Heads Up | Volume 27, Issue 2
February 10, 2020

In This Issue

SEC Proposes Rule to Modernize MD&A and Related Financial Disclosure Requirements

by Anish Alemao and Lisa Mitrovich, Deloitte & Touche LLP

Introduction

On January 30, 2020, the SEC issued a proposed rule[1] that would modernize and simplify Management's Discussion and Analysis (MD&A) and certain financial disclosure requirements in SEC Regulation S-K. Specifically, the proposal would:

- Eliminate Regulation S-K, Item 301, "Selected Financial Data."
- Eliminate Regulation S-K, Item 302, "Supplementary Financial Information."
- Amend certain aspects of Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations."
- Make conforming changes to the forms used by foreign private issuers.

As noted in the proposed rule, the amendments are "intended to eliminate duplicative disclosures and modernize and enhance MD&A disclosures . . . while simplifying compliance efforts for registrants." Further, the amendments would promote the principles-based nature of MD&A disclosures and give registrants the flexibility to present meaningful MD&A.

The main provisions of Regulation S-K, which is the central repository for disclosure requirements for public companies (other than financial statement requirements), were established more than 30 years ago. The proposal is part of a comprehensive SEC review of

[1] SEC Proposed Rule Release No. 33-10750, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*.

its disclosure requirements (the disclosure effectiveness initiative) and reflects input from comment letters received in response to these disclosure modernization efforts.[2]

In addition to the proposal, the SEC separately issued interpretive guidance[3] on disclosure considerations related to key performance indicators (KPIs) and metrics in MD&A. Further, SEC Chairman Jay Clayton released a public statement on the proposed amendments and interpretive guidance as well as other topics, including environmental and climate-related disclosure. These items and the proposed rule are discussed below.

Key Proposed Amendments to Regulation S-K

The following table summarizes the significant changes outlined in the proposal and compares the current disclosure requirements with the proposed changes:

Current Requirements	Proposed Changes
Selected Financial Data (Item 301)	
Certain registrants must disclose specific items in comparative tabular form for each of their last **five** fiscal years as well as any additional fiscal years necessary to keep the information from being misleading.	Proposal would **eliminate** the requirement.
Selected Quarterly Financial Data (Item 302(a))	
Certain registrants must (1) disclose select financial information for each quarter during the two most recent fiscal years, (2) disclose variances in results from amounts previously presented on Form 10-Q, and (3) describe the effect of any discontinued operations and any unusual or infrequently occurring items.	Proposal would **eliminate** the requirement.[4]
Information About Oil and Gas Producing Activities (Item 302(b))	
Certain registrants that are engaged in significant oil and gas producing activities must provide the information required by ASC 932.[5]	Proposal would **eliminate** this requirement, subject to the FASB's issuance of related amendments[6] to U.S. GAAP that will require disclosures that are substantially consistent with those required by Item 302(b).
Objective of MD&A	
Item 303 does not contain a succinct *objective* for MD&A but instead provides various instructions that explain its purpose.	Proposal would rename current Item 303(a) as Item 303(b) and establish a new Item 303(a) that concisely states the purpose of MD&A. The new content would (1) incorporate parts of current instructions and describe the objectives of MD&A and (2) codify the requirement in the SEC's 2003 and 1989 interpretive releases[7] that a registrant provide a narrative explanation of its financial statements that allows an investor to see the company "through the eyes of management."

[2] See the SEC staff's 2013 *Report on Review of Disclosure Requirements in Regulation S-K*, its 2016 *Report on Modernization and Simplification of Regulation S-K*, and the SEC's 2016 Concept Release *Business and Financial Disclosure Required by Regulation S-K*.

[3] SEC Interpretative Guidance No. 33-10751, *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*.

[4] Registrants would continue to consider the guidance in ASC 270-10-50-2, which requires disclosure of the disposal of components of an entity and unusual or infrequent items occurring during the fourth quarter.

[5] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[6] See FASB Proposed Accounting Standards Update *Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*.

[7] SEC Interpretive Release No. 33-8350, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations* and SEC Interpretive Release No. 33-6835, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*.

