

SEC Amendments to MD&A and Related Disclosures

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Overview

- **On November 19, 2020, the U.S. Securities and Exchange Commission (the “SEC”) adopted amendments (the “Amendments”) to modernize, simplify and improve financial disclosure requirements in Regulation S-K, including Items 301 (Selected Financial Data), 302 (Supplementary Financial Information) and 303 (Management’s Discussion and Analysis, or “MD&A”) and related rules and forms**
 - The Amendments also make parallel changes to the financial disclosure requirements applicable to foreign private issuers
- **The Amendments reflect the SEC’s commitment to a principles-based, registrant-specific approach to disclosure and are intended to improve disclosure by enhancing its readability, discouraging repetition and eliminating information that is not material**
 - The Amendments continue the trend of allowing companies to provide disclosure appropriately tailored to their facts and circumstances with the goal of providing investors with the most meaningful information
- **The Amendments were adopted by a 3-2 vote, with Commissioners Crenshaw and Lee dissenting**
 - Commissioners Crenshaw and Lee’s objections include, among others, the belief that eliminating the contractual obligations table “obscures information [and] makes some information, such as purchase obligations, inaccessible” and that the Amendments fail to address climate risk and human capital management
- **The Amendments are scheduled to become effective February 10, 2021**
 - Registrants are required to comply with the Amendments beginning on (i) August 9, 2021 (the “mandatory compliance date”) and (ii) a registration statement or prospectus that on its initial filing date is required to contain financial statements for a period on or after the mandatory compliance date
 - Accordingly, for calendar year companies compliance will be required commencing with the 10-K for the year ending December 31, 2021
 - Voluntary early compliance with the Amendments is allowed if disclosure responsive to an amended item is provided in its entirety
 - There is a possibility the timing of the effectiveness of the Amendments could be delayed as a result of the transition to the Biden administration

Highlights

- **The Amendments eliminate a number of existing disclosure requirements, including the requirements:**

- To provide selected financial data in comparative tabular form (the five year table) (former Item 301)
- To provide a contractual obligations table (former Item 303(a)(5))
- To discuss the impact of inflation and related price changes if not material (former Item 303(a)(3)(iv))
- To include a separately captioned section for off-balance sheet arrangements in MD&A (former Item 303(a)(4))

- **The Amendments also expand or enhance required disclosures, including:**

- Replacing the requirement to provide two years of tabular selected quarterly financial data with a new requirement to disclose, if applicable, material retrospective changes relating to an income statement within the last two years and to provide an explanation of the reasons for material retrospective changes (Item 302(a))
- Requiring material cash requirements disclosure, including, but not limited to, capital expenditures (Item 303(a)(2))
- Requiring disclosure of critical accounting estimates (Item 303(b)(3))
- Allowing for a comparison of the most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or the immediately preceding quarter (Item 303(c))

Selected Financial Data

▪ Current Rule

- Item 301 currently requires registrants (other than emerging growth companies that have been registrants for a shorter period) to furnish selected financial data in comparative tabular form for each of the registrant's last five fiscal years and any additional fiscal years necessary to keep the information from being misleading

▪ Amendment

- Item 301 and the requirement to provide selected financial data in comparative tabular form is eliminated

▪ Rationale

- Eliminate additional costs and prevent duplication of disclosure available in prior filings
- Prevent duplication of material trend disclosure that Item 303 continues to require
- Acknowledgment that emerging growth companies frequently disclose fewer years of data

▪ Guidance

- The SEC encourages 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"
- The SEC also encourages registrants to consider whether a tabular presentation of relevant financial or other information, as part of an introductory section or overview, including to demonstrate material trends, may help a reader's understanding of the business
 - Although the vast majority of emerging growth companies already choose not to include five years of financial information in their initial public offering ("IPO") prospectus, the analysis may be different for mature companies who already have five years of historical financial information audited and available on EDGAR
- In offerings where five years of information is not presented, eliminating the five year table will eliminate the need for underwriters to consider getting a second comfort letter from a prior auditor if the company has switched auditors over four or five years ago (which can lead to additional costs)
- In the offering context, if a company omits five years of financial data from its 10-K and prospectus, then the issuer and underwriters may need to consider whether they are comfortable with the "older" years being included in a road show but not the prospectus

