

Clients & Friends Memo

SEC Adopts Amendments to Management's Discussion and Analysis and Other Financial Disclosures

December 8, 2020

On November 19, 2020, the Securities and Exchange Commission adopted final amendments to the disclosure rules affecting Management's Discussion and Analysis (MD&A) and related financial disclosures. The amendments were proposed on January 30, 2020¹ and are intended to modernize, simplify and enhance certain financial disclosures called for by Regulation S-K and related rules and forms in a manner that reduces the costs and burdens on registrants while continuing to provide material information to investors.

The amendments will go into effect 30 days after publication in the Federal Register. Registrants will be required to follow the amended rules for their first fiscal year ending on or after the date 210 days after publication in the Federal Register, or in their annual report for the year ending December 31, 2021 for calendar-year companies. Registrants may voluntarily provide disclosure consistent with the amendments any time after the effective date.

Selected Financial Data (Item 301)

The new amendments eliminate the requirement for a tabular disclosure of five years (or, in the case of an emerging growth company, two years) of selected financial data contained in Item 301 of Regulation S-K. The SEC notes in the adopting release that "[n]otwithstanding the amendments to eliminate Item 301, we encourage registrants 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." Emerging growth companies (EGCs) that are providing the information called for by Item 301 in a Securities Act registration statement need not present selected financial data for any period prior to the earliest audited financial statement presented in connection with the EGC's initial public offering (IPO) of its common equity securities. In addition, an EGC that is providing the information called for by Item 301 in a registration statement, periodic report, or other report filed under the Exchange Act need not present selected financial data for any period prior to

¹ See SEC Release No. 33-10750, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information* (January 30, 2020), available at <https://www.sec.gov/rules/proposed/2020/33-10750.pdf>.

the earliest audited financial statements presented in connection with its first registration statement that became effective under the Exchange Act or Securities Act.

Supplementary Financial Information (Item 302)

Under the new rules, registrants are no longer required to provide tabular disclosure of two years of selected quarterly financial data. In order to reduce repetition and focus disclosure on material information, Item 302(a) has been revised to 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 and any subsequent interim period for which financial statements are included or required to be included by Article 3 of Regulation S-X, and that, individually or in the aggregate, are material. In such instances, 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 change. Item 302(a) does not apply to first-time registrants conducting an IPO because it only applies to companies that already have a class of securities registered under Section 12 of the Exchange Act at the time of filing. The new amendments do not revise the population of registrants that are not required to provide disclosure pursuant to Item 302(a), including, but not limited to, first time registrants conducting an IPO.

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

The new amendments reorganize Item 303 of Regulation S-K and streamline its requirements in order to "enhance the MD&A disclosures for investors while reducing the compliance burdens for registrants."

- Objective of MD&A. A new Item 303(a) was adopted to clarify the objectives of MD&A. Item 303(a) explains the overarching requirements of MD&A and applies throughout amended Item 303. These requirements "emphasize registrant's future prospects and highlight the importance of materiality and trend disclosures to a thoughtful MD&A." More specifically, Item 303(a) calls for the following disclosures, which are expected to provide investors with an enhanced view of the registrant from management's perspective:
 - Material information relevant to an assessment of the registrant's financial condition and results of operations, 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 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 material financial and 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.
- Liquidity and Capital Resources. Currently, Item 303(a)(2) requires a registrant to discuss material commitments for capital expenditure as of the end of the latest fiscal period and to indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments. The new rules amend Item 303(a)(2) to specify that a registrant should broadly disclose material cash commitments, including, but not limited to, capital expenditures. The amendment requires a company to describe its 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.
- Results of Operations. The SEC has streamlined the disclosure requirements for results of operations as provided below:
 - Known Trends or Uncertainties. Registrants will be required 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 materials or price increases or inventory adjustments. This amendment reflects a change from the current rule, which limited such disclosure to those that *will* cause such a change.
 - Net Sales and Revenues. To the extent that there are *material changes* in net sales or revenue a narrative discussion will be required explaining the extent to which the changes are attributable to changes in prices, the amount of goods or services being sold or the introduction of new products or services. This amendment reflects a change from the current rule, which limited such disclosure to *material increases* of net sales or revenue.
 - Inflation and Price Change. The new rules will eliminate Item 303(a)(3)(iv) and Instructions 8 and 9 to Item 303(a), which generally require companies, for the three most recent fiscal years, or for those fiscal years in which the company has been engaged in business, whichever period is shortest, to discuss the impact of inflation and price changes on their net sales, revenue and income from continuing operations.

However, the adopting release specifies that, under the new rules, registrants will still be required to “discuss the impact of inflation or changing prices if they 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.”

- Off-Balance Sheet Arrangements. Instead of the current separately captioned requirement for a discussion of off-balance sheet arrangements under Item 303(a)4, the new amendments adopt a new principle-based instruction to Item 303(b) that requires registrants 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 expense, results of operations, liquidity, cash requirements, or capital resources even when the arrangement results in no obligations being reported in the company’s consolidated balance sheet.
- Contractual Obligations Table. Registrants are no longer required to provide a contractual obligations table. However, a discussion of material contractual obligations will remain required through the enhanced principles-based liquidity and capital resources disclosure requirements focused on material short- and long-term cash requirements from known contractual and other obligations. Known contractual obligations may include lease obligations, purchase obligations or other liabilities reflected on the company’s balance sheet.
- Critical Accounting Estimates. The new amendments codified previous SEC guidance and adopted an explicit requirement to disclose critical accounting estimates. New Item 303(b)(3) expressly requires disclosure of qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimates have had or are reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available. This information should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how much each estimate and/or assumption has changed over a relevant period, as well as the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation.
- Interim Period Comparisons. The requirements for an interim period discussion remain largely the same except that registrants will be permitted to compare the most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or the immediately preceding quarter. If a registrant elects to discuss changes as compared to the immediately preceding quarter, the registrant must include the prior quarter’s summary financial information or, alternatively, reference the EDGAR filing that presents such previous quarter information. If it decides to change the manner of quarterly comparison from that in the previous

interim comparison, it is required to disclose the rationale for the change and present both comparisons in the filing in which the change is disclosed.

Application to Foreign Private Issuers

The SEC adopted certain parallel amendments to the financial disclosure requirements applicable to foreign private issuers, including to Forms 20-F and 40-F, as well as other conforming amendments to the SEC's rules and forms, as appropriate.

Note on Environmental, Social and Governance Issues

In the adopting release, the SEC noted that in keeping with its principles-based approach to the MD&A, it has declined to add any requirements relating to environmental, social or governance issues (ESG) and sustainability matters. This approach is consistent with the SEC's past guidance outlined in the Commission Guidance Regarding Disclosure Related to Climate Change² and that taken in the modernization of certain items under Regulation S-K earlier this year.³ However, in a joint statement,⁴ Commissioners Lee and Crenshaw advocate for new rules to address climate, human capital and other ESG risks, noting that the amendments fail to address such risks and that, in their view, a principles-based approach to disclosure is not sufficient because ESG matters pose a significant risk to global financial stability, thus requiring a more uniform and standardized approach.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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² See SEC Release No. 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change* (February, 2010), available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>.

³ See SEC Release No. 33-10825, *Modernization of Regulation S-K items 101, 103, and 105* (November, 2020), available at <https://www.sec.gov/rules/final/2020/33-10825.pdf>.

⁴ See *Joint Statement on Amendment to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, Commissioners Caroline A. Crenshaw and Allison Herren Lee (November 19, 2020), available at <https://www.sec.gov/news/public-statement/lee-crenshaw-statement-amendments-regulation-s-k>.