The proposal would eliminate certain disclosure requirements and enhance others to make the information provided to investors more useful.

What you need to know

- The SEC proposed eliminating the requirements for companies to include selected financial data, selected quarterly financial data and a contractual obligations table in their filings.
- The proposal would change or clarify the requirements for disclosures in MD&A about capital resources, known trends and uncertainties, off-balance sheet arrangements and interim periods.
- The proposal would codify MD&A disclosure requirements about critical accounting estimates, which were previously provided only in interpretive guidance.
- Comments are due within 60 days of publication in the Federal Register.

Overview

The Securities and Exchange Commission (SEC) proposed amending its rules under Regulation S-K to eliminate certain disclosure requirements and to enhance the usefulness of management’s discussion and analysis (MD&A) for investors while simplifying its preparation for companies.

The proposal, which would also make conforming changes to the forms used by foreign private issuers, is part of the SEC’s disclosure effectiveness initiative. The SEC adopted a final rule in May 2019 and issued another proposal in August 2019 to modernize and simplify certain other requirements in Regulation S-K.
“The improved disclosures would allow investors to make better capital allocation decisions, while reducing compliance burdens and costs without in any way adversely affecting investor protection,” SEC Chairman Jay Clayton said.

Key considerations

Selected financial data and selected quarterly financial data

The proposal would eliminate the requirement for registrants to present selected financial data for each of the last five years in registration statements and Form 10-K filings. While the disclosures originally were intended to highlight significant trends in a registrant’s financial condition and results of operations, the proposal notes that the same information now can be readily accessed online and can be easily compiled by investors.

The proposal would also eliminate the requirement to present selected quarterly financial data for each quarter of the last two years in Form 10-K filings. The SEC said investors can find that information in earlier quarterly reports, except for the information about the fourth quarter. The proposing release seeks feedback from stakeholders on the proposed omission of the fourth quarter information.

How we see it

The selected financial data table, which the SEC proposes eliminating, is likely of limited usefulness to investors and redundant, given the availability of multiple years of data-tagged financial statements online today. We made this point in our comment letter on the SEC’s 2016 concept release on Regulation S-K disclosures. In that letter, we also discussed the time and cost of preparing selected financial data for periods before the first year of financial statements included in a company’s registration statement for its initial public offering.

Management’s discussion and analysis

The proposal would amend Regulation S-K to clearly enumerate the following objectives of MD&A:

- To provide 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
- To present the material financial and statistical data that will enhance a reader’s understanding of the registrant’s financial condition, changes in financial condition and results of operations
- To disclose material events and uncertainties that would cause reported financial information not to be indicative of future operating results or financial condition

The proposal also would revise the MD&A instructions to clarify and emphasize that registrants must provide a narrative discussion of the underlying reasons for material changes in balance sheet and income statement line items from period to period in both quantitative and qualitative terms.

How we see it

The proposed amendments to the instructions on disclosures about material changes would codify the staff’s expectations for disclosures about the underlying reasons for the changes. In its filing reviews, the SEC staff frequently requests enhanced disclosure about the underlying reasons for material changes.
The proposal would also eliminate the following MD&A requirements:

- **Contractual obligations table** – The SEC said much of the information in this table is redundant with US GAAP disclosures and provides neither sufficient insight about a registrant’s ability to meet its obligations nor a complete picture of the expected uses of cash that would be captured in the enhanced liquidity and capital resources discussion the SEC proposed, as discussed below.

- **Inflation and price changes** – Registrants would no longer be required to discuss the effect of inflation and price changes on their net sales, revenue and income from continuing operations, unless the effect is material, in which case it would be discussed in the context of other MD&A disclosures.

The proposal would also codify in Item 303(a) of Regulation S-K a requirement to disclose critical accounting estimates, including why the estimate is subject to uncertainty, how much the estimate has changed during the period and its sensitivity to the underlying method of calculation, assumptions and estimates. This requirement currently appears in SEC interpretative guidance.

The proposal would define a critical accounting estimate as “an estimate made in accordance with generally accepted accounting principles that involves a significant level of estimation uncertainty and has had or is reasonably likely to have a material impact on the registrant’s financial condition or results of operations.”

A proposed instruction would state that the disclosures should supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements. In the proposing release, the SEC also reiterated the view previously expressed by the staff that critical accounting estimates may not fully align with critical audit matters, which auditors are required to discuss in their auditor’s reports.

**How we see it**

The proposed codification of critical accounting estimate disclosures is intended to elicit information beyond what is included in most companies’ significant accounting policy disclosures, which is consistent with the SEC staff’s historical view about the purpose of these disclosures. Accordingly, we recommend that registrants consider the proposed amendments when preparing their critical accounting estimate disclosures for their next filings.

The proposal would make the following modifications to current MD&A requirements:

- **Off-balance sheet arrangements** – Today’s prescriptive requirements for disclosures about off-balance sheet arrangements would be replaced with more principles-based requirements. Instead of a separately captioned disclosure, the proposal would require MD&A to address commitments or obligations with unconsolidated entities that have or are reasonably likely to have material effect on the registrant’s financial condition, operations or liquidity.

- **Capital resources** – The proposal would expand the requirement for a registrant to discuss its material commitments for capital expenditures at the end of the latest fiscal period to include all material cash commitments, not just capital expenditures. These commitments may include funding investments in human capital and intellectual property, as well as current operations.
Known trends or uncertainties – Registrants would be required to disclose events that are reasonably likely to cause a material change in the relationship between costs and revenues (e.g., changes in the cost of labor or materials, price increases, inventory adjustments), not just those that will cause a material change.

Interim periods – Registrants would be able to compare their most recently completed quarter to either the corresponding quarter of the previous year or to the immediately preceding quarter, depending on which comparison they believe is most meaningful. Registrants discussing changes from the immediately preceding quarter would be required to provide summary financial information for that quarter or identify the EDGAR filing that presents that information.

How we see it
An alternative approach would be to allow interim MD&A to focus on year-to-date results of operations and to discuss material items from a particular quarter in that context, as we observed in our comment letter on the SEC’s 2019 Request for Comment on Earnings Releases and Quarterly Reports. We question whether separate MD&A disclosure of discrete quarterly periods is always necessary.

Climate change
The proposal did not include any proposed disclosure related to climate change. However, Chairman Clayton said the SEC continues to focus on how its existing disclosure requirements apply to environmental and climate-related matters. He said he is especially interested in how issuers use climate-related metrics in their operations and planning and how asset managers use these metrics to allocate capital. He also highlighted the continued relevance of the 2010 SEC interpretive release on such disclosures, which the staff in the Division of Corporation Finance continues to consider in its filing reviews.

How we see it
Although the SEC hasn’t proposed requirements for climate change risk disclosures, companies have begun providing many more disclosures about environmental, social and governance-related topics, including disclosures about climate change. We expect these disclosures and others about sustainability and long-term value to evolve in response to demand from stakeholders.

Endnote: