KPMG

Hot Topic: Coronavirus

SEC provides coronavirus-related disclosure guidance

March 27, 2020 (Updated September 9, 2020[1])

KPMG reports on SEC staff disclosure guidance[2] that assists companies with disclosure obligations as the effects of COVID-19 evolve.

Background

The impacts of the novel coronavirus (COVID-19) are evolving and presenting challenges to companies as they report on their financial condition and results of operations. When the effects of COVID-19 are material to a company, disclosure of the risks and COVID-19 related effects may be necessary for investors' investment and voting decisions. The SEC's Division of Corporation Finance reinforced the importance of providing timely, sufficient, and accurate information to investors while acknowledging the unprecedented challenges companies are facing. As the effects of the coronavirus evolve, companies have an obligation to timely disclose information that clearly depicts the effects COVID-19 is having and is expected to have on their business.

Our Hot Topic on the SEC's extended regulatory relief explains the conditions and requirements for companies impacted by the coronavirus to rely on the SEC's Orders to delay certain filing obligations.

Assessing and disclosing impacts to operations, liquidity, and capital resources**

On June 23, 2020, the SEC staff released CF Disclosure Guidance Topic No. 9A (a supplement to Topic No. 9) to provide companies affected by COVID-19 with additional disclosure considerations and guidance. Specifically, as a calendar quarter-end approaches, the SEC stressed the importance of disclosures relating to operations, liquidity, and capital resources, including the impacts of government financial assistance and going concern.

Companies should consider their disclosure obligations when adjustments made to operations had, or will have, a material effect. Examples of these changes in the current environment include the transition to telework, adjustments to supply chain or distribution networks, and modified operations to

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1 New guidance or significant updates are indicated with **

2 CF Disclosure Guidance: Topic No. 9, March 25, 2020, and CF Disclosure Guidance: Topic No. 9A, June 23, 2020

comply with health guidelines. As certain areas begin to reopen from mandatory stay-at-home orders, companies should also consider disclosures relating to impacts of transitions back to the workplace. Further, robust disclosures may be needed when companies undertake financing activities in response to COVID-19 effects, particularly when these activities present new risks or uncertainties to the company. The disclosures should provide an investor with information from the viewpoint of management and the Board of Directors.

The staff's guidance provides a list of illustrative questions (not meant to be all inclusive) for companies to consider when assessing and disclosing the ongoing impact of COVID-19 to operations, liquidity, and capital resources. We have summarized a subset of the questions as follows.

Operations, Liquidity and capital resources

— What are the material operational challenges that management and the Board of Directors are monitoring? How has the company altered operations, such as implementing health and safety policies for employees or customers? How are the changes impacting or reasonably likely to impact the company's financial condition and short- and long-term liquidity?

— How is the company's overall liquidity position and outlook evolving? Are any decreases in cash flow from operations having a material impact on the company's liquidity position and outlook?

— Has the company accessed revolving lines of credit or raised capital in the public or private markets to address liquidity needs? Are disclosures regarding these actions and any unused liquidity sources providing investors with a complete discussion of the company's financial condition and liquidity? Is COVID-19 impacting the company's ability to access traditional funding sources on similar terms as recent periods?

— If cash burn rates are disclosed, are company's providing a clear definition of the metric? Are estimates or assumptions used in the metric and disclosed?

— Has the company reduced capital expenditures, dividend payments or share repurchase programs and if so, how? What is the short- and long-term impact of these reductions?

— Has the company taken advantage of any debt payment deferrals or forbearance periods? What liquidity challenges may arise when these accommodations end?

— Has the company altered payment terms with customers, and do these modifications materially impact the company's financial condition and liquidity?

— Has the company assessed the impact of material events in the subsequent events period, and their potential impact on liquidity? Are MD&A disclosures sufficient if these subsequent events impact known trends or uncertainties?

— Is the company using supplier finance arrangements (i.e. supply chain financing, structured trade payables, reverse factoring or vendor financing) to manage its cash flows that have a material impact on its balance sheet, statement of cash flows or liquidity? What is the impact? What are the material terms of the arrangement? Is there a material risk to the company if a party to the arrangement terminates it? Did the company or its subsidiaries provide any guarantees related to them? What is the amount of payables at period-end related to such arrangements, and what amounts were settled by an intermediary of the company on its behalf?**

Government assistance – CARES Act

Companies receiving CARES Act[3] or other government assistance should consider the short- and long-term impacts of that assistance on its financial condition and liquidity as well as disclosures and critical accounting estimates and assumptions. For example, companies should consider:

[3] Coronavirus Aid, Relief, and Economic Security (CARES) Act

— How does a CARES Act loan impact liquidity and capital resources? Do the terms and conditions of the CARES Act loan limit the company's ability to seek other financing sources?

