

## SEC modernizes public company MD&A and other financial disclosure requirements



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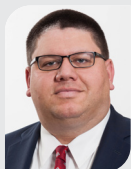
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On Nov. 19, 2020, the U.S. Securities and Exchange Commission (SEC) adopted amendments to the financial disclosures that public companies are required to make pursuant to Regulation S-K. Of significance, the amendments eliminate the requirement to:

1. Provide five fiscal years of selected financial information in comparative tabular form under Item 301, including in Form 10-K
2. Streamline the Form 10-K requirements to disclose certain selected quarterly operating results under Item 302
3. Update the requirements for Management's Discussion and Analysis of Financial Condition and Results of Operations, commonly known as MD&A. Similar to [the September 2020 amendments to Regulation S-K](#), these amendments are intended to modernize the MD&A disclosures for the benefit of the investors, simplify compliance efforts for public companies and eliminate duplicative disclosures.

These amendments will become effective 30 days after they are published in the Federal Register. Public companies are required to comply with the rule beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register. For calendar year-end companies, mandatory compliance will begin for the fiscal year 2021 Form 10-K that is filed in 2022. Companies will have the option of applying the amended rules any time after the effective date, so long as they provide disclosure responsive to an amended item in its entirety.

### Item 301: Selected Financial Data

The SEC amended Regulation S-K to eliminate Item 301 (Selected Financial Data). Accordingly, companies will no longer be required to furnish selected financial data in comparative tabular form for each of the last five fiscal years of the company, as well as additional fiscal years to keep the information from being misleading. From the SEC's perspective, these disclosures provide little value to investors, as technological advances allow for easy access to this information in prior filings on EDGAR and material trends disclosure is required in the MD&A. The SEC noted that it encourages companies to consider whether trend information for periods earlier than those presented in the financial statements may be necessary as part of the MD&A's objective to "provide material information relevant to an assessment of the financial condition and results of operations," including whether a tabular presentation will help readers.

*The information contained herein is based on a summary of legal principles. It is not to be construed as legal advice and does not create an attorney-client relationship. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.*

## Item 302: Supplementary Financial Information

The SEC revised Item 302 (Supplementary Financial Information) to eliminate largely duplicative disclosures. Item 302 requires the disclosure of selected quarterly financial data of certain operating results and disclosures related to oil and gas producing activities. The SEC is retaining Item 302, but disclosure will be required only if 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 and that, individually or in the aggregate, are material. The SEC eliminated the disclosure of oil and gas producing activities in this item as well.

## Item 303: Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 303 of Regulation S-K requires disclosure of information relevant to assessing a company's financial condition, changes in financial condition and results of operations. The amendments are intended to modernize, simplify and streamline the MD&A.

The following is a summary of the significant updates:

- **Objective (New Item 303(a)):** The amendments added a new section to the MD&A, titled "Objective," in which companies will be required to state the principal objectives of the MD&A. In this new section, the company must disclose:
  1. 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
  2. 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
  3. The material financial and statistical data that the company believes will enhance a reader's understanding of the company's financial condition, cash flows and other changes in financial condition, and results of operations

These requirements are intended, in part, to remind companies that the MD&A should provide an analysis that encompasses short-term results as well as future prospects, from "management's perspective."

- **Reasons underlying material changes:** The SEC noted that it has observed many companies simply recite the magnitude of changes from year-to-year that are readily computable from their financial statements. In amending Item 303, the SEC restructured and revised the item to emphasize that registrants are required to provide the underlying reasons for material changes in quantitative and qualitative terms.
- **Liquidity and capital resources:** The SEC's amendments provide and clarify the overarching requirements for liquidity and capital resources disclosures. Specifically, the amended rule defines "liquidity," codifies prior guidance specifying capital resources as it relates to short- and long-term liquidity, and requires a discussion of material cash requirements, including, but not limited to, commitments for capital expenditures as well as known contractual and other obligations. The amendments are intended to improve the transparency of a company's short- and long-term liquidity and capital resources needs and demands while reducing undue burdens to prepare such disclosure.
- **Contractual obligations:** Under the amended rules, companies will no longer be required to provide a tabular disclosure of contractual obligations. Rather, disclosure of material cash requirements from known contractual and other obligations will be part of the liquidity and capital resources discussion, as described above.

