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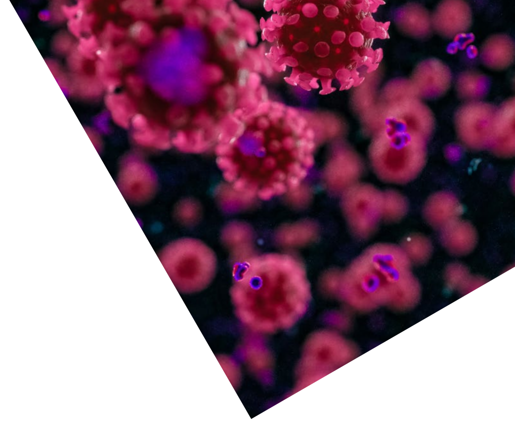

COVID-19 U.S.: Considerations for quarterly reports on Form 10-Q

April 6, 2020

Introduction

The COVID-19 pandemic continues to unfold rapidly and in uncertain directions. Companies will need to report the current and potential future effects and risks of COVID-19 on their businesses, financial condition, and results of operations in their upcoming Form 10-Q quarterly reports. Below is a list of considerations for preparing Form 10-Q disclosure, beginning with general considerations and then addressing individual items of the report.

FORM 10-Q and COVID-19

General considerations – SEC guidance

Companies should consider their disclosure obligations related to COVID-19 against the background of their prior SEC filings and other public communications, and ensure that they convey a consistent message across the different disclosure items of Form 10-Q. On March 25, the SEC staff outlined key questions for issuers to ask in evaluating potential disclosures in light of their own situation. The following are among the most pertinent questions relevant to Form 10-Q identified by the staff (shortened here for brevity in some cases):

- How has COVID-19 affected, and how might it affect, your financial condition and results of operations?
- How has COVID-19 impacted capital and financial resources, including overall liquidity position and outlook?
- Do you expect to disclose or incur any material COVID-19-related contingencies?
- How do you expect COVID-19 to affect assets on your balance sheet?
- Do you anticipate any impairments, increases in allowances for credit losses, restructuring charges, other expenses, or changes in accounting judgments that could materially impact your financial statements?
- Have COVID-19-related circumstances adversely affected your ability to maintain operations, including financial reporting systems, internal control over financial reporting, and disclosure controls and procedures?
- Have you experienced challenges in implementing business continuity plans or do you foresee material expenditures or material resource constraints in doing so?
- Do you expect COVID-19 to materially affect the demand for your products or services, your supply chain, or the methods used to distribute your products or services?
- Will your operations or business goals be materially affected by travel restrictions, border closures, or constraints or impacts on your human capital resources and productivity?

The SEC staff recognizes that it may be difficult to assess or predict with precision the broad effects COVID-19 will have on a company, and that the actual impact will depend on many factors beyond the company’s control and knowledge. The staff emphasizes, however, that investors might find material not only the current effects of COVID-19, and the pandemic’s expected future impact, but also how management is responding to and planning for COVID-19-related events and uncertainties.

FORM 10-Q and COVID-19

Part I – Financial information

Item 1. Financial statements

Numerous accounting standards are implicated by potential developments related to COVID-19. A handful of key considerations follow. We recommend that companies closely consult with their independent auditors in considering how to address COVID-19-related impacts to accounting treatment and disclosure in the financial statement notes. We also recommend early and close coordination with the auditors to ensure timely alignment in approach to the quarterly review in light of coordination challenges resulting from the remote working environment adopted by many businesses. See "Item 4. Controls and procedures" and "Other considerations" below.

Loss contingencies

Requirement: ASC 450, Contingencies, requires description of a contingency when there is a reasonable possibility of a loss and disclosure of related amounts when the amounts are reasonably estimable. The SEC has historically kept a watchful eye on contingencies disclosures, particularly in situations where a material loss suddenly appears in a filing with no disclosure of the possibility of that loss in earlier filings.

