SEC Modernizes MD&A and Related Financial Disclosure Requirements
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Introduction

On November 19, 2020, the SEC issued a final rule1 that modernizes and simplifies Management's Discussion and Analysis (MD&A) and certain financial disclosure requirements in SEC Regulation S-K. Specifically, the final rule:

- Simplifies Regulation S-K, Item 302, “Supplementary Financial Information.”
- Amends certain aspects of Regulation S-K, Item 303, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”
- Makes conforming changes to the forms used by foreign private issuers.

As noted in the final rule, the amendments are “intended to eliminate duplicative disclosures and enhance MD&A disclosures for the benefit of investors, while simplifying compliance efforts for registrants.” The amendments also “promote the principles-based nature” of MD&A disclosures and give registrants the flexibility to present a discussion of management’s perspective on the registrants’ financial condition and results of operations.

The final rule stems from the SEC’s comprehensive review of the disclosure requirements in Regulation S-K (the disclosure effectiveness initiative2), which began in 2013, and reflects public comment on the SEC’s January 2020 proposed rule.3 It also demonstrates the SEC’s

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1 SEC Final Rule Release No. 33-10890, Management’s Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information.
continued focus on improving disclosure effectiveness and modernizing the disclosure requirements in Regulation S-K. For example, the SEC also recently modernized the disclosure requirements in Regulation S-K, Item 101, “Description of Business”; Item 103, “Legal Proceedings”; and Item 105, “Risk Factors” (see Deloitte’s September 3, 2020, *Heads Up* for further information).

### Key Amendments to Regulation S-K

The following table summarizes the key amendments to Regulation S-K and compares the disclosure requirements before and after the final rule’s amendments:

<table>
<thead>
<tr>
<th>Before the Amendments</th>
<th>Final Rule</th>
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<tbody>
<tr>
<td><strong>Selected Financial Data</strong></td>
<td></td>
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<tr>
<td>Item 301 requires certain registrants to disclose specific items in comparative tabular form for each of their last five fiscal years as well as for any additional fiscal years necessary to keep the information from being misleading.</td>
<td>Registrants are no longer required to provide selected financial data; however, they are encouraged to consider whether they may need to present trend information within MD&amp;A for periods earlier than those periods presented in the financial statements.</td>
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</tbody>
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<table>
<thead>
<tr>
<th><strong>Selected Quarterly Financial Data</strong></th>
<th><strong>Disclosure of Material Quarterly Changes</strong></th>
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<tbody>
<tr>
<td>Item 302(a) requires certain registrants to disclose (1) select financial information for each quarter during the two most recent fiscal years, (2) variances in results from amounts previously presented on Form 10-Q, and (3) the effect of any discontinued operations and any unusual or infrequently occurring items as well as the aggregate effect and nature of year-end or other adjustments that are material to the results of that quarter.</td>
<td>Registrants generally are not required to disclose select financial information for each quarter during the two most recent fiscal years. However, if a registrant reports a material retrospective change (or changes) for any of the quarters within the two most recent fiscal years, Item 302(a) requires the registrant to disclose (1) an explanation for the material change(s) and (2) select financial information reflecting such change(s) for the affected quarterly periods, including the fourth quarter. Material retrospective changes may include, for example, a change in accounting principle in accordance with ASC 250 or a disposition of a business that is accounted for as a discontinued operation in accordance with ASC 205-20.</td>
</tr>
</tbody>
</table>

While a first-time registrant undergoing an IPO is not required to provide these disclosures, it will need to do so “beginning with the first filing on Form 10-K” after its initial registration statement.

In addition, a registrant must continue to consider the guidance in ASC 270-10-50-2, which requires disclosure of (1) the disposal of the components of an entity and (2) unusual or infrequent items occurring during the fourth quarter.

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4 For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”
### Before the Amendments | Final Rule

#### Objective of MD&A

Item 303 does not contain a succinct **objective** for MD&A but instead provides various instructions that explain its purpose.

The final rule renames current Item 303(a) as Item 303(b) and establishes a new Item 303(a), which concisely states the purpose of MD&A. Further, the new content (1) incorporates parts of current instructions and (2) codifies the requirement in the SEC's **2003** and **1989** interpretive releases^5^ that a registrant must provide a discussion and analysis that allows an investor to see the company "from management's perspective." Such disclosure must, on the basis of "management's assessment," address matters that are reasonably likely to have a material impact on future operations.

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#### Liquidity and Capital Resources

Item 303(a)(1) requires a registrant to disclose the sources of liquidity and any "trends, demands, commitments, events, or uncertainties" that are known and will, or are reasonably likely to, result in a material increase or decrease in the registrant's liquidity. Under Item 303(a)(2), a registrant must also discuss (1) "its material **commitments for capital expenditures** as of the end of the latest fiscal period" (emphasis added) and (2) "the general purpose of such commitments and the anticipated sources of funds needed to fulfill [them]."

The final rule creates a new Item 303(b)(1) that provides overarching requirements related to liquidity and capital resources. It codifies the guidance in the SEC's 1989 interpretive release, which specifies that short-term liquidity and capital resources should address cash needs for known contractual or other obligations for up to 12 months, while long-term liquidity and capital resources should address cash needs beyond 12 months.

The final rule also codifies the guidance in the SEC's 2003 interpretive release, under which registrants must 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, contractual obligations, off-balance-sheet arrangements, and other such requirements. See Instruction 8 to Item 303(b).

