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SEC Modernizes Certain Regulation S-K Disclosure Requirements

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Introduction

On August 26, 2020, the SEC issued a [final rule](#)¹ that modernizes the disclosure requirements in Regulation S-K, Item 101, "Description of Business"; Item 103, "Legal Proceedings"; and Item 105, "Risk Factors."

The main provisions of Regulation S-K, which is the central repository for disclosure requirements for public companies (other than financial statement requirements), were established more than 30 years ago. The SEC stated that the final rule is intended to improve the readability of disclosures, reduce repetition, and eliminate immaterial information, thereby simplifying compliance for registrants and making disclosures more meaningful for investors. The final rule stems from the SEC's comprehensive review of its disclosure requirements and reflects the SEC staff's 2016 [Report on Modernization and Simplification of Regulation S-K](#),² public comments on the SEC's 2016 concept release [Business and Financial Disclosure Required by Regulation S-K](#),³ public comment on the SEC's August 2019 proposed rule,⁴ and changes in the regulatory