Disclosure considerations: Companies should consider whether any loss related to COVID-19 is remote, reasonably possible, or probable. Companies may need to begin analyzing possible estimated loss contingencies arising out of COVID-19 earlier in the reporting process given the complexity of the situation and the pace of developments.

Asset impairments

Requirement: Various accounting principles address accounting for and disclosures related to impairment losses related to inventory, intangibles, long-lived assets, investments, and other assets.

Disclosure considerations: Companies will need to assess whether the impacts of COVID-19 have led to impairment of assets.

Subsequent events

Requirement: ASC 855, Subsequent Events, requires certain disclosures with respect to events that occur after the balance sheet date but before financial statements are issued or are available to be issued, including events that provide additional evidence about conditions that existed at the balance sheet date. In recent dialogues with representatives of the four largest U.S. accounting firms, the SEC staff has emphasized the need to consider potential COVID-19-related disclosure in accordance with ASC 855.

Disclosure considerations: ASC 855 requires issuers to consider developments after period-end. As a result of the rapidly evolving nature of the pandemic, related legislation, and other related company-specific developments (such as debt incurrences) after the end of the current quarter, COVID 19-related disclosure could be necessary in a subsequent event footnote.

Other accounting and financial statement note disclosures are potentially affected by COVID-19. These include disclosures related to revenue recognition, hedge accounting, restructuring, risks and uncertainties disclosure, including related to significant accounting estimates, and, in the case of some registrants, the ability to continue as a going concern.

Part I – Financial information (cont'd)

Item 2. Management's Discussion and Analysis of financial condition and results of operations

Generally/Overview

Requirement: Long-standing SEC guidance indicates that MD&A should begin with an executive-level overview to provide context for the remainder of the discussion, and that MD&A should be written in a way that enables investors to understand the issuer's financial results and prospects "through the eyes of management."

Disclosure considerations: Companies should discuss and analyze in MD&A the impact and uncertainties associated with the pandemic. The general impact of COVID-19 could be introduced in a separately captioned item in the overview or another form of highlighted commentary. Although COVID-19 effects may not have been significant until the end of the most recently completed quarter, it has become clear that the effects are likely to be significant in future periods for most businesses. A more detailed consideration of the current and expected effects should be addressed in the following sections of MD&A.

Liquidity and capital resources

Requirement: Item 303(b) of Regulation S-K requires the company to disclose material changes in measures of financial condition described in Item 303(a) of Regulation S-K. Item 303(a)(1) requires disclosure of known demands, commitments, events, or uncertainties reasonably likely to result in material changes to liquidity, and Item 303(a)(2) requires disclosure of known material trends in capital resources.

Disclosure considerations: Companies should consider whether COVID-19 has impacted capital and financial resources and the company's overall liquidity position and outlook, for the long term as well as for the next 12 months. For example, companies should consider disclosing any COVID-19-related decisions or developments with respect to capital market issuances, credit facility draws, or other incurrences of debt, and whether the cost of or access to future capital has changed or is now uncertain. Companies may also need to consider whether there is any material uncertainty about the future ability to meet financial covenants in existing borrowing facilities, such as under leverage or interest coverage ratios or similar covenants, and assess whether the pandemic could potentially affect future access to borrowing. Companies will need to consider carefully the requirement to disclose known trends and uncertainties as they relate to debt service and other obligations, access to liquidity, changes in the valuation of collateral (including the effect under margin loan arrangements) and counterparty risk.

Results of operations

Requirement: Item 303(a)(3) of Regulation S-K requires disclosure of (i) any unusual or infrequent events or significant economic changes that materially affected income from continuing operations and (ii) known trends or uncertainties that the company reasonably expects will have a material favorable or unfavorable impact on sales, revenue, or income.

Disclosure considerations: Companies should discuss how COVID-19 has resulted in changes to revenues, expenses, and other financial measures in the relevant quarter, as well as uncertainties related to the future impact of the pandemic on these measures. In crafting their disclosure, companies should be mindful of the SEC's view that one of the principal purposes of this discussion is to provide information about the variability of a company's earnings so that readers can determine the likelihood that past performance will be indicative of future performance.

