

The Legal Intelligencer

Less Is More for SEC Disclosure Effectiveness Changes

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On Oct. 4, the Securities and Exchange Commission (the SEC) published final rules adopting amendments to certain disclosure requirements that have become redundant, overlapping or outdated in light of other SEC disclosure requirements, U.S. generally accepted accounting principles (GAAP), international financial reporting standards (IFRS) and changes in the information environment. The SEC sought to simplify compliance for disclosures “without significantly altering the total mix of information provided by investors.” The final rules became effective on Nov. 5.

These amendments are part of an ongoing effort by the SEC to evaluate disclosure requirements with the goal of reducing compliance costs for companies and improving investors’ ability to make investment decisions efficiently. Most changes are technical, but they are considerable. In total, the SEC’s final release changes 102 rules and 17 forms that impact disclosure requirements. This article summarizes some of the major highlights and items to consider in preparing disclosure for future filings with the SEC.

OVERLAPPING REQUIREMENTS

Most changes adopted by the SEC fall into a category that the SEC described as “overlapping.” To be overlapping, disclosure requirements must be related to, but not the same as, GAAP, IFRS or other SEC disclosure requirements. The SEC’s goal was to identify and delete requirements that are encompassed by compliance with other disclosure regimes (such as GAAP or IFRS) expected of public companies, issuers of securities and others filing with the SEC. The SEC sought to delete overlapping requirements and integrate requirements that overlap with, but require information incremental to, other SEC disclosure requirements.

The changes to address overlapping disclosure include eliminating: fiscal period consolidation, distributable earnings for registered investment companies, insurance company liability assumptions, REIT disclosures related to undistributed gains or losses on the sale of properties, risks related to foreign operations, and changes in accounting principles for interim financial statements. The SEC also eliminated requirements for disclosure on:

- **Research and Development Spending.** The SEC no longer requires disclosure of material amounts spent on R&D activities under Regulation S-K Items 101(c)(1)(xi) and 101(h)(4)(x) as these are captured in the footnotes to financial statements.

- **Geographic Area Financial Information.** The SEC removed requirements to disclose financial data by geographic area under Item 101(d)(2) of Regulation S-K because similar information is required in the footnotes to financial statements. The rules clarified however that geographic information should be included under Item 303 if it would aid an investor in understanding the business.
- **Financial Information by Segment.** Disclosure of financial information by segment is no longer required under Item 101(b) of Regulation S-K and Rule 3-03(e) of Regulation S-X, because similar disclosures are covered by GAAP and Item 303(b) of Regulation S-K.
- **Cash Dividend History.** The SEC removed the requirement to disclose the amount and frequency of cash dividends under Item 201(c)(1) because the information is covered by amended Rule 3-04 of Regulation S-X.
- **Seasonality.** Companies no longer need to discuss seasonality in the management's discussion and analysis (MD&A) section of quarterly reports, but disclosure of seasonality will remain required in annual reports under Item 101(c)(1)(v) of Regulation S-K.
- **Earnings to Fixed Charges Ratio.** The SEC no longer requires disclosure of the ratio of earnings to fixed charges under Item 503(d) of Regulation S-K because GAAP already requires disclosure of the component figures to calculate the ratio.
- **Exhibits.** Certain exhibit filing requirements were eliminated primarily as a result of duplication with other disclosure requirements or exhibit filings.

OUTDATED REQUIREMENTS

The SEC also amended requirements that have become outdated as a result of the passage of time or changed in the regulatory, business, or technological environments. These amendments included references to transition dates that have already passed and income tax disclosures that are no longer relevant. The SEC acknowledged the widespread availability of daily market prices of publicly traded common stock and the incredible depth of information available for free to average investors, so they eliminated the requirement to disclose high and low sales prices under Item 201(a)(1) of Regulation S-K. As a result, this information will no longer need to be reported in a company's annual report and applicable registration statements. In a sign of the times, the SEC eliminated the requirement to refer to its public reference room and disclose its address and phone number. The amendments instead require all companies to disclose their internet addresses if they have one, which was previously only encouraged. Finally, foreign private issuers no longer are required to provide exchange rate data for prepared financial statements based on a currency other than USD, so long as the exchange data is widely available online.

SUPERSEDED REQUIREMENTS

As disclosure requirements have changed over time, inconsistencies have arisen. Part of the SEC's simplification effort consisted of updating requirements to reflect more recently updated GAAP requirements or changes in other SEC requirements. For example, with respect to the statement of cash flows required by Rule 3-02 of Regulation S-X, the new rules replace the reference to "changes in financial position" in the title with "cash flows" because similar amendments to various SEC rules and forms were made back in 1992. Further, references to "income statement" were replaced with "statement of comprehensive income" because the FASB had replaced it in 2011. Finally, the SEC updated the rules to fix incorrect references and typographical errors.

WHAT DIDN'T MAKE IT IN

While the vast majority of proposed changes were eventually adopted by the SEC, there were notable rules that were not incorporated due to concerns expressed and identified by commenters. After receiving particularly close attention, the SEC chose not to adopt changes to the legal proceedings disclosure noting several differences between SEC and GAAP requirements. The SEC rightly was concerned that integration between the two could have unforeseen consequences. In addition, while specific seasonality disclosure was deleted from Management's Discussion and Analysis pursuant to Item 303 of Regulation S-K (which would have resulted in seasonality discussion in quarterly reports), the SEC elected to retain seasonality disclosure under Item 101(c)(1)(v) (which is required for purposes of Annual Reports on Form 10-K). The SEC identified concerns about the potential loss of information in the fourth quarter about the extent to which the business of an issuer or its segments is or may be seasonal, so the annual report should provide the proper place for this information.

In addition, the SEC referred many overlapping requirements to the FASB for their review on whether they should instead be included in GAAP rules. These include certain disclosures related to discounts on shares, income tax disclosures, major customers, equity compensation plans, and revenues of products and services. In many cases, commenters suggested the SEC refer the proposed changes to the FASB because the changes represented only incremental changes from those already required by GAAP. The SEC agreed and requested the FASB review these requirements and make a determination in the next 18 months whether they should be updated.

WORD OF CAUTION

While these changes can be widely characterized as technical and do not alter the "total mix of information provided to investors," many of the updates change where information is located in disclosures. In some cases, this movement of information may impact prominence of the disclosure. Moving information to the financial statements may have other consequences, including imposing XBRL tagging requirements and making the safe harbor under the Private Securities Litigation Reform Act of 1995 for forward-looking statements unavailable. Further, as information is moved to different portions of public filings, the information may be read and interpreted in a new and different context. Companies should therefore pay close attention to these issues and prepare for such changes in upcoming periodic filings and registration statements by reviewing disclosure with their advisers. Companies should also consider changes to their disclosure controls and procedures in light of the amendments. These items should be considered over time, as new practices may emerge as the market and investors react to the disclosure changes.

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