Supplementary Financial Information

▪ Current rule

- Item 302(a) currently requires disclosure of quarterly operating results (and variances in these results from amounts previously reported on a Form 10-Q) for each full quarter within the two most recent fiscal years and any subsequent period for which financial statements are included or required by Article 3 of Regulation S-X

▪ Amendments

- Item 302(a) is amended to eliminate the requirement for two years of quarterly selected financial data
- Disclosure is required 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 or Regulation S-X and that, individually or in the aggregate, are material
 - The SEC provided a non-exhaustive list of examples of retrospective changes that may trigger Item 302(a) disclosure, including (i) correction of an error; (ii) disposition of a business that is accounted for as discontinued operations; (iii) a reorganization of entities under common control; and (iv) a change in accounting principles
 - However, not all changes in accounting principles result in a retrospective change (e.g., certain calendar year-end emerging growth companies that elected to adopt ASC 842, *Leases* (“ASC 842”) for their full fiscal year 2022 Form 10-K filed in 2023 but that do not adopt ASC 842 in interim periods until their first Form 10-Q filed in 2023 would not constitute a retrospective change in the 2022 Form 10-K)
- Item 302(a) is amended to require registrants to provide an explanation of the reasons for such material retrospective changes and to 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

Supplementary Financial Information (continued)

▪ Rationale

- Eliminate duplicative disclosures provided elsewhere, such as in Form 10-Q or, in the case of fourth quarter results, that can be derived from annual results disclosed in Form 10-K
- Further aid investors' understanding of the reasons for the material retrospective change and the related quantitative effect on the quarterly periods affected

▪ Guidance

- Although the Amendments do not generally require fourth quarter disclosure on a standalone basis, the SEC expects that some registrants will voluntarily provide fourth quarter disclosure or disclosure of selected quarterly financial information. In such instances, that information would be subject to the Public Company Accounting Oversight Board Auditing Standard 2710 requirements for auditors to read and consider such information for material inconsistencies with the audited financial statements
- Amended Item 302(a) will apply beginning with the first filing on Form 10-K after the registrant's initial registration of securities under Section 12(b) or 12(g) of the Securities Exchange Act of 1934, as amended. The SEC stated that it would be unnecessarily burdensome for registrants to be required to provide disclosure for interim periods prior to those presented in an IPO registration statement
 - This could be especially beneficial if a registrant were to conduct a follow-on or secondary offering more than 180 days after its IPO (which is when lock ups typically expire) but before its first 10-K filing, particularly when combined with the relief that registrants do not need to include certain financials in their initial IPO filings if they are not going to be expected to include them at the time of the IPO

Objective of MD&A

▪ Current Rule

- Item 303(a) currently requires disclosure of information relevant to assessing a registrant's financial condition, changes in financial condition and results of operations. The disclosure requirements for full fiscal years in Item 303(a) include five components: liquidity, capital resources, results of operations, off-balance sheet arrangements and contractual obligations
- Item 303(a) currently also requires that where, in the registrant's judgment, a discussion of segment information and/or other subdivisions (e.g., geographic areas) of the registrant's business would be appropriate to an understanding of such business, the discussion shall focus on each relevant reportable segment and/or other subdivision

▪ Amendments

- Item 303(a) is amended to state the objectives of MD&A that will apply throughout amended Item 303 as disclosure of:
 - Material information relevant to an assessment of the financial condition and results of operations of the registrant, 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
- Item 303(a) is amended to include "product lines" as an example (but not a requirement, if such disclosure is not necessary to an understanding of the business) of a subdivision of a registrant's business that should be discussed where, in the registrant's judgment, it is necessary to an understanding of the registrant's business
- Item 303(b) requires underlying reasons for (rather than only the causes of) "material" changes in quantitative and qualitative terms

