SEC Proposes to Amend Financial Disclosure Requirements of Regulation S-K

On January 30, 2020, the Securities and Exchange Commission (the "SEC") issued a release (the "Release")[1] proposing amendments to the financial disclosure requirements of Regulation S-K and certain parallel amendments to applicable foreign private issuers' financial disclosures. Among other things, the SEC is proposing to eliminate Item 301, *Selected Financial Data*, Item 302, *Supplementary Financial Information*, and Item 305(a)(5), *MD&A, Tabular disclosure of contractual obligations* and to amend Item 303, *Management's Discussion & Analysis of Financial Condition and Results of Operations*. The SEC's goals in adopting the proposed amendments are to continue to revise and eliminate overlapping or unnecessary disclosure requirements and to reduce the burden on registrants, while also enhancing readability to benefit investors.

I. Summary

Key proposed changes to Regulation S-K in the Release include:

- Item 301: Eliminate the requirement that registrants provide 5 years of selected financial data;
- Item 302: Eliminate the requirement that registrants provide 2 years of selected quarterly financial data;
- (New) Item 303(a): Require registrants to state the principal objectives of their MD&A;
- Item 303(a)(2): Require registrants to disclose material cash requirements as of the latest fiscal period, the anticipated source of funds and general purpose of such requirements;
- Item 303(a)(3): Require registrants to disclose known events reasonably likely to cause a material change in the relation between costs and revenues; clarify that a discussion of the reasons underlying material changes in net sales or revenues is required; and eliminate instructions 8 and 9 on inflation and price changes;
- Item 303(a)(4): Replace instructions on off-balance sheet arrangements with new instructions requiring registrants to discuss off-balance sheet arrangements within the context of their MD&A;
- Item 303(a)(5): Eliminate the requirement to provide a contractual obligations table;
- Instruction 4: Clarify the requirement that underlying reasons for material changes in line items be disclosed, even if they offset one another; and
- Item 303(b): Allow registrants to choose whether to compare their most recently completed quarter to the corresponding quarter of the prior year or to the immediately preceding quarter.

Attached to this memorandum as Annex 1 is a copy of the chart included in the Release summarizing the proposed amendments.

II. Background

Section 108 of the Jumpstart Our Business Startups Act ("JOBS Act") required the SEC to review Regulation S-K to comprehensively analyze the current requirements and determine how they should be updated to modernize and simplify the registration process and reduce costs and burdens associated with the requirements for

[1] For the full text of the release, see Securities and Exchange Commission, Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Data, SEC Release No. 33-10750, available at https://www.sec.gov/rules/proposed/2020/33-10750.pdf (January 30, 2020) [hereinafter the "*Release*"]. Unless otherwise specified, quoted statements in this memorandum are taken from the Release.

emerging growth companies. In the course of this review, the SEC solicited comments on whether the current registration requirements actually provide the material information investors need to make informed decisions or whether the current rules have become outdated. Based on its review and feedback received, the SEC is proposing the amendments set forth in the Release.

III. Proposed Amendments

Selected Financial Data (Item 301)

In the Release, the SEC is proposing to eliminate Item 301 of Regulation S-K, which requires registrants and reporting entities to furnish, in comparative columnar form, selected financial data for "(a) [e]ach of the last five fiscal years of the registrant . . . and (b) [a]ny additional fiscal years necessary to keep the information from being misleading."[2] The SEC stated in the Release that the information required by Item 301 "can be readily accessed and compiled through prior filings on EDGAR" and the "information is tagged using eXtensible Business Reporting Language ("XBRL") data format." Additionally, since Item 303 "specifically calls for disclosure of material trend information" and the SEC has emphasized that registrants should discuss trend information in the Management's Discussion & Analysis section ("MD&A"), the SEC concluded that the information that would be eliminated in Item 301 is largely duplicative.

Supplementary Financial Information (Item 302)

In the Release, the SEC is proposing to eliminate Item 302, which, in summary, requires registrants to (1) disclose selected quarterly financial data, (2) describe the reasons for any differences when there are variances from previous quarterly results, and (3) "describe the effect of any operations and unusual or infrequently occurring items recognized in each full quarter within the two most recent fiscal years . . . ." (Item 302(a)(3)).[3] The SEC concluded that the Item 302 disclosure requirement should be eliminated due to the duplicative nature of the information called for and explained that the information is covered by other requirements.

