From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

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SEC Staff Brings Down its Q1 COVID-related Reporting Guidance for Q2:

Focus on Liquidity and Capital Resources, CARES Act Assistance, Ability to Continue as a Going Concern and High-Quality Financial Reporting

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As June 30 rapidly approaches, public companies are busy with the quarter's close and planning their Q2 earnings releases and quarterly reports on Form 10-Q. Even with the experience of the first quarter under their belts, management faces an ongoing challenge of determining to what extent historical results may -- or may not -- be predictive of future performance amidst the continuing uncertainties of the COVID-19 pandemic and related market volatility. In apparent recognition that their guidance for Q1 reporting required a bring-down for Q2, the Securities and Exchange Commission's Division of Corporation Finance and Chief Accountant each issued public statements on June 23, available here and here, that largely reaffirmed but also augmented prior guidance provided in CF Topic No. 9 (Topic 9) and statements by SEC Chair Jay Clayton and Division of Corporation Finance Director William Hinman on April 8 and by Chief Accountant Sagar Teotia on April 3. We discussed the prior guidance here and here.

As the SEC announced on June 24, available here, FASB also issued a set of FAQs dated June 22, available here, providing useful guidance on the application of U.S. GAAP taxonomy to disclosures made in financial statement footnotes on the effects of COVID-19 and governmental relief efforts, such as the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). Topics covered in the FAQs are income taxes, payroll taxes, loans, grants of governmental relief, pensions and overall discussions of COVID-19.

We expect there to be additional Q2 financial reporting guidance and insights emanating from the SEC's June 30 Roundtable entitled "Q2 Reporting: A Discussion of COVID-19 Related Disclosure Considerations" to be moderated by Chair Clayton. We will report on this in a subsequent alert.

CF Topic No. 9A

CF Topic No. 9A (Topic 9A) refines and updates the Q1 financial reporting guidance provided by the Division of Corporation Finance in Topic 9, issued on March 25 in the light of what companies and the economy experienced over the subsequent three months. Topic 9 is available here. Observing that it continues to monitor how companies are disclosing the effects and risks of COVID-19 on their businesses, financial condition and results of operations, the Staff "continue[s] to encourage companies to provide disclosures that enable investors to understand how management and the Board are analyzing the current and expected impact of COVID-19" and "to proactively revise and update disclosures as facts and circumstances change."

Questions Relating to Operations, Liquidity and Capital Resources [UPDATED/REFINED]

The Staff noted that companies are making a diverse range of operational adjustments and entering into diverse, complex and sometimes novel financing arrangements in response to the effects of COVID-19. Accordingly, the Staff urges companies to carefully consider their obligations to disclose information relating to operational adjustments, since the effects may be material to an investment or voting decision. Illustrative examples include the shift to telework, supply chain and distribution adjustments, and the suspension or modification of certain operations (e.g., store closings) to comply with health and safety guidelines for the protection of employees, contractors and customers. Similarly, the Staff urges companies to provide robust and transparent disclosures about how they are dealing with short- and long-term liquidity and funding risks in the current economic environment, particularly where these efforts present new risks or uncertainties to their businesses.

The Staff noted that it has observed some of these high-quality disclosures being made in earnings releases. A key takeaway from Topic 9A is that the Staff is encouraging companies to evaluate the need to disclose the information in MD&A as well, in light of its potential materiality. Keep in mind that the Staff often compares what management discloses regarding past and prospective company performance on the earnings call and/or in the earnings release with the contents of the MD&A and accompanying financial statements included in the corresponding Form 10-Q or Form 10-K, and raises questions about any perceived material disparities.

Companies analyzing their Q2 disclosure obligations in light of their specific facts and circumstances should weigh the following non-exhaustive list of questions presented in Topic 9A:

- 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?
- 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?
- 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?
- 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?
- 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 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?

- 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?
- 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?
- 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 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?
- 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?

Questions Relating to CARES Act Assistance [NEW]

The Staff suggested that companies receiving financial assistance under the CARES Act in the form of loans and/or tax relief should consider the following questions when evaluating 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 (including any required U.S. GAAP disclosures of accounting principles and methods) and critical accounting estimates and assumptions:

- 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?
- 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?

Questions Relating to the Company's Ability to Continue as a Going Concern [NEW]

Finally, the Staff stated that, in addition to the appropriate financial statement disclosure, management should consider the following questions regarding MD&A disclosure where, based on relevant conditions and events that are known and reasonably knowable at the date the financial statements are issued, 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:

- 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?
- For additional insights, the Staff referred readers to the Chief Accountant's statement, which we discuss below.

Statement from the Chief Accountant

In a follow up to his statement of April 3, on June 23 the Chief Accountant issued a statement underscoring the continued importance of high-quality financial reporting for investors in light of COVID-19, and the important role played by preparers, auditors and audit committees in providing this information. The following are key takeaways from the Chief Accountant's statement:

- Recognizing that companies have been required to make significant judgments and estimates, the Office of Chief Accountant (OCA) will continue not to object to "well-reasoned judgments." OCA reminds companies to disclose significant judgments and estimates "in a manner that is understandable and useful to investors," and to ensure that "resulting financial reporting reflects and is consistent with the company's specific facts and circumstances." This reassuring statement echoes the Chief Accountant's previous statement issued on April 3, available here.
- OCA recognizes that financial reporting processes are being adapted to respond to the changing telework environment, which may bring changing risks of the effectiveness of internal control over financial reporting (ICFR) and the potential need for new or enhanced controls. OCA reminds companies to be mindful that if any change materially affects, or is reasonably likely to materially affect, ICFR, the change must be disclosed in the fiscal quarter in which it occurred (or fiscal year in the case of a foreign private issuer).
- In parallel with Topic 9A, OCA reminds management to consider, on a quarterly basis, whether relevant conditions and events, taken as a whole, raise substantial doubt about their company's ability to meet its obligations as they become due within one year after the issuance of the financial statements. In the event of substantial doubt, management must consider whether its plans alleviate the substantial doubt and, where that is not the case, inform investors through appropriate disclosures.
    - OCA also notes that, although interim reviews are not designed to identify conditions or events that indicate substantial doubt about a company's ability to continue as a going concern, auditors may become aware of such conditions or events and, if they do so, auditors must make inquiries of management and consider whether the company's disclosures meet GAAP requirements. Accordingly, auditors should, and companies should expect that auditors will, raise going concern issues with management or the audit committee, as appropriate, as part of their interim review process.
- OCA continues to make itself available for consultation on complex financial reporting questions arising from COVID-19 or other emerging issues.
- Finally, the Chief Accountant reemphasizes the importance in these times of uncertainty of auditor independence and of audit committee oversight of both the auditor and management preparers of the earnings release and Form 10-Q.

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