

Client Alert

February 2020

SEC Proposes Amendments to Regulation S-K Financial Disclosures

On January 30, 2020, the Securities and Exchange Commission (SEC) voted to propose amendments to certain financial disclosure requirements in Regulation S-K, with a dissent from Commissioner Allison Herren Lee. The proposed amendments are intended to eliminate duplicative disclosures, modernize and enhance Management's Discussion and Analysis (MD&A) disclosures and simplify compliance efforts. The proposals build on the SEC's ongoing efforts to modernize and simplify corporate disclosure requirements.

The SEC also released interpretive guidance on key performance indicators and metrics in MD&A.

Proposed Amendments

The SEC is proposing changes to Items 301, 302 and 303 of Regulation S-K.

Item 301: Item 301 currently requires registrants to provide five years of selected financial data in comparative tabular form. In proposing to eliminate Item 301, the SEC opined that the utility of having the selected financial information may not justify the cost to prepare such disclosures since Item 303 already requires the disclosure of material trends and the information required by Item 301 now can be readily accessed and compiled through prior filings on EDGAR.

Item 302: Item 302(a) currently requires registrants to provide two years of selected quarterly financial data. In proposing to eliminate Item 302(a), the SEC explained that Item 302(a) was originally "intended to help investors understand the pattern of corporate activities throughout a fiscal period by disclosing trends over quarterly periods to reflect seasonal patterns"; however, most of the information now required to be disclosed by Item 302(a) can be found in prior quarterly reports on EDGAR. The SEC noted that while Item 302(a) requires separate disclosure of certain fourth quarter information, which is not otherwise required to be disclosed, the SEC believes that this data generally can be calculated from a registrant's third quarter Form 10-Q or its annual report. The SEC further opined that where "fourth quarter results are material or there is a material retrospective change," existing requirements, such as Item 303, would still require this disclosure.

In addition, Item 302(b) requires registrants engaged in oil- and gas-producing activities to disclose information about those activities for each period presented. The SEC proposes to eliminate Item 302(b) subject to the Financial Accounting Standards Board's finalizing its related amendments to US GAAP, which, upon effectiveness, would be duplicative of the requirements of Item 302(b).

Item 303: Item 303 requires disclosure of information relevant to assessing a registrant's financial condition, changes in financial condition and results of operations. The SEC proposes several amendments to Item 303, including, among others:

- Establish a new Item 303(a) to clarify the objective of MD&A for both full fiscal years and interim periods and streamline the 14 instructions;

- Replace the current Item 303(a)(4), which currently requires registrants to provide off-balance sheet arrangement disclosures in a separate section, with a principles-based instruction 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, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources;
- Eliminate Item 303(a)(5), which currently requires registrants to provide a tabular disclosure of contractual obligations, given the overlap with information required in the financial statements;
- Establish a new disclosure requirement to Item 303, to codify existing SEC guidance and explicitly require the disclosure of critical accounting estimates; and
- Revise the interim MD&A requirement in Item 303(b), which would allow registrants the flexibility to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter.

The SEC also proposed certain parallel amendments applicable to financial disclosures provided by foreign private issuers.

A full description of the SEC's proposed amendments may be found in the [SEC's proposed rule](#), which also includes a table summarizing the proposed changes.

Next Steps

The comment period for the SEC's proposed amendments will be open for 60 days. The SEC proposes a compliance date of 180 days after effectiveness of the final rule, if adopted, to provide time for registrants to come into compliance with the amended disclosure requirements. The SEC requested comment on whether this time period is a sufficient transition period in light of the proposed amendments and whether certain proposed amendments (e.g., critical accounting estimates) may require more time to prepare for than other requirements.

Climate-Related Disclosure

[Commissioner Allison Herren Lee](#) issued a separate dissenting statement opining that the "proposal is most notable for what it does not do: make any attempt to address investors' need for standardized disclosure on climate change risk." Commissioner Lee criticized the proposal for modernizing existing items in Regulation S-K that may require disclosure related to climate change "without mentioning climate change or even asking a single question about its relevance to these disclosures."

[Chairman Jay Clayton](#) and [Commissioner Hester Peirce](#) also issued separate statements addressing climate-related disclosure. Chairman Clayton discussed the SEC's ongoing environmental and climate-related disclosure efforts, including, among others, interpretive guidance, regular filing reviews, issuer and investor engagement, and participation with non-US regulators in international disclosure review initiatives.

Commissioner Peirce, on the other hand, opined that due to "an elite crowd pledging loudly to spend virtuously other people's money" and calling on the SEC to expand its disclosure framework to require ESG and sustainability disclosures, "the concept of materiality is at risk of degradation." In expressing support for the proposed amendments, Commissioner Peirce stated that "the proposed amendments and companion guidance do not bow to demands for a new disclosure framework, but instead support the principles-based approach that has served us well for decades."

Interpretive Guidance on MD&A Metrics

The SEC also issued [interpretive guidance](#) on the disclosure of key performance indicators and metrics in MD&A. In the guidance, the SEC reminds registrants that Item 303(a) “requires disclosure of information not specifically referenced in the item that the company believes is necessary to an understanding of its financial condition, changes in financial condition and results of operations.” If there are key variables and other qualitative and quantitative factors that are not specifically required by Item 303 that the company’s management uses to evaluate and manage the company’s business that are material to investors, those key variables and factors would constitute “key performance indicators and other metrics” that should be disclosed. The guidance provides some examples of such metrics, including metrics that relate to external or macro-economic matters, metrics that are company- or industry-specific, such as company-specific sales metrics, and environmental metrics, including metrics regarding the observed effect of prior events on their operations. If a registrant includes a metric in its MD&A, the SEC expects, based on the facts and circumstances, that the following disclosures would accompany the metric:

- A clear definition of the metric and how it is calculated;
- A statement indicating the reasons the metric provides useful information to investors; and
- A statement indicating how management uses the metric in managing or monitoring the performance of the business.

If a registrant decides to change the method by which it calculates or presents the metric from one period to another or otherwise, the guidance advises that the registrant should consider disclosing (1) the differences in the way the metric is calculated or presented compared to prior periods, (2) the reasons for such changes, (3) the effects of any such change on the amounts or other information being disclosed and on amounts or other information previously reported and (4) such other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the registrant’s performance or prospects.

The guidance also advises registrants to consider the requirements of Exchange Act Rules 13a-15 and 15d-15 with respect to maintaining disclosure controls and procedures when disclosing metrics.

Contacts

W. Lake Taylor Jr.
tlake@HuntonAK.com

Lawton B. Way
lway@HuntonAK.com

Susan S. Failla
sfailla@HuntonAK.com

Courtney Cochran Butler
courtneybutler@HuntonAK.com

Scott H. Kimpel
skimpel@HuntonAK.com

Hannah Flint
hflint@HuntonAK.com

© 2020 Hunton Andrews Kurth LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.