

## SEC Adopts Amendments to Modernize MD&A and Other Financial Disclosure Requirements



### CONTRIBUTORS



Richard C. Blake



Jose F. Macias

### ALERTS

December 7, 2020

On November 19, 2020, the U.S. Securities and Exchange Commission (SEC) announced that it voted to adopt amendments to modernize, simplify, and enhance certain financial disclosure requirements in Regulation S-K, including Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The amendments are intended to eliminate duplicative disclosures and enhance MD&A disclosures for the benefit of investors, while simplifying compliance efforts for companies. The SEC adopted these amendments substantially as proposed with certain modifications based, in part, on comment letters received by the SEC in response to its January 2020 proposing release (discussed in our previous alert).

Reflecting a more "principles-based" approach to disclosure, these amendments:

- eliminate the requirement to disclose selected financial data,
- streamline the requirement to disclose supplementary quarterly financial data, and
- substantially amend Item 303 (MD&A) of Regulation S-K, to include, among other things:
  - an explicit and expansive disclosure requirement relating to critical accounting estimates,
  - elimination of the contractual obligations tabular disclosure,
  - optionality in the presentation for interim periods of material changes in results of operations (quarter comparisons), including either presentation on a quarter-over-quarter basis or on a sequential basis,
  - a new Item 303(a) that sets forth the overarching objectives of MD&A, and
  - the reorganization and recaptioning of the entire Item 303 and its instructions, generally, and codifying certain prior SEC guidance, including as set forth in the SEC's 1989 MD&A Interpretive Release and 2003 MD&A Interpretive Release.<sup>1</sup>

Although beyond the scope of this alert, the SEC also adopted corresponding amendments to Forms 20-F and 40-F, applicable to foreign private issuers.

The final amendments will be effective 30 days after publication of the adopting release in the *Federal Register*. However, companies will not be required to apply the amended rules until their first fiscal year ending on or after the date that is 210 days after publication of the adopting release in the *Federal Register*, referred to as the mandatory compliance date. Companies will be required to apply the amended rules in a registration statement and prospectus that on its initial filing date is required to contain financial statements for a period on or after the mandatory compliance date.

Of note, although companies are not required to apply the amended rules until the mandatory compliance date, companies may provide disclosure consistent with the final amendments any time after the effective time, so long as they provide disclosure responsive to an amended item in its entirety. Therefore, if a company voluntarily provides disclosure pursuant to a particular subsection

in Item 303 prior to the mandatory compliance date, then it must provide disclosure pursuant to all of the provisions of amended Item 303, and must continue to do so in all applicable filings going forward.

A detailed summary of these amendments follows.

### Summary of Final Amendments

*Current Item 301.* Item 301 of Regulation S-K (Item 301) generally requires companies to furnish selected financial data in comparative tabular form for each of the last five fiscal years and any additional fiscal years necessary to keep the information from being misleading, with limited exceptions or accommodations for smaller reporting companies and emerging growth companies. The purpose of this disclosure requirement is to provide selected financial data in a convenient and readable format which highlight certain significant trends in the company's financial condition and results of operations.

*Final amendments.* The final amendments eliminate Item 301 entirely.

*Commentary.* As a result of the elimination of Item 301, companies will no longer be required to furnish selected financial data for each of the last five fiscal years. In the adopting release, the SEC reiterated its support for its 2003 MD&A Interpretive Release and noted that Item 303 requires, and will continue to require under the amendments, disclosure of trend data.<sup>2</sup> Thus, notwithstanding the elimination of Item 301 and its five fiscal-year look-back period, the SEC encourages companies to consider whether trend information for periods earlier than those presented in the financial statements are advisable, as well as whether tabular presentation of relevant financial or other information is appropriate as part of an introductory section or overview to the MD&A.

*Current Item 302(a), Selected quarterly financial data.* Item 302(a) of Regulation S-K (Item 302(a)) generally requires companies, with limited exceptions for smaller reporting companies, foreign private issuers, first-time registrants conducting an initial public offering, and companies only required to file reports under Section 15(d) of the Securities Act of 1933, to 1) provide selected quarterly financial data for specified line items of their operating results for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or required by Article 3 of Regulation S-X, 2) reconcile and describe the reasons for any quarterly information that varies from the amounts previously reported on the applicable quarterly report on Form 10-Q, and 3) describe the effect of any discontinued operations and unusual or infrequently occurring items recognized in each of the full quarters presented and the aggregate effect and nature of year-end or other adjustments which are material to the results of that quarter.

