



# SEC Simplification of 10K Disclosures





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On November 19, 2020, (in their latest efforts to modernize, simplify, and enhance certain financial disclosure requirements in Regulation S-K) the U.S. Securities and Exchange Commission (SEC) adopted amendments to eliminate the requirements to provide selected financial data and supplementary financial data, and amended the Management's Discussion and Analysis (MD&A) requirement to revise or eliminate certain disclosure obligations.

"Today's rules will improve the quality and accessibility of the disclosure that companies provide their investors, including, importantly giving investors greater insight into the information management uses to monitor and manage the business," said outgoing SEC chairman Jay Clayton in a statement. "The improved approach to these disclosures reflects the broad diversity of issuers in our public markets and will allow investors to make better capital allocation decisions, while reducing compliance burdens and costs and maintaining strong investor protection."

### Overview

The SEC adopted amendments to Regulation S-K to eliminate certain disclosure requirements and to revise several others to make the disclosures provided in MD&A more useful for investors.

The amendments reflect the Commission's long-standing commitment to a principles-based, registrant-specific approach to disclosure. This approach, as applied to MD&A, should yield material information relevant to an assessment of the financial condition and results of operations of the registrant, and allow investors to view the registrant from management's perspective. The amendments are also intended to improve disclosure by enhancing its readability, discouraging repetition and eliminating information that is not material.

**The amendments are intended to focus financial disclosures on material information while simplifying compliance for registrants.**

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## Key Considerations

### Selected Financial Data

The final amendments eliminate the requirement in Item 301 of Regulation S-K to present a five-year table of selected financial data in the MD&A. The SEC noted that this information was readily available on EDGAR and trend information already required in MD&A, and that providing this information can create additional costs and complexity for companies. However, the SEC did encourage companies to include trend information for the earlier periods in MD&A if material, as well as a tabular presentation of relevant financial or other information, as part of an introduction to MD&A.

The SEC had originally proposed to also eliminate the requirement to provide quarterly tabular operating data for two years. However, in response to comments critical of the change, the SEC instead amended Item 302(a) of Regulation S to replace the current requirement for quarterly tabular disclosure with a principles-based requirement for disclosure regarding material retrospective changes, such as correction of an error, disposition of a business that is accounted for as discontinued operations, a reorganization of entities under common control or a change in an accounting principle.

Under such conditions a registrant must provide the reasons for the material change and “to disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to the statements of comprehensive income (as specified in Rule 1-02(bb)(ii) of Regulation S-X) and earnings per share reflecting such changes.” Rule 1-02(bb) was also amended to add flexibility for registrants to use the same line items that appear in their financial statements.

### Management’s Discussion and Analysis

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 SEC adopted several amendments to Item 303 of Regulation S-K intended to modernize and simplify the MD&A requirements.

The SEC adopted a new Item 303(a) largely as proposed to succinctly state the purposes of MD&A. The amendments add the objectives of MD&A disclosure. The new objectives differ from the objectives provided in the SEC’s 2003 interpretive guidance on MD&A in that the new objectives say that disclosures that meet the requirements are expected to better allow an investor to view the registrant “through the eyes of management,” specifying that “discussion and analysis that meets these requirements is expected to allow investors to view the registrant from management’s perspective.” as opposed to the 2003 guidance, which framed viewing the registrant “through the eyes of management” as a primary goal of MD&A.



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## The objectives focus the disclosure on:

- Material information relevant to assessing the financial condition and the results of the company, including an evaluation of the amounts and certainty of cash flows from operation and outside sources.
- Both historical and forward-looking material financial and other statistical data that will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations.
- Material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition, including descriptions and amounts of matters that: (i) have had a material impact on future operations; and (ii) are reasonably likely, based on management's assessment, to have material impact on future operations.

The SEC clarified and emphasized that registrants must provide a description of the causes of material changes from year-to-year in line items of the financial statements in both quantitative and qualitative terms and to the extent necessary to an understanding of the company's business as a whole, rather than only the "cause" for material changes. The SEC also amended the language to clarify that companies should discuss material changes within a line item, even when such material changes offset each other

### Future Events

This amendment conforms the language to other requirements for known trends and aligns the disclosure requirement with the SEC's guidance on forward-looking disclosure. The SEC clarified that, as part of MD&A's objectives, "whether a matter is 'reasonably likely' to have a material impact on future operations is based on 'management's assessment.'"

The SEC notes that, with respect to the evaluation of whether a known trend or uncertainty is reasonably likely, "the development of MD&A disclosure should begin with management's identification and evaluation of what information...is important to providing investors and others an accurate understanding of the company's current and prospective financial position and operating results."

The SEC indicates that the "reasonably likely" threshold "does not require disclosure of any event that is known but for which fruition may be remote, nor does it set a bright-line percentage threshold by which disclosure is triggered." Instead, this threshold "requires a thoughtful analysis that applies an objective assessment of the likelihood that an event will occur balanced with a materiality analysis regarding the need for disclosure regarding such event." The "reasonably likely" standard is currently used for liquidity disclosures.

