

## ■ SECURITIES DISCLOSURE

# COVID-19 Issues for SEC Reporting Companies

*The SEC Division of Corporation Finance has issued guidance on disclosure considerations and other securities law obligations related to COVID-19. Public companies should start thinking about their upcoming COVID-19 disclosures in order to allow time for drafting and internal review of appropriate language.*

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In addition to a host of significant general business concerns, such as those relating to liquidity and financing opportunities, revenues, supply chain, and employee and community health and welfare, the novel coronavirus known as COVID-19 has raised a number of issues specific to public companies that file reports with the US Securities and Exchange Commission (SEC), including the application of SEC disclosure requirements and other Federal securities law requirements.

### Staff Guidance

On March 25, 2020, the SEC's Division of Corporation Finance (Division) issued CF Disclosure Guidance: Topic No. 9<sup>1</sup> (Guidance) on disclosure considerations and other securities law obligations related to COVID-19. The Guidance recognized that it may be difficult for companies to assess or predict with precision the broad effects of COVID-19 and that its actual impact will depend on many factors beyond a company's control and knowledge. At the same time, the Guidance observed that "the effects COVID-19 has had on a company, what management expects its future impact will be, how management is responding to evolving events,

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and how it is planning for COVID-19-related uncertainties can be material to investment and voting decisions." (Editor's note: On April 8, 2020, SEC Chairman Clayton and Division of Corporation Finance Director Hinman issued a joint statement encouraging companies to provide information not only on their historical results but also their current financial and operating status, as well as how this might change due to COVID-19.)

The Guidance emphasized that under the SEC's principles-based disclosure framework, "disclosure requirements can apply to a broad range of evolving business risks even in the absence of a specific line item requirement that names the particular risk presented." As examples, the Guidance noted that COVID-19-related disclosures "may be necessary or appropriate in management's discussion and analysis, the business section, risk factors, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and the financial statements."

### Assessing and Disclosing the Evolving Impact of COVID-19

To illustrate the types of impacts COVID-19 may have that could give rise to disclosure obligations, the Guidance included a non-exhaustive series of questions for companies to consider with respect both to their present and future obligations, including:

- How has COVID-19 impacted your financial condition and results of operations?
- How has COVID-19 impacted your capital and financial resources, including your overall liquidity position and outlook?
- How do you expect COVID-19 to affect assets on your balance sheet and your ability to timely account for those assets?
- Do you anticipate any material impairments, increases in allowances for credit losses,

restructuring charges, other expenses or changes in accounting judgments?

- Have COVID-19-related circumstances such as remote work arrangements adversely affected your ability to maintain operations, including controls and procedures?
- Have you experienced challenges in implementing your business continuity plans, or do you foresee requiring material expenditures to do so?
- Do you expect COVID-19 to materially affect the demand for your products or services?
- Do you anticipate a material adverse impact of COVID-19 on your supply chain or the methods used to distribute your products or services?
- Will your operations be materially impacted by any constraints or other impacts on your human capital resources and productivity?
- Are travel restrictions and border closures expected to have a material impact on your ability to operate and achieve your business goals?

The Guidance encouraged disclosure that is tailored to the company's business, providing material information about the impact of COVID-19 through the eyes of management. In addition, the Guidance encouraged companies to "proactively revise and update disclosures as facts and circumstances change." The Guidance noted that companies can present forward-looking information in a manner that would be covered by the safe harbors in Section 27A of the Securities Act of 1933 (Securities Act) and Section 21E of the Securities Exchange Act of 1934 (Exchange Act).

#### **Trading Before Dissemination of Material Non-Public Information**

The Guidance reminded companies and related persons that they need to consider their federal securities law obligations when issuing or trading in their company's securities. The Guidance emphasized that when companies, directors, officers, and other corporate insiders are aware of material COVID-19 impacts or risks to their company that have not been publicly disclosed, they "should refrain from trading

in the company's securities until such information is disclosed to the public."

In addition, the Guidance warned companies to avoid selective disclosures regarding the impact of COVID-19 by broadly disseminating such material information. According to the Guidance, companies should consider, depending on their particular circumstances, whether they "need to revisit, refresh, or update previous disclosure to the extent that the information becomes materially inaccurate."

