Corporate

SEC Revises Disclosure Requirements Regarding Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information

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On November 19, 2020, the Securities and Exchange Commission (the Commission or the SEC) finalized amendments to its rules and forms relating to disclosure requirements applicable to various public filings, such as registration statements, periodic reports, and certain proxy statements filed with the SEC.[1] These amendments are intended to promote a more principles-based and materiality-focused approach to disclosure obligations in an effort to (i) increase the relevancy and materiality of the information disclosed in a company's filings, (ii) eliminate duplicative disclosures, and (iii) enhance Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A) disclosures for the benefit of investors, while at the same simplifying compliance efforts for companies. The amendments are part of the Commission's efforts to modernize, simplify, and enhance certain financial disclosure requirements in Regulation S-K.[2]

The amended rules are effective 30 days after publication in the Federal Register and companies will be required to apply the amended rules for their first fiscal year ending on or after the date that is 210 days after publication of the amended rules in the Federal Register. As a result, companies filing their annual reports during the early part of 2021 will not be required to comply with the rules.

<table>
<tr><th colspan="2">Rules at a Glance</th></tr>
<tr><td>Item 301: Selected Financial Data</td><td>Item 301 will be eliminated and thus companies will no longer be required to provide 5 years of selected financial data in a comparative tabular form.</td></tr>
<tr><td>Item 302(a): Supplementary Financial Information</td><td>Item 302(a) will apply beginning with the first filing on Form 10-K after the company's initial registration of securities under Sections 12(b) or 12(g) of the Exchange Act.
Companies will only be required disclose material retrospective changes to the statements of comprehensive income which pertain to any quarter within the two most recent fiscal years and subsequent interim periods.</td></tr>
<tr><td>Item 303(a): MD&A</td><td>Item 303(a) will be amended and restated as new Item 303(b), which will provide the requirements for full fiscal year disclosure.
New Item 303(b) will be broken down into three subsections which will group together the five components previously encompassed by current Item 303(a), with addition for disclosure of critical accounting estimates.</td></tr>
<tr><td>Item 303(a)(2): Capital Resources</td><td>Item 303(a)(2) is amended and restated as Item 303(b)(1), which provides overarching requirements for liquidity and capital resources disclosure.
Companies will need to disclose material cash requirements, including commitments for capital expenditures, as of the latest fiscal period, the</td></tr>
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	anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements.
Item 303(a)(3)(ii): Results of Operations	• Item 303(a)(3)(ii) is amended and restated as Item 303(b)(2), which requires disclosure of known events that are "reasonably likely" to cause a "material change" (as compared to a material increase) in the relationship between costs and revenues, such as known or "reasonably likely" future increases in costs of labor or materials or price increases or inventory adjustments.
Item 303(a)(3)(iii): Results of Operations	• Clarifies that a discussion of material changes in net sales or revenue is required (rather than only material increases).
Item 303(a)(3)(iv): Results of Operations; Instructions 8 and 9	• Item 303(a)(3)(iv) and Instructions 8 and 9 are eliminated, and thus the requirement to discuss the impact of inflation and changing prices where material, except as noted below.
Item 303(a)(4): Off-balance Sheet Arrangements	• Item 303(a)(4) is replaced by a new Instruction 8 to Item 303(b), whereby companies are required to discuss certain off-sheet balance arrangements as noted below.
Item 303(a)(5): Contractual Obligations	• Item 303(a)(5) is eliminated, and thus companies are no longer required to provide a contractual obligations table. • The discussion of contractual obligations will remain as part of the principles-based discussion regarding liquidity and capital resources in new Item 303(b)(1).
Instruction 4 to Item 303(a): Material changes in line items	• Instruction 4 to Item 303(a) is eliminated and reincorporated into a portion of the instruction included in amended Item 303(b). • As part of the new instruction, registrants are required to disclose where there are material changes in a line item, including where material changes within a line item offset one another, the underlying reasons for these material changes in quantitative and qualitative terms.
Item 303(b): Interim Periods	• Companies are now permitted to compare their most recently completed quarter to either (i) the corresponding quarter of the prior year or (ii) to the immediately preceding quarter.
Critical Accounting Estimates	• New Item 303(b)(3) explicitly requires companies to disclose critical accounting estimates, including, to the extent material, why the estimate is subject to uncertainty, how much each estimate has changed during the reporting period, and the sensitivity of the reported amounts to the methods, assumptions, and estimates underlying the estimate's calculation.
Item 303(c): Safe Harbor	• Item 303(c) is eliminated and the statutory and regulatory safe harbor for forward-looking disclosure is applied consistently for all of amended Item 303.
Item 303(d): Smaller	• Item 303(d) is eliminated. However, smaller reporting companies are still obligated to disclose material cash requirements from known contractual and

Reporting Companies	other obligations as part of a liquidity and capital resources discussion.

