

# Technical Line

Financial reporting development

## Accounting and reporting considerations for the effects of the coronavirus outbreak

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### What you need to know

- ▶ Companies need to consider whether they face any accounting or disclosure implications resulting from the coronavirus (COVID-19) outbreak and its related uncertainties.
- ▶ Affected SEC registrants may face additional disclosure requirements.
- ▶ While some companies may be directly affected by the outbreak, others may be indirectly affected if their suppliers, customers or distributors experience operational disruptions.
- ▶ Business disruptions may indicate a change in circumstances that could result in asset impairments or require a change in accounting estimates.
- ▶ Companies with significant operations in affected regions may experience delays in obtaining financial information required for preparing consolidated financial statements, which may inhibit timely reporting.
- ▶ The possible accounting and disclosure implications may range from very narrow to extensive depending on the circumstances.

### Overview

Companies need to consider whether they face any accounting or disclosure implications resulting from the coronavirus outbreak. Many countries have required companies to limit or suspend business operations and have implemented travel restrictions. These actions have disrupted supply chains and curtailed operations of many companies around the world. Companies that have already been affected include those in the tourism, hospitality, transportation, retail, entertainment and manufacturing sectors.

The World Health Organization has characterized the coronavirus outbreak as a pandemic. While the extent and duration of the effect of the coronavirus outbreak on businesses remains unclear, affected companies need to consider factors such as whether operational disruptions indicate a change in circumstances that might trigger asset impairments; whether they need to revisit accounting estimates, such as the amount of variable consideration they expect to be entitled to; and what the effect might be on hedging relationships. Securities and Exchange Commission (SEC) filers also should consider whether the disclosures in management's discussion and analysis (MD&A) and the risk factor disclosures about the current and potential effects of the coronavirus outbreak are appropriate.

This publication addresses accounting and financial reporting considerations for affected companies. It also discusses disclosure considerations, including considerations for filings with the SEC.

## Accounting considerations

### Asset impairments

Many travel, hospitality, retail and entertainment companies have seen or expect to see a decline in revenues. In addition, some manufacturers have said they expect supply chain disruptions and temporary business closures in affected regions to limit their ability to meet demand for their products. Companies may also see their costs rise if they have to replace suppliers or move operations to another region.

These factors could be indicators of impairment, depending on the significance and duration of the disruption. While short-term, temporary disruptions may not indicate an impairment; the effects of a prolonged outbreak may cause asset impairments.

If a company determines that the effects of the coronavirus outbreak are impairment indicators that require them to perform impairment tests, the company needs to make sure it performs those tests in the appropriate order. Indefinite-lived intangible assets are tested first for impairment in accordance with Accounting Standards Codification (ASC) 350, *Intangibles – Goodwill and Other*. Groups of long-lived assets are then tested for impairment in accordance with ASC 360, *Property, Plant, and Equipment*. Goodwill is tested for impairment last, and those tests are performed at the reporting unit level.

### *Inventory – net realizability*

If there is a decline in the net realizable value or utility of inventory, ASC 330, *Inventory*, requires the decline to be recognized as a charge in the period in which it occurs. A loss may result from damage, contamination, physical deterioration, obsolescence, changes in price levels or other causes.

Inventory measured using any method (e.g., first-in, first-out (FIFO), average cost) other than LIFO (last-in, first-out) or the retail inventory method is measured at the lower of cost or net realizable value. Inventory measured using the LIFO or the retail inventory method is measured at the lower of cost or market.

Companies whose supply chains have been disrupted or whose sales have fallen because of the outbreak should evaluate whether they need to adjust the carrying value of their inventory. Seasonal inventories, perishable products and products with shorter shelf lives would be most exposed to the risk of loss.

It is challenging to predict the extent companies will be affected because it isn't clear how widespread the virus will become or how long it will take to contain.