Connecting the Dots

A registrant often uses KPIs and other metrics to enhance its MD&A to allow an investor to see the company "through the eyes of management." For additional information on the use of KPIs and other metrics in MD&A, see the discussion below.

Current Requirements	Proposed Changes
Capital Resources (Item 303(a)(2))	
A registrant must (1) discuss its material **commitments for capital expenditures** as of the end of the latest fiscal period and (2) indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill them.	Proposal would codify the requirement in the SEC's 2003 interpretive release that registrants disclose (1) material **cash requirements** as of the end of the latest fiscal period, (2) the anticipated source of funds needed to satisfy those cash requirements, and (3) the general purpose of such requirements. Material cash requirements are intended to encompass capital expenditures as well as expenditures for human capital, intellectual property, and other such requirements.
Results of Operations — Known Trends or Uncertainties (Item 303(a)(3)(ii))	
A registrant must disclose any *known events* that **will cause** a material change in the relationship between costs and revenues (e.g., known future increases in costs).	Proposal would require a registrant to disclose any *known events* that are **reasonably likely to cause** a material change in the relationship between costs and revenues (e.g., known or reasonably likely future increases in costs).
Results of Operations — Net Sales and Revenues, and Instruction 4 (Items 303(a)(3)(iii) and 303(a))	
Item 303(a)(3)(iii) requires a registrant to discuss certain factors (e.g., changes in prices or volume) that led to material **increases** in net sales or revenues in the financial statements. Instruction 4 to Item 303(a) further requires a discussion of the causes for material changes in the consolidated financial statements from year to year in one or more line items.	Proposal would require a registrant to discuss certain factors (e.g., changes in prices or volume) that led to material **changes** from period to period in net sales or revenues in the statement of comprehensive income. Proposed Item 303(b) would codify the guidance in the SEC's 2003 and 1989 interpretive releases on disclosure of results of operations and would require a discussion of the underlying reasons for material changes in **quantitative and qualitative terms** in situations in which financial statements reflect material changes from period to period in one or more line items (including those in which material changes within a line item **offset** one another).
Results of Operations — Inflation and Price Changes (Item 303(a)(3)(iv))	
A registrant must discuss the impact of inflation and changing prices on (1) net sales and revenues and (2) income from continuing operations.	Proposal would **eliminate** the requirement; however, under the principles-based disclosure framework, a registrant would still be required to discuss the impact of inflation and price changes, if material.

Current Requirements	Proposed Changes
Off-Balance-Sheet Arrangements (Item 303(a)(4))	
A registrant must disclose its off-balance-sheet arrangements (as that term is defined in Item 303(a)(4)(ii)) in a separately captioned section.	Proposal would **eliminate** the requirement; however, under a new principles-based instruction, a registrant would be required to disclose material off-balance-sheet arrangements as part of the capital resources discussion. Such disclosure would no longer be required in a separately captioned section.
Contractual Obligations Table (Item 303(a)(5))	
Certain registrants must disclose the aggregate amount of its contractual obligations in a tabular format, by prescribed categories and periods.	Proposal would **eliminate** the requirement; however, as outlined above, proposed Item 303(b)(2), *Capital Resources*, would specifically require a discussion of material cash requirements of the company, which would include material contractual obligations.
Interim Periods (Item 303(b))	
A registrant must discuss any material changes in its results of operations presented in its statement of comprehensive income for (1) the most recent fiscal year-to-date period presented and (2) the corresponding year-to-date period of the preceding fiscal year. The discussion must also cover material changes with respect to (1) the most recently completed fiscal quarter and (2) the corresponding fiscal quarter of the prior fiscal year.	A registrant would continue to be required to discuss any material changes in its results of operations presented in its statement of comprehensive income for (1) the most recent year-to-date period presented and (2) the corresponding year-to-date period of the preceding fiscal year. The proposal would give registrants the flexibility to disclose comparisons of their results of operations of the most recently completed fiscal quarter to either (1) the corresponding fiscal quarter of the prior year (as currently required) or (2) the immediately preceding fiscal quarter. A registrant that opts to compare the most recently completed fiscal quarter to the immediately preceding fiscal quarter would either (1) include summarized financial information for the preceding fiscal quarter or (2) identify the EDGAR filing that presents such information so that it is readily accessible to a reader. Further, a registrant that changes the period used in its comparison would be required to explain the reason for the change and present both comparisons in the filing in which the change is announced.

