

Financial Reporting Pressures and the COVID-19 Crisis

Considerations for the Quarter Ending March 31, 2020

Part Three: Defining Risks in a Balanced Manner

As public registrants prepare their financial reports for the first quarter of 2020, they will be dealing with unique reporting judgments due to the economic impact of COVID-19 and recent government actions. Many of the financial reporting judgments will be especially difficult because of so many unique unknowns such as the duration of the crisis, whether vendors will be able to deliver on commitments, possible accounts receivable collection problems, and other matters that each registrant may be encountering.

To help our clients understand and assess the financial reporting matters under consideration, we are presenting a multi-part series dealing with several of these topics. Today's subject relates to considerations for defining risks in a balanced manner.

Registrants are required under rules promulgated by the United States Securities and Exchange Commission ("SEC") to report on the most significant risk factors that make an investment in the registrant speculative or "risky." Of significance, disclosures are required that pertain specifically to the registrant, and the section is not for risks that could apply generically to all businesses. In reality, this distinction may be blurred due to the uncertainties many registrants are currently facing.

Balanced Reporting is Critical

For many, among the other stresses on the financial reporting process for the first quarter of 2020, will be how to balance the need for transparent disclosures regarding the risks encountered by the current crisis with the uncertainties and unknowns also in play.

Guidance issued earlier this year from the SEC discussed the need for risk disclosures regarding the registrant's reliance on China, and supply chain issues, as part of fourth quarter subsequent events.

As registrants report on the first quarter of 2020, this is obviously now a global issue, and not just an issue related to China.

Unique risk factors that registrants may consider in Q1 2020 include:

- Health of the workforce and key management members;
- Length of government restrictions;
- Impact of economic crisis on customer base;
- Disruption in supply chain;
- Potential quarantine impact on key offices or manufacturing locations;
- Increased litigation exposure related to contract defaults or other legal issues; and
- Other company specific factors.

Presenting these risk disclosures in a fair and transparent manner without causing investors to panic will require skillful drafting. Balancing full disclosure without creating a catastrophic impression will be challenging.

For comparison, certain media reports present worst-case scenarios and speak of an economic depression, whereas a recent [Wall Street Journal](#) story presented thoughtful comparisons to the economic fallout of the financial crisis. Similarly, a recent report by [Goldman Sachs](#) presented serious economic consequences arising from the current crisis, but also described subsequent quarters' economic recovery in a very balanced manner.

Identifying Company Specific Risk Factors

The current crisis presents many industry and market wide risks, but companies should avoid boilerplate language that doesn't also address company specific considerations that may be worthy of disclosure. We have discussed the need for a company-wide assessment in both of our previous discussions, as well as financial modeling for various scenarios. As part of that process, registrants should compile a list of the most sensitive risk factors and assumptions identified by management arising from the current crisis, including those considered in managements' financial models, and discuss those risk factors with the board of directors, advisors, legal counsel and external auditors when assessing which warrant specific disclosure.

We hope this discussion is informative and offers practical advice on an approach to deal with the unique circumstances arising from the current crisis. If you have questions or suggestions, please let us know. Thank you.