***Inventory – changes in manufacturing levels and excess capacity***

Unplanned work stoppages, labor or material shortages, or production bottlenecks could cause production levels to drop below normal capacity levels. If this happens, a company will need to consider the effects on its inventory costing. The amount of fixed overhead allocated to each unit of production is not increased when production is abnormally low, and the costs associated with underutilized capacity (known as “excess capacity costs”) are expensed in the period they are incurred without adjusting overhead absorption rates.

Companies will need to use judgment to determine when production is lower than normal capacity. The range of normal capacity can vary based on business- and industry-specific factors.

***Goodwill and other indefinite-lived intangible assets***

Goodwill and indefinite-lived intangible assets are tested for impairment at least annually and more frequently if events or changes in circumstances indicate that it is more likely than not that the asset is impaired. ASC 350 provides examples of events and circumstances that should be considered in evaluating whether an interim impairment test is required for both goodwill and indefinite-lived intangible assets.

To determine whether an interim impairment test is required, companies will need to consider the potential effects of the outbreak on the fair value measurement of their reporting units and indefinite-lived intangible assets.

***Long-lived assets***

Long-lived assets to be held and used (including right-of-use assets under ASC 842, *Leases*) are tested for impairment when factors are present that indicate that the recorded value of a long-lived asset or asset group may not be recoverable. The impairment evaluation of long-lived assets to be held and used involves three steps:

- ▶ Step 1: determining whether an indicator of impairment exists and, if one is present, proceeding to Step 2 – examples of indicators of impairment include a significant decrease in market value, an adverse change in how a long-lived asset or asset group is planned to be used or a significant change in the business environment that could adversely affect the value of the long-lived asset or asset group.
- ▶ Step 2: testing the long-lived asset or asset group for recoverability – estimated undiscounted cash flows for a long-lived asset or asset group being evaluated for recoverability are compared with the carrying amount of that asset or asset group. If the estimated undiscounted cash flows exceed the carrying amount of the long-lived asset or asset group, the carrying amount of the long-lived asset or asset group is considered recoverable and an impairment would not be recorded. If the carrying amount of the long-lived asset or asset group exceeds the estimated undiscounted cash flows (i.e., the carrying amount of the long-lived asset or asset group is not recoverable), the entity would proceed to Step 3.
- ▶ Step 3: measuring the amount of the impairment – an entity that determines that the carrying amount is not recoverable is required to determine the fair value of the long-lived asset or asset group and recognize an impairment loss if the carrying amount of the long-lived asset or asset group exceeds its fair value.

Companies may need to revisit their estimates of service periods for long-lived assets if they take steps such as relocating factories or business units to other locations. Changes in the planned service period could result in changes to the depreciable lives of those long-lived assets.

**Equity method investments**

Equity method investments (including investments in joint ventures) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the investment might not be recoverable in accordance with ASC 323, *Investments – Equity Method and Joint Ventures*. Evidence that could indicate the carrying amount of the investment might not be recoverable includes:

- ▶ The investor does not have the ability to recover the carrying amount of the investment.
- ▶ The investee cannot sustain earnings.
- ▶ The current fair value of the investment is less than the carrying amount.
- ▶ Other investors have ceased providing support or reduced their financial commitment to the investee.

Entities should consider whether there are any changes in circumstances that might require an impairment assessment for equity method investments. If there has been a significant decline in the value of an investee, an investor would need to exercise judgment to determine whether the decline is other than temporary. An impairment loss is recognized for a loss in value of an investment that is other than a temporary decline.

An investor also should consider whether its investment might be impaired when an investee recognizes an impairment loss and the investor recognizes a portion of that loss through its application of the equity method.

**Equity securities measured using the measurement alternative (after the adoption of Accounting Standards Update (ASU) 2016-01)**

For equity securities measured using the measurement alternative in ASC 321, *Investments – Equity Securities*, entities are required to perform a qualitative impairment assessment. Impairment indicators an entity needs to consider include factors such as a significant deterioration in earnings and a significant adverse change in the economic environment of the investee. If a qualitative assessment indicates that the investment is impaired, and if the investment's fair value is less than its amortized cost basis, the excess of the amortized cost basis over fair value is recognized as an impairment loss.