Objective of MD&A (continued)

▪ Rationale

- Underscore materiality as the overarching principle of MD&A
- Emphasize a registrant's future prospects and highlight importance of trend disclosure
- Remind registrants that MD&A should provide an analysis that encompasses short-term results as well as future prospects
- Encourage registrants to provide a more meaningful discussion of the underlying reasons that may be contributing to material changes in line items
- Clarify, consistent with prior SEC guidance, that registrants should discuss material changes within a line item even when such material changes offset each other

Known Trends or Uncertainties

■ Current Rule

- Item 303(a)(3)(ii) currently requires a registrant to describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations. In addition, if the registrant knows of events that will cause a material change in the relationship between costs and revenues, the change in the relationship must be disclosed

■ Amendments

- Item 303(b)(2)(ii) is added to clarify that the “reasonably likely” threshold (described below) applies throughout Item 303
- Item 303(a) is amended to state that, as part of MD&A’s objectives, whether a matter is “reasonably likely” to have a material impact on future operations is based on “management’s assessment”

■ Rationale

- Conform the language to other Item 303 disclosure requirements for known trends
- Align Item 303(a)(3)(ii) with the SEC’s guidance on forward-looking disclosure, which specifies that, where a trend, demand, commitment, event or uncertainty is known, management must make an assessment of what a “reasonable investor” would find material

■ Guidance

- The SEC encourages registrants to analyze and disclose information regarding a known trend, demand, commitment or uncertainty if it is likely to come to fruition
 - The “reasonably likely” threshold does not require disclosure of any event that is known but for which fruition may be remote, nor does it set a bright-line percentage threshold by which disclosure is triggered. Rather, 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 impact of such event
 - This analysis should be made objectively and with a view to providing investors with a clearer understanding of the potential material consequences of such known forward-looking events or uncertainties
 - SEC reiterates its emphasis that the standard in this area should be based on objective reasonableness

Net Sales and Revenues

▪ Current Rule

- Item 303(a)(3)(iii) currently specifies that, to the extent financial statements disclose “material increases” in net sales or revenues, a registrant must provide a narrative discussion of the extent to which such increases are attributable to increases in prices, increases in the amount of goods or services being sold, or the introduction of new products or services

▪ Amendments

- Item 303(b)(2)(iii) is adopted to require disclosure of “material changes” in net sales or revenues, rather than solely “material increases” in these line items
 - Where the financial statements reveal material changes from period to period in one or more line items, registrants must describe the underlying reasons for (rather than only the causes of) these material changes in quantitative and qualitative terms

▪ Rationale

- Reiterate that MD&A disclosure should include both qualitative and quantitative analysis and clarify that a results of operations discussion should address material increases or decreases in any line item, including net sales or revenues
- Enhance disclosure by requiring registrants to provide a nuanced discussion of the underlying reasons that may be contributing to material changes in line items rather than simply reciting the amounts of year-to-year changes

▪ Guidance

- Analysis should present a balanced view of the underlying dynamics of the business
- When isolating reasons for specific material changes and quantifying such isolated reasons is challenging because they are highly interrelated, the SEC encourages registrants to acknowledge this fact and to explain the interrelated circumstances to the extent possible

Inflation and Price Changes

▪ **Current Rule**

- Item 303(a)(3)(iv) currently requires registrants, in general, to discuss the impact of inflation and price changes on their net sales, revenue and income from continuing operations either for the three most recent fiscal years or for those fiscal years in which the registrant has been engaged in business, whichever period is shorter

▪ **Amendments**

- Eliminate Item 303(a)(3)(iv) and the related Instructions 8 and 9 to Item 303(a)

