REGULATION S-K AMENDMENTS TO MD&A

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BACKGROUND AND MANDATORY COMPLIANCE DATE

- On November 19, 2020, the SEC voted to adopt amendments to Regulation S-K items covering MD&A and certain selected financial disclosures.
- These amendments became effective on February 10, 2021 (the “effective date”), but early compliance is permitted so long as the registrant provides disclosure responsive to an amended Item in its entirety.
- The amendments do not require companies to comply with the amended rules until the first fiscal year that ends on or after the date that is 210 days after the effective date, i.e., on and after August 9, 2021.
  - *Compliance with these amendments will be required for most calendar year companies beginning with the Annual Report on Form 10-K for the fiscal year ending December 31, 2021 and periodic reports going forward.*

RATIONALE FOR CHANGES TO MD&A

- Item 303 requires disclosure of information relevant to assessing a registrant's financial condition, changes in financial condition, and results of operations.
  - Item 303(a) requires disclosure of 5 components for full fiscal years: (i) liquidity, (ii) capital resources, (iii) results of operations, (iv) off-balance sheet arrangements, and (v) contractual obligations.
  - Item 303(b) covers interim periods and requires disclosure of material changes to the matters listed in Item 303(a).
- The SEC proposed amendments to Item 303 to "modernize, simplify, and enhance the MD&A disclosures for investors while reducing compliance burdens for registrants."

OVERVIEW OF AMENDMENTS TO ITEM 303

- Established new paragraph Item 303(a) to emphasize purpose of the MD&A.
- Expanded Item 303(b)(1)(ii) to require a discussion of material cash requirements, in addition to commitment of capital expenditures.
- Clarified the liquidity and capital resources disclosure requirements of Item 303(b)(1), including to specifically require disclosure of material cash requirements from known contractual and other obligations.
- Amended 303(b)(2)(ii) to clarify that a registrant should disclose *reasonably likely* changes in the relationship between costs and revenues.
- Replaced current Item 303(a)(4) with an instruction emphasizing a more principles-based approach with respect to off-balance sheet arrangement disclosures.
- Eliminated current Item 303(a)(5), the requirement that registrants provide a tabular disclosure of contractual obligations.
- Adopted Item 303(b)(3) to explicitly require disclosure of critical accounting estimates.
- Amended Item 303(c) to allow for more flexibility in interim periods compared.

AMENDED ITEM 303(a): MD&A OBJECTIVE

- Objective of MD&A is to provide material information relevant to the assessment of financial condition and results of operations, including an evaluation of the amounts and certainty of cash flows from operations and outside sources
  - Focus specifically on material events and uncertainties known to management that are *reasonably likely* to cause reported financial information to not be necessarily indicative of future operating results or financial condition, including descriptions of amounts and matters that have had, or are *reasonably likely* to have based on management's assessment, a material impact on operations.
  - Discussion must be of the financial statements and statistical data that a company believes will enhance the reader's understanding of its financial condition, cash flows and other changes in financial condition, and results of operations.
- Item 303(a) provides overarching requirements of MD&A, which apply throughout amended Item 303.
- An MD&A that meets these requirements should allow the reader "to view the registrant from management's perspective."

AMENDED ITEM 303(b): MD&A DISCLOSURE GENERALLY

- Re-captioned previous Item 303(a) as Item 303(b), while retaining the previous language of Item 303(b) that outlines what should be disclosed in the discussion of a company's financial condition, changes in financial condition, and results of operations.
- Moved portion of prior Instruction 4, which requires description of *underlying reasons* for material changes from year-to-year in financial statement line items, to Item 303(b) to enhance analysis in MD&A.
  - Response to SEC's observations that "many registrants simply recite the amount of changes from year to year that are readily computable from their financial statements."
- Added product lines as an example of subdivisions of a company's business that must be discussed when necessary to an understanding of the company's business.