#### **Reporting Earnings and Financial Results**

The Guidance also addressed earnings releases recognizing that the ongoing and evolving COVID-19 situation "may present a number of novel or complex accounting issues, that, depending on the particular facts and circumstances, may take time to resolve." Therefore, the Guidance encouraged companies to address financial reporting matters earlier than usual, consulting with experts as needed.

The Guidance also reminded companies of their obligations with respect to non-generally accepted accounting practices (GAAP) financial measures, including the SEC's recent guidance with respect to disclosure of key performance indicators and metrics.<sup>2</sup> For example, if a company presents a non-GAAP financial measure or performance metric to adjust for or explain the impact of COVID-19,

it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations.

According to the Guidance, if a GAAP financial measure is not available at the time of the earnings release because COVID-19-related adjustments require additional information and analysis to complete,

the Division would not object to companies reconciling a non-GAAP financial measure to preliminary GAAP results that either

include provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results.

The non-GAAP financial measure should not be disclosed more prominently than the most directly comparable GAAP financial measure or range of GAAP measures. However, for SEC filings, such as Form 10-K or Form 10-Q, where GAAP financial statements are required, companies should reconcile to GAAP results and not include provisional amounts or a range of estimated results.

The Guidance specified that in a circumstance where a company presents non-GAAP financial measures that are reconciled to provisional amount(s) or an estimated range of GAAP financial measures, the company must only include non-GAAP financial measures that it uses to report financial results to its Board of Directors. According to the Guidance, companies should use non-GAAP financial measures and performance metrics

for the purpose of sharing with investors how management and the Board are analyzing the current and potential impact of COVID-19 on the company's financial condition and operating results,

and not for the purpose of presenting a more favorable view of the company. When reconciling non-GAAP financial measures to provisional amount(s) or an estimated range of GAAP financial measures, companies should explain to the extent practicable why the line item(s) or accounting is not complete and what additional information or analysis may be needed.

### **SEC Disclosure and Related Requirements to Consider in Light of COVID-19**

As noted in the Guidance, SEC disclosure requirements are principles-based to a large degree and there are many areas where existing SEC rules, while not

expressly mentioning pandemics, could require disclosure. Such disclosure considerations could arise in the context of a regularly scheduled periodic report, such as an annual or quarterly report. Or, there could be an issue that requires more immediate disclosure through a current report on Form 8-K, Form 6-K, or in a press release. Depending on the circumstance, COVID-19 disclosures also may need to be discussed in registration statements, prospectuses, proxy statements or information statements. In this regard, disclosures should be specific, not generic, and should be tailored to the particular facts and circumstances applicable to the issuer. Areas in which COVID-19 may give rise to disclosure or other securities law considerations are elaborated on below.

### **Risk Factors**

Item 105 of Regulation S-K requires risk factors to discuss the most significant factors that make an investment in a company speculative or risky, as opposed to presenting risks that could apply generically to any company. With the impact from COVID-19 intensifying rapidly, companies may become increasingly aware of additional ways in which the pandemic poses specific risks beyond what they may have disclosed previously. It would be useful for companies to begin drafting more detailed risk factors relating to COVID-19 for inclusion in their next SEC filing that requires risk factor disclosure. If a company determines that a particular risk or development relating to COVID-19 is sufficiently material that it should be disclosed prior to its next periodic report or registration statement filed with the SEC, such as might be the case if it is currently in the market buying or selling its securities, it may decide to disclose a new COVID-19 risk factor through a current report filing.

### **Forward-Looking Statements**

Companies disclosing how COVID-19 may affect their future performance should consider framing their discussions to take advantage of the safe harbor for forward-looking statements set forth

in Section 27A of the Securities Act and Section 21E of the Exchange Act. For example, when discussing COVID-19 matters, companies may want to include an explanation regarding the use of forward-looking statements, indicating that actual results of the impact of COVID-19 may be materially different and identifying forward-looking remarks with words such as “believes,” “expects,” or “hopes.” Companies also may want to expressly include the impact of COVID-19 as a factor that could impact actual results in their more general discussions of forward-looking information.