▪ **Rationale**

- Avoid giving undue attention to inflation and changing prices

▪ **Guidance**

- Registrants are still 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
- Through Item 303, the SEC also requires that, where the 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 terms, which may also implicate a discussion of inflation and changing prices

Off-Balance Sheet Arrangements

▪ Current Rule

- Item 303(a)(4) currently requires a registrant to discuss, in a separately captioned section, off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on the registrant's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources

▪ Amendments

- Eliminate the requirement for a separately captioned section for off-balance sheet arrangements
- Item 303(a)(4) is replaced by a new instruction to Item 303(b). Under the new instruction, registrants are required to discuss off-balance sheet commitments and obligations, including contingent obligations, that have, or are reasonably likely to have, a material current or future effect on the registrant's financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources even if the arrangement results in no obligation being reported in the registrant's consolidated balance sheet

▪ Rationale

- Consistent with consideration of off-balance sheet financing arrangements as part of the liquidity and capital resources discussion

▪ Guidance

- The SEC expects that registrants will incorporate their discussion of off-balance sheet arrangements into the broader discussion of liquidity and capital resources
- The SEC also believes that a discussion of off-balance sheet arrangements that is more integrated with other aspects of MD&A will produce better disclosure and facilitate a more meaningful understanding of the potential impact of such arrangements; however, to the extent that a registrant determines that some discussion of off-balance sheet arrangements should be highlighted separately or in a separately captioned section in order to facilitate an understanding of such disclosure, or to highlight particularly material information about such arrangements, it has the discretion to do so

Liquidity and Capital Resources

▪ Current Rule

- Item 303(a)(2) requires a registrant to discuss its material commitments for capital expenditures as of the end of the latest fiscal period and to indicate the general purpose of, and the anticipated sources of funds for, these commitments. A registrant also must discuss, among other others, any known material trends, favorable or unfavorable, in its capital resources, and indicate any expected material changes in the mix and relative cost of such resources

▪ Amendments

- Item 303(a)(2) is amended to specify that a registrant should broadly disclose material cash commitments, including, but not limited to, capital expenditures
 - Registrants are now required to describe their 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 these cash requirements and the general purpose of these requirements

▪ Rationale

- Recognition that, while capital expenditures remain important in many industries, there are other cash requirements that are important to many companies, such as those for human capital or intellectual property
- Continued emphasis on the importance of a discussion of a company’s short- and long-term liquidity requirements that is tailored to the company’s specific situation
- Enhance the discussion of capital resources and complement the deletion of the contractual obligations table

Contractual Obligations Table

▪ Current Rule

- Item 303(a)(5) currently requires most registrants to disclose in tabular format their known contractual obligations in a specified manner

▪ Amendments

- Eliminate the requirement for a contractual obligations table
- New Item 303(b)(1) provides the overarching requirements for liquidity and capital resources disclosures
- A discussion of both short-term liquidity (next 12 months) and long-term liquidity (beyond 12 months) is required
- Requires an analysis of material cash requirements from known contractual and other obligations, with specification of the type of obligation and the relevant time period for the related cash requirements
 - The discussion of material cash requirements from known contractual obligations may include, for example, lease obligations, purchase obligations or other liabilities reflected on the registrant's balance sheet; however, specific categories of contractual obligations are not prescribed
 - Focus is on material disclosures only – *i.e.*, disclose contractual obligations for periods where the effect of cash requirements on liquidity is material
- The analysis of liquidity and capital resources should be in a format that facilitates easy understanding and does not duplicate disclosure already provided in the filing; however, registrants still have the discretion to either combine or separate the discussions of liquidity and capital resources

▪ Rationale

- Improve the transparency of a registrant's short-term and long-term liquidity and capital resources needs while reducing undue burdens to prepare such disclosure
- Allow registrants flexibility in discussing material cash requirements from known contractual and other obligations
- Allow registrants flexibility to present certain obligations and liquidity requirements in a different manner from the traditional contractual obligations table, but suggesting that the underlying material information that is disclosed is unlikely to change

