ALERT MEMORANDUM

First Quarter Earnings and COVID-19 – SEC Officials Ask for More

April 10, 2020

As U.S. public companies plan for their next disclosures, the COVID-19 crisis presents exceptionally difficult circumstances. The Securities and Exchange Commission and its senior staff have put out a succession of releases that combine some relief, some guidance and some warnings. The SEC Coronavirus (COVID-19) Response page is available here.

The latest in the series came on Wednesday, April 8, in the form of a long, forceful public statement published on the SEC's website by Jay Clayton, the SEC Chair, and Bill Hinman, the Director of the Division of Corporation Finance. It focused on upcoming corporate disclosures – with a particular view to first-quarter earnings releases of calendar-year companies – and it contained some helpful guidance about what companies should focus on.

But the central concern of the April 8 statement is an argument that goes well beyond previous SEC guidance for corporate disclosure personnel and those who advise them.

- Taking up a fundamental policy question outside of securities regulation – how to balance containing the public-health threat with reviving the economy – the statement contends that there now appears to be "an emerging consensus" that "we can, anchored by advice of healthcare specialists, incrementally foster economic activity."

- The statement urges companies to provide "as much information as is practicable regarding their current operating status and their future operating plans."

- It also makes a "request that companies strive to provide, and update and supplement, as much forward-looking information as is practicable."

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- If, as requested, corporate disclosures this quarter are more granular and more forward-looking, the statement contends that will benefit the fight against COVID-19 and contribute to a positive dynamic across the economy as a whole.

The April 8 statement gives the personal views of two leading regulators, but it is not rulemaking or an interpretation by the Commission or its staff. Reporting companies will want to consider it, as they weigh the difficult disclosure decisions of this extraordinary quarter. The statement emphasizes the two most difficult of those decisions:

— How granular should our disclosures be? It is hard to demonstrate the impact of the COVID-19 crisis without slicing performance data finely, but that might require information the company has not previously disclosed – for example, by week or by business line. It might also require data from after the end of the quarter and right up to the publication of earnings. Going granular raises difficult questions – among them, the quality of controls, the risk of material omissions, competitive concerns and the risk of creating a demand (if not a duty) to update.

— What forward-looking information can we responsibly provide? Many companies have withdrawn previously issued guidance, and it seems likely that more will do so with their first-quarter earnings. Of course, the customary types of guidance on the consolidated top line and bottom line are not the only imaginable forms of forward-looking information. Many companies will be thinking about sensitivity analyses, or other more limited or targeted ways to depict the possible impact of specified assumptions. But they will also be concerned that this is a challenging moment to experiment, when the principal features of the COVID-19 crisis so far have been speed, surprise and uncertainty.

In considering these questions, companies will of course be thinking about investors and their legitimate appetite for information, but they will also be thinking about legal risks. They will be adding risk factor disclosures, and strengthening MD&A on known trends and on liquidity and funding. They will be making difficult accounting judgments about fair value, impairments, valuation allowances and in some cases going-concern considerations. They will be considering whether their controls are affected by dramatically different operating conditions.

They will be doing all this in an environment of volatility and uncertainty that strongly suggests heightened litigation and enforcement risk. The April 8 statement calls attention to the safe harbors for forward-looking statements, and it suggests that the authors “would not expect to second-guess good-faith attempts” to provide “appropriately framed forward-looking information.” Of course, the plaintiffs’ bar, and even future enforcement staff, may not be as generous, and those concerns along with every other aspect of the current situation suggest prudence.

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