### Management’s Discussion and Analysis

Management’s discussion and analysis (MD&A) must include information that a company “believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations.” With COVID-19 impacting so many companies, often negatively, but in some cases providing opportunities, it is important for the MD&A to not only disclose COVID-19 as a known trend or uncertainty but also management’s perspective on the type and extent of COVID-19’s effect on the company, to the extent material. There are many possible questions for companies to assess for materiality in the COVID-19 context as they prepare their MD&A. For example, has the company experienced supply chain issues? Are these supply chain issues anticipated to be ongoing? How has COVID-19 affected liquidity? Has the company drawn down on bank facilities for any reason, including because it has not been able to finance in the capital markets? Has the company needed to close any locations? If the company switched its workforce to telecommuting, has there been any reduction in productivity? Is the company party to contracts with force majeure provisions that are or may be triggered by the COVID-19 pandemic, and if so, is that having a material impact on the company’s business? Is the company having a dispute with its insurance carrier regarding business continuity coverage?

### Financial Statement Footnotes

Companies should discuss with their accountants whether COVID-19 disclosure is needed as part of their financial statement footnotes. This could include a subsequent event footnote. (*Editor’s note:* See excerpt from the SEC’s Chief Accountant’s Statement on Quality Financial Reporting in this April 2020 issue of *Insights*.)

### Business

To the extent a company is filing a report or registration statement with the SEC that requires a business description, the company will need to consider whether additional or revised disclosure is needed to the extent that COVID-19 has materially changed its business. For example, did the company exit any business line? Did the company close any facility? Is the company having difficulty sourcing inventory and considering alternative sources than those previously used? Are some segments of the company’s business impacted more than others? Did the company lay off workers as a result of a business slowdown? Were any acquisitions or organic growth initiatives put on hold?

### Litigation

Litigation arising out of COVID-19 also may require disclosure. For instance, it is possible that some companies might face class action lawsuits alleging failure to protect customers or workers from the virus.

### Updating Disclosures

The SEC’s reporting system generally is a periodic system of reporting, as opposed to a continuous system of reporting. For US reporting companies, the basic framework generally includes an annual report on Form 10-K, followed by three quarterly reports on Form 10-Q. In between, a Form 8-K is required to provide prompt disclosure of specifically identified types of presumptively material information. The question of updating disclosure outside of these required reports can be a challenging one, requiring assessments of

materiality, judgment calls, and investor relations considerations.

Various impacts from the COVID-19 pandemic could trigger Form 8-K filing requirements, including termination of a material contract (Item 1.02), creation of a direct financial obligation (Item 2.03), acceleration or increase of financial obligations (Item 2.04), and costs associated with exit or disposal activities (Item 2.05), or material impairments (Item 2.06). A Form 8-K also may be used by a company to voluntarily report other matters that it deems of importance to its security holders (Item 8.01) and intends to incorporate by reference into its registration statements or that it wants to broadly disseminate for the purposes of Regulation FD (Item 7.01).

Except for the disclosure requirements discussed above and those that arise when a company is selling securities, the SEC does not impose a specific obligation on when a company must otherwise update its disclosures. However, the anti-fraud provisions of the federal securities laws could imply an obligation to correct or revise information in certain circumstances, for example, where a company or its insiders are trading in the company's securities or when a company realizes that there is a material error in information that it previously disclosed. Similarly, some courts have applied a duty to update in particular circumstances. Furthermore, the Guidance specifically urged companies to consider revising and updating COVID-19 disclosure as circumstances warrant.

In addition to SEC disclosure requirements, companies need to consider the applicable rules of any securities exchange on which they list securities when assessing whether they should be updating disclosure on the impact COVID-19. Securities exchanges generally require companies to disclose information that is material to investors promptly. For example, Section 202.05 of the New York Stock Exchange Listed Company Manual addresses timely disclosure of material news developments by specifying that a "listed company is expected to release quickly to the public any news or information which might

reasonably be expected to materially affect the market for its securities."

### **Earnings Releases, Earnings Calls and Guidance**

Because of the widespread impact of COVID-19, companies should consider addressing, to the extent material, the impact of COVID-19 in upcoming earnings releases. They also should be prepared to answer analysts' questions about the effect of COVID-19 on their earnings calls. It may be useful to script and practice answers to such questions in advance.

Although, except as described above, the federal securities laws do not mandate a specific duty to update prior statements, including guidance, some courts have recognized a duty to update in certain situations. Consequently, companies that have provided guidance to investors should consider updating that guidance, or advising investors to no longer rely on that guidance, to the extent their guidance has materially changed.