*Final amendments.* In the January 2020 proposing release, the SEC proposed eliminating this requirement in its entirety. However, in the final amendments, the SEC retained Item 302(a) but replaced the presentation of selected quarterly financial data with a principles-based requirement for material retrospective changes. In streamlining this item, the SEC will require disclosure only when 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 or any subsequent interim period for which financial statements are included or are required to be included by Article 3 of Regulation S-X, and that, individually or in the aggregate are material. If there are any such material retrospective changes, then amended Item 302(a) will require the company to 1) provide an explanation of the reasons for such material changes and 2) disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to the statements of comprehensive income as specified in Rule 1-02(bb)(ii) of Regulation S-X and earnings per share reflecting such changes. The "affected quarterly period" may include a single quarter or may flow through to subsequent quarters during the relevant look-back period.

*Commentary.* As a result of these amendments, companies will no longer be required to provide, regardless of materiality, two years of tabular selected quarterly financial data. Rather, disclosures will be required only for material retrospective changes, and only in the affected quarterly period and the fourth quarter in the affected year. In the adopting release, the SEC provided a non-exhaustive list of types of retrospective changes that may trigger disclosure under amended Item 302(a), depending on materiality. The examples provided include: correction of an error; disposition of a business that is accounted for as discontinued operations; a reorganization of entities under common control; or a

change in an accounting principle, for which the SEC also included its view of whether changes in accounting principles would result in a retrospective change for emerging growth companies that elected to take advantage of extended transition periods for new or revised financial accounting standards, including for those companies that subsequently lose their emerging growth company status.<sup>3</sup>

Of note, amended Item 302(a) requires a newly public company to provide disclosure, if applicable, beginning in the first annual report on Form 10-K filing after its initial public offering. However, if a newly public company has a material retrospective change to its year-to-date interim period information in its initial public offering registration statement but has not yet disclosed that interim period information in quarterly increments, the SEC will not object if Item 302(a) disclosures in the annual report on Form 10-K are presented for the affected year-to-date interim period (rather than for each affected quarter during that time) and the fourth quarter in the affected year.

**General structure.** Consistent with the January 2020 proposing release, the final amendments reorganize Item 303 of Regulation S-K (Item 303). At a high level, the reorganized structure of Item 303 is well summarized in the following abridged version of the chart that was included in the adopting release:

Current Structure	Amended Structure
N/A	Item 303(a), <i>Objective</i>
Item 303(a), <i>Full fiscal years</i>	Item 303(b), <i>Full fiscal years</i>
Item 303(a)(1), <i>Liquidity</i> Item 303(a)(2), <i>Capital resources</i>	Item 303(b)(1), <i>Liquidity and Capital Resources</i> (i) Liquidity (ii) Capital resources
Item 303(a)(3), <i>Results of operations</i> (i) Unusual or infrequent events (ii) Known trends or uncertainties (iii) Material increases (iv) Inflation and changing prices	Item 303(b)(2), <i>Results of operations</i> (i) Unusual or infrequent events (ii) Known trends or uncertainties (iii) Material changes
Item 303(a)(4), <i>Off-balance sheet arrangements</i>	Replace with Instruction 8 to Item 303(b)
Item 303(a)(5), <i>Tabular disclosure of contractual obligations</i>	Eliminate (with some content incorporated into Item 303(b)(1) and Instruction 4 to Item 303(b))
2003 MD&A Interpretive Release, Critical accounting estimates	Item 303(b)(3), <i>Critical accounting estimates</i>
Item 303(b), <i>Interim periods</i> (1) Material changes in financial condition (2) Material changes in results of operations, Rule 3-03(b) of Reg. S-X matters	Item 303(c), <i>Interim periods</i> (1) Material changes in financial condition (2) Material changes in results of operations (i) Material changes in results of operations (year-to-date) (ii) Material changes in results of operations (quarter comparisons)
Item 303(c), <i>Safe harbor</i>	Eliminate
Item 303(d), <i>Smaller reporting companies</i>	Eliminate

#### New Item 303(a), Objective of MD&A

**Final amendments.** The final amendments create a new Item 303(a) of Regulation S-K, which states the objectives that will apply throughout amended Item 303. The objectives set forth in new Item 303(a) are drawn largely from the substance of current Instructions 1, 2, and 3 of existing Item 303(a).

New Item 303(a) will require the following disclosure, which is expected to better allow investors to view the company from management's perspective:

- material information relevant to an assessment of the financial condition and results of operations of the company including an evaluation of the amounts and certainty of cash flows from operations and from outside sources;
- 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, which includes descriptions and amounts of matters that 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; and
- the material financial and statistical data that the company believes will enhance a reader's understanding of its financial condition, cash flows and other changes in financial condition and results of operations.

