the company's particular industry and business, and comprehensively address the ways COVID-19 has impacted or will impact the company's business. We expect COVID-19 disclosures will continue to be a focus

area for the SEC staff.

Recent SEC guidance on COVID-19-related disclosures

Operations, liquidity and capital resources

On June 23, the SEC Division of Corporation Finance issued Disclosure Guidance: Topic No. 9A (Disclosure Guidance Topic No. 9A, the full text of which is available [here](#)) to supplement Disclosure Guidance Topic No. 9, which was issued on March 25 (Disclosure Guidance Topic No. 9, the full text of which is available [here](#)). In Disclosure Guidance Topic No. 9A, the SEC staff stressed the need to keep COVID-19-related disclosures up-to-date, noting that companies should “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.” The SEC staff noted that, while companies have frequently made disclosures regarding their operational adjustments and financing activities in earnings releases, companies should also consider whether such information should be included in the “management’s discussion and analysis of financial condition and results of operations” (MD&A) section of their reports to the extent not already being included, depending on the materiality of the information.

Disclosure Guidance Topic No. 9A provides an extensive list of questions for companies to consider related to a company’s operations, liquidity and capital resources, including ones addressing: overall liquidity; access to revolving lines of credit or capital raised in public or private markets; ability to access traditional financial sources; any material risk of failing covenants in credit and other agreements; definitions of any metrics included in disclosures (such as cash burn rate or daily cash use) and how they are used by management; reduction in capital expenditures; reduction or suspension of stock repurchase programs or dividend payments; termination of any material business operations; disposal of any material asset or line of business; any increased human capital resource expenditures; the ability to timely service debt and other obligations, and the ability to take advantage of available payment deferrals, forbearance periods or other concessions; altered terms with customers; use of supplier finance programs (also referred to as supply chain financing, structured trade payables, reverse factoring or vendor financing); and assessment of the impact of material events that occurred after the reporting period but before the issuance of the financial statements. Companies should review each of these questions, as well as those the SEC staff previously raised in Disclosure Guidance Topic No. 9, to ensure any of the issues that are material for the company are addressed in their disclosures.

The CARES Act

Disclosure Guidance Topic No. 9A encouraged companies who received assistance under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) 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,” including on the following specific questions:

- “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?”

In addition to these questions, a reporting company that received CARES Act assistance should consider how such CARES Act assistance may be relevant to the general questions raised by Disclosure Guidance Topic No. 9 and Disclosure Guidance Topic No. 9A.

Internal controls and disclosure controls

The need for reporting companies to evaluate the impact of the COVID-19 pandemic on their disclosure controls and procedures and internal control over financial reporting continues for second quarter reporting. On June 23, the SEC Office of the Chief Accountant (OCA) issued a “Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19” (the OCA Statement, the full text of which is available [here](#)), which noted that companies have altered their financial reporting procedures due to the COVID-19 pandemic. Such changes may include how disclosure controls operate and can be tested, whether there are any changes to the risk of controls operating correctly due to remote work, and business changes and additional uncertainty that result in additional risks of a material misstatement. The OCA Statement stressed that “if any change materially affects, or is reasonably likely to materially affect, an entity’s [internal control over financial reporting], such change must be disclosed in quarterly filings in the fiscal quarter in which it occurred (or fiscal year in the case of a foreign private issuer).”

A company’s ability to continue as a going concern

Both Disclosure Guidance Topic No. 9A and the OCA Statement addressed disclosure of a reporting company’s ability to continue as a going concern. Disclosure Guidance Topic No. 9A states that “[w]here 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 the appropriate respective disclosures in the financial statements” and should consider the questions below in preparing MD&A disclosure:

- “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?”

In the OCA Statement, the SEC Staff echoed these points, and added that “GAAP requires such disclosure in the notes of the financial statements and this may be incremental to other disclosure requirements in filings with the [SEC].”

Updates to SEC conditional relief regarding filing deadlines

Since the beginning of the COVID-19 pandemic, the SEC has provided a wide array of types of regulatory relief. The status of these efforts was summarized in a release issued on June 26 (the

Update, the full text of which is available [here](#)). One type of relief the SEC had given was conditional regulatory relief for reporting companies in connection with filing and delivery deadlines. However, based on the Update, further relief of this kind that would apply to second quarter reports does not appear probable. The Update states that this type of regulatory relief is “unlikely to be extended,” noting that “[a]s participants have worked to implement business continuity plans and adjusted in many cases to a more remote and distributed workforce, the present need for extensions of certain regulatory deadlines has diminished.”

Updating disclosures for quarterly reports on Form 10-Q

Although many reporting companies have filed quarterly reports in 2020 with COVID-19-related risk factors, such companies may encounter an obligation to update their risk factors in their upcoming quarterly reports. Part II, Item 1A of Form 10-Q requires reporting companies to “[s]et forth any material changes from the risk factors as previously disclosed in the registrant’s Form 10-K.” Whether or not the risk factor requires updates to the prior Form 10-Q disclosure, to adhere precisely to the instruction to Form 10-Q that requires disclosure of any material changes from the risk factors disclosed in the company’s last annual report on Form 10-K, many companies repeat and update risk factors first disclosed in a prior Form 10-Q. Similarly, companies should evaluate whether the risks listed in their cautionary language regarding forward-looking statements are adequate in quarterly reports on Form 10-Q and current reports on Form 8-K or 6-K, as well as in any other communications with the market that typically contain forward-looking statements, such as earnings and other press releases.

A company’s MD&A section should continue to discuss the extent to which the effects of the COVID-19 pandemic, including business disruptions and continuity concerns, governmental measures made in response and market volatility, can generally be expected to have an impact on reporting companies’ financial condition and create substantial discrepancies between past and future performance. In addition to disclosure that may be appropriate or required elsewhere in periodic reports, if a reporting company is subject to material legal proceedings relating to COVID-19, the legal proceeding would need to be disclosed, as a handful of companies have done since the beginning of the COVID-19 pandemic. Several companies have also noted delays in ongoing material legal proceedings due to COVID-19.

Conclusion

The COVID-19 pandemic continues to present new challenges and considerations for reporting companies as they prepare their reports and filings. Comment letters and guidance from the SEC staff serve as a helpful tool for reporting companies as they ensure their COVID-19-related disclosures are comprehensive, up-to-date and tailored to their specific circumstances.

The full text of Disclosure Guidance Topic No. 9A is available [here](#). The full text of the OCA Statement is available [here](#). The full text of the Update is available [here](#).

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