WHITEPAPER

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Effects of COVID-19 on Financial Reporting and Disclosure Requirements

SEC Release No. 34-88318; (Issue Date: March 4, 2020)

Link to Release: SEC Release No. 34-88318

Overview

COVID-19 is a global issue that is not only significantly impacting business and consumer activity but will also impact upcoming financial reporting and disclosure requirements. Given the current market conditions and concerns about the growing pandemic, the coming months are likely to be particularly challenging from an accounting and reporting perspective for many companies and may present challenges in meeting certain of their obligations under the federal securities laws in a timely manner. In response to this, the Securities and Exchange Commission (SEC) released Order 34-88318 on March 4, 2020. This order grants registrants impacted by COVID-19 the period from and including March 1, 2020 to April 30, 2020 an extra 45 days to file their financial statements.

Applying for delayed issuance

In order to apply for relief under order 34-88318, registrants must do the following:

- File a current report on Form 8-K (or Form 6-K if applicable);
- State the estimated date in which the related filling will be issued;
- If appropriate and material, risk factors describing the impact of COVID-19 on the registrant's business.

The 8-K (or 6-K) would need to include certain information as follows:

- The company is relying on Order 34-88318;
- A brief description of the reasons why the company could not file on a timely basis;
- The estimated date by which the report, schedule, or form is expected to be filed;
- If appropriate, a risk factor explaining, if material, the impact of COVID-19 on its business;
- If the reason the subject report cannot be filed timely relates to a person or company, other than the registrant, in order to furnish any required opinion, report or certification, the 8-K or 6-K shall have attached as an exhibit a statement signed by such person stating the specific reasons why such person is unable to furnish the required opinion, report or certification on or before the date such report must be filed.

Numerous companies have already filed a Form 8-K to obtain this relief. Below are several examples of disclosures used by various companies regarding their reason for not being able to file timely:

- "…The Company's operations and business have experienced disruption due to the unprecedented conditions surrounding the COVID-19 pandemic spreading throughout the United States and the world and thus the Company's business operations have been disrupted and it is unable to timely review and prepare the Company's financial statements for the 2019 fiscal year. As such, the Company will be making use of the 45-day grace period provided by the SEC's Order to delay filing of its Annual Report…"

- "…The current outbreak of COVID-19 in the United States, which has accelerated in the several weeks prior to the date of this report, has resulted in the closing of our offices and has required our internal staff to work remotely. Moreover, similar social distancing measures were taken by both our outside accountants and our independent registered public accounting firm in order to protect the health of their employees. All of the foregoing has slowed the accounting and auditing work required to compile and audit our financial statements for the year ended December 31, 2019 to be included the Annual Report…."

- "…The Company's key financial personnel and outside service providers important to the development of its financial statements currently are on "lock-down" orders or "shelter in place" recommendations due to the COVID-19 pandemic or are otherwise displaced due to the COVID-19 pandemic. As a result of the travel and work restrictions stemming from the COVID-19 pandemic, the Company is unable to develop and complete financial records needed for the Company to file a timely and accurate Annual Report on Form 10-K for its year ended December 31, 2019, by the prescribed date without undue hardship and expense to the Company…"

Additionally, provided below are some examples of disclosures included by registrants related to the potential impact the pandemic could have on their business:

- "…We expect that the ultimate significance of the impact of COVID-19 on our businesses will vary but will generally depend on the extent of governmental measures affecting day to day life and the length of time that such measures remain in place to respond to COVID-19. At this point, it is impossible to predict such extent and duration and the degree to which supply and demand for our products and services, including advertising, will be affected. This uncertainty makes it challenging for management to estimate the future performance of our businesses, particularly over the near to medium term. However, the impact of COVID-19 could have a material adverse impact on our results of operations over the near to medium term…"

- "…The adverse public health developments and economic effects of the outbreak in the United States, which have become more severe in the weeks prior to the date of this report, could adversely affect the Company's operations as a result of quarantines, facility closures and logistics restrictions in connection with the outbreak. More broadly, the outbreak could potentially lead to an economic downturn, which would likely decrease spending, adversely affecting our business, results of operations and financial condition. The Company cannot accurately predict the effect the Coronavirus outbreak will have on the Company…"

Impact to Financial Statements and Disclosures

While the SEC believes that the filing extension provided by Order 34-88318 is necessary and appropriate in the public interest and consistent with the protection of investors, registrants are expected to continue to evaluate their obligations to make materially accurate and complete disclosures in accordance with the federal securities laws.