**Financing receivables and contract assets**

Entities with financing receivables (e.g., loans, trade accounts receivable) and contract assets should consider the guidance in ASC 310, *Receivables*, if they haven't yet adopted the new credit losses standard, and ASC 326, *Financial Instruments – Credit Losses*, if they have already adopted it, to evaluate whether and to what extent the coronavirus affects the collectibility of their receivables and contract assets.

Companies applying ASC 326 are required to consider reasonable and supportable forecasts of future economic conditions in the estimate of expected credit losses. Affected companies that apply ASC 326 will need to consider whether the effects of the outbreak could change their forecast of future economic conditions. In particular, disruption of supply chains and changes in demand may increase the likelihood of borrowers taking a longer time to repay amounts outstanding or the probability of borrowers being unable to repay their obligations when due. This may be particularly true for companies in industries or in geographies that have been affected by the coronavirus. While forecasted economic conditions may not significantly affect loss estimates for short-term receivables and contract assets when the economy is stable, we believe that entities affected by the coronavirus outbreak may need to challenge these assumptions.

ASC 326 requires companies to pool financial assets but allows them to choose which risk characteristics to use. Affected companies may need to assess whether assets in pools continue to display similar risk characteristics or determine whether they need to revise their pools or perform an individual assessment of expected credit losses.

We expect that it may be difficult to determine the economic effect of the coronavirus since historical data may not include the effects of similar events. Finally, affected companies should consider whether the effects increase the likelihood of reasonably expected troubled debt restructurings (TDRs) since it may be necessary to modify a borrower's payment terms (including providing a borrower more time to pay its debt)<sup>1</sup> if the impact of the coronavirus outbreak affects a borrower's liquidity.

There are significant uncertainties about what the effects will ultimately be. Entities should consider highlighting these risks in their qualitative and quantitative disclosures about credit risk and the allowance for credit losses. They should also consider the disclosures related to the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated.

If an entity believes it is appropriate to incorporate in its expected credit loss model an input, assumption or forward-looking adjustment associated with the coronavirus outbreak, and if the effect of this is significant or it is otherwise useful to understand the uncertainty of future cash flows, the entity should disclose such an input, assumption or forward-looking adjustment.

Refer to our Financial reporting developments publications, [\*\*\*Credit impairment under ASC 326\*\*\*](#) and [\*\*\*Credit impairment for short-term receivables under ASC 326\*\*\*](#), for more information on measuring credit impairment after the adoption of ASC 326.

### **Leases**

While lessors follow the guidance on credit losses (i.e., ASC 310 or ASC 326 as applicable) to consider possible impairments of net investments in sales-type leases and direct financing leases, they need to follow the guidance in ASC 842, *Leases* (if they adopted this standard), to evaluate the collectibility of lease payments (and any residual value guarantee) for operating leases.

Under that guidance, if a lessor determines that it is no longer probable that it will collect operating lease payments and any residual value guarantee from an affected lessee, the lessor's lease income is limited to the lesser of (1) the income that would have been recognized if collection were probable, including income from variable lease payments, and (2) the lease payments, including variable lease payments, that have been collected from the lessee. Lease income is reversed if the lease payments, including variable lease payments, that have been collected from the lessee are less than the lease income recognized to date.

Lessees and lessors should also consider whether certain events (e.g., a lessor provides a payment to a retailer/lessee to help mitigate the effects of reduced customer traffic) are a modification to the contract. A lease modification generally requires the reallocation of consideration in the contract, reassessment of lease term, liability and lease classification.

Refer to our Financial reporting developments publication, [\*\*\*Lease accounting \(ASC 842\)\*\*\*](#), for more information.