— How do recent tax relief measures impact liquidity? Does the company expect material tax refunds from prior periods?

— What are new material accounting estimates or judgments arising from this assistance? Do they change prior critical accounting estimates? What are the uncertainties when applying the related accounting guidance?

Going concern

Where substantial doubt exists about a company's ability to continue as a going concern or the substantial doubt is alleviated by management's plans, management should provide appropriate disclosures in the financial statements and consider the following questions regarding MD&A disclosures:

— Are there conditions or events that give rise to substantial doubt about the company's ability to continue as a going concern (e.g., labor challenges, work stoppages, defaults on obligations)?

— What are the company's plans to address these challenges? Have these plans been implemented?

Assessing and disclosing the evolving impact of COVID-19

Assessing the risks and related effects of COVID-19 will be a facts-and-circumstances based analysis. Companies are encouraged to provide disclosures that are specific to the business and provide investors the ability to evaluate the current and expected impact of COVID-19 'through the eyes of management'. Disclosures should be updated timely as the facts and circumstances and impact of COVID-19 evolve. Some examples of communications with investors that should include COVID-19 related disclosures, if material, include:

— Exchange Act[4] filings including Forms10-K,10-Q, and 20-F;

— Registration statements including those on Forms S-1, S-3, S-4, and S-8;

— Form 8-K furnished to rely on the SEC Order granting relief to companies affected by coronavirus[5]; and

— Earnings releases in a furnished or filed Form 8-K (or Form 6-K).

Companies' disclosures will involve forward-looking information. The SEC staff guidance reminds companies that providing such information can be done in a way to take advantage of the safe harbors provided in the Securities Act[6] and Exchange Act[7]. The staff's disclosure guidance provides a list of illustrative questions (not meant to be all inclusive) for companies to consider when assessing and disclosing the impact of COVID-19 on present and future operations. We have summarized a subset of the questions as follows.

— How has COVID-19 impacted the company's financial condition and results of operations and does the company expect such an impact to continue into the future or will the impact be different on future operations?

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[4] Refers to the Securities Exchange Act of 1934

[5] SEC Order granting relief to companies affected by coronavirus, March 25, 2020

[6] Refers to Section 27A of the Securities Act of 1933

[7] Refers to Section 21E of the Securities Exchange Act of 1934

- How has or does the company expect COVID-19 will materially impact the company's supply chain and/or the demand for the company's products or services?
- How has COVID-19 affected the company's capital and financial resources including its ability to access such resources, the cost of such resources, and its ability to continue to meet debt covenants?
- How does the company expect COVID-19 will affect its assets and its ability to timely account for those assets (e.g. determining fair value)?
- Does the company expect any material impairments, increases in allowances for credit losses, restructuring charges, or other expenses that are likely to have a material impact on its financial statements?
- Has the company been able to maintain operations, including financial reporting systems, internal control over financial reporting, and disclosure controls and procedures?
- Does the company face any material resource constraints, including those that may impact implementing business continuity plans?
- Have travel restrictions and border closures had or are they expected to have a material impact on the company's ability to operate its business?

SEC Chairman Jay Clayton and the Director of the Division of Corporation Finance William Hinman are urging companies to provide as much information as is practicable regarding their current status and forward-looking plans for addressing the effects of COVID-19.[8] They recognize that preparing forward-looking disclosure will likely be difficult as many future events that will help shape company decisions are out of the control of the company. However, Chairman Clayton and Director Hinman believe investors and the capital markets are relying on forward-looking information and that taking on that challenge is appropriate and necessary. Companies are encouraged to take all reasonable steps to convey information through the eyes of management that provides investors insight into the key operational and financial considerations and challenges the company faces. Companies that respond to the call for forward-looking disclosure should take advantage of the safe harbors for such statements and should not expect good faith attempts to provide appropriately framed forward-looking information to be second guessed by the SEC.

Need to refrain from trading prior to disseminating material non-public information

Companies and other related persons are reminded that they may be in a position to understand how COVID-19 may impact the company before investors, and that information may be material to investors. Companies, their management, and their directors and officers should not trade on information that has not been disclosed to investors. Companies should not provide selective disclosures but rather be sure they disclose the relevant information broadly to investors. This includes updating information previously disclosed that becomes materially inaccurate.

[8] The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19, Pubic statement, April 8, 2020

Reporting earnings and financial results

Many companies report earnings prior to filing their required financial reporting (e.g. on Form 10-K and 10-Q). For example, a company may release its fourth quarter earnings prior to filing its Form 10-K in both an earnings call and in an earnings release furnished in a Form 8-K. Due to the COVID-19 impact, many companies are finding it more difficult for not only themselves, but also for their auditors to complete the steps necessary in order to timely file required financial reporting. As part of their earnings release or other financial results released prior to finalizing their required financial reporting, companies may present non-GAAP financial measures and metrics (non-GAAP financial measures) to adjust or help explain the impact of COVID-19. Examples of where non-GAAP financial measures may be presented include:

- earnings release furnished or filed in a Form 8-K (or Form 6-K);
- earnings calls;
- webcasts;
- investor presentations; and
- websites.