The foregoing disclosures are intended to emphasize forward-looking disclosure and highlight the importance of materiality and trend disclosure in MD&A.

*The following bolded captions reference the applicable subsections as set forth in amended Item 303 of Regulation S-K, unless otherwise noted.*

#### **Item 303(b), Full Fiscal Years**

*Current Item 303(a), MD&A.* Item 303(a) requires companies to discuss their financial condition, changes in financial condition, and results of operations for full fiscal years. Generally, this discussion covers the periods covered by the financial statements in the filing.<sup>4</sup> This discussion is required to cover liquidity, capital resources, results of operations, off-balance sheet arrangements, contractual obligations, and any other information that the company believes would be necessary to understand its financial condition, changes in financial condition, and results of operations.

The company must also discuss segment information and/or subdivisions of the business (for example, geographic areas) if, in the company's judgment such discussion would be appropriate to an understanding of the business. This discussion must focus on each relevant, reportable segment and/or subdivision of the business and on the company as a whole.

*Final amendments.* In the final amendments, current Item 303(a) will be recaptioned as Item 303(b). As amended, the discussion of a company's financial condition, changes in financial condition, and results of operations will be required to include liquidity, capital resources, results of operations, critical accounting estimates, and any other information that the company believes would be necessary to understand its financial condition, changes in financial condition, and results of operations. In addition, the final amendments move and amend Instruction 4 to the main text of this new item. Thus, as amended, where the financial statements reflect material changes from period-to-period in one or more line items, including where material changes within a line item offset one another, companies will be required to describe the underlying reasons (not just the causes) for these material changes in quantitative and qualitative terms. In the adopting release, the SEC emphasized that it is seeking greater analysis of the material changes, and not a line-by-line recitation of the amounts of changes.

In addition, the SEC added "product lines" as another example of a subdivision of the business (in addition to geographic areas) that should be discussed when necessary to an understanding of the business. This amendment is not intended to require product line disclosure unless, in the company's judgment, discussion of product lines is necessary to an understanding of the company's business; rather, it was added as a reminder to companies of the type of disclosure that may be required.

#### **Item 303(b)(1) and 303(b)(1)(ii), Liquidity and Capital Resources**

*Current Item 303(a)(2).* Item 303(a)(2) requires a company to describe its material commitments for capital expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.

*Final amendments.* The final amendments expand this disclosure, consistent with the 2003 MD&A Interpretive Release (emphasizing disclosure of cash requirements), to require a description of material cash requirements, including but not limited to commitments for capital expenditures, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirement.

In addition, the SEC added a new Item 303(b)(1), which provides the overarching requirements for the liquidity and capital resources disclosures. This new item will require companies to analyze their ability to generate and obtain adequate amounts of cash to meet their requirements, as well as their plans for cash in the short-term (i.e., the next 12 months from the most recent fiscal period end required to be presented) and also in the long-term (i.e., beyond the next 12 months). In addition, while the contractual obligations table has been eliminated from Item 303 (as discussed below), this new Item 303(b)(1) will require the liquidity and capital resources discussion to include an analysis of the material cash requirements from known contractual and other obligations, including specifying the type of obligation and the relevant time period for the related cash requirements. A new Instruction 4 to amended Item 303(b) will be added providing that the discussion of material cash requirements from known contractual obligations may include, for example, lease obligations, purchase obligations, or other liabilities reflected on the company's balance sheet, thereby providing flexibility for company-specific disclosure.

Commentary. Unlike the contractual obligations table, which required disclosure regardless of materiality, the final amendments relating to the liquidity and capital resources discussion in the MD&A (including the discussion relating to known contractual and other obligations) "are intended to focus only on material disclosures and specifically, disclosure of those periods where the cash requirements or reasonably likely effect of these cash requirements on liquidity and capital resources is material."

Although amended Item 303(b)(1) discusses the liquidity and capital resources disclosures on a combined basis, companies will still be permitted to discuss them separately, if preferred, which is consistent with guidance from the 2003 MD&A Interpretive Release. In addition, the discussion of short- and long-term cash requirements in this new item codifies certain guidance from the 1989 MD&A Interpretive Release, which specifies that short-term liquidity and capital resources covers cash requirements up to 12 months into the future, while long-term liquidity and capital resources covers cash requirements beyond 12 months.