### **Other assets**

Other assets for which impairment or similar guidance exists include:

- Debt securities (ASC 320 before the adoption of ASU 2016-13 and ASC 326 after the adoption of ASU 2016-13)

- ▶ Equity securities (ASC 320 before the adoption of ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities*, and ASC 321 after the adoption of ASU 2016-01)
- ▶ Other investments (ASC 325)
- ▶ Deferred tax asset valuation allowance assessments (ASC 740)

For asset impairments not addressed by other literature, ASC 450, *Contingencies*, provides guidance on the initial and subsequent measurement and recognition of loss contingencies.

### How we see it

When an affected company concludes that the effects of the coronavirus outbreak trigger an impairment loss, the company should disclose the facts and circumstances leading to impairment. When other circumstances also contributed to a triggering event, companies should be transparent about all circumstances contributing to the impairment or loss.

### Fair value measurement

ASC 820, *Fair Value Measurement*, defines the term fair value and provides a principles-based framework for measuring fair value when US GAAP requires or permits a fair value measurement. For example, fair value measurements may be required in measuring impairment of long-lived assets, goodwill, indefinite-lived intangible assets and equity securities. The objective of a fair value measurement is to determine the price at which an orderly transaction would take place between market participants under the market conditions that existed at the measurement date. While volatility in the financial markets may suggest that the prices are aberrations and do not reflect fair value, it would not be appropriate for a company to disregard market prices at the measurement date unless those prices are from transactions that are not orderly.

The concept of an orderly transaction is intended to distinguish a fair value measurement from the price in a distressed sale or forced liquidation. The intent is to convey the current value of the asset or liability at the measurement date, not its potential value at a future date. Refer to our Financial reporting developments publication, [Fair value measurement](#), for more information on fair value measurements and related disclosures.

### Hedge accounting

Business transactions may be postponed or canceled or occur in significantly lower volumes than initially forecasted. If a company has designated a transaction such as the purchase or sale of goods or the expected issuance of debt, as a hedged forecasted transaction in a cash flow hedge accounted for under ASC 815, *Derivatives and Hedging*, the company will need to consider whether the transaction is still “probable of occurring,” whether the volume or amounts involved will be lower than forecasted or whether it is now probable that the forecasted transaction will not occur.

That is, if the outbreak affects the probability of hedged forecasted transactions occurring during the time period and in the amounts designated at the inception of a hedge, a company will need to determine whether it can still apply hedge accounting. In addition, if a company determines that it is probable that a forecasted transaction will not occur within the specified time period (or within an additional two-month period thereafter), it has to immediately reclassify to earnings the balances from past changes in the fair value of derivative contracts that have been recorded in accumulated other comprehensive income.

Companies also need to consider whether the outbreak could affect their assessment of whether hedging relationships continue to be highly effective. A fundamental requirement is that a hedging relationship, both at inception and on an ongoing basis, is expected to be highly effective in offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated.

### **Debt modifications and loan covenants**

Affected companies may experience cash flow challenges as a result of disruptions in their operations, higher operating costs or lost revenues. Such companies may need to obtain additional financing, amend the terms of existing debt agreements or obtain waivers if they no longer satisfy debt covenants. Affected companies may need to consider the debt guidance in ASC 470-50, *Debt – Modifications and Extinguishments*, and ASC 470-60, *Debt – Troubled Debt Restructurings by Debtors*, to determine whether any changes to existing debt arrangements represent a troubled debt restructuring, a debt modification or potentially a debt extinguishment, which would have accounting implications in each case. In addition, they may need to consider the guidance in ASC 470-10-45 on the classification of long-term debt when there has been a covenant violation or other default at the balance sheet date.

### **Revenue recognition**

The coronavirus outbreak could affect revenue estimates in new and ongoing customer contracts in the scope of ASC 606, *Revenue from Contracts with Customers*. This is because when a contract with a customer includes variable consideration (e.g., discounts, refunds, price concessions, performance bonuses and penalties), an entity is generally required to estimate, at contract inception, the amount of consideration to which it will be entitled in exchange for transferring promised goods or services. The amount of variable consideration an entity can include in the transaction price is constrained to the amount for which it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainties related to the variability are resolved.