### **Regulation FD**

Companies may be fielding many questions regarding COVID-19 because of its pervasive effect on the global economy. Public companies must be careful to avoid selective disclosure of material non-public information about how COVID-19 is affecting them by disseminating such information in a Regulation FD-compliant manner, such as a press release or an Item 7.01 Form 8-K.

### **Insider Trading; Stock Repurchases**

Directors, officers and employees of public companies should not be trading in securities while in possession of material, non-public information. The COVID-19 pandemic is a rapidly evolving situation. If a company becomes aware of a COVID-19 development that may have material ramifications to the company, the company, as well as its directors, officers and employees should avoid trading in the company's securities until that development has been publicly disclosed, unless such trading is accomplished pursuant to a Rule 10b5-1 trading

plan entered into while not in possession of material non-public information regarding the company. Companies may need to consider whether any special black-out period should be implemented to prevent insider trading when there is material information that has not been disclosed to the public. Given recent stock price deterioration as a result of generalized market volatility, some companies may be considering effecting stock repurchases. Careful consideration should be given to the company's quarterly blackout period, as well as to whether all information material to the company has been disclosed.

### Controls and Procedures

Because the COVID-19 pandemic is affecting so many aspects of business, companies should consider what changes should be made to their disclosure controls and procedures, including making the potential impacts of COVID-19 an express part of their disclosure controls and procedures. Companies also may need to assess whether COVID-19 is having any impact on their internal controls over financial reporting.

### Effecting Securities Offerings

All of the considerations discussed above become particularly timely should a company be contemplating issuing securities.

### Enforcement

Be aware that the disclosure obligations and other securities law obligations discussed above may give rise to SEC enforcement. For example, on March 23, 2020, the co-directors of the SEC's Division of Enforcement issued a statement<sup>3</sup> emphasizing that trading in securities based on inside information may violate the securities laws. They urged:

public companies to be mindful of their established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions to ensure to the greatest

extent possible that they protect against the improper dissemination and use of material nonpublic information.

## Practical Considerations

Investors and the SEC are likely to review any COVID-19 disclosure carefully. Therefore, public companies should start thinking now about upcoming COVID-19 disclosures in order to allow time for drafting and internal review of appropriate language. For example, it would be useful for companies to begin drafting more detailed risk factors relating to COVID-19 for inclusion in their next SEC filing for which risk factor disclosure is required or otherwise appropriate. Such disclosure should be specific and must be tailored to the specific impacts to the company's operations from the COVID-19 outbreak. Similarly, companies also should start preparing and discussing the COVID-19 disclosure in advance of their next SEC filing requiring a management's discussion and analysis section, as well as discussing potential accounting and financial reporting issues that COVID-19 may create.

As companies prepare to report their earnings, they should take into account the portion of the Guidance relating to non-GAAP financial measures, while also being mindful of the SEC's guidance in recent years regarding the limited and careful approach that companies must take when presenting non-GAAP financial measures. Companies also should consider whether it would be appropriate to revise or update any COVID-19-related disclosure.

Because of the rapidly changing COVID-19 situation and related impacts on companies, it is especially important for companies to take into account all aspects of their business, including reaching out to business units that may not normally be part of their disclosure controls and procedures, to ascertain whether anything is happening that could require disclosure.

Companies should coordinate their responses when responding to COVID-19 inquiries. It is

important not to selectively disclose material non-public information to any investor. To the extent a company has material non-public information to disclose relating to COVID-19, that information should be disclosed in a Regulation FD-compliant method. If there has been an inadvertent selective material disclosure regarding COVID-19, the company must promptly disseminate such information by a press release or a Form 8-K.

The SEC has expressed its willingness to discuss on a case-by-case basis issues in complying with federal securities laws that may arise in connection with COVID-19, in addition to ones addressed in the Guidance. Companies that have particular concerns should reach out to the SEC Staff to discuss how to handle the issues that may arise. The SEC has taken, and continues to take, other actions as

part of its evolving COVID-19 response, including issuing compliance and disclosure interpretations and exemptive relief. Companies might find the SEC's COVID-19 Response Webpage<sup>4</sup> to be a helpful resource.

#### Notes

1. Available at <https://www.sec.gov/corpfin/coronavirus-covid-19>.
2. See "Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations," available at <https://www.sec.gov/rules/interp/2020/33-10751.pdf>.
3. Available at <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>.
4. Available at <https://www.sec.gov/sec-coronavirus-covid-9-response>.