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#### Results of Operations — Known Trends or Uncertainties

Item 303(a)(3)(ii) requires a registrant to disclose (1) any **known trends or uncertainties** that have had or that the registrant **reasonably expects** will have a material impact on revenues or income and (2) any **known events** that "**will cause** a material change in the relationship between costs and revenues (such as **known future increases in costs. . .")" (emphasis added).

Item 303(b)(2)(ii) requires a registrant to disclose (1) any **known trends or uncertainties** that have had or are **reasonably likely** to have a material impact on revenues or income and (2) any **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 . . .")" (emphasis added).

Under the "reasonably likely" requirement, the registrant would have to disclose a known trend or uncertainty if it (1) is reasonably likely to occur and (2) would be material to the registrant if it did occur (e.g., the two-step test described in the SEC’s 1989 interpretive release).

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**Results of Operations — Net Sales and Revenues**
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. In addition, Instruction 4 to Item 303(a) requires discussion of the causes of material changes from year to year in one or more line items in the consolidated financial statements.
Item 303(b)(2)(iii) requires 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.

The amendments (1) codify the guidance in the SEC's 2003 and 1989 interpretive releases and (2) require registrants to discuss the underlying reasons for material changes in **quantitative and qualitative terms** in situations in which one or more line items in the financial statements reflect material changes from period to period (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) requires a registrant to discuss the impact of inflation and changing prices on (1) net sales and revenues and (2) income from continuing operations.
In accordance with Item 303(b)(2)(ii), a registrant is no longer required to discuss the impact of inflation and changing prices; however, under the principles-based disclosure framework, it must still disclose the impact of inflation and price changes if such conditions are part of a known trend or uncertainty that has had, or is reasonably likely to have, a material impact on revenues or income.

**Off-Balance-Sheet Arrangements**
Under Item 303(a)(4), a registrant must disclose its off-balance-sheet arrangements in a separately captioned section.
Under Item 303(b)(1), a registrant is no longer required to disclose its off-balance-sheet arrangements in a separately captioned section; however, in accordance with Instruction 8 to Item 303(b), a registrant must disclose material off-balance-sheet arrangements as part of the Liquidity and Capital Resources discussion.

**Contractual Obligations Table**
Under Item 303(a)(5), certain registrants must disclose, in a tabular format, the aggregate amount of their contractual obligations by prescribed categories and periods.
Under Item 303(b)(1), a registrant is no longer required to disclose the aggregate amount of its contractual obligations in a tabular format; however, as outlined above, Item 303(b) specifies that the registrant must provide an analysis of “material cash requirements from known contractual and other obligations.” See also Instruction 4 to Item 303(b).
Before the Amendments | Final Rule
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**Interim Periods**

Item 303(b) requires a registrant to 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.

Under Item 303(c), a registrant is still 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.

However, the amendments give registrants the flexibility to disclose their results of operations of the most recently completed fiscal quarter compared 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 should either (1) disclose 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 is required to explain the reason for the change and present both comparisons in the filing in which the change is announced.

**Critical Accounting Estimates**

The SEC's 2003 interpretative release outlines the circumstances in which registrants must disclose critical accounting estimates (CAEs) or assumptions.

The amendments codify the SEC's 2003 interpretive release to explicitly require disclosure of CAEs in MD&A. Further, Item 303(b)(3) defines CAEs as “estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the financial condition or results of operations of the registrant.”

For each CAE, the amendments require a registrant to discuss, to the extent material and reasonably available, (1) why the CAE is subject to uncertainty, (2) how much the CAE or assumption (or both) has changed during the relevant period, and (3) the sensitivity of reported amounts to the methods, assumptions, and estimates underlying the CAE’s calculation. Further, Instruction 3 to Item 303(b) states that disclosure of CAEs should “supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements.”
Other Considerations

Other considerations related to the final rule include the following:

- **Foreign private issuers (FPIs)** — The final rule amends the instructions to Forms 20-F and 40-F to substantially align the financial disclosure requirements for FPIs with the changes discussed above, as applicable.

- **Smaller reporting companies (SRCs)** — Several of the eliminated requirements discussed above (e.g., those related to selected financial data) currently do not apply to SRCs. Therefore, after adoption of the final rule, the requirements for SRCs are largely aligned with those for other registrants. However, SRCs continue to be exempt from the amended requirements in Item 302.

- **Oil and gas producing activities** — The SEC proposed to eliminate Item 302(b), which addresses disclosures about oil and gas producing activities. The proposed elimination was subject to the FASB’s issuance of related amendments to U.S. GAAP that would have required disclosures that are substantially consistent with those required by Item 302(b). The FASB has not finalized the amendments, so Item 302(b) has been retained. The SEC may reconsider the proposal in the future.

Effective Date and Transition

The final rule is effective on February 10, 2021 (effective date), and must be applied in a registrant’s first fiscal year ending on or after August 9, 2021 (mandatory compliance date). For example, a calendar-year registrant would be required to reflect the amendments in its periodic reports, beginning with its Form 10-K for the year ending December 31, 2021. Because the mandatory compliance date is based on the end of the registrant’s fiscal year, Forms 10-Q for quarterly periods in 2021 need not reflect the amendments. Early adoption on an Item-by-Item basis is permitted after the effective date; however, a registrant must fully comply with each adopted Item in its entirety. For example, it is acceptable for a registrant to early adopt the amendments to Item 301, and thereby no longer provide selected financial data, but adopt the amendments to other Items on the basis of the mandatory compliance date. In addition, the final rule must be applied if a registration statement or prospectus is initially filed with annual financial statements that reflect a period on or after the mandatory compliance date.

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See FASB Proposed Accounting Standards Update, *Codification Amendments in Response to the SEC’s Disclosure Update and Simplification Initiative*. 
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