Purposes of MD&A (Proposed Item 303(a))

In an effort to restructure and streamline Item 303, the SEC is proposing to include a new Item 303(a) which requires registrants to state the principal purposes of their MD&A, giving drafters more information as to what information should be presented to investors. The current Instructions 1, 2, and 3 of Item 303(a) would be incorporated in the new Item 303(a) describing that the objectives of the MD&A are to provide disclosures regarding (1) "material information relevant to an evaluation of the financial condition and results of operations of the registrant," (2) financial and statistical data that "will enhance a reader's understanding of the registrant's financial condition" and (3) "material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."

MD&A for Full Fiscal Years (Item 303(a))

The SEC is proposing to amend Item 303(a) of Regulation S-K, which provides the MD&A disclosure requirements for full fiscal years and is comprised of five key components: (1) liquidity, (2) capital resources, (3)

[2] 17 C.F.R. § 229.301 (2017).

[3] 17 C.F.R. § 229.302 (2018).

results of operations, (4) off-balance sheet arrangements and (5) contractual obligations. In an effort to modernize, simplify and enhance the MD&A, the SEC is proposing the following amendments to Item 303(a):

(1) *Capital Resources (Item 303(a)(2))*: To broaden the disclosures around capital resources, the SEC is proposing to amend Item 303(a)(2) to require a registrant to "*broadly disclose material cash commitments*, including but not limited to capital expenditures." The proposed amendment would require, depending on the registrant, disclosures about items such as "funds necessary to *maintain current operations*, complete projects underway, and achieve stated objects or plans," not only cash commitments in connection with capital expenditures.

(2) *Results of Operations – Known Trends or Uncertainties (Item 303(a)(3))*: The SEC is proposing to amend Item 303(a)(3)(ii), which requires disclosures regarding known trends or uncertainties in the results of operations. The proposed amendment would require a registrant that "knows of events that are *reasonably likely* to cause (as opposed to *will* cause) a material change in the relationship between costs and revenues, to disclose such change." Additionally, for clarity, the SEC is proposing to amend Item 303(a)(3)(iii) to require discussion of the underlying reasons behind material changes in net sales and revenues. The SEC is also proposing to eliminate Item 303(a)(3)(iv), which requires a registrant to disclose the impact of inflation and changing prices on its net sales, revenues and income from continuing operations. However, the SEC pointed out that registrants will still need to disclose the impact from inflation or changing prices under other items of Item 303 if they are part of a known trend or uncertainty.

(3) *Off-Balance Sheet Arrangements (Item 303(a)(4))*: The current Item 303(a)(4) requires registrants to discuss off-balance sheet arrangements that "have or are reasonably likely to have a current or future effect on a registrant's financial condition . . . ." In light of the overlapping disclosure requirements under Item 303 and U.S. GAAP, the SEC is proposing to eliminate Item 303(a)(4) and instead include instructions "emphasizing the importance of discussing these obligations in the broader context of MD&A disclosure when such obligations have or are reasonably likely to have a material current or future effect on a registrant's financial condition . . . results of operations, liquidity, cash requirements or capital resources."

(4) *Contractual Obligations Table (Item 303(a)(5))*: The SEC has also proposed to eliminate Item 303(a)(5), which requires a registrant to disclose in tabular format its known contractual obligations by amount, aggregated by type of contractual obligations. The SEC noted that there is a significant overlap with U.S. GAAP and that contractual obligations are required to be disclosed in the financial statements. To the extent not disclosed in the financial statements, the amendments to Item 303(a)(2) would capture anything not required by U.S. GAAP and would address the concern that the current tabular format does not "provide insight into the registrant's ability to pay its obligations as they become due."

(5) *Material Changes in Line Items (Instruction 4)*: The SEC is proposing to amend the language of Instruction 4 to clarify that the MD&A requires a narrative discussion of the underlying reasons for material changes from period-to-period in one or more line items in quantitative and qualitative terms. The SEC is also proposing that registrants discuss material changes within a line item even when they offset each other, with the goal that registrants will provide a more nuanced discussion of the underlying reasons that may be contributing to material changes.

(6) *Critical Accounting Estimates (Item 303)*: The SEC is proposing to codify a requirement for registrant's to disclose critical accounting estimates in an effort to eliminate duplicative disclosures contained in "the financial statement discussions of significant accounting policies and, instead, promote enhanced analysis of measurement uncertainties." The SEC is proposing to require registrants 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 material methods, assumptions, and estimates underlying the estimate's calculation."