**The SEC amendment now requires that when a company knows of events that are "reasonably likely" to cause (as opposed to will 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, price increases or inventory adjustments, the reasonably likely change must be disclosed.**

## Liquidity and Capital Resources

Registrants are no longer required to include a contractual obligations table in MD&A. The SEC made amendments “intended to clarify the requirements while continuing to emphasize a principles-based approach focused on material short-term and long-term liquidity and capital resources needs, while also specifying that material cash requirements from known contractual and other obligations should be considered as part of these disclosures.”

Specifically, these amendments clarify:

- “Liquidity” as the ability to generate adequate amounts of cash to meet the needs for cash.
- Short-term liquidity and capital resources covers cash needs up to 12 months into the future while long-term liquidity and capital resources covers items beyond 12 months.
- Discussion on both a short-term and long-term basis is required.
- The discussion to analyze material cash requirements from known contractual and other obligations and such disclosures to specify the type of obligation and the relevant time period for the related cash requirements is required.
- The discussion of material cash requirements, their general purpose and the anticipated source of the funds needed to satisfy them.
- That analysis should be in a format that facilitates easy understanding and does not duplicate disclosure already provided in the filing.

## Off-Balance Sheet Arrangements

The SEC replaced the more prescriptive legacy requirement to disclose off-balance sheet arrangements in a separate captioned section. Companies would be required to discuss through a more principles-based approach, 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. Where material, this would be throughout the MD&A.

## Critical Accounting Estimates

The amendments explicitly require disclosure of critical accounting estimates, consistent with prior SEC guidance on the topic. Specifically, the amendments require disclosure of qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available.

Although there are some differences between the new requirement and the interpretive guidance, the SEC clarified that:

- The application of the material and reasonably available qualifier applies not only to quantitative information but to all parts of the disclosure,
- The discussion on how much each estimate has changed may also be met through a discussion of changes in the assumptions during the period; and
- The disclosure of changes in the estimate/assumption will cover a “relevant period,” rather than a “reporting period.”

## Results of Operations – Net Sales and Revenues

The SEC clarified that registrants should provide disclosure of “material changes” in net sales or revenues, rather than solely to “material increases” in those line items. These should also describe not only increases but decreases in net sales or revenues.

### Results of Operations – Inflation & Price Changes

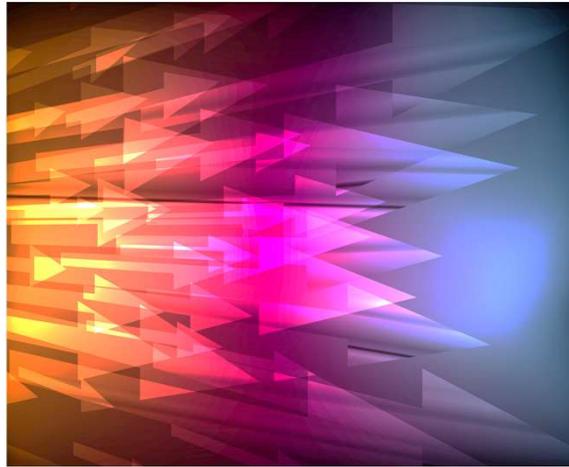
The SEC clarified that a company must provide a discussion of the effects of inflation and other changes in prices only to the extent it is material. The discussion may be made in whatever manner

appears appropriate under the circumstances and that no specific numerical financial data is required, except as may be required elsewhere.

The SEC commented that companies “will be required to discuss the impact of inflation or changing prices if they are part of a known trend or uncertainty that had or is reasonably likely to have a material impact on net sales, revenue, or income from continuing operations.” Further, where the financial statements reveal material changes from period-to-period in one or more-line items, “registrants must describe the underlying reasons for these material changes in quantitative and qualitative terms, which may also implicate a discussion of inflation and changing prices.”

### MD&A for Interim-Period Result

The SEC adopted amendments to permit companies to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter. A registrant that chooses this option must provide summary financial information that is the subject of the discussion for that quarter or identify the prior filing on EDGAR that includes this information. If a company changes the comparison from the prior interim period comparison, the company would be required to explain the reason for the change and present both comparisons in the filing where the change is announced. Registrants must continue to include a comparison of year-to-date results as well.



**Information disclosed should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how much each estimate and/or assumption has changed over a relevant period, and the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation.**

## Transition

The rules can be applied 30 days after publication in the Federal Register, which is referred to as the “effective date” and compliance is mandatory 210 days after publication which is referred to as the “mandatory compliance date.” Assuming publication of the new rules this year, companies with calendar-year fiscal years will be required to comply beginning with their Forms 10-K for 2021 to be filed in 2022.

Although companies will not be required to apply the amended rules until after the mandatory compliance date, they may provide disclosure consistent with the final amendments any time after the effective date, so long as they provide disclosure responsive to an amended item in its entirety.

For example, a registrant could stop providing Item 301 selected financial data disclosures after the effective date but wait until the mandatory compliance date to apply the other new rules. However, the SEC notes a registrant “may voluntarily provide disclosure pursuant to amended Item 303 before its mandatory compliance date. In this case, the registrant must provide disclosure pursuant to each provision of amended Item 303 in its entirety, and must begin providing such disclosure in any applicable filings going forward.”

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Simplification of 10K Disclosures  
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