Non-GAAP financial measures

Requirement: Regulation G, Item 10 of Regulation S-K, and antifraud laws, as interpreted through guidance issued by the Commission and the SEC staff, require companies to provide specified information in connection with disclosure of non-GAAP financial measures in which GAAP measures are adjusted to exclude or include certain amounts. The SEC considers it potentially misleading to present non-GAAP measures solely to present a more positive view of a company's financial situation. Recent guidance by the Division of Corporation Finance reiterates this point in the COVID-19 context.

Item 2. Management's Discussion and Analysis of financial condition and results of operations (cont'd)

Non-GAAP financial measures (cont'd)

Disclosure considerations: Companies should consider whether it is appropriate to use non-GAAP financial measures to adjust for costs related to COVID-19. Any company doing so must take care to comply with SEC rules requiring presentation of the most directly comparable GAAP financial measure with equal or greater prominence, reconciliation of the non-GAAP measure to the comparable GAAP measure, and an explanation of why the non-GAAP measure provides useful information to investors and how management is using the adjusted measure. Companies also should recall the SEC staff's caution that a company could be providing misleading disclosure if a non-GAAP measure is presented inconsistently between periods by adjusting a particular charge in the current period where such a charge was not also adjusted in prior periods. The company can address such an inconsistent presentation based on COVID-19 by disclosing the inconsistency and the reasons for it.

Safe harbor language

Requirement: Section 21E of the Exchange Act provides companies a safe harbor from specified liability under the federal securities laws for forward-looking statements provided they identify the cautionary factors that might cause forward-looking statements not to be accurate in material respects.

Disclosure considerations: Forward-looking statement disclaimers should be narrowly tailored to the specific forward-looking information that is intended to be protected. Companies should refer to the particular forward-looking statements as well as the potential risks and uncertainties related to COVID-19 that affect an evaluation of the company's business and prospects. It is preferable to avoid general statements – such as references to "the impacts of COVID-19" – in favor of more specific cautionary language about the current or expected effects of the pandemic.

Item 3. Quantitative and qualitative disclosures about market risk

Requirement: Item 305 of Regulation S-K requires both quantitative and qualitative disclosures about market risk, to the extent material, in the company's Form 10-K. Item 305(c) requires companies to update the discussion in their Form 10-Q reports to enable readers to assess the sources and effects of material changes in the market risk since the end of the fiscal year.

Disclosure considerations: Companies should reassess prior disclosures about market risk in light of market conditions, interest rates, and asset values. For example, credit and debt capital markets have been impacted by COVID-19, with recent debt transactions pricing with generally higher interest rate spreads than transactions in 2019 and earlier in 2020.

Item 4. Controls and procedures

Requirement: Item 307 requires the conclusions of the company's principal executive and financial officers regarding effectiveness of disclosure controls and procedures as of quarter-end, while Item 308(c) requires disclosure of changes in internal control over financial reporting during the quarter that have materially affected, or are reasonably likely to affect, internal control over financial reporting.

Disclosure considerations: To the extent circumstances such as remote working and government-imposed restrictions have disrupted usual financial and other disclosure reporting processes and procedures, companies should consider whether such disruptions have weakened existing internal controls and may require new controls or modifications to existing ones. Advance attention to disclosure regarding controls and procedures will be essential to avoid last-minute surprises that could delay the filing.

Part II – Other information

Item 1A. Risk factors

Requirement: Part II Item 1A of Form 10-Q requires disclosure of material changes to risk factors disclosed in the Form 10-K. SEC staff guidance requires the company to present risk factor disclosure tailored to its particular facts and circumstances, and to identify specific material events or material factual circumstances that represent instances of the disclosed risk.