Elimination of Item 301 (Selected Financial Data)

Item 301 currently requires companies (other than smaller reporting companies and certain emerging growth companies) to furnish selected financial data in comparative tabular form for each of the company's last five fiscal years and any additional fiscal years necessary to keep the information from being misleading. The purpose of this requirement was to provide investors with a convenient and readable format to evaluate selected historical financial data. However, with advances in technology since the adoption of Item 301, investors have other methods to access the information outside of Item 301 and thus Item 301 adds complexity and additional costs without commensurate benefit to investors. Notwithstanding the elimination of Item 301, the SEC noted that companies should continue to consider whether trend information for periods earlier than those presented in the financial statements may be necessary as part of MD&A's objective to "provide material information relevant to an assessment of the financial condition and results of operations,"[3] including whether tabular presentation of relevant financial or other information may help a reader's understanding of MD&A.[4]

Amendments to Item 302(a) (Supplementary Financial Information)

Current Item 302(a) is intended to provide information about changes to retrospective results and can be broken down into three parts:

- Current Item 302(a)(1) requires disclosure of quarterly financial data of specified operating results.
- Current Item 302(a)(2) requires disclosure of variances in these results from amounts previously reported on a Form 10-Q.
- Current Item 302(a)(3) requires a description of the effect of any discontinued operations and unusual or infrequently occurring items recognized in each quarter, as well as the aggregate effect and the nature of year-end or other adjustments that are material to the results of that quarter.

Amended Item 302(a) seeks to streamline these disclosure requirements in an effort to better highlight material retrospective changes to financial information. In the first instance, disclosure will be required only where there are one or more retrospective changes that pertain to the statements of comprehensive income for any of the quarters within the two most recent fiscal years and any subsequent interim period for which financial statements are included or required by be included by Article 3 of Regulation S-X. Further, only retrospective changes that are deemed material, whether individually or in the aggregate, are required to be disclosed, along with an explanation of the reasons for such material change and the financial data relevant to and reflecting such change.[5] By limiting the disclosure only to affected quarters, the amendments to Item 302(a) are intended to balance the costs to companies of preparing such disclosures, while providing investors with material information regarding the impact of material changes.[6] Amended Item 302(a) will apply beginning with the first filing on Form 10-K after the registrant's initial registration of securities under sections 12(b) or 12(g) of the Exchange Act.

Amendments to Item 303 (Management's Discussion and Analysis of Financial Condition and Results of Operations)

Item 303(a) –Setting the Objectives of Item 303 Disclosure

The amendments to Item 303(a) seek to provide clarity and focus to companies as they consider what information to discuss and analyze in MD&A. In particular, by succinctly stating the objectives of MD&A

at the outset of Item 303,[7] the Commission believes that management teams will now be able to better engage in thoughtful discussion and analysis about factors specific to the company's business, while simultaneously underscoring materiality as part of a principles-based approach to MD&A. Companies should refer back to the purpose paragraph in crafting responsive disclosure.

Item 303(b) – Introductory Instruction

Following the lead of the amendments to Item 303(a), the amendments to Item 303(b) further streamline and clarify the disclosure requirements previously prescribed by Items 301(a)(1) through 301(a)(4). Two substantial changes should be noted at the outset, as these changes are critical to understanding the requirements now set forth in amended Item 303(b).

First, former Item 303(a) (now Item 303(b)) included instruction that, where the consolidated financial statements reveal material changes from year to year in one or more line items, the causes for such changes are required to be described. With the amendments to what is now Item 303(b), the instruction now requires with respect to such material changes clarification of the "reasons underlying" the material changes in both quantitative and qualitative terms, rather than just the "causes" for such material changes.

Second, former Item 303(a) (now Item 303(b)) included instruction that, with respect to a company's discussion of segment information and/or other subdivisions of the company's business, only a discussion of each relevant reportable segment and/or other subdivision was required. The amendments to what is now Item 303(b) expand this disclosure requirement to include "product lines" as an example of a subdivision of a company's business, although the Commission makes clear that such list of examples is not to be considered exhaustive, nor shall disclosure of such examples be required where, for example, disclosure a product line is not necessary to understanding a company's business.

Following the amendments to the instructions prefacing Item 303(b), amended Item 303(b) is broken out into three subsections.