The guidance reminds companies when presenting non-GAAP financial measures to explain why management finds the measure useful and how it helps investors assess the impact of COVID-19 on the financial information being presented.

Due to the challenges COVID-19 is presenting, some of the GAAP measures may not be available at the time of an earnings release (or other releases of financial information prior to filing required financial reporting). For example, accounting for a goodwill impairment may not be completed and audited at the time of an earnings release due to challenges caused by COVID-19. Those challenges could include not having the personnel available to timely complete the analysis and related internal controls, challenges in determining the best estimate of assumptions used in the goodwill impairment analysis considering the uncertainties in the COVID-19 environment, or not having timely access to experts needed to assist the company in preparing its estimate. In these circumstances, the staff would not object to reconciling a non-GAAP financial measure to 'preliminary GAAP results' that either include provisional amounts based on a reasonable estimate or a range of reasonably estimable GAAP results.

To demonstrate the concept of 'preliminary GAAP results', the staff provides an example in which a company may intend to disclose on an earnings call its earnings before interest, taxes, depreciation and amortization (EBITDA). A company could reconcile that measure to either its GAAP earnings, a reasonable estimate of its GAAP earnings that includes a provisional amount, or its reasonable estimate of a range of GAAP earnings. If a provisional amount or range is provided, it should reflect a reasonable estimate of COVID-19 related charges not yet finalized, such as impairment charges.

If non-GAAP financial measures are reconciled to preliminary amounts, the company should explain why the amounts are preliminary and what incremental information and/or analysis is required to complete the accounting. If the non-GAAP financial measures relate to COVID-19 or companies change the method historically used to calculate the non-GAAP financial measures as a result of COVID-19, companies should consider the SEC's guidance on key performance indicators and other metrics[9] in order for the non-GAAP financial measures to not be misleading.

When a company presents non-GAAP financial measures that are reconciled to preliminary GAAP results, they should limit the measures in their presentation to those non-GAAP financial measures used to report financial results to the Board of Directors. The staff believes companies should use non-

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[9] SEC issues MD&A guidance on KPIs and metrics, Release No. 33-10751

GAAP financial measures to demonstrate how management and the Board of Directors analyze the current and future potential impact of COVID-19 on the company.

KPMG observation

- When the guidance refers to 'preliminary GAAP results' which includes provisional amounts based on a reasonable estimate or a range of reasonably estimable GAAP results, the guidance does not permit such preliminary amounts to be subsequently be used in the required GAAP financial statements. 'Preliminary GAAP results' may only be used in earnings release estimates and other financial results provided in advance of the required financial reporting. Therefore, the required financial statements (e.g. those filed in Form 10-K or Form 10-Q) should continue to be prepared in accordance with Regulation S-X and apply the appropriate GAAP.
- Although COVID-19 has presented many companies with unprecedented challenges, Item 10 of Regulation S-K and Regulation G continue to be effective. As a result, there is no change to prohibited non-GAAP financial measures, such as a full non-GAAP income statement. Other examples of non-GAAP measures that continue to be prohibited include (but are not limited to):
  - excluding normal, recurring, cash operating expenses necessary to operate a registrant's business;
  - inconsistent presentation between periods without disclosing the effect and reason for change;
  - excluding charges, but not similar gains;
  - individually tailored accounting principles to calculate non-GAAP earnings; and
  - per-share measures of liquidity.

In light of COVID-19, it would not be appropriate to adjust for normal payroll expenses when no corresponding revenues are recognized due to the suspension of operations because of COVID-19. Likewise, it would not be acceptable to adjust for lost revenues. However, situations may arise in which it may be appropriate to adjust for COVID-19-related items. Depending on the facts and circumstances, it could be acceptable to exclude incremental or unusual costs that were incurred because of COVID-19 (e.g. cleaning costs).

Also, non-GAAP financial measures should not be disclosed more prominently than the most directly comparable GAAP financial measure or range of GAAP measures. In filings where GAAP financial statements are required, companies should continue to reconcile to GAAP results. As noted above, provisional amounts or a range of estimated results continue to be inappropriate in GAAP financial statements filed with the SEC. For further information on non-GAAP financial measures, see KPMG's Issues In-Depth, Non-GAAP financial measures.

Evolving information

The potential global and economic impacts of the coronavirus continue to evolve rapidly, and companies should monitor the situation. Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress. Stay informed at read.kpmg.us/coronavirus

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