AMENDED ITEM 303(b)(1): LIQUIDITY AND CAPITAL RESOURCES

- New Item 303(b)(1) provides overarching requirements of Liquidity and Capital Resources discussion, including that a registrant should analyze its ability to obtain cash to meet its requirements and plans for cash in the short term (i.e., next 12 months) and long term (i.e., beyond next 12 months).
  - Discussion should analyze material cash requirements from known contractual and other obligations, which may include lease obligations, purchase obligations, or other balance sheet liabilities. This reflects deletion of Contractual Obligations table in previous 303(a)(5) and movement of similar discussion to Liquidity and Capital Resources.
- Liquidity: Item 303(b)(1)(i) retains the same language requiring disclosure of known trends, demands, commitments, events or uncertainties that will or are reasonably likely to affect the company’s liquidity.
- Capital Resources:
  - Item 303(b)(1)(ii)(A) requires disclosure of material cash requirements, including commitments for capital expenditures (as of the latest fiscal period), anticipated source of funds needed to satisfy such cash requirements, and general purpose of such cash requirements.
  - Item 303(b)(1)(ii)(B) retains prior 303(a)(2)’s requirement to describe known material trends in capital resources, but requires registrants to indicate any *reasonably likely* (as opposed to “expected”) material changes in the mix and cost of such resources.

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AMENDED ITEM 303(b)(2): RESULTS OF OPERATIONS

- Known Trends or Uncertainties
  - Amendments require disclosure of trends or uncertainties that have had or are *reasonably likely* to have a material impact on net sales or revenues or income from continuing operations.
    - If a company knows of events that are *reasonably likely* to cause (instead of “will cause”) a material change in the relationship between costs and revenues (such as known or *reasonably likely* increases in costs of labor or material, price increases or inventory adjustments), that change must be disclosed.
  - SEC noted that amended Item 303(a) clarifies that “whether a matter is ‘reasonably likely’ to have a material impact on future operations is based on ‘management’s assessment.’”

AMENDED ITEM 303(b)(2): RESULTS OF OPERATIONS (CONT'D)

- Known Trends or Uncertainties: "*Reasonably Likely*" Threshold
  - The "reasonably likely" threshold requires "a thoughtful analysis that applies an objective assessment of the likelihood that an event will occur balanced with a materiality analysis" of the need to disclosure such event. To apply the threshold, consider whether a known trend, demand, commitment, event or uncertainty is (i) *likely* to come to fruition, and (ii) if it did, *and* would be reasonably likely to have a material effect on future results or financial condition, disclosure is required.
    - If a trend is not remote *or* management cannot assess the likelihood that it will come to fruition, *and* it would be reasonably likely to effect future results or financial condition, it should be disclosed if a reasonable investor would consider the *omission* of the information as significantly altering the mix of information made available in the company's disclosure.
  - Threshold is grounded in whether disclosure of event or uncertainty would be material to investors.

AMENDED ITEM 303(b)(2): RESULTS OF OPERATIONS (CONT'D)

- Net Sales and Revenues
  - Amends prior Item 303(a)(3)(iii) to codify guidance that the results of operation discussion should describe both increases *and decreases* in net sales or revenue by using "material changes" instead of "material increases."
  - As amended, if statement of comprehensive income shows material changes from period to period in net sales or revenue, describe the extent to which such *changes* (instead of "increases") are applicable to changes in prices, volume or amount of goods or services being sold, or to introduction of new products and services.
- Impact of Inflation and Price Changes
  - Eliminated prior Item 303(a)(3)(iv) which required discussion of the impact of inflation and price changes, and related prior Instructions 8 and 9.
    - Adopting release notes that a discussion of inflation or changing prices will be required if they are part of a known trend or uncertainty.
    - Further, amended Item 303 requires disclosure of the underlying reasons for material changes to financial statements from period-to-period, which may implicate a discussion of inflation and changing prices.

