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COVID-19 Disclosure: Guidance for Q2 Reporting

I. Introduction

As public companies prepare their second quarter earnings releases and Quarterly Reports on Form 10-Q, they will need to grapple with what to say to their shareholders about the implications of the COVID-19 pandemic and the various government regulations and initiatives that have been adopted in connection with the pandemic, including total business shut downs in many states and countries. While many companies have already made some COVID-related disclosure either following the end of the first quarter or in connection with securities offerings completed since March, for others, the full impact of the pandemic may have only taken shape in the second quarter, which includes a full three months of operations during the pandemic. Companies have had to make fundamental changes to the way they do business in order to survive and thrive. The implications of these changes and broader economic conditions may not be predictable, but companies need to face the challenge of providing sufficient disclosure, so the market can properly assess new risks and, in some cases, opportunities. This memorandum brings together in one place a brief summary of the SEC guidance regarding COVID-related disclosure and suggests approaches companies can use to craft robust disclosure under these evolving circumstances.

II. Overview of SEC Guidance

In response to the spread of COVID-19, the staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission (the "SEC") has provided non-binding guidance to assist reporting companies in disclosing COVID-19 related risks and effects.

On March 25, 2020, the Staff issued guidance on appropriate disclosure concerning COVID-19 related risks and effects on business, financial condition, and results of operations.[1] The March 25, 2020 guidance provides factors that companies should look to when considering their disclosure obligations relating to COVID-19, stating that disclosure may be required in multiple sections of a company's disclosure document, including risk factors, management's discussion and analysis of financial condition and results of operations ("MD&A"), business, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and financial statements. It sets forth the following illustrative list of considerations for companies when revising disclosure to address the impact of COVID-19:

- Overall financial condition and results of operations;
- Capital and financial resources, liquidity and access to capital and funding sources;
- Balance sheet, particularly in determining the fair value of assets;
- Line items in the company's financial statements;
- Operations or ability to maintain proper internal financial reporting, particularly as to any remote work arrangements or similar arrangements;
- Implementation of business continuity plans;
- Demand for the company's products or services;
- Company's supply chain;
- Human capital and productivity; and
- Effect of travel restrictions and border closures on company's business.

[1] CF Disclosure Guidance: Topic No. 9, available at https://www.sec.gov/corpfin/coronavirus-covid-19.

The Staff also explains disclosure must be tailored and specific to the company, and that it should follow the SEC's principles-based approach that focuses on material information. The March 25, 2020 guidance was previously summarized in our March 30, 2020 memorandum available here.

On April 8, 2020, SEC Chairman Jay Clayton and Director of the Division of Corporation Finance William Hinman issued a statement to further assist companies with their first quarter disclosures.[2] In the statement, they emphasize that the disclosure should address where the company stands as of the date of disclosure as well as the company's expectations regarding how that may change. The statement urges companies to make forward-looking statements to aid the markets and investors in assessing the risks, and reminds companies to avail themselves of the safe harbor provided by the Private Securities Litigation Reform Act. The statement encourages companies to discuss in detail the impact of COVID-19 on its liquidity and financial resources, and to provide disclosure that would allow investors to see the key operational risks and financial challenges through the eyes of management.

On June 23, 2020, the Staff issued guidance supplementing the earlier guidance and providing some additional factors for companies to consider for general disclosure obligations.[3] In the June 23, 2020 guidance, the Staff reminds companies to proactively revise and update their disclosure of COVID-19 related impacts, including those concerning operations and liquidity. Regarding liquidity, the Staff recommends a robust and transparent discussion of the impact of COVID-19, including on revenues, access to financing of all kinds, compliance with covenants, capital expenditures, terms of customer contracts, and reliance on government loans or tax relief. The Staff also recommends that companies should consider disclosure about operational changes, including transition to telework, supply chain and distribution adjustments, suspension or modification of operations, and safety measures for employees and customers. The June 23, 2020 guidance also discusses recommendations regarding going concern disclosure as well as factors to consider relating to disclosure of the impacts of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The June 23, 2020 guidance was previously summarized in our July 6, 2020 memorandum available here.

The Staff notes that the factors provided in the March 25, 2020 and June 23, 2020 guidance are not exclusive and encourages companies to consider a broad range of questions when determining their disclosure obligations. Furthermore, the Staff notes that the details of any COVID-19 related disclosure will be fact- and circumstance-specific, and will differ from company to company. As a result, companies have adopted a variety of approaches when implementing the SEC guidance, as discussed below.

III. Disclosure Approaches

Depending on their existing disclosure and the amount and nature of the additional disclosure to be made, companies should determine whether they want to add stand-alone COVID-19 disclosure or incorporate COVID-19 disclosure throughout the relevant parts of the business section, risk factors, and MD&A. Companies with already robust risk factor disclosure may opt for a stand-alone risk factor (or set of risk factors) or to enhance an existing stand-alone risk factor to minimize the extent of revisions throughout the filing. Similarly, in the MD&A, a separate comprehensive discussion of the impact of COVID-19 on the financial position and liquidity of the company may be included in the general introduction section or appear in the discussion of each income statement and balance sheet item affected, as well as the subsection addressing liquidity. For some companies, it may be best to adopt an approach that incorporates both—starting with a general overview and then adding specifics where additional detail would help investors have a better understanding. In any event, the disclosure should include a

[2] The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19, available at https://www.sec.gov/news/public-statement/statement-clayton-hinman.