Interim Period Discussions (Item 303(b))

The current Item 303(b) generally requires a registrant to provide MD&A disclosures for interim periods such as discussing material changes to the results of operations in the income statement for the most recent year-to-date period. To allow registrants flexibility in providing an analysis the registrant believes would be most relevant to investors, the SEC is proposing to amend Item 303(b) to "permit registrants to 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."

Safe Harbor for Forward-Looking Statements (Item 303(c))

Item 303(c) provides that the safe harbors provided in Section 27A of the Securities Act and Section 21E of the Exchange Act apply to forward-looking statements included as a result of Item 303(a)(4) (off-balance sheet arrangements) and Item 303(a)(5) (contractual obligations). The SEC is proposing to eliminate Item 303(c) as it is also eliminating Items 303(a)(4) and 303(a)(5).

Application of Amendments to Foreign Private Issuers

The Release also includes proposals to make many of the same changes applicable to foreign private issuers. Please see Annex A for more information on these conforming changes.

IV. Conclusion and Next Steps

With the proposed amendments to Regulation S-K, the SEC is seeking to update and eliminate the rules that have become outdated and unnecessary. The SEC hopes that, by revising or eliminating the overlapping or unnecessary disclosure requirements, it will reduce the burdens on registrants and enhance readability without negatively affecting the information provided to investors.

The SEC is seeking comments on the amendments proposed in the Release until 60 days following its publication in the Federal Register.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Brock Bosson at 212.701.3136 or bbosson@cahill.com; Chérie R. Kiser at 202.862.8950 or ckiser@cahill.com; Joel Kurtzberg at 212.701.3120 or jkurtzberg@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; John Papachristos at 212.701.3691 or jpapachristos@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; Bruna Amaral at 212.701.3389 or bamaral@cahill.com; or Paul Rafla at 212.701.3388 or prafla@cahill.com.

Current Item or Issue	Summary Description of Proposal	Principal Objective(s)	Corresponding FPI Change(s)?
Item 301, *Selected financial data*	Registrants would no longer be required to provide 5 years of selected financial data.	Modernize disclosure requirement in light of technological developments and simplify disclosure requirements.	Yes
Item 302(a), *Supplementary financial information*	Registrants would no longer be required to provide 2 years of selected quarterly financial data.	Reduce repetition and focus disclosure on material information. Modernize disclosure requirement in light of technological developments.	N/A
Item 303(a), *MD&A*	Clarify the objective of MD&A and streamline the fourteen instructions.	Simplify and enhance the purpose of MD&A.	Yes
Item 303(a)(2), *Capital resources*	Registrants would disclose 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.	Yes
Item 303(a)(3)(ii), *Results of operations*	Registrants would 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.	Clarify item requirement by using a disclosure threshold of "reasonably likely," which is consistent with the Commission's interpretative guidance on forward-looking statements.	Yes
Item 303(a)(3)(iii), *Results of operations*	Clarify that a discussion of the *reasons* underlying material *changes* in net sales or revenues is required.	Clarify MD&A disclosure requirements by codifying existing Commission guidance.	Yes
Item 303(a)(3)(iv), *Results of operations* **Instructions 8 and 9 (Inflation and price changes)**	The item and instructions would be eliminated. Registrants would 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.	Yes
Item 303(a)(4), *Off-balance sheet arrangements*	The item would be replaced by a new instruction added to Item 303. Under the new instruction, registrants would 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.	Yes
Item 303(a)(5), Contractual obligations	Registrants would no longer be required to provide a contractual obligations table.	Promote the principles-based nature of MD&A and simplify disclosures by reducing redundancy.	Yes
Instruction 4 (Material changes in line items)	Incorporate a portion of the instruction into proposed Item 303(b). Clarify that where there are material changes in a line item, including where material changes within a line item offset one another, disclosure of the underlying reasons for these material changes in quantitative and qualitative terms is required.	Enhance analysis in MD&A. Clarify MD&A disclosure requirements by codifying existing Commission guidance on the importance of analysis in MD&A.	Yes

Current Item or Issue	Summary Description of Proposal	Principal Objective(s)	Corresponding FPI Change(s)?
Item 303(b), ***Interim periods***	Registrants would 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 would be afforded the same flexibility.	Allow for flexibility in comparison of interim periods to enhance the disclosure provided to investors.	N/A
Critical Accounting Estimates	Explicitly require disclosure of 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.	Yes