An entity that makes such an estimate is also required to update the estimate throughout the term of the contract to depict conditions that exist at each reporting date. This will involve updating the estimate of variable consideration (including any amounts that are constrained) to reflect an entity's revised expectations about the amount of consideration to which it expects to be entitled, considering uncertainties that are resolved or new information about uncertainties related to the coronavirus outbreak.

Estimation of variable consideration and the constraint may require entities to exercise significant judgment and make additional disclosures. For example, an entity is required to disclose information about the methods, inputs and assumptions used for estimating variable consideration and assessing whether an estimate of variable consideration is constrained. Entities should also consider the requirements to disclose the judgments and changes in judgments that significantly affect the determination of the amount and timing of revenue. Refer to our Financial reporting developments publication, [\*\*Revenue from contracts with customers \(ASC 606\)\*\*](#), for more information.

### **Insurance recoveries**

Entities often maintain insurance to mitigate the losses associated with property damage (property and casualty loss) or a business interruption, such as lost revenue during extended periods of suspended operations or stemming from supply chain interruption (i.e., business interruption insurance).

The accounting for insurance claims varies, depending on factors such as the nature of the claim, the amount of proceeds (or anticipated proceeds), and the timing of the loss and recovery.

Accounting for any potential insurance recovery needs to be carefully evaluated. That is, companies need to analyze the terms of their insurance policies and the ability of an insurer to satisfy a claim. For example, while insurance may cover interruptions of deliveries of raw materials, recoveries are often limited to losses stemming from certain suppliers specified in the policy. Further, the policy may contain exclusions for events, such as epidemics, that cause business interruptions.

### How we see it

Anticipated reimbursements for business interruption (e.g., lost revenue) are considered a gain contingency and are subject to the guidance in ASC 450-30. This guidance requires that all contingencies must be resolved before such a reimbursement can be recognized in earnings. The contingencies would be considered resolved only if the proceeds have been received or if confirmation of the amount of the proceeds has been received from the insurer.

If a company determines it has incurred property and casualty losses as a result of the outbreak, any insurance recoveries would be recognized when the company believes it is probable<sup>2</sup> that the insurer will settle the claim for at least the amount of the costs incurred to date. However, anticipated proceeds in excess of the recognized loss are considered a gain and are subject to the guidance in ASC 450-30. We believe insurance recoveries for temporary relocation costs would be treated as the recoveries of property and casualty losses.

### Future operating losses

While affected companies may account for some effects of the outbreak in the current period, other direct and indirect effects such as losses or lost revenue, may need to be accounted for in subsequent periods. Companies may anticipate losses that are directly or indirectly related to the current outbreak. These might include losses related to significant reduction in demand, supply chain disruptions and losses due to an overall decline in economic output. Future operating losses do not meet the definition of a liability and, therefore, should not be recognized until the losses are incurred; however, affected registrants may need to consider whether additional disclosures are required.

### Income taxes – indefinite reinvestment assertion

Companies with operations in affected regions should challenge whether they can continue to assert their intent and ability to indefinitely reinvest foreign earnings. The assertion that earnings from foreign operations will be indefinitely reinvested should be supported by projected working capital and long-term capital needs in the locations in which those earnings are generated (or other foreign locations), and an analysis of why those funds are not needed upstream. Although companies may have historically been able to demonstrate their ability to indefinitely reinvest foreign earnings, changing market conditions may call into question a company's ability to continue to indefinitely reinvest foreign earnings, particularly if a company is shifting the location of operations.

### Financial statement disclosures

An affected company's disclosures will depend on the magnitude, duration and nature of the effects on its business. Companies will need to closely monitor developments and assess the implications for their businesses.



Affected companies will be required to make disclosures that generally address loss contingencies, risks and uncertainties and/or subsequent events. In other cases, disclosures may depend on the nature of the loss (e.g., whether an asset is impaired).