[3] CF Disclosure Guidance: Topic No. 9A, available at https://www.sec.gov/corpfin/covid-19-disclosure-considerations.

discussion of all relevant risks that the company is facing due to COVID-19, and the actual and potential impacts of each on the business. In this regard, it may be helpful to consider the impact in six primary areas: 1) supply, manufacturing and distribution 2) increased/decreased demand 3) disruption to the workforce, 4) general economic and market instability, 5) disruption to corporate planning, and 6) increased legal risks and obstacles. Below are some suggested questions for companies to consider in each of the six areas. While many of the questions will not yield answers that fit squarely in an SEC rule requiring disclosure, they can be used to generate facts that companies can evaluate, with counsel as appropriate, to determine whether additional disclosure is required or prudent.

Supply, Manufacturing and Distribution

- Have factories or other production facilities been forced to shut down? Have stores shut down? Is your workforce able to keep working at 100%?
- Are there any other significant parts of your manufacturing process that have been shut down? For example, do you typically rely on research processes such as clinical trials or in-person focus groups that have had to be suspended or reconfigured?
- How have border closures and shutdowns affected your supply chain?
- How have your third-party contractors been affected by the pandemic? Are there certain materials or services you are no longer receiving? Have any defaulted under material contracts?
- How are you mitigating your current COVID-19 losses (if any)? What are the future potential impacts of those mitigation efforts?
- How have air travel limitations and quarantines affected your shipping or distribution of products?
- Are suppliers raising prices to make up for short demand? Have you made efforts to reduce supply costs to minimize the impact of reduced demand?
- How have the changes in supply chain or distribution affected your costs? Can the additional costs be passed on to customers via price increases?
- Are you considering any write-offs in regard to facilities shut down temporarily or permanently?

Increased/Decreased Demand

- Has there been an increase or decrease in demand for your products or services? How are you meeting new demands or mitigating your losses? Do you anticipate any permanent changes to consumer demand for your products or services?
- How have shutdowns, travel restrictions or distancing restrictions affected your business? How have you adapted your sales operations? Have you had to move your services online or reconfigure physical spaces?
- What is the observed impact of COVID-19 on the demand for your company's products or services?
- Has there been an increase in backlog?
- Have you identified or developed new sources of demand or new products to address a demand? How have you adapted to accommodate this new demand?

Disruption to the Workforce

- Have there been reductions in workforce or furloughs? Has there been any increase to paid-time-off or similar policies? What has been the impact on severance or other termination payments?

- How has remote working affected your company? Is there an increase in absenteeism? Reduced productivity? Have there been increased costs associated with remote working, such as providing equipment for employees?
- Are there any potential or actual new cybersecurity or privacy risks that have arisen from remote work?
- Are there any potential or actual union or collective bargaining related concerns arising from the pandemic?
- Has there been any change in healthcare policies or increase in healthcare costs or are any anticipated?
- How are reopening plans in your locations affecting the workforce? What planning is underway or anticipated to accommodate phased reopenings?
- How have changes in the workforce affected your direct labor costs? Your SG&A?

General Economic and Market Instability

- Is your industry reliant on a stronger economy, for example, does a general reduction in leisure or discretionary spending tend to negatively impact your industry?
- How has COVID-19 affected access to capital in your industry? Have you had or do you anticipate having trouble accessing capital or debt financing? Do you anticipate having to pay higher interest rates for such financings?
- Are any of your third-party counterparties in default or at risk of defaulting on material contracts? Have you seen a delay in payments from customers? Have any customers/vendors requested contract modifications or extended payment terms? Have any declared bankruptcy? Based on your revenue recognition policies, will you need to write down or change your accounting for any accounts receivable?
- Has your industry experienced market volatility in stock prices? Bond yields? How has your company fared in this regard?

Disruption to Corporate Planning

- Has COVID-19 affected any planned or current mergers, acquisitions or joint ventures?
- Has COVID-19 affected plans for capital expenditures?
- Has your board or any key employees been affected by COVID-19? Has your board been able to meet on a regular basis?

Increased Legal Risks and Obstacles

- Have there been any material issues relating to delays in regulatory approvals, whether for planned mergers, new drugs or product approvals, or any other approvals typically required for filers in your industry?
- Has there been increased scrutiny or oversight from regulators in your industry?
- Have you been the focus of a regulatory investigation?
- Have you been subject to litigation or threatened litigation related to your responses to COVID-19?
- Have you relied on any government assistance programs in order to mitigate your losses, such as the CARES Act or the Paycheck Protection Plan?

IV. Conclusion

Although the appropriate disclosure will ultimately depend on the specific facts and circumstances facing a company during the COVID-19 pandemic, by using an organized set of probing questions, management can efficiently gather the information needed to prepare robust and transparent disclosure for their investors.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Helene Banks at 212.701.3439 or hbanks@cahill.com; Emma O'Hara at 212.701.3150 or eohara@cahill.com; or Yekaterina Fomitcheva at 212.701.3199 or yfomitcheva@cahill.com; or email publications@cahill.com.