#### **Item 303(b)(2), Results of Operations**

##### *Known Trends and Uncertainties*

Current Item 303(a)(3)(ii). Item 303(a)(3)(ii) requires companies to 1) 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 revenue or income from continuing operations and 2) disclose any known events that will cause a material change in the relationship between costs and revenues (e.g., known future increases in costs of labor or materials or price increases).

Final amendments. The final amendments will recaption this as Item 303(b)(2)(ii) and will require companies to:

- describe any known trends or uncertainties that have had or that are *reasonably likely* to have (rather than *reasonably expects will have*) a material impact, favorable or unfavorable, on net sales or revenue or income from continuing operations and
- disclose any known events that are *reasonably likely* to cause (rather than *will cause*) a material change in the relationship between costs and revenues.

These changes to the "reasonably likely" threshold conform the language in this item to other Item 303 disclosure requirements for known trends (e.g., disclosures relating to liquidity), as well as the two-part test in the 1989 MD&A Interpretive Release that is to be used when analyzing forward-looking disclosure in the MD&A under this "reasonably likely" disclosure threshold.<sup>5</sup>

Commentary. In the adopting release, the SEC clarified that the "reasonably likely" threshold applies throughout Item 303, including in amended Item 303(b)(2)(ii), which the SEC believes is the appropriate standard for prospective matters and forward-looking information that is required in MD&A, stating that "this threshold requires a thoughtful analysis that applies an objective assessment of the likelihood that an event will occur balanced with a materiality analysis regarding the need for disclosure regarding such event."

In addition, based in part on commenters that suggested that the SEC's two-part test was unclear, the SEC clarified and explained how companies should analyze and disclose information under the "reasonably likely" threshold regarding known trends, demands, commitments, or uncertainties under the two-step test, stating as follows:

[W]hen applying the "reasonably likely" threshold, registrants should consider whether a known trend, demand, commitment, event, or uncertainty is likely to come to fruition. If such known trend, demand, commitment, event or uncertainty would reasonably be likely to have a material effect on the registrant's future results or financial condition, disclosure is required. Known trends, demands, commitments, events, or uncertainties that are not remote or where management cannot make an assessment as to the likelihood that they will come to fruition, and that would be reasonably likely to have a material effect on the registrant's future results or financial condition, were they to come to fruition, should be disclosed if a reasonable investor would consider omission of the information as significantly altering the mix of information made available in the registrant's disclosures. This analysis should be made objectively and with a few to providing investors with a clearer understanding of the potential material consequences of such known forward-looking events or uncertainties.

#### *Net Sales and Revenues – Material Changes*

*Current Item 303(a)(3)(iii)*. Item 303(a)(3)(iii) requires, to the extent that the financial statements disclose material increases in net sales or revenues, companies to 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.

*Final amendments*. The final amendments will recaption this as Item 303(b)(2)(iii) and codify guidance from the 1989 MD&A Interpretive Release, requiring companies to disclose "material changes" in net sales or revenues, that is, both material increases *and* material decreases. In addition, this item has been amended to apply to disclosures of material changes in the company's *statement of comprehensive income*.

#### *Inflation and Price Changes*

*Current Item 303(a)(3)(iv)*. Item 303(a)(3)(iv) generally requires companies to discuss the impact of inflation and price changes on their net sales, revenue, and income from continuing operations. Instruction 8 to this item clarifies that companies are only required to provide this disclosure to the extent material.

*Final amendments*. The final amendments eliminate Item 303(a)(3)(iv) and its related instructions (i.e., Instruction 8 and 9 to this item) in their entirety.

*Commentary*. Although no longer an explicit disclosure requirement, companies are still expected to discuss the impact of inflation or price changes if they are part of a known trend or uncertainty that has had, or is reasonably like to have, a material favorable or unfavorable impact on net sales, revenue, or income from continuing operations. In addition, the discussion of the underlying reasons for material changes from period-to-period may implicate a discussion of inflation and changing prices.

#### **Off-Balance Sheet Arrangements**

*Current Item 303(a)(4)*. Adopted as part of implementation of the Sarbanes-Oxley Act of 2002, Item 303(a)(4) requires companies to discuss, in a separately-captioned section of the MD&A, off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

*Final amendments*. The final amendments eliminate this item but add a new principles-based Instruction 8 to amended Item 303(b). This new Instruction 8 will require companies to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on a company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources. Companies are no longer required to include a separately-captioned section, and the SEC indicated a preference for any discussion of off-balance sheet arrangements to be integrated with other aspects of MD&A (e.g., as part of the broader liquidity and capital resources discussion); however, the SEC will allow companies to continue to discuss off-balance sheet arrangements separately or in a separately captioned section

if the applicable company determines that this discussion should be highlighted separately in order to enable a better understanding of such disclosure, or to highlight particular material information about these arrangements.

In light of these amendments, the SEC also amended Items 2.03 and 2.04 of Form 8-K to add the definition of "off-balance sheet arrangements," which is in current Item 303(a)(4)(ii). Thus, the Form 8-K disclosures retain the current definition of "off-balance sheet arrangements" for purposes of the Form's four business-day filing requirement.

### **Contractual Obligations Table**

*Current Item 303(a)(5)*. Item 303(a)(5) requires companies, other than smaller reporting companies, to disclose in tabular format their known contractual obligations, by type of obligation, overall payments due, and four prescribed time periods. There is no materiality threshold for this disclosure item.

*Final amendments*. The final amendments eliminate Item 303(a)(5). While the table will no longer be required, as discussed above, the amended liquidity and capital resources disclosure requirements will include a requirement to disclose material cash requirements from known contractual and other obligations, including specifying the type of obligation and the relevant time period for the related cash requirements. While not required, companies could choose to present information in tabular form.

### **Item 303(b)(3), Critical Accounting Estimates**

*Current rule*. This disclosure is not specified in current Item 303. However, in the 2003 MD&A Interpretive Release, the SEC included a separate section on critical accounting estimates, which it defined as "accounting estimates and assumptions that may be material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and that have a material impact on financial condition and operating performance." The guidance further stated that "[c]ompanies should consider enhanced discussion and analysis of these critical accounting estimates that: supplements, but does not duplicate, the description of accounting policies in the notes to the financial statements; and provides greater insight into the quality and variability of information regarding financial condition and operating performance."

*Final amendments*. The final amendments include new Item 303(b)(3), explicitly requiring disclosure of critical accounting estimates. It defines critical accounting estimates as "those estimates made in accordance with general accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the financial condition or results of operations of the registrant." Consistent with the 2003 MD&A Interpretive Release, the SEC also added a new instruction specifying that this discussion should supplement, but not duplicate, the description of accounting policies in the notes to the financial statements.

This new item will require companies to 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 financial condition or results of operations to the extent the information is *material and reasonably available*. Thus, for each critical accounting estimate, companies will be required to discuss, to the extent material and reasonably available:

- why each estimate is subject to uncertainty;
- how much each estimate and/or assumption has changed during the relevant period; and
- the sensitivity of the reported amount to the methods, assumptions, and estimates underlying its calculation.

The "relevant period" is undefined, and is intended to provide companies with flexibility to determine the relevant period necessary to describe material changes in estimates or assumptions that would facilitate an understanding of estimation uncertainty, which period may differ from estimate to estimate.<sup>6</sup> In addition, in the adopting release, the SEC noted that, in practice, where disclosure is "impracticable" to provide, it would not be "reasonably available."

*Commentary*. In the adopting release, the SEC stated that its intent with these disclosure requirements is for companies "to provide investors with a greater understanding of the variability that is reasonably likely to affect the financial condition or results of operations so investors can adequately evaluate the estimation uncertainty of a critical accounting estimate." In addition, the SEC highlighted the distinction between U.S. generally accepted accounting principles (U.S. GAAP)

disclosure and this new item. First, according to the SEC, "U.S. GAAP requires discrete disclosure of the underlying assumptions for certain accounting estimates" but "does not require a discussion of material changes in those assumptions over a relevant period" as this new item will require. And second, "unlike existing requirements in U.S. GAAP, [these] amendments emphasize forward-looking information as they are intended to provide investors with greater insight into estimation uncertainty that is reasonably likely to have a material impact on financial condition and operating performance."

### **Item 303(c), Interim Period Discussion**

*Current Item 303(b)*. Item 303(b) generally requires companies to provide MD&A for interim periods, other than discussions of the impact of inflation and changing prices on operations, and the contractual obligations table. Item 303(b)(1) requires companies to discuss any material change in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet. Item 303(b)(2) requires companies to discuss any material changes in their results of operations for the most recent fiscal year-to-date period presented in their income statement, along with a similar discussion of the corresponding year-to-date period of the preceding fiscal year. If the company is required or elects to provide an income statement for the most recent fiscal quarter, then the discussion must also cover material changes with respect to that fiscal quarter and the corresponding fiscal quarter in the preceding fiscal year.