When other circumstances contributed to a triggering event, companies should be transparent about all circumstances contributing to the impairment or loss.

### **Loss contingencies**

ASC 450 requires disclosure of the nature of a contingency when there is at least a reasonable possibility that a loss has been incurred. For contingencies that meet the threshold for disclosure but no liability has been recognized, companies must disclose an estimate of the possible loss or the range of possible losses or state that such an estimate cannot be made. If a company has recognized a liability, it has to disclose the amount only if not doing so would make the financial statements misleading. If there is at least a reasonable possibility that a loss in excess of the amount recognized exists, the company is required to disclose an estimate of the possible loss or range of losses or state that such an estimate cannot be made.

#### **How we see it**

Loss contingency disclosures have been an area of focus for the SEC staff. The SEC staff focuses on disclosures about reasonably possible losses and the clarity and timeliness of loss contingency disclosures.

Specifically, the SEC staff has questioned a company's failure to make required footnote disclosures when losses are considered reasonably possible of occurring or to disclose the range of reasonably possible losses, including when there is a reasonable possibility of a loss in excess of the amount accrued. Companies should consider whether any contingent loss resulting from the outbreak is reasonably possible and make disclosures as appropriate.

### **Risks and uncertainties**

ASC 275 requires disclosures about certain risks and uncertainties. They include qualitative disclosures about risks and uncertainties that in the near term (i.e., within one year from the date of the financial statements) could significantly affect the amounts reported in the financial statements or the functioning of the reporting entity. Companies whose operations are affected by the outbreak may be required under ASC 275 to disclose certain significant estimates and current vulnerability due to concentrations (e.g., concentration in the volume of business with a particular customer or supplier or in a market or geographic area).

#### ***Certain significant estimates***

Companies should disclose certain estimates that are sensitive to change such as those used to evaluate an asset for impairment if information known to management before the financial statements are issued or available to be issued meets both of the following criteria:

- ▶ It is at least reasonably possible that management's estimate of the effect on the financial statements of a condition, situation or set of circumstances existing at the date of the financial statements will change in the near term as a result of one or more future confirming events.
- ▶ The effect of the change would be material to the financial statements.

The objective of this disclosure is to provide an early warning signal regarding the possibility that certain estimates made by management in preparing the financial statements may change in the near term. Public companies have similar responsibility under SEC requirements to discuss in MD&A known material events and uncertainties that may make historical financial information not indicative of future operations or financial condition.

For uncertainties that meet both of ASC 275's criteria for disclosure, entities are required to state the nature of the contingency or estimate that is sensitive to change and indicate that it is reasonably possible that a change in the estimate will occur in the near term. Additionally, ASC 275 encourages, but does not require, disclosure of the factors that cause an estimate to be sensitive to material change.

If an entity uses risk-reduction techniques, such as obtaining insurance to mitigate risks related to uncertainties, ASC 275 encourages, but does not require, disclosure of the uncertainty along with the risk-reduction strategy.

#### ***Current vulnerability due to certain concentrations***

Companies with concentrations face greater risk of loss than other companies. ASC 275 requires the disclosure of certain concentrations, as described in ASC 275-10-50-18, if, based on information known to management before the financial statements are issued or available to be issued, all three of the following criteria are met:

- ▶ The concentration exists at the date of the financial statements.
- ▶ The concentration makes the entity vulnerable to the risk of a near-term "severe impact."
- ▶ It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

Companies that have identified concentrations of activities in areas affected by the outbreak (e.g., a high volume of business with customers in that region or key suppliers in that region) that have not previously disclosed the concentration because they did not believe that the company was vulnerable to the risk of a near-term severe impact should reconsider making such a disclosure.

When the criteria for disclosure are met, a company should provide information that is adequate to inform users of the financial statements of the general nature of the risks or uncertainties associated with the concentration. For concentrations of operations located outside of the entity's home country, an entity is required to disclose both the carrying amount of net assets and the geographic areas in which they are located.