Disclosure considerations:

- ***"Acts of God"***: Companies should consider referring specifically to pandemics, including COVID-19, in risk factors that address the unpredictable effects of various calamities such as war, famine, or economic, social, or political upheaval on business generally or on specific aspects of the business.
- ***Economic conditions***: Companies should consider adding specific references to the effect of COVID-19 on the economy, unemployment, and spending in risk factors discussing the impact of general broad economic conditions on the company.
- ***Reliance on third parties***: Companies in various industries describe risks related to reliance on third parties, including participants in the supply chain, service providers, and selling channel partners. Companies should consider the relevance to these risk factors of COVID-19-related restrictions and disruptions.
- ***Unfavorable changes in laws***: In risk factors dealing with the impact of changes in laws and regulations, companies should consider adding a discussion of the possible adverse effects of government action taken in response to the pandemic, including government-imposed restrictions on the movement of people and goods, insurance or sick pay requirements, and other new legal rights and obligations.
- ***Access to capital***: Companies that regularly require additional capital often describe risks relating to market disruptions or the inability to raise capital on acceptable terms, if at all. Companies should consider whether to augment their disclosure to refer to the potential impact of COVID-19 on their access to capital.
- ***Standalone COVID-19 risk factor***: The existing disclosure may be expanded to include a standalone coronavirus risk factor that discusses the myriad possible effects of COVID-19 in light of the company's specific circumstances. This risk factor may refer to risks cited in other risk factors as well as other risks specific to the company's business.

Item 2. Unregistered sales of equity securities and use of proceeds

Stock repurchases

Requirement: Item 703 of Regulation S-K requires tabular disclosure of stock buyback activity within the applicable quarter.

Considerations: In addition to the required disclosure, companies may want to consider qualifying disclosure to reflect the discretionary nature of programs, if applicable, noting the ability to modify, suspend, or discontinue the program at any time, and to reflect any significant changes in buyback activity as a result of COVID-19. A company that has previously announced a suspension of its buyback program should consider a need to update the disclosure in this Item to refer to the suspension.

Part II – Other information (cont'd)

Signatures

Requirement: Rule 302(b) of Regulation S-T requires signatories to SEC-filed documents to "manually" sign the signature page or a document adopting the signatory's signature prior to upon filing, and issuers to retain signatures for five years. The SEC staff has granted limited relief in light of COVID-19-related difficulties, indicating that the SEC will not recommend enforcement action if (i) the signatory maintains a manually signed signature page and provides it as promptly as reasonably practicable to the filer, (ii) the document indicates the date and time of the signature, and (iii) the filer establishes and maintains policies and procedures governing this process. The staff noted that signatories may send a PDF or photograph of the document to the issuer when signed.

Considerations: Companies should continue to require signatories to their Form 10-Q and officer certifications filed with the Form 10-Q to manually sign the form and certifications. If offices are closed or signatories are working remotely, registrants could arrange for the signatory either to retain the signed page or transmit to the company an electronic copy of the signed page. Notably, the staff guidance does not address the use of electronic signatures via platforms such as DocuSign.

Other considerations

Early engagement with accounting team

In-house lawyers responsible for disclosure should work with the accounting team early to consider and discuss the matters noted above, including issues related to liquidity, impairments, known trends and uncertainties, subsequent events and any potential delays in completion of the quarterly review process that could affect the company's ability to meet its filing deadline. In addition, every company should discuss the practical implications of COVID-19 on the conduct of the quarter-end closing process, such as procedures for the review of internal control procedures and other period-end processes and assessments that are typically done in person.

Early engagement with audit committee

The SEC has emphasized that companies should work with their audit team and audit committees to ensure that their financial reporting, auditing, and review process are as robust as practicable given the circumstances. In addition, given the audit committee's oversight role over financial reporting, management should consider engaging with the audit committee early and building in sufficient time for the audit committee to review and consider the impact of COVID-19 on accounting and financial disclosure and enterprise risk management and the potential effect of the developing regulatory landscape related to the pandemic.

Hogan Lovells COVID-19 Topic Center

For tools, advice, and insights to help your business respond to the legal and contractual challenges COVID-19 presents anywhere in the world, head to our Hogan Lovells COVID-19 Topic Center.

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