SEC Staff, Chief Accountant Provide Additional Guidance Related to COVID-19

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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On June 23, 2020, the Division of Corporation Finance (the Division) of the U.S. Securities and Exchange Commission (SEC) issued CF Disclosure Guidance: Topic No. 9A (Guidance) on disclosures focusing on the impact of COVID-19 on operations, liquidity and capital resources. In addition, SEC Chief Accountant Sagar Teotia issued a statement (Statement) on the same day regarding significant accounting, auditing and financial reporting issues recently addressed by the Office of the Chief Accountant (OCA) in connection with the COVID-19 pandemic. Below is a summary of the Guidance and Statement.

Division Guidance on Disclosure Considerations Regarding Operations, Liquidity and Capital Resources

The Guidance supplements the Division's earlier views, which focused on disclosing the evolving impact of COVID-19, as well as reporting earnings and financial results, issued in "CF Disclosure Guidance: Topic No. 9" on March 25, 2020.[1] Echoing Topic No. 9, the Guidance encourages companies to provide disclosure that allows 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 Guidance also emphasizes that companies should provide clear and complete disclosure regarding how they are managing short- and long-term liquidity and funding risks given the current economic environment, especially if such efforts present new risks or uncertainties.

Operations, Liquidity and Capital Resources. The Guidance acknowledges that companies have responded to the disruptions from COVID-19 with various adjustments to their operations — such as transitioning employees to telework and back to the workplace — and through financing activities — such as obtaining and utilizing credit facilities and negotiating new or modified customer payment terms. The Guidance encourages companies to evaluate whether any of the information, in light of its potential materiality, should be disclosed in the Management's Discussion and Analysis (MD&A) section of upcoming periodic reports, while observing that companies have disclosed some of this information in their earnings releases.

[1] See our March 27, 2020, client alert, "SEC Extends Relief, Staff Offers Further Guidance and Flexibility to Companies Affected by COVID-19."

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Similar to Topic No. 9, the Guidance provides a non-exhaustive, illustrative list of questions for companies to consider:

- **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 Position and Outlook.** 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?
- **Financing Activities.** 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?
- **Funding Sources.** 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?
- **Capital Expenditures.** 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 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?
- **Customer Arrangements.** 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?
- **Supplier Arrangements.** 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?

Government Financial Assistance and the CARES Act.

The Guidance also notes that companies receiving government assistance, such as loans or tax relief under the CARES Act, should consider the short- and long-term impact of such assistance on their financial condition, results of operations, liquidity and capital resources, in addition to critical accounting estimates and assumptions. The Guidance poses the following questions for such companies to consider:

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- **Loans.** 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?
- **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?

Ability To Continue as a Going Concern. The effects of COVID-19 have led to uncertainty among many companies regarding their ability to continue business operations as a going concern. The Guidance reminds company management to evaluate whether the relevant conditions and events, taken as a whole, would raise substantial doubt about the company's ability to meet its obligations as they become due within one year after issuing the company's financial statements. When there is substantial doubt about the company's ability to continue as a going concern, or if there is substantial doubt that is alleviated by management's plans, management should provide the appropriate disclosures in the financial statements and consider the following questions from the Guidance in preparing MD&A disclosure:

- **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?
- **Management's Plans.** What are your plans to address these challenges? Have you implemented any portion of those plans?

Companies also should note the additional considerations summarized below regarding going concern disclosures.

Chief Accountant's Statement on High-Quality Financial Reporting

The statement from the SEC chief accountant describes significant accounting, auditing and financial reporting issues on which OCA has engaged with stakeholders since its April 3, 2020, "Statement on the Importance of High-Quality Financial Reporting in Light of the Significant Impacts of COVID-19."

Among other things, the Statement expresses the importance of a continued focus on high-quality financial reporting. The Statement recognizes that many companies continue to work through accounting and financial reporting issues related to operational and other challenges resulting from COVID-19. As summarized below, the Statement provides key reminders emphasizing the importance of high-quality financial reporting:

- **Accounting Estimates and Judgments.** Significant estimates and judgments regarding accounting and financial reporting matters should be disclosed in a manner that is understandable and useful to investors, and the resulting financial reporting should accurately reflect the company's specific facts and circumstances. The Statement also notes that OCA would not object to a company's well-reasoned judgments in accounting and financial reporting matters.
- **Disclosure Controls and Procedures; Internal Control Over Financial Reporting.** Companies should note that OCA continues to emphasize the importance of robust disclosure controls and procedures, and internal control over financial reporting. As companies adapt their financial reporting processes to the changing environment, they should consider whether to implement new or enhanced internal controls to mitigate the risks of operating in a telework environment or the additional risks of material misstatements resulting from changes to the business and other uncertainties. Any changes that materially affect, or are reasonably likely to materially affect, a company's internal control over financial reporting should be disclosed in the periodic report for the fiscal period in which the change occurred.
- **Going Concern Issues.** If there is substantial doubt about a company's ability to continue as a going concern, management should disclose the conditions giving rise to substantial doubt as well as management's evaluation of those conditions and plans to alleviate substantial doubt.
- **Audit Committee Oversight.** The need for audit committees to be engaged and effective in their oversight of financial reporting is critical in these times of rapid change and increasing uncertainty.

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