

RED FLAGS FOR DIRECTORS: SEC MAY TAKE MAGNIFYING GLASS TO DISCLOSURES INVOLVING SIGNIFICANT JUDGMENTS IN COVID-19 ERA

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In a fast-paced [webinar](#), the Heartland NACD chapter recently explored the board's role in SEC inquiries and discussed red flags for directors, as well as SEC trends and developments. Panelists included **Terri Vaughan**, a seasoned board leader; **Lory Stone**, an SEC enforcement attorney; and **Terry Pritchard**, an experienced securities litigator at Bryan Cave Leighton Paisner LLP.

During a discussion of red flags that should draw directors' attention, Ms. Stone noted that the SEC may take a magnifying glass to disclosures involving significant judgements and estimates, particularly in the current economic conditions. She quoted her former colleague Steven Peikin, previous Co-Director of the Division of Enforcement, who stated in a [speech](#) at a recent securities enforcement forum:

Recognizing that the economic impacts of any downturn may vary across different industries and sectors, the [SEC's Coronavirus] Steering Committee has developed a systematic process to review public filings from issuers in highly-impacted industries, with a focus on identifying disclosures that appear to be significantly out of step with others in the same industry. We are also looking for disclosures, impairments, or valuations that may attempt to disguise previously undisclosed problems or weaknesses as coronavirus-related.

Other red flags discussed during the webinar included:

- Tips/hotline reports, which should be closely examined by the board;
- "Domineering" CEOs who may have unchecked power;
- Auditor resignations, which should prompt the board to understand the reason for the resignation;
- Management shake-ups, with abrupt terminations or resignations;
- Government investigations;

- Financial restatements;
- Practice changes in judgment areas (debt restructuring, revenue recognition practices); and
- Disclosure of impairments, or adoption of new accounting approaches.

Panelists encouraged directors to keep asking questions until they understand red flag issues and to be alert to changes and shifts in areas that involve significant judgments and estimates. As discussed in an earlier [post](#), Delaware courts view directors' duties as including the requirement to conduct oversight of mission-critical areas in good faith to ensure that information monitoring and reporting systems are working effectively and heed warnings or "red flags" that are discovered. For a full version of the recorded webinar, see [Recording Link](#).

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R. Randall Wang

St. Louis

randy.wang@bclplaw.com

[+1 314 259 2149](tel:+13142592149)

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