- **Results of Operations:** The amendments update Item 303(b)(2) (Results of Operations) in three significant ways:
  1. *Known trends or uncertainties:* Currently, the SEC requires a company to describe any known trends or uncertainties that have had or that the company reasonably expects *will* have a material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations. The company must also disclose any known event that *will* cause a material change in the relationship between costs and revenues. Under the amended rules, companies must disclose any known trends, uncertainties or events that are “reasonably likely” to have a material impact on future operations, instead of disclosing only those that “will.”
  2. *Net sales and revenues:* To the extent the financial statements disclose “material increases” in net sales or revenues, the current rules require companies to provide a narrative discussion of the extent to which such increases are attributable to increases in prices, increases in the volume or amount of goods or services being sold, or the introduction of new products or services. The SEC amendments codify prior guidance that disclosure should describe increases or decreases in any line item, including net sales or revenues. As amended, this item will also apply to the statement of comprehensive income.
  3. *Inflation and price changes:* The amendments eliminate the explicit requirement for companies to discuss the impact of inflation and price changes on their net sales, revenue and income from continuing operations, to the extent material. However, a discussion on the impact of inflation or changing prices may still be warranted if, for example, it is part of a known trend or uncertainty or explains why there have been material changes in the financial statements from period to period in one or more line items.
- **Off-balance sheet arrangements:** The amendments replace the current more prescriptive off-balance sheet arrangement definition and related disclosure requirement with an instruction emphasizing a more principles-based approach. Specifically, the instruction requires 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.” By no longer requiring this disclosure in a separately captioned section, the SEC expects that a company will incorporate its discussion of off-balance sheet arrangements into its broader discussion of liquidity and capital resources. This disclosure should be tailored to a company’s arrangements and circumstances.
- **Critical accounting estimates:** As amended, the rules require companies to include a disclosure of critical accounting estimates in the MD&A, which is 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 financial condition or results of operations of the registrant.” The intent of this rule is to provide more clarity on the uncertainties involved in creating an accounting policy and how significant accounting policies between companies may differ.
- **Interim period discussions:** Currently, companies must provide MD&A disclosure for interim periods that enables market participants to assess material changes in financial condition and results of operations between certain specified periods. The interim period discussion has been amended to allow for flexibility when comparing interim periods, in order to help companies provide a more tailored and meaningful analysis while also providing investors with material information to assess quarterly performance. As amended, companies must compare 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 elects to discuss changes from the immediately preceding quarter, the company must provide summary financial information for that quarter or identify the prior EDGAR filing that contains the information so that it is readily accessible to the reader. In addition, if in a subsequent Form 10-Q, a company changes the comparison from the comparison presented in the immediately prior Form 10-Q, the company must explain the reason for the change and present both comparisons in the filing where the change is announced. The year-to-date comparative information is still required as well.

**Other recent amendments:**

The SEC has recently adopted other amendments that may impact public company filings. In particular, the SEC revised the requirements related to redacting information from material contract exhibit filings. Under the existing confidential information standard, companies are permitted to redact provisions or terms of required exhibits filed if those provisions or terms are both not material and would likely cause competitive harm to the company if publicly disclosed. The recent replace the competitive harm requirement with a standard that permits information to be redacted from material contracts if it is the type of information that the issuer both customarily and actually treats as private and confidential, and which is also not material.

Also, on Nov. 17, 2020, the SEC revised the rules relating to the signing of documents electronically filed with the SEC to permit a signatory to sign an authentication document through an electronic signature that meets certain requirements. The SEC's rules have historically required each signatory to manually sign before or at the time of the electronic filing to authenticate, acknowledge, or otherwise adopt the signature that appears in typed form, as well as retain the authentication document for a period of five years and furnish a copy to the SEC upon request. Under the amended rules, the process for electronic signatures must include the following:

1. A physical, logical, or digital credential that authenticates the signatory's individual identity
2. Reasonably provide for non-repudiation of the signature
3. Provide that the signature be attached, affixed, or otherwise logically associated with the signature page or document being signed
4. A timestamp to record the date and time of the signature
5. The signatory must have initially manually authorized the use of electronic signature and the filer must retain this initial authorization for seven years

Under the amendments, filers still have the option to manually sign documents. This amendment is effective immediately upon publication in the Federal Register. Companies are permitted to comply with these signature requirements in advance of the effective date.

**If you have any questions on the amendments, please contact a member of Godfrey & Kahn's Corporate & Securities Practice Group.**