Current Requirements	Proposed Changes
Critical Accounting Estimates	
While not specified in the text of Item 303, the SEC's 2003 interpretative release outlines guidance that requires disclosure of critical accounting estimates (CAEs) or assumptions.	The proposal would codify the SEC's 2003 interpretive release to explicitly require disclosure of CAEs in MD&A. Further, it would define a CAE 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." For each CAE, the proposal would require a registrant to discuss, to the extent material, (1) why the CAE is subject to uncertainty, (2) how much the CAE has changed during the period, and (3) the sensitivity of reported amounts to the methods, assumptions, and estimates underlying the CAE's calculation. Further, the proposal's instructions indicate that disclosure of CAEs should "supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements."

KPIs and Metrics in MD&A

In addition to the proposed rule, the SEC separately issued interpretive guidance[8] on disclosure considerations for KPIs and metrics in MD&A. The SEC indicated that a registrant should consider the need to disclose KPIs or metrics that it uses to manage its business in MD&A because this information may be material to investors and necessary in the evaluation of the company's performance.

Among other things, this guidance reminds registrants that the SEC would generally expect the following disclosures to accompany all KPIs and metrics:

- A clear definition of the metric and how it is calculated.
- A statement indicating the reasons why the metric provides useful information to investors.
- A statement indicating how management uses the metric in managing or monitoring the performance of the business.
- Disclosures accompanying any changes in the calculation or presentation of KPIs and metrics from period to period.

The guidance also reminds registrants of the importance of maintaining effective disclosure controls and procedures over KPIs and metrics, including maintaining consistency and accuracy of disclosure.

Connecting the Dots

This guidance is generally consistent with the disclosures requested by the SEC staff in recent SEC comment letters. For additional information on KPIs and metrics, see Section 3.4.9 of Deloitte's *A Roadmap to SEC Comment Letter Considerations, Including Industry Insights* and Section 2.4 of Deloitte's *A Roadmap to Non-GAAP Financial Measures*.

[8] See footnote 3.

Environmental and Climate-Related Disclosures

In his public statement announcing the proposal, Chairman Clayton commented on other areas of disclosure and rulemaking focus, including environmental and climate-related disclosures. While the proposal does not specifically address such disclosures, Mr. Clayton summarized the work being performed by the SEC on this topic and noted that considerations related to environmental and climate-related disclosures are complex as a result of a number of factors. He referred to the guidance in the SEC's 2010 interpretive release,[9] which highlights how the SECs existing disclosure requirements apply to this topic. Mr. Clayton noted that the "Commission's and the SEC staff's focus on and work in this area will continue" and encouraged "market participants to continue to engage with us."

Connecting the Dots

The proposal did not specifically address environmental, social, and governance (ESG) disclosure; however, investors, customers, and employees have been calling for ESG transparency and for bringing such disclosure into the mainstream. In response, companies are increasingly measuring, managing, and disclosing ESG performance, as evidenced by the rise in the number of S&P 500 companies that have published some form of an ESG disclosure. Companies are also placing more emphasis on the extent, form, location, and content of these disclosures. For additional information, see Deloitte's September 24, 2019, *Heads Up*.

Next Steps

The SEC is interested in feedback on the proposed rule from market participants and does not require a specific format for the submission of comments. Some commenters may choose to present their views in a narrative format without any reference to specific questions posed by the SEC, and others may choose to answer all, or only some, of the specific requests for comment. Any format is acceptable, and the SEC encourages all types of feedback. Comments on the proposed rule are due 60 days after its publication in the *Federal Register*.

[9] SEC Interpretive Release No. 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change*.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Controllership perspectives.
- Driving enterprise value.
- Financial reporting.
- Governance, risk, and compliance.
- Innovation in risk and controls.
- Tax accounting and provisions.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to *Dbriefs*, or to receive accounting publications issued by Deloitte's Accounting Services Department, please register at My.Deloitte.com.

The Deloitte Accounting Research Tool

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also subscribe to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.