*Final amendments*. The final amendments recaption Item 303(b) as Item 303(c). In addition, Item 303(b)(2) (recaptioned as Items 303(c)(2)(i) and 303(c)(2)(ii)) will 1) retain the requirement that companies discuss any material changes in their results of operations between the most recent year-to-date interim period(s) and the corresponding period(s) of the preceding fiscal year for which statements of comprehensive income are provided and 2) will require companies to compare changes in their results of operations for their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or to the immediately preceding quarter. If a company chooses to discuss the immediately preceding quarter, then it must provide summary financial information for that quarter or identify the prior EDGAR filing where such information is discussed. In addition, if a company chooses to discuss the immediately preceding quarter in a Form 10-Q, and then chooses to discuss the corresponding quarter of the prior year in a subsequent Form 10-Q, then it will be required to explain its reasons for the change and to present both comparisons in that subsequent Form 10-Q.

*Commentary*. The final amendments are intended to provide flexibility for companies to provide a more tailored and meaningful analysis relevant to their specific business cycles. For example, for businesses that are not seasonal, quarter-over-quarter disclosures may not be as meaningful as sequential disclosures. For clarity, the alternative disclosure presentations apply only to a portion of current Item 303(b)(2), relating to quarterly changes in results of operations, and do not apply to 1) current Item 303(b)(1), relating to material changes in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet, or 2) the other portion of current Item 303(b)(2), relating to year-to-date changes in results of operations.

The final amendments also 1) delete the reference to "the impact of inflation and changing prices" consistent with the similar deletion in Item 303(a) (recaptioned as Item 303(b) in the final amendments) and 2) deletes most of the Instructions to current Item 303(b).

### **Safe Harbor**

*Current Item 303(c)*. Item 303(c) acknowledges that the statutory safe harbors for forward-looking information apply to the disclosures relating to off-balance sheet arrangements and the contractual obligations table.

*Final amendments*. Given that the final amendments will eliminate current Item 303(a)(4), *Off-balance sheet arrangements*, and Item 303(a)(5), *Tabular disclosure of contractual obligations*, the final amendments also will eliminate current Item 303(c). The elimination of this item does not alter the availability or scope of the statutory and regulatory safe harbors for all of amended Item 303. As a reminder, however, the statutory safe harbors do not apply to forward-looking statements made in the MD&A in registration statements on Form S-1 filed in connection with an initial public offering.

### **Smaller Reporting Companies**

*Current Item 303(d)*. Item 303(d) provides certain accommodations to smaller reporting companies from the disclosure requirements of Item 303(a).

*Final amendments.* Given that the final amendments eliminate the two sections referenced in Item 303(d), for which accommodations are provided to smaller reporting companies, the final amendments eliminate this section in its entirety. Notwithstanding the foregoing, smaller reporting companies will continue to be able to rely on Instruction 1 to Item 303(a) (recaptioned as Item 303(b)), which provides that a smaller reporting company's MD&A shall cover the two-year period required in Article 8 of Regulation S-X.

### What to Do Now?

These amendments are significant and will require companies to undertake a deliberative review of current MD&A disclosure practices. Even year-end 2020 companies, which are not required to comply with these amendments in their upcoming annual reports on Form 10-K, should discuss the new rules, for example in disclosure committee meetings, to begin considering changes that they will need to make once the rules are implemented, including any changes that will be required in the companies' disclosure controls and procedures. Some preliminary considerations include:

- *Item 301:* While companies will no longer be required to disclose selected financial data under Item 301 in applicable reports, including annual reports on Form 10-K and registration statements on Form S-1 (which generally cover 2 or 3 years of financial statements), they may want to consider whether tabular presentation of relevant financial data is appropriate as part of an introductory or overview section of the MD&A to reflect any trends that may be discussed in the narrative discussion that follows, or whether trend information for periods earlier than those presented in the financial statements may be advisable as part of the MD&A objective to provide material information relevant to an assessment of the company's financial condition and results of operations.
- *Item 302:* Companies will no longer be required to disclose, without a materiality threshold, selected quarterly financial data for the prior two fiscal years in their filings, including annual reports on Form 10-K and registration statements on Form S-1 (filed after the initial public offering). Rather, new Item 302(a) will require, in effect, a two-step analysis to determine whether any disclosure is required. First, companies must determine whether there were any retrospective changes for any quarters during the last two fiscal years and, second, companies must determine whether those retrospective changes were material. In addition, consideration will need to be given as to how the material retrospective change flows through any subsequent quarters, and whether disclosures under new Item 302(a) may be required for any of those subsequent quarters.
- *Item 303, MD&A:* In the adopting release, the SEC indicated its dissatisfaction with MD&A disclosures that merely recited the amounts of changes in line items of financial statements from year to year. Companies may want to consider undertaking a review of their current MD&A disclosure to assess whether any additional qualitative or quantitative disclosures may be needed when describing material changes from period-to-period in one or more line items of the financial statements, including whether existing disclosures cover the *underlying reasons* for these material changes.
  - *Liquidity and Capital Resources:* Companies may want to consider undertaking a review of their material cash requirements, including both on a short- and long-term basis, and, if not disclosed already, assessing and preparing disclosures related to the foregoing. In addition, with the elimination of the current requirement to include a contractual obligations table, which was not subject to any materiality threshold, and the flexibility provided in the final amendments for company-specific disclosure relating to known contractual and other obligations (which includes a materiality threshold), companies should consider reviewing their current disclosures in their contractual obligations table (if applicable) and determining whether and to what extent those disclosures should be adapted for purposes of the liquidity and capital resources discussion required under amended Item 303(b)(1).
  - *Results of Operations:* Companies should review carefully the SEC's clarification of the two-step test to determine the adequacy of their disclosures of known trends and uncertainties under the "reasonably likely" threshold.
  - *Off-Balance Sheet Arrangements:* While still permitted to do so under the final amendments, companies should consider whether it is advisable to continue to include a separately captioned section for off-balance sheet arrangements. If companies have such arrangements, then consideration should be given as to whether and how to incorporate a discussion of these arrangements into the liquidity and capital resources discussion (or elsewhere) in the MD&A.
  - *Critical Accounting Estimates:* While most companies already disclose critical accounting estimates in their MD&A discussion, additional disclosure will likely be required, notwithstanding the materiality and "reasonably available" qualifiers applicable to this new item. Among other things, the disclosures relating to the amount an estimate or assumption has changed over a relevant period and the sensitivity analysis may require extensive

consideration and analysis. Companies should start reviewing and assessing the impact of these disclosure requirements now to ensure that their accounting teams, and outside accounting firms, are aligned on any new disclosures to be made.

- *Interim Periods:* Companies should consider which presentation of interim MD&A disclosure is most useful to its investors. If a sequential presentation is preferred, then companies will also need to assess whether to include summary financial information for the prior quarter in its filing, or whether to identify the EDGAR filing where that information exists, including any implications of including this information in the current filing.
- *Timing of Adoption:* Given the flexibility in date of adoption (i.e., between the effective date of the final amendments and the mandatory compliance dates), companies will need to consider when to adopt these final amendments, keeping in mind that early adoption of one subsection of amended Item 303 would require early adoption of the entire amended Item 303.

For more information on the amendments to certain financial disclosure requirements, including MD&A disclosure, or any related matter, please contact any member of the firm's [public company representation](#) or [capital markets practices](#).

## ANNEX

### Summary of Amendments and Principal Objectives

For reference, set forth below is a summary of the amended rules and their respective objectives, as provided by the SEC in its adopting release:

Current Item or Issue	Summary Description of Amended Rules	Principal Objective(s)
Item 301, <i>Selected financial data</i>	Registrants will no longer be required to provide 5 years of selected financial data.	Modernize disclosure requirement in light of technological developments and simplify disclosure requirements.
Item 302(a), <i>Supplementary financial information</i>	Registrants will no longer be required to provide 2 years of tabular selected quarterly financial data. The item will be replaced with a principles-based requirement for material retrospective changes.	Reduce repetition and focus disclosure on material information. Modernize disclosure requirement in light of technological developments.
Item 303(a), <i>MD&amp;A</i>	Clarify the objective of MD&A and streamline the fourteen instructions.	Simplify and enhance the purpose of MD&A.
Item 303(a)(2), <i>Capital resources</i>	Registrants will need to provide material cash requirements, including commitments for capital expenditures, as of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements, and the general purpose of such requirements.	Modernize and enhance disclosure requirements to account for capital expenditures that are not necessarily capital investments.
Item 303(a)(3)(ii), <i>Results of operations</i>	Registrants will need to disclose known events that are reasonably likely to cause a material change in the relationship between costs and revenues, such as known or reasonably likely future increases in costs of labor or	Clarify item requirement by using a disclosure threshold of "reasonably likely," which is consistent with the Commission's interpretative guidance on forward-looking statements.

	materials or price increases or inventory adjustments.	
Item 303(a)(3)(iii), Results of operations	Clarify that a discussion of material changes in net sales or revenue is required (rather than only material increases).	Clarify MD&A disclosure requirements by codifying existing Commission guidance.
Item 303(a)(3)(iv), Results of operations Instructions 8 and 9 (Inflation and price changes)	The item and instructions will be eliminated. Registrants will still be required to discuss these matters if they are part of a known trend or uncertainty that has had, or the registrant reasonably expects to have, a material favorable or unfavorable impact on net sales, or revenue, or income from continuing operations.	Encourage registrants to focus on material information that is tailored to a registrant's businesses, facts, and circumstances.
Item 303(a)(4), Off- balance sheet arrangements	The item will be replaced by a new instruction to Item 303. Under the new instruction, registrants will be required to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on such registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources even when the arrangement results in no obligation being reported in the registrant's consolidated balance sheets.	Prompt registrants to consider and integrate disclosure of off-balance sheet arrangements within the context of their MD&A.
Item 303(a)(5), Contractual obligations	Registrants will no longer be required to provide a contractual obligations table. A discussion of material contractual obligations will remain required through an enhanced principles-based liquidity and capital resources requirement focused on material short- and long-term cash requirements from known contractual and other obligations.	Promote the principles-based nature of MD&A and simplify disclosures.
Instruction 4 to Item 303(a) (Material changes in line items)	Incorporate a portion of the instruction into amended Item 303(b). Clarify in amended Item 303(b) that where there are material changes in a line item, including where material changes within a line item	Enhance analysis in MD&A. Clarify MD&A disclosure requirements by codifying existing Commission guidance on the importance of analysis in MD&A.

	offset one another, disclosure of the underlying reasons for these material changes in quantitative, and qualitative terms is required.	
Item 303(b), Interim periods	Registrants will be permitted to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter. Registrants subject to Rule 3-03(b) of Regulation S-X will be afforded the same flexibility.	Allow for flexibility in comparison of interim periods to help registrants provide a more tailored and meaningful analysis relevant to their business cycles.
Critical Accounting Estimates	Registrants will be explicitly required to disclose critical accounting estimates.	Facilitate compliance and improve resulting disclosure. Eliminate disclosure that duplicates the financial statement discussion of significant policies. Promote meaningful analysis of measurement uncertainties.

[1] The 1989 MD&A Interpretive Release refers to *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Release No. 33-6835 (May 18, 1989), available [here](#). The 2003 MD&A Interpretive Release refers to *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-8350 (December 29, 2003), available [here](#).

[2] See current Item 303(a)(1) and (a)(2)(ii) of Regulation S-K; *see also* amended Items 303(a), 303(b)(1)(i), (b)(1)(ii)(B) and (b)(2)(ii) of Regulation S-K.

[3] In footnote 70 of the adopting release, the SEC states as follows:

For example, certain calendar year-end EGCs that elected to take advantage of the extended transition period for new or revised financial accounting standards in their initial public offerings, will adopt in accordance with U.S. GAAP ASC 842, *Leases* for the full fiscal year in their 2022 Form 10-K filed in 2023 and will not adopt ASC 842 in interim periods until the Forms 10-Q filed in 2023. We do not view the adoption of ASC 842 in the 2022 Form 10-K, in this scenario, to constitute a retrospective change that should trigger disclosure under Item 302(a) in the registrant's 2022 Form 10-K. By contrast, a registrant that loses EGC status as of December 31, 2022, would have a retrospective change that would require evaluation of materiality under Item 302(a) because the registrant would be required to adopt ASC 842 in the 2022 Form 10-K for both the full fiscal year and interim periods within that fiscal year.

[4] As amended in 2019, companies that cover three years in a filing may omit discussion about the earliest of the three years if this discussion was already included in the company's prior filings on EDGAR, provided that the company include a statement that identifies the location in the prior filing where the omitted discussion may be found. See FAST Act Modernization and Simplification of Regulation S-K, 84 Fed. Reg. 12674 (April 2, 2019), available [here](#).

[5] The 1989 MD&A Interpretive Release provides the two-part test, which states that:

Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments: (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required. (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the company's financial condition or results of operations is not reasonably likely to occur.

[6] In the adopting release, the SEC stated that “[f]or certain estimates or assumptions, providing information about estimates and/or assumptions only as of the balance sheet date may be appropriate to inform investors about the nature of the estimation uncertainty and how reported amounts bear the risk of change. In contrast, other estimates and assumptions may require disclosure over the number of years presented in the financial statements to facilitate an understanding of the estimation uncertainty.”