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SEC Reporting & Compliance Alert

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SEC Amends MD&A and Other Financial Disclosure Requirements

On November 19, 2020, the Securities and Exchange Commission (SEC) adopted amendments to certain financial disclosure requirements of Regulation S-K, including those applicable to the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). Consistent with recent SEC rulemaking, the new rules move from a prescription-based disclosure framework toward a principles-based one that emphasizes a company-specific assessment and discussion of material information. Under the new rules, certain disclosure requirements have been eliminated, such as the requirement to provide selected financial data under Item 301 and to include a tabular disclosure of contractual obligations under Item 303(a)(5), while others have been streamlined, clarified or reorganized. The SEC expects the amended rules to reduce regulatory burden and expense while continuing to provide material information to investors.

The SEC also adopted conforming amendments applicable to foreign private issuers, including to disclosures on Forms 20-F and 40-F.

Some of the key changes, which are discussed in more depth below, include:

- Eliminating Item 301, which requires disclosure of selected financial data for the last five years.
- Replacing the Item 302(a) tabular disclosure requirement for two years of tabular quarterly financial data with a principles-based disclosure requirement for material retrospective changes from the period.
- Streamlining and reorganizing the MD&A disclosure framework and instructions in Item 303(a). The amendments create an overview section with general disclosure requirements and objectives in Item 303(a), and streamline and relocate the more specific instructions to Item 303(b).
- Eliminating the Item 303(a)(5) requirement for a tabular disclosure of contractual obligations. Instead, the amendments mandate disclosure of material cash requirements from known contractual and other obligations as part of the liquidity and capital resources discussion under amended Item 303(b)(1).
- Adding a requirement that registrants explicitly disclose critical accounting estimates, largely codifying existing SEC guidance.
- Modifying certain additional disclosure requirements to enhance clarity, codify existing practice and/or provide for additional flexibility for issuers to tailor their disclosures and make them more meaningful to investors.

Selected Financial Data

Item 301 currently requires registrants to present up to five years of selected financial data in a tabular format. The SEC noted that this requirement was initially imposed to facilitate a discussion of key trends in financial metrics but that (i) this information is now more easily available to investors, who can access past filings electronically, and (ii) considerable cost is associated with presenting this information, especially when prior years' financials need to be restated due to a change in accounting standard, change in business or other reasons. Nevertheless, in eliminating Item 301, the SEC noted that a material trends disclosure that dates beyond the period where financial statements are provided may continue to be helpful to investors and that a tabular disclosure of this selected financial information, even though not required under the new rules, may remain a helpful way of communicating these trends to investors depending on the registrant.

Supplementary Financial Information

Currently, Item 302(a)(1) requires that certain registrants disclose selected quarterly financial data of specified operating results (such as net sales, gross profit and net income) for at least the past two years, and Item 302(a)(2) requires disclosure of variances in these results from amounts previously reported on a Form 10-Q. Under the new rules, disclosure of supplementary financial information will be required only when there are one or more retrospective changes that pertain to the financial statements for any of the quarters within the two most recent fiscal years that, individually or in the aggregate, are material. In such cases, registrants would provide an explanation of the reasons for the material changes and disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information and earnings per share reflecting such changes. The SEC predicted that retooling Item 302 would give greater prominence to any material retrospective changes, the reasons they occurred and their quantitative effect on the quarterly periods affected than relying exclusively on Item 303 disclosures would permit.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Objective of MD&A

Currently, 14-part instructions to the MD&A are contained in Item 303(a). The amendments lift much of the substance of the first three instructions and combine it with codifying guidance that the MD&A should reflect management's perspective and assessment into a new Item 303(a). The reformulation is broadly worded and intended to emphasize the principles-based and company-specific approach that should guide registrants throughout the drafting of the MD&A. The remaining instructions have been moved to a new Item 303(b) with various streamlining and clarifying changes, as well as changes targeted at enhancing the meaningfulness of disclosure for investors. Some of these changes are described in more detail below.

Material Cash Requirements/Contractual Obligations

Currently, a registrant is required to disclose its material cash commitments for capital expenditures. Under the amended rules, this has been expanded to require disclosure of the material cash requirements generally, including, but not limited to, capital expenditures and known contractual requirements. Registrants must still disclose the general purpose of the requirement and the anticipated funding source.

In light of the expanded scope of the material cash requirements disclosure, the final rules eliminated the requirement that registrants include a separate contractual obligations table. Currently, registrants must disclose all contracts, regardless of materiality, falling within a particular type and subject matter.

Critical Accounting Estimates

The SEC's interpretive guidance issued in 2003 provided that, among other things, registrants, while preparing MD&A disclosure, should consider whether accounting estimates and judgments could materially affect reported financial information. The amended rules largely codify this long-standing guidance, explicitly mandating disclosure of critical accounting estimates. A registrant should provide qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on the registrant's financial condition or results of operations, to the extent the information is material and reasonably available. Additionally, the disclosure should include a discussion of why each critical accounting estimate is subject to uncertainty; how much each estimate and/or assumption has changed over a relevant period, to the extent the information is material and reasonably available; and the sensitivity of the reported amounts to the material methods, assumptions and estimates underlying its calculation.

Other Amendments

The SEC has adopted certain other clarifying and disclosure-enhancing amendments. Some of the notable amendments include:

- **Known Trends or Uncertainties:** Changing the applicable disclosure standard from a requirement to disclose known trends or uncertainties that the registrant reasonably expects will have a material impact on net sales, revenues or income from continuing operations to whether, in management's assessment, the material impact is "reasonably likely."

- **Changes in Net Sales/Revenues:** Changing the requirement that a registrant disclose material increases in net sales and revenues to one that the registrant disclose material changes (whether increases or decreases) in net sales and revenues.
- **Inflation and Price Changes:** Eliminating the requirement that issuers specifically disclose the impact of inflation and price changes on their net sales, revenue and income from continuing operations to the extent material. Registrants will still be required to discuss the impact of inflation and prices, if material.
- **Off-Balance Sheet Arrangements:** Replacing the current requirement that every quarterly and annual report disclose all material off-balance sheet arrangements in a separate section, with a principles-based instruction to discuss, in the context of and integrated with the rest of the MD&A, commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that are, or are reasonably likely to be, material.
- **Interim Period Discussion:** Modifying the existing requirement that registrants compare their most recently completed quarter to the corresponding quarter of the prior year, and permitting registrants greater flexibility and the ability to alternatively compare their most recently completed quarter to the immediately preceding one.

Next Steps

The amendments will become effective 30 days after publication in the Federal Register, and compliance will be required upon the first fiscal year ending on or after the date that is 210 days after publication of the amendments in the Federal Register. Thus, for calendar year-end companies, the new rules will likely apply to annual reports for the fiscal year ending December 31, 2021. Voluntary compliance is permitted at any time after the amendments become effective, so long as the disclosure provided is responsive to an amended item in its entirety.

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