#### **Going concern**

ASC 205-40, *Presentation of Financial Statements – Going Concern*, requires management to evaluate an entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable). Disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt. Management is required to make its evaluation and provide the relevant disclosures for both annual and interim reporting periods.

Affected companies will need to consider the effects of the outbreak in their going concern evaluations. For example, prolonged plant closures or significant delays or the inability to collect from counterparties whose businesses are severely affected by the outbreak may significantly affect a company's operating cash flow and liquidity. Accordingly, management may need to update the cash flow projections it uses in its going concern evaluation.

#### **Subsequent events**

Companies should evaluate whether an outbreak-related event (e.g., bankruptcy of a customer) provides additional evidence about conditions that existed at the balance sheet date, including the estimates used to prepare financial statements. All information that

becomes available before the financial statements are issued or available to be issued should be considered in the evaluation of the conditions on which financial statement estimates are based, because these events typically represent the culmination of conditions that existed over a relatively long period and, most importantly, existed before the balance sheet date. The financial statements should be adjusted for any changes in estimates resulting from such recognized subsequent events.

For outbreak-related events that do not provide additional evidence about conditions that existed at the balance sheet date, affected companies should consider disclosing the nature of the event and an estimate of its effect on the financial statements, or a statement that such an estimate cannot be made. Additionally, companies that may be indirectly affected by the event, such as a company with a concentration of revenue from customers in the affected region, should consider whether subsequent event disclosures are necessary to keep the financial statements from being misleading.

## SEC reporting and interim disclosures

The effects of the coronavirus outbreak may trigger a number of SEC reporting and disclosure requirements.

SEC Chairman Jay Clayton said in a statement in late January that he asked the SEC staff to monitor and, if necessary or appropriate, provide guidance and other assistance to issuers and other market participants on disclosures about the current and potential effects of the coronavirus outbreak.

In addition, Mr. Clayton, Public Company Accounting Oversight Board Chairman William Duhnke and senior members of the SEC staff issued a statement in mid-February addressing meetings with senior representatives of the largest US audit firms regarding, among other things, the potential effect of the coronavirus outbreak on financial disclosures and audit quality. The statement urges issuers to work with their audit committees and external auditors to make sure their financial reporting, auditing and review processes are as robust as practicable.

### MD&A

When discussing the results of operations for the period, affected companies should disclose any unusual or infrequent events, transactions or any significant economic changes that materially affected income from continuing operations (such as lost revenue or costs attributable to the event) related to the coronavirus outbreak.

Companies are also required to disclose known trends or uncertainties that have had, or are reasonably expected to have, a material effect on the registrant's revenue or income from continuing operations, liquidity or capital resources.<sup>3</sup> If a registrant cannot determine whether a material trend or uncertainty is reasonably likely to occur, it must assume that the uncertainty will occur and disclose any associated material future effects in MD&A. The level and nature of the disclosure will depend on a company's facts and circumstances, including the implications to its operations, liquidity and financial condition.

As an example, these disclosures might include a discussion of potential effects of the outbreak on a company's ability to maintain appropriate labor levels, obtain necessary supplies and arrange logistical services. The disclosures might also include any expected changes in business practices that will affect operations and liquidity, including situations in which the relationship between costs and revenues could be materially affected. Disclosures related to the uncertainty associated with key assumptions underlying fair value estimates may also be warranted.

SEC registrants should consider including disclosures in MD&A about the effects of the outbreak or the potential effects, if material.

## Risk factor disclosures

A registrant is required to disclose in its quarterly report on Form 10-Q any material new risks or changes in risk factors previously disclosed in its annual report on Form 10-K. In its next quarterly (or annual) report, a registrant should consider whether there have been material changes in its previously disclosed risk factors or whether the company is exposed to any new risk factors, as a result of the coronavirus outbreak.