Comparisons of Interim Periods

■ Current Rule

- Item 303(b) currently requires registrants to provide MD&A disclosure for interim periods that enables market participants to assess material changes in financial condition and results of operations between periods, including the corresponding period from the prior fiscal year

■ Amendments

- Allow for flexibility in comparisons of interim periods and permit registrants to compare their most recently completed quarter to either the corresponding quarter of the prior year *or* the immediately preceding quarter
 - If a registrant elects to discuss changes from the immediately preceding quarter, the registrant must ensure that summary financial information for both quarters that are the subject of the comparison is available to the reader (which may be accomplished by identifying the prior EDGAR filing that presents such information)
 - This requirement may create more work for many companies that do not generally provide summary financial information for their fourth quarters if they want to compare either the fourth quarter to the third quarter (in the 10-K) or the first quarter to the immediately preceding fourth quarter (in the first quarter 10-Q)
 - If in a subsequent Form 10-Q a registrant changes the comparison from the comparison presented in the immediately prior Form 10-Q, the registrant will be required to explain the reason for the change and present both comparisons in the filing where the change is announced

■ Rationale

- Provide more relevant information by recognizing that not all businesses are seasonal, and so a comparison to the corresponding quarter of the preceding year may not be as meaningful as a comparison to the preceding quarter
- By requiring registrants to explain the reasons for a change in comparison from prior periods, investors get greater insight into a registrant's decision making and have sufficient disclosure to understand any period over period change
- Whether issuers begin to compare results against the prior quarter will likely depend, in part, on the seasonality of the business and what peers do. Issuers may be reluctant to change well-established reporting practices of comparing against the period in the prior year, especially if competitors do not do this

Critical Accounting Estimates

■ Current Rule

- While registrants are not currently specifically required to disclose critical accounting estimates, the SEC has stated in prior guidance that registrants should consider whether (1) they have made accounting estimates or assumptions where the nature of the estimates or assumptions is 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 (2) the impact of the estimates and assumptions on financial condition or operating performance is material

■ Amendments

- Expressly requires disclosure of critical accounting estimates
- Critical accounting estimates are defined as those estimates made in accordance with generally 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 registrant's financial condition or results of operations
 - For each accounting estimate, registrants are required to disclose, to the extent material, (1) why the estimate is subject to uncertainty, (2) how much each estimate has changed during the reporting period and (3) the sensitivity of the reported amounts to the methods, assumptions and estimates underlying the estimate's calculation
- Discussion should provide quantitative as well as qualitative information when quantitative information is reasonably available and will provide material information to investors

■ Rationale

- Eliminate duplicative disclosure – particularly with regard to discussion of significant accounting policies in the financial statement notes – and, instead, promote enhanced analysis of measurement uncertainties

Application to Foreign Private Issuers

▪ Foreign Private Issuers

- Although Regulation S-K does not apply in its entirety to the disclosure regime for foreign private issuers, some parts are applicable, and the SEC also made other conforming changes to Forms 20-F and 40-F
- Some of the Form 20-F conforming amendments include:
 - Eliminating Item 3.A's selected historical financial data disclosure requirement for the most recent five financial years
 - Eliminating Item 5's contractual obligations table disclosure requirement
 - Amending Item 5 to specify the purpose of MD&A and highlight the item's objective
 - Amending Item 5 to require critical accounting estimate disclosure
 - Amending Item 5.B's liquidity and capital resources requirement to include disclosure of material cash commitments, including, but not limited to, capital expenditures
 - Eliminate Item 5.E's off-balance sheet disclosure requirement if not material
- Some of the Form 40-F conforming amendments include:
 - Eliminating General Instruction B.(12)'s contractual obligations disclosure requirement
 - Only requiring disclosure of off-balance sheet arrangements and an analysis of material cash requirements if not already provided in the MD&A required by Canadian law

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