

## Harter Secrest &amp; Emery LLP

ATTORNEYS AND COUNSELORS

## SECURITIES AND CAPITAL MARKETS

**SEC PROPOSES FURTHER AMENDMENTS TO MD&A DISCLOSURE**

Authors: Alexander R. McClean and Kevin R. Pregent

On January 30, 2020, the Securities and Exchange Commission (“SEC”) proposed new rules to modernize, simplify, and enhance financial disclosure requirements in Regulation S-K, including Item 303, Management’s Discussion and Analysis of Financial Condition and Results of Operation (“MD&A”). The bulk of the proposed rules would amend Item 303 of Regulation S-K (“MD&A Disclosure”). The proposed rules are designed to eliminate duplicative disclosures, enhance and modernize disclosures for the benefit of investors, and simplify compliance efforts for public companies. The proposed rules will not become effective until the SEC has published a final rule.

**Recent Guidance and Amendments to MD&A Disclosure**

The SEC has made amending the MD&A Disclosure requirements a top priority within the past year. On March 20, 2019, the SEC approved final rules that simplified MD&A Disclosure by allowing companies to provide a period-to-period comparison between the two most recent fiscal years presented in the corresponding report’s financial statements instead of three fiscal years. Registrants that elect not to include the comparison between the second and third year of financial statements should identify the location where this comparison can be found in prior filings.

Subsequently, on January 24, 2020, the SEC released three new Compliance and Disclosure Interpretations (“C&DI”) to provide guidance to companies that elect to omit the comparison between the second and third year of financial statements. Generally, these new C&DI state that:

- including the required identification of the prior filing where the second-to-third year comparison can be found does not incorporate that previous disclosure by reference into the current filing;
- if the second-to-third year comparison is necessary to an understanding of a company’s current financial condition, the company must include the comparison in the current filing; and
- the filing of a new annual report on Form 10-K that operates as an update to an existing registration statement (which itself incorporates the Form 10-K by reference), and which omits the second-to-third year comparison, results in a new effective date of the registration statement. Accordingly, this updated registration statement does not incorporate by reference the second-to-third year comparison of the financial statements.

**Summary of the Proposed Rules**

Following on its earlier amendments to the MD&A Disclosure rules, the SEC proposed the following amendments to financial disclosure requirements in Regulation S-K:

**Elimination of Selected Financial Data.** The proposed rules would eliminate Item 301, Selected Financial Data, from Regulation S-K. Item 301 currently requires certain public companies to furnish selected financial data in tabular form for the prior five fiscal years in order to provide investors with insight into financial trends. The SEC’s reasoning for eliminating this requirement is two-fold. First, in light of the technological

developments since this rule was initially implemented, investors may easily obtain historical financial information of companies from publicly available resources. Second, the SEC believes Item 301 is duplicative of the MD&A requirement to disclose material trend information.

**Elimination of Supplemental Financial Information.** The proposed rules would also eliminate Item 302(a), Supplemental Financial Information, from Regulation S-K. Item 302(a) currently requires certain public companies to disclose selected quarterly financial data of specific operating results metrics and variances in such metrics from amounts previously reported. The SEC also believes that Item 302(a) is duplicative of existing disclosures because most of such information can be found in prior quarterly reports on Form 10-Q.

The SEC also proposed to eliminate Item 302(b), subject to the Financial Accounting Standards Board's ("FASB") expected finalization of amendments to certain generally accepted accounting principals in the United States ("U.S. GAAP"). Item 302(b) is applicable only to companies engaged in oil and gas producing activities and, if the FASB finalizes its U.S. GAAP amendments, the disclosure required by Item 302(b) will be required by U.S. GAAP, rendering Item 302(b) duplicative.

Item 302(c), which exempts smaller reporting companies from complying with Item 302, would be eliminated if Item 302(a) & (b) were eliminated, as it would no longer be applicable.

**Modification of MD&A Disclosure.** The proposed rules would make several changes to Item 303 of Regulation S-K, which are discussed below.

A new Item 303(a) would be added to the MD&A Disclosure rules that would clarify the objective of MD&A and streamline the existing instructions in order to simplify the current disclosure requirements.

Existing Item 303(a)(2) would be amended to specifically require a discussion of material cash requirements in the larger discussion of capital expenditures.

Existing Item 303(a)(3) would be amended in the following ways:

- A company would be required to disclose any known events that are reasonably likely to cause a material change in the relationship between costs and revenues as opposed to the existing standard which requires disclosure when the company knows of any events that will cause such a change.
- The proposed rule would codify previous SEC guidance that a discussion of results of operations should include all material changes in net sales or revenues, not only material increases.
- The proposed rule would eliminate the specific requirement to discuss the impact of inflation and price changes on results of operation when material because such disclosure would be required under the disclosure of known, material trends.

Existing Item 303(a)(4), which currently requires companies to provide disclosures regarding off-balance sheet arrangements in a separately-captioned section, would be eliminated and replaced by a new instruction to Item 303. This new instruction would require the discussion of off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on a company's financial condition.

The SEC's proposed rules would eliminate existing Item 303(a)(5), which requires a tabular disclosure of contracts by certain categories of obligations these contracts fall into. Because of existing financial statement disclosure requirements and the proposed expansion of Item 303(a)(2), discussed above, the SEC believes that retaining Item 303(a)(5) would be duplicative of other required disclosures.

A new Item 303(b) would be added to the MD&A Disclosure rules that would explicitly require the disclosure of accounting estimates and judgments that could materially affect reported financial information. The SEC believes this new requirement would eliminate duplicative disclosures from the discussion of significant accounting policies and promote enhanced analysis of uncertainties in a company's accounting measurements.

Existing Item 303(b), which governs MD&A in interim financial periods, is proposed to be amended to provide companies with greater flexibility in how to present comparisons of the current period to prior periods. Specifically, the SEC proposes to allow a company to compare its most recently completed quarter to either the corresponding quarter of the prior year, as currently required, or to the immediately preceding quarter. After implementation, if the company changes the comparison it chooses, it would be required to explain the reasoning for changing which comparison it discusses and provide both comparisons in the filing where the change is announced.

## What to Watch For

As demonstrated by the SEC's continued focus on simplifying and enhancing the MD&A Disclosure rules, public companies should begin to contemplate how the proposed rules would affect current MD&A disclosure. The comment period on the proposed rules will be open for 60 days after the proposed rules are published in the Federal Register. The proposed rules will not become effective until the SEC publishes final rules that, according to the proposed rules, would have a transition period of 180 days after effectiveness for companies to begin complying with the new rules.

If you would like more information on the SEC's proposed rule changes to MD&A Disclosure, which can be found at this [link](#), please contact a member of Harter Secrest & Emery LLP's [Securities and Capital Markets](#) group at 716.853.1616, 585.232.6500, or visit [www.hselaw.com](http://www.hselaw.com)

Alexander R. McClean, 585.231.1248, [amcclean@hselaw.com](mailto:amcclean@hselaw.com)

Kevin R. Pregent, 585.231.1307, [kpregent@hselaw.com](mailto:kpregent@hselaw.com)

Attorney Advertising. Prior results do not guarantee a similar outcome. This publication is provided as a service to clients and friends of Harter Secrest & Emery LLP. It is intended for general information purposes only and should not be considered as legal advice. The contents are neither an exhaustive discussion nor do they purport to cover all developments in the area. The reader should consult with legal counsel to determine how applicable laws relate to specific situations. © 2020 Harter Secrest & Emery LLP