Item 303(b)(1): Changes to Liquidity and Capital Resources

The Commission has consolidated the disclosure requirements set forth in current Item 303(a)(1) and current Item 303(a)(2) into what is now Item 303(b)(1). Generally speaking, the disclosure requirements regarding liquidity formerly set forth in Item 303(a)(1) have been restated in new Item 303(b)(1)(i). With respect to the disclosure requirements previously set forth in Item 303(a)(2) regarding capital resources, however, the Commission has sought to modernize these disclosure requirements into what is now Item 303(b)(1)(ii). Specifically, whereas this Item previously required that a company discuss its material commitments for "capital expenditures" as of the end of the latest fiscal period, the Commission recognized that capital expenditures may not be broad enough to solicit disclosure of all material cash commitments or requirements of a company's business. Therefore, Item 303(b)(1), as amended, expands current Item 303(a)(2) to require that a company describe its material cash "requirements," including commitments for capital expenditures, as of the end of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements. For companies concerned about the potential impact of this amended Item 303(b)(1)(ii), the Commission has indicated that it does not expect that companies will have to deviate substantially from current practices as the amendments reflect the current Commission guidance and resulting disclosure practice, and is further limited to address only those cash requirements that are material.[8]

Item 303(b)(2): Describing Trends

The requirements set forth in current Item 303(a)(3)(i) through current Item 303(a)(3)(iv) have been consolidated, amended and restated into what is now Item 303(b)(2). Of particular note among the various new subsections to Item 303(b)(2) are first the disclosure requirements regarding known trends and uncertainties. Current Item 303(a)(3)(ii) requires a company to describe any known trends or uncertainties that have had, or that the company reasonably expects will have, a material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations. Further, if a company knows of events that will cause a material change in the relationship between costs and revenues, the change in the relationship must be disclosed. As amended, Item 303(b)(2)(ii) changes the standard for certain forward-looking information. Rather than only having to disclose events that "will cause" a material change in relationship, registrants must now disclose events that are "reasonably likely to cause" a material change in the relationship (such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments). This "reasonably likely" standard now applies throughout Item 303, with such determination to be based on management's assessment and objective reasonableness under the circumstances, with a view toward providing investors with a clearer understanding of the potential material consequents of any such known forward-looking events or uncertainties.[9]

In addition, Item 303(b)(2)(iii) amends the rules formerly set forth in Item 303(a)(3)(iii) regarding disclosure of net sales and revenue information. Current Item 303(a)(3)(iii) requires that, to the extent the financial statements disclose "material increases" in net sales or revenues, a company must provide a narrative discussion of the extent to which such "increases" are attributable to increases in prices, or to increases in the volume or amount of goods or services being sold, or to the introduction of new products or services. Following the principles-based approach adopted elsewhere in the amendments, the Commission has amended Item 303(a)(3)(iii) in what is now Item 303(b)(2)(ii) to clarify that disclosure of any "material change" (rather than only material increases) in net sales or revenue is required, along with the same standard for narrative discussion regarding such material change. This amendment further complements the amendments elsewhere in Item 303(b) which require that, where financial statements reveal material changes from period-to-period in one or more line items, registrants must describe the underlying reasons for these material changes in quantitative and qualitative format.

Further of note, current Item 303(a)(3)(iv) regarding disclosure of the impacts of inflation and price changes on a registrant's net sales, revenue and income from continuing operations was eliminated, along with related instructions thereto. In its place, rather than adopting a new Item, the Commission again relies on a principles-based approach to MD&A to emphasize that registrants should take into consideration and disclose where appropriate the impact of inflation or changing prices that are part of a known trend or uncertainty that had, or is reasonably likely to have a material impact on net sales, revenue, or income from continuing operations.

With regard to off-balance sheet arrangements previously required to be disclosed by current Item 303(a)(4), the Commission noted that disclosure of these off-balance sheet arrangements is contemplated elsewhere throughout Item 303, such as where off-balance sheet arrangements are necessary to an understanding of the registrant's financial condition, changes in financial condition or results of operations. In addition, since the adoption of Item 303(a)(4), the FASB issued additional requirements that have caused US GAAP to further overlap with this item. Therefore, in an effort to reduce the disclosure of seemingly duplicative information and further ease registrant's compliance burden, the Commission replaced the current, more prescriptive Item 303(a)(4) with a principles-based instruction at the outset of Item 303 which provides the registrant with discretion to discuss off-balance sheet arrangements if disclosure of such arrangements is particularly material or necessary to facilitate the understanding of other required disclosures.

Finally, the Commission eliminated the required disclosure of a contractual obligations table previously required by Item 303(a)(5). This elimination is made, in part, in light of amendments to the liquidity and capital resources requirements in amended Item 303(b), and, in part, due to the fact that much of the disclosure required by current Item 303(a)(5) is now provided in a company's financial statements which, with advances in technology, are now more widely accessible. Thus, by eliminating the prescriptive requirement to prepare a contractual obligations table and refocusing instead on a principles-based approach, including a discussion of contractual obligations, the Commission is seeking to balance competing objectives of a registrant's compliance burden against the ability to provide investors with material information.

