

## Commission Guidance on Management’s Discussion and Analysis of Financial Condition and Results of Operations

SEC Release Nos. 33-10751; 34-88094; FR-87 (Issue Date: January 30, 2020)

Link to Guidance: [Release Nos. 33-10751; 34-88094; FR-87](#)

Link to Proposed Rule: [Release Nos. 33-10750; 34-88093; IC-33795; File No. S7-01-20](#)

### Overview

In recent years, the Securities and Exchange Commission (SEC) has sought to update disclosure requirements for registrants. Here, we provide a summary and insights related to these updates, with a focus on the recently issued Release Nos. 33-10751; 34-88094; FR-87 in January 2020, in addition to the Proposed rule Release No. 33-10750; 34-88093; IC-33795; File No. S7-01-20.

The SEC issued this update (Release Nos. 33-10751; 34-88094; FR-87) to bring further clarity to the Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) by providing guidance on key performance indicators and metrics.

Current SEC guidance requires disclosures related to items that the registrant believes to be necessary in understanding “its financial condition, changes in financial condition and results of operations.” Additionally, entities must make disclosures related to other statistical data that furthers the reader’s understanding of the Company’s condition and operations, which requires judgment on the part of the filing entity. Rather than changing these requirements, this new update provides guidance to registrants when key performance indicators or other variables and metrics are included in MD&A.

The released guidance (Release No. 33-10751) is part of a larger effort by the SEC to enhance the MD&A section by simplifying and increasing transparency for stakeholders through more uniform disclosures across individual companies and industries. The proposed Release No. 33-10750 aims to streamline disclosures by eliminating Item 301 (“Selected Financial Data”) and Item 302 (“Supplementary Financial Information”) of Regulation S-K due to the duplicative nature of these items in that the data has already been presented in prior filings. Additionally, in the proposed Release No. 33-10750, the SEC proposed multiple updates to Item 303 (“Management’s discussion and analysis of financial condition and results of operations”).

### Background

In March 2019, the SEC voted to “modernize and simplify disclosure requirements in Regulation S-K, in a manner that reduces the costs and burdens on registrants while continuing to provide all material information to investors.” This had led to a series of amendments and proposed amendments to simplify disclosures, while also increasing transparency for readers. The updates passed in 2019 allow for entities to

reduce the discussion presented in the financial statements from three years to a two-year period, so long as the discussion is already present in an entity's prior filings. This helps to streamline disclosures by eliminating pieces that may be redundant. Additionally, this amendment advises entities to reduce disclosures related to immaterial items, as these items may not provide much value to the reader in understanding the entity's performance. For example, underlying assumptions used to calculate metrics that are not material to the business should be omitted, although registrants must use their own judgement in determining materiality.

With the Release No. 33-10751 passed in January 2020, the SEC aims to provide further guidance on key performance indicators and other key metrics included in the MD&A section. Entities should disclose "all key variables and other factors that management uses to manage the business and would be material to investors, and therefore required." This encompasses both industry-wide metrics, as well as any metrics or factors, both qualitative and quantitative, specific to a registrant that would provide readers with a better understanding of the registrant's underlying business and how they measure performance.

The guidance reminds entities that, when including metrics in the disclosures, an entity should adhere to existing MD&A requirements by including any material information that would make the metric not misleading to the reader, such as any underlying assumptions or estimates used in the calculation. Entities must first adhere to any existing frameworks, such as GAAP, when considering what to disclose. Generally, the Commission would expect the following disclosures related to a metric:

- A clear definition of the metric and how it is calculated;
- A statement indicating the reasons why 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.

Release No. 33-10751 also addresses when a registrant changes the method for calculating a presented metric from one period to the next. If the change in the underlying calculation is material, an entity should disclose the following:

- The difference in how the metric is calculated compared to the prior period;
- The reasons for making the change;
- The effects of the change on the amounts previously disclosed; and
- Any other differences in method or results that is relevant to understanding the business.

Lastly, with Release No. 33-10751, the SEC reminds us of the requirement to "maintain effective disclosure controls and procedures." Effective controls and procedures are just as important as the disclosure itself, as it relates to maintaining the integrity of the data underlying the disclosures. Without effective controls and procedures in place, it is difficult for the reader to be reasonably assured that the presented material is not misleading.

Proposed Release No. 33-10750, aims to “allow investors to make better capital allocation decisions, while reducing compliance burdens and costs without in any way adversely affecting investor protection.” With the increase in technology, and thus, readily available information, readers can easily look up historical information. By eliminating Item 301 (selected financial data) and Item 302 (supplementary financial data), the proposed amendments will simplify disclosures and reduce redundant information for the reader, allowing for greater transparency in the data. The following updates to Item 303 (MD&A) are also included in the proposed updates:

- Add a new Item 303(a), *Objective*, to state the principal objectives of MD&A;
- Replace Item 303(a)(4), *Off-balance sheet arrangements*, with a principles-based instruction to prompt registrants to discuss off-balance sheet arrangements in the broader context of MD&A;
- Eliminate Item 303(a)(5), *Tabular disclosure of contractual obligations* given the overlap with information required in the financial statements and to promote the principles-based nature of MD&A;
- Add a new disclosure requirement to Item 303, *Critical accounting estimates*, to clarify and codify existing SEC guidance in this area;
- Revise interim MD&A requirement in Item 303(b) to provide flexibility by allowing registrants to compare their most recently completed quarter to either the corresponding quarter of the prior year or to the immediately preceding quarter.

## Insights

The guidance issued in Release No. 33-10751 provides valuable clarifying guidance for registrants when KPIs and key metrics are used to articulate business performance. This guidance should benefit financial statement users in the form of clear understanding of such metrics and their related value.

It is anticipated that the proposed Release No. 33-10750 will result in several streamlined and modernization updates to SEC Rules in Reg. S-K upon finalization. Many of the proposals should ease the compliance burden for registrants and support the SEC’s ongoing initiative to streamline disclosures. This proposed guidance will also give some relief to private companies that are considering an IPO, but would not meet the definition of smaller reporting company (SRC), as one of the benefits of being a SRC is not being required to provide item 301 or 302. Additionally, financial statement users should benefit from the streamlining and modernization efforts of the Commission through more focused and material information aligned with the current economic operating environment.

## Final Thoughts

Registrants should immediately begin applying the updated guidance included in Release No. 33-10751 and should prepare to apply the guidance in proposed Release No. 33-10750, in anticipation that it will soon pass. In doing so, both the registrant and stakeholders will benefit from the simplified and modernized disclosures. These amendments will lessen the burden of reporting requirements, and thus cost, for the reporting entity, and reduce the time it takes for the reader to gain a full understanding of the reporting entity.

### Effective Date

- Release No. 33-10751 is effective as of February 25, 2020.
- Release No. 33-10750 was proposed on January 30, 2020.

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