WINSTON & STRAWN LLP

BLOG

New SEC Guidance for COVID-19 Disclosures

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On June 23, 2020, the Division of Corporation Finance (the Division) at the Securities and Exchange Commission (SEC) provided new guidance to companies making coronavirus-related disclosures about their operations, liquidity, and capital resources. The Division provided guidance on how companies should examine their specific facts and circumstances when deciding to make disclosure by providing specific questions for self-analysis. The Division's guidance is particularly applicable to the disclosures contained in the MD&A sections of registration statements filed under the Securities Act of 1933 and of periodic filings under the Securities Exchange Act of 1934.

Operations, Liquidity, and Capital Resources

Operations

The Division acknowledged that most companies are in the midst of adapting to the effects of COVID-19, including telework arrangements, supply chain or distribution disruptions, and suspension or modification of operations to comply with new federal, state, and local health regulations. The division noted that these adaptations may have effects on a company that "would be material to an investment or voting decisions," so companies should carefully weigh their obligations to disclose this information to their investors.

Liquidity and Capital Resources

Similarly, companies facing financial pressure as a result of COVID-19 have entered into "a diverse and sometimes complex range of financing activities" involving "obtaining and utilizing credit facilities, accessing public and private markets, implementing supplier finance programs, and negotiating new or modified customer payment terms." Consequently, the Division noted that, as a result of these financing activities, companies should provide "robust and transparent disclosures about how they are dealing with short- and long-term liquidity and funding risks… particularly to the extent efforts present new risks or uncertainties in their business." Such disclosures would be relevant not just in earnings releases, but, if material, in MD&A sections. In other words, it is not sufficient merely to describe the COVID-19 related financings, but it is necessary to describe the effects that such financings might have on future operations as the result of the interest rate and other financial terms of such financings as well as any material financial and operating covenants that the financings impose on the company.

Questions Companies Should Ask Themselves

In an effort to help companies analyze their specific facts and circumstances and weigh their disclosure obligations, the Division provided a list of questions, including:

TOPIC	QUESTION
Operational Changes	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	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?
Lines of Credit and Market Access	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 Resources	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?

TOPIC	QUESTION
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 metrics and explaining how management uses the metrics 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?
Expenses	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 Servicing	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 Relationships	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?
Financing 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?

TOPIC	QUESTION
Material 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 Assistance

Many companies have received financial assistance from all levels of government, especially under the auspices of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). The Division urged companies receiving governmental aid 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.” To aid companies who have received federal aid, the Division posed three additional questions for determining if additional disclosure is necessary:

TOPIC	QUESTION
Federal 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 Treatment	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?

Continuing as a Going Concern

Finally, the Division encouraged management to consider whether the conditions and events that their company has faced, taken as a whole, "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." If there is "substantial doubt" about either a company's ability to continue as a going concern or if such "substantial doubt" has been alleviated by management's plans, disclosure should be provided in the company's financial statements. The Division listed two more questions to help companies making disclosures on their ability to continue as a going concern:

TOPIC	QUESTION
Going Concern Doubts	Are there conditions and events that give rise to 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?
Company Plans	What are your plans to address these challenges? Have you implemented any portion of those plans?

Conclusion

The questions that the Division provided are helpful for companies considering when and how to make COVID-19-related disclosures. Above all, the Division emphasized that it encourages companies to "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." As companies react to COVID-19 in the summer and fall, they should continue keeping their investors and the public informed on how the pandemic has affected both their day-to-day realities and long-term planning.

Winston & Strawn has provided updates on changes to securities regulation and corporate governance best practices throughout the COVID-19 pandemic, covering topics from the SEC's COVID-19 Relief Order, exchange listing requirements relief, virtual-only meetings, earnings calls, and ESG considerations in the new marketplace. Continue to monitor our Capital Markets & Securities Law Watch for updates and analysis on changes in securities law and policy.

If you have further questions, contact your Winston relationship attorney for more information. View all of our COVID-19 perspectives here. Contact a member of our COVID-19 Legal Task Force here.

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