ELIMINATED OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS DISCLOSURE

- Off-Balance Sheet Arrangements
  - Eliminated Item 303(a)(4), requiring a separately captioned section discussing a company's off-balance sheet arrangements.
  - Added new Instruction 8 to amended Item 303(b) requiring disclosure of 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 financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources.
- Contractual Obligations
  - Eliminated prior Item 303(a)(5) requiring tabular disclosure of contractual obligations.
  - Amended Item 303(b) to require disclosure of material cash requirements from known contractual and other obligations as part of Liquidity and Capital Resources discussion.

NEW ITEM 303(b)(3): CRITICAL ACCOUNTING ESTIMATES

- Consistent with prior SEC guidance, Item 303(b)(3) now explicitly requires disclosure of critical accounting policies.
  - "Critical accounting estimates" is defined as "those 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 operation of the registrant."
- Registrants must provide qualitative and quantitative information necessary to understand the estimate uncertainty and impact that estimate has or is reasonably likely to have on registrant's financial condition or results of operations, to the extent information is material and reasonable available.
  - This information should include why each estimate is subject to uncertainty and, to the extent material and reasonably available, how much each estimate and/or assumption has changed over a relevant period.
  - Should also include the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation.
- Intended to allow investors to better evaluate uncertainty associated with critical accounting estimates by observing changes over time.

AMENDED ITEM 303(c): INTERIM PERIODS

- Amended prior Item 303(b) to allow registrants to discuss material changes in results of operations in their most recently completed quarter by comparison to *either* the corresponding quarter of the prior year (as previously required) *or* to the immediately preceding quarter.
  - If a registrant chooses to discuss changes from immediately preceding quarter, it must provide summary financial information that is the subject of the discussion for that quarter or identify the prior filing on EDGAR that presents that information.
  - If a registrant changes its comparison from the prior interim period's comparison, it must explain the reason for the change and present both comparisons in the first filing in which the change is made.
- Amendments intended to "help registrants provide a more tailored and meaningful analysis that is relevant to their specific business cycle."
- Item 303(c) still requires the interim discussion and analysis to include discussion of material changes in items specified in the full fiscal year requirements in amended Item 303(b).

ELIMINATED PRIOR ITEM 303(c)

- Eliminated prior Item 303(c), which stated that safe harbors provided in Section 27A of the Exchange Act apply to forward-looking information provided in response to prior Items 303(a)(4) and (5) (off-balance sheet arrangements and contractual obligations).
  - Corresponds with elimination of prior Items 303(a)(4) and (5).
- SEC noted that these amendments do not alter the availability or scope of statutory safe harbors.
- Disclosure of off-balance sheet arrangements and contractual obligations is still required within the broader MD&A discussion, but now whether and to the extent such disclosure constitutes forward-looking statements that fall within statutory or regulatory safe harbors will be evaluated consistently with other forward-looking disclosures in the MD&A.

INITIAL ITEMS TO CONSIDER IN PREPARING DISCLOSURE UNDER AMENDED RULES

- Liquidity discussion under amended Item 303(b)(1):
  - Short-term and long-term liquidity disclosure
  - Contractual obligations table
- Known trends and uncertainties under amended Item 303(b)(2)
- Critical accounting estimates under amended Item 303(b)(3):
  - Avoid duplicating financial statement disclosures
  - Sensitivity analysis

REMINDER: AMENDMENTS TO ITEMS 301 AND 302

- SEC also adopted amendments to Items 301 and 302 at the same time as the previously discussed MD&A amendments.
- Item 301: Selected Financial Data
  - *Eliminated Item 301's requirement to furnish selected financial data for each of the registrant's last five fiscal years because Item 303 already calls for disclosure of material trend information.*
- Item 302(a): Supplementary Financial Information
  - *Streamlined Item 302(a) to eliminate disclosure requirement except when there are one or more retrospective changes to the statements of comprehensive income for any of the quarters within the two most recent fiscal years and any subsequent interim period that, individually or in the aggregate, are material.*

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