MD&A - Updates to the MD&A need to include the known, or estimated impact if they are material. Companies are required to disclose trends or uncertainties they have had or can reasonably predict. These effects can include, but aren't limited to, the effect the virus has had or will have on revenue, if there are, or are anticipated supply chain disruptions, and any related impairments. Discussion of these topics can be included in the Non-GAAP financial measures section. Registrants should be mindful of the SEC's rules and regulations regarding the use of non-GAAP financial measures and the SEC staff Compliance and Disclosure Interpretations on the use of these measures. In particular, companies can identify one-time impacts related to virus and their effect on the financial statements.

Impairment - Registrants should consider impact of any financial statement areas that rely on forward looking measures as a means of determining impairment. Projections need to be updated to include declines in projected revenue, supply chain disruptions and business closures. These tend to be indicators of impairment and could potentially trigger impairment testing for long lived and indefinite lived assets including intangible assets and goodwill. Companies should also consider whether there are any changes in circumstances that might require an impairment assessment for equity method investments. An impairment would occur if the damage to the investment is not temporary. If there has been a significant decline in an investment's value, companies should exercise judgment to determine whether the decline is permanent or temporary.

Accounts Receivable – The economic downturn and disruption of normal business operations caused by the outbreak may increase the likelihood of customers being unable to pay outstanding obligations. Companies may need to reassess bad debt reserves as a result of this pandemic or write-off certain receivables, as appropriate.

Inventories — Companies with COVID-19-related revenue declines or disrupted supply chains should evaluate whether they need to adjust the carrying value of their inventory. Unplanned work stoppages or severe slowdowns due to labor or material shortages could cause manufacturing levels to drop below standard levels. If so, excess fixed overhead costs that cannot be allocated to production due to underutilized capacity must be expensed in the period they are incurred.

Debt modifications and loan covenants – Companies experiencing decreased revenues, higher operating costs and/or cash flow challenges due to COVID–19 may need to obtain additional or bridge financing, restructure existing debt agreements, or obtain waivers in debt covenants. These changes may represent a debt modification, debt extinguishment or a troubled debt restructuring, and all three have different accounting and reporting implications. If covenants are breached, the debt may need to be reclassified from long-term to current on the balance sheet.

Revenue recognition – In addition to the obvious impacts of reduced revenue due to the impact of COVID-19, companies also need to consider the initial and ongoing evaluation of variable consideration inherent in customer contracts, such as discounts, refunds, price concessions, performance bonuses and penalties.

Going Concern - With the all the disruptions to operations, management may need to reevaluate their ability to continue as a going concern within one year after the date financial statements are issued. Affected companies will need to consider the effects of the outbreak in their going concern evaluations and possibly update the cash flow projections it uses in its going concern evaluation.

Safe Harbor - With the uncertainty surrounding the virus and the lasting impact it has, companies may find it difficult to accurately estimate all the effects. For circumstances like these there is Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934. These allow companies to include in their disclosures "safe harbor" language as means to reduce their liabilities for forward looking statements. If Registrants identify the cautionary factors that might cause the forward-looking statements not to be accurate in material respects, they should be protected. This is why it is important to take a close examination of their financial statements, including the risk factors, and forward-looking statements in order to have safe harbor.

Subsequent Events - Entities will need to evaluate whether the impact of COVID-19 represents a subsequent event for their business and include appropriate disclosures depending on the type of subsequent event caused. For example, entities may enter into new lending agreements, experience business operational shutdowns, or run into trouble with debt covenants. These should be considered for potential inclusion in subsequent event disclosures, as necessary.

Final Thoughts

Registrants who need an extension for their upcoming filings because of COVID-19 should take advantage of SEC Release No. 34-88318. Upon doing so, companies should use that time to assess the impact on the company and determine where additional disclosures, or modification of existing disclosures, are necessary. It is expected that any material impacts of the virus will be disclosed in the financial statements. This includes both from the reporting period, as well as forward looking statements. While we are in uncertain times, safe harbor language can reduce company's liabilities as long as they identify the cautionary factors that might cause the forward-looking statements not to be accurate in material respects.

It goes without saying this virus has had and will continue to have a significant, pervasive impact on business operations. Companies should consider these items above, and any other known impacts of the virus on their operations when preparing their financial statements and related disclosures.

Please look for future accounting and finance papers at www.fidatopartners.com

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