In his January statement, Mr. Clayton noted that while there may be challenges in assessing or predicting the effects of the coronavirus, how issuers plan for that uncertainty and how they plan to respond to unfolding events could be material to an investment decision.

While the SEC staff has not yet provided any explicit disclosure guidance, registrants with material operations that could be affected by the coronavirus outbreak should closely monitor and evaluate their risk exposures. As discussed above, the level and nature of the risk factor disclosures will depend on a company's facts and circumstances.

For example, affected companies may consider disclosing risks associated with supply chain disruption, closure of stores, a general reduction in consumer activity, and/or decreased demand for certain goods and services.

In addition, disclosures required under Item 305 of Regulation S-K<sup>4</sup> related to market risks may be necessary to help users of the financial statements understand material changes in market risk exposures as of the date of the most recent interim balance sheet that affect the quantitative and qualitative disclosures presented as of the end of the preceding fiscal year.

## Non-GAAP financial measures

Companies 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.

For example, a company may choose to disclose a non-GAAP measure that adjusts for certain costs related to an event such as the coronavirus outbreak. Such costs can only be described as "nonrecurring" if they have not occurred within the most recent two years and are not expected to recur within the following two years. Also, it likely would be inappropriate to disclose a historical non-GAAP measure of operating performance that adds to net income an estimate of revenues lost as a result of the outbreak.

## SEC filing relief

The disruptions caused by the coronavirus outbreak could affect a registrant's ability to make timely filings with the SEC or comply with other regulatory requirements (e.g., Regulation S-X Rule 3-09 for significant equity method investments). The SEC recently issued an order providing temporary relief from certain filing and regulatory requirements to registrants affected by the outbreak.

The order provides an additional 45 days for registrants to file Exchange Act reports (e.g., Forms 10-K and 10-Q) that would otherwise have been due between 1 March and 30 April 2020 if they are unable to make a filing deadline due to circumstances related to COVID-19. A company relying on the relief must file a Form 8-K (or Form 6-K for a foreign private issuer) by the later of 16 March or the original report deadline that includes (1) a statement that it is relying on the order, (2) a brief description of why it could not file timely, (3) the estimated date by which the report or form is expected to be filed, and (4) if appropriate, a risk factor explaining the effect of COVID-19, if material.

Any registrant relying on the order would not need to file a Form 12b-25, as long as the report is filed within 45 days of the original filing deadline. But if the reason the report cannot be filed timely relates to the inability of another person, other than the registrant, to furnish an opinion or report, the Form 8-K or Form 6-K must include a statement signed by such person as an exhibit, similar to the requirements of Rule 12b-25(c). Upon filing the delayed report, the registrant must also disclose that it is relying on the order and provide the reasons it could not file timely.

Companies needing additional assistance with filing requirements (e.g., the inability to file financial statements required by Rule 3-09 or inability to obtain required signatures from officers or directors) are encouraged to contact the SEC staff, which will address issues on a case-by-case basis.

### Other

Affected companies should consider the effects of the outbreak on their reporting obligations on Form 8-K. For example, a company that performs interim impairment tests that result in impairment charges because of disruptions and a decline in economic activity should consider whether the impairment charge is material, which would require reporting within four business days under Item 2.06 of Form 8-K.

Companies may also need to consider updating disclosures for the effects of the coronavirus outbreak when filing their annual reports or registration statements, including the description of the business and properties under Items 101 and 102 of Regulation S-K, respectively.

### Endnotes:

- <sup>1</sup> ASC 310-40-15-17 states that a delay in payment that is insignificant is not a concession. As such, providing a short-term extension of payment terms would generally not be considered a TDR.
- <sup>2</sup> "Probable" is defined in the ASC Master Glossary as "the future event or events are likely to occur."
- <sup>3</sup> Item 303 of Regulation S-K.
- <sup>4</sup> Smaller reporting companies are not required to provide the disclosures specified in Item 305 of Regulation S-K. However, if a smaller reporting company chooses to voluntarily provide this information, it must comply with all of the disclosure requirements of Item 305.