

# Hot Topic: Coronavirus

## Potential impacts of coronavirus on SEC issuers

February 7, 2020



### SEC Chairman advises companies to monitor current and potential effects of coronavirus on disclosures.



#### Background and SEC Chairman statement

Stock markets around the world have started to react to uncertainties around the economic impacts of the coronavirus. On February 3, Chinese markets dropped sharply when they reopened after an extended Lunar New Year holiday. Global markets have also seen decreases in value and are experiencing volatility in asset prices, currency exchange rates and commodities indices.

Several countries have banned travel to and from China. Many companies have suspended operations in China until further notice, and cross-border business transactions with China-based companies have been impacted. These disruptions to business operations and economic activity in China have had a cascading effect on both upstream and downstream supply chains.

In a public statement on January 30, SEC Chairman Jay Clayton stated that:

- he has asked the SEC staff to monitor and, as necessary or appropriate, provide guidance and other assistance to issuers regarding disclosures on current and potential effects of the coronavirus;
- he acknowledges that impacts may be difficult to assess at this time; and
- how an issuer plans for an uncertainty and how it responds to current events can be material to an investment decision.



#### What should companies consider?

Affected companies should continue to monitor information coming from the SEC staff. Additionally, companies should assess the effects that the virus outbreak may have on required reporting. The following list provides an overview of items that companies should consider.

- **Periodic disclosures.** Companies should consider their disclosure obligations regarding business risks related to the impacts of coronavirus within the context of the US securities laws. Disclosures should be specific to individual circumstances, avoiding broad or generic language.

Disclosure within periodic filings to address these current – and evolving – events may be appropriate in:<sup>1</sup>

- Item 1. Description of Business
- Item 1A. Risk Factors
- Management’s Discussion and Analysis of Financial Condition and Results of Operations
  - Liquidity
  - Results of Operations – Known Trends and Uncertainties
- Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Companies should consider similar disclosure in the relevant sections of interim filings, including material changes in financial condition. A company’s normal disclosure controls and procedures should be applied to the reporting of this information.

While not exhaustive, the following table provides example disclosure considerations related to business risks.

| <b>Business risk</b>         | <b>Disclosure considerations</b>   |
|------------------------------|--|
| <b>Customer demand</b>       | <ul style="list-style-type: none"> <li>— Is the company experiencing (or expecting) any changes in demand from China-based customers or products made in China?</li> <li>— How sensitive is demand and pricing to exchange rates and/or commodity indices (e.g. volatility of crude oil prices)?</li> </ul>  |
| <b>Supply chain</b>          | <ul style="list-style-type: none"> <li>— Is the company experiencing (or expecting) supply chain impacts such as shortages related to the import/export of machinery, components or raw materials?</li> <li>— Is the company making new arrangements to purchase goods from sources outside of the affected areas? Will there be significant costs or other risks associated with those alternative arrangements?</li> <li>— Is the company experiencing (or expecting) issues with the flow of goods and trade to/from China due to travel restrictions, canceled passenger and cargo shipments by airlines, or border closings?</li> </ul> |
| <b>Products and services</b> | <ul style="list-style-type: none"> <li>— Are there risks of production delays for products manufactured in China?</li> <li>— Is the company experiencing plant or office closures?</li> <li>— Does the company anticipate product shortages?</li> <li>— Is the company impacted by rent concessions or abatements associated with office and/or retail closings in China?</li> </ul>   |
| <b>People</b>                | <ul style="list-style-type: none"> <li>— Is the company experiencing staffing shortages due to quarantines in China?</li> <li>— Does the company have a large workforce in China?</li> <li>— Are there employee compensation matters that will result in material costs?</li> </ul>  |
| <b>Market</b>                | <ul style="list-style-type: none"> <li>— Is the company heavily invested in Chinese stocks?</li> <li>— To what extent does the company have exposure to the global economy?</li> <li>— Is the company exposed to volatility in commodities markets impacted by current events?</li> <li>— Does the company have exposure to the Chinese Yuan?</li> </ul>   |

<sup>1</sup> Foreign private issuers should consider disclosures based on the corresponding Items and requirements of Forms 20-F or 40-F, as applicable.

- **Accounting and financial reporting impacts.** Companies should consider whether economic uncertainties and market volatility have or will affect accounting conclusions. While not exhaustive, example considerations include the following.
  - Key assumptions and sensitivities – reevaluate as necessary to reflect current economic conditions and uncertainties.
  - Strategies and policies to manage risk – have these been adequately updated and disclosed if there have been changes?
  - Adequacy of disclosures for:
    - potential inventory writedowns and impairment losses;
    - loan defaults or covenant breaches;
    - credit risk from Chinese customers or others negatively impacted by these events;
    - insurance recoveries;
    - changes in the business or economic circumstances that affect the fair value of the company’s financial and nonfinancial assets and liabilities; and
    - changes in Chinese growth forecasts that may impact impairment evaluations (e.g. goodwill, other intangible assets).
- **Subsequent events (ASC 855).** Companies should evaluate whether events occurring after the balance sheet date require disclosure or possibly recognition.
  - **Nonrecognized subsequent events.** For December 31, 2019 filings, financial reporting impacts will likely be limited to nonrecognized subsequent events that should be disclosed. For example, companies may experience losses due to supply chain issues or volatility in commodities markets that should be disclosed.
  - **Recognized subsequent events.** There may be existing conditions before December 31 that are further impacted by the outbreak, such that recognition in the financial statements for the year ended December 31, 2019 may be required. For example, a customer’s bankruptcy after the reporting date is often the culmination of a sequence of events that started before that date (e.g. the US-China trade tension). In this scenario, receipt of information about the bankruptcy may be a recognized subsequent event.
  - **Later periods.** For later filings (e.g. March 31, 2020), any accounting impacts will likely be recognized.
- **Access to information.** A company’s ability to obtain and provide financial statements or information relating to Regulation S-X Rule 3-09 (equity method investments), Rule 3-10 (guarantors), and Rules 3-05 and 3-14 (acquired businesses), could be impacted. Companies with significant operations in China may encounter delays in receiving financial data for consolidated financial statements.
- **ICFR.** Companies with significant operations or business transactions in China may consider whether there is any effect on internal control over financial reporting. For example, new controls may be implemented and/or modified as companies start to implement emergency procedures, modify IT access to enable remote workforces, or account for unanticipated significant unusual events (e.g. accounting for insurance recoveries related to business interruption). Disclosure of material changes in ICFR would be required.
- **Late filings.** If companies anticipate filing delays due to the outbreak or related travel restrictions, they should contact the SEC staff directly to discuss their facts and circumstances. To the extent necessary, companies may consider using Form 12b-25, Notification of Late Filing, to extend reporting time frames. Failure to follow regulations and timely report could result in a company losing its ability to issue securities using Form S-3.

## Evolving information

The potential global and economic impacts of the coronavirus continue to evolve rapidly. Companies should monitor the situation as changes in circumstances may require additional or revised disclosure in current and future filings. Disclosures should include material, relevant information for investors as of the date of the periodic filing.

Companies are encouraged to maintain close communications with their board of directors, external auditors, legal counsel and other service providers as the circumstances progress.

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