Item 303(b)(3): Critical Accounting Estimates

The Commission has amended Item 303 to add a new Item 303(b)(3) regarding the disclosure of critical accounting estimates. Specifically, new Item 303(b)(3) explicitly requires disclosure where a company made accounting estimates or assumptions, where the nature of the estimates or assumptions is material and where the impact of the estimates or assumptions on financial condition or operating performance is material. On a more granular level, for each critical accounting estimate, new Item 303(b)(3) requires registrants to disclose, to the extent material, why the estimate is subject to uncertainty, how much each estimate has changed during the reporting period, and the sensitivity of the reported amounts to the methods, assumptions, and estimates underlying the estimate's calculation. Based on comments received in response to the proposed rule, the Commission further clarified this requirement such that (i) the application of the material and reasonably available qualifier applies to all parts of the disclosure, not just to quantitative information; (ii) the discussion on how much each estimate has changed may also be met through a discussion of changes in the assumptions during the period; and (iii) the disclosure of changes in the estimate/assumption will cover a "relevant period," rather than a "reporting period." This new Item 303(b)(3) is intended to supplement US GAAP in this area, given that US GAAP does not require a discussion of material changes in critical accounting estimates or assumptions over a relevant period and there is no general requirement to disclose underlying assumptions for all material accounting estimated included in a company's financial statements.

Item 303(c) – Interim Period MD&A

Current Item 303(b) covers MD&A disclosure for interim periods that enables market participants to assess material changes in financial condition and results of operations between certain specified periods. As amended, current Item 303(b) (now Item 303(c)) permits companies to compare their most recently completed quarter to either (i) the corresponding quarter of the prior year (as is currently required), or (ii) the immediately preceding quarter. However, companies should be aware that, if in a subsequent Form 10-Q a company changes the comparison from the comparison presented in the immediately prior Form 10-Q, the company is required to explain the reason for the change and present both comparisons in the filing where the change is announced. In line with amendments to amended Item 303(b) regarding full-year disclosure, amended Item 303(c) will require similar disclosure, albeit on an interim period basis, for material changes in results of operations both on a year-to-date and quarterly comparison basis (at the option of the company as described above).

Safe Harbor

Current Item 303(c) acknowledges the application of a statutory safe harbor for forward-looking information provided in off-balance sheet arrangements and contractual obligations disclosures required to be made under current Item 303(a)(4) and current Item 303(a)(5), respectively. Because the amendments eliminate current Item 303(a)(4) and current Item 303(a)(5), Item 303(c) has also been eliminated. However, such elimination is not intended to alter the application of statutory safe harbors, which protect eligible forward looking statements in MD&A against private legal actions that are based on allegations of a material misstatement or omission, with certain exceptions. Rather, the extent to which the disclosure relates to contractual obligations, or off-balance sheet arrangements constitutes forward-looking statements that fall under the protections of either the statutory or regulatory safe harbors will be evaluated consistently with other forward-looking disclosures in MD&A.

Smaller Reporting Companies

Current Item 303(d) regarding certain disclosure obligations for smaller reporting companies was eliminated. SRCs are no longer subject to a prescriptive requirement to provide a contractual obligations table; the disclosure of material cash requirements from known contractual or other obligations are now encompassed within a larger discussion and disclosure of liquidity and capital resources. This elimination of current Item 303(d) was made in an effort to reduce the burdens associated with preparing the contractual obligations table itself, and mirrors the Commission's stance on principles-based disclosure emphasized throughout the amendments to Item 303.

Compliance Date

The amended rules are effective 30 days after publication in the Federal Register and companies will be required to apply the amended rules for their first fiscal year ending on or after the date that is 210 days after publication of the amended rules in the Federal Register.

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[1] Securities and Exchange Commission, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, *available at* https://www.sec.gov/rules/final/2020/33-10890.pdf (Adopting Release).

[2] For a discussion on other recent amendments related to Regulation S-K, *see* our previous client alert.

[3] Adopting Release at 14. *See* amended Item 303(b).

[4] Adopting Release at 14.

[5] Some examples of a retrospective change that the SEC noted may trigger Item 302(a) disclosure include: correction of an error; disposition of a business that is accounted for as discontinued operations; or a reorganization of entities under common control. Adopting Release at 20, fn.70.

[6] It is worth noting that the SEC specifically considered the impact of fourth quarter results (which are generally not required to be reported in Form 10-K) in the amendments to Item 302(a) and specifically stated that "Item 302(a) does not generally require fourth quarter disclosure on a standalone basis." Adopting Release at 22.

[7] "The objective of the discussion and analysis is to provide material information relevant to an assessment of the financial condition and results of operations . . . including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. The discussion and analysis must focus specifically on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely based on management's assessment to have a material impact on future operations. The discussion and analysis must be of the financial statements and other statistical data that the registrant believes will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations." Amended Item 303(a).

[8] Adopting Release at 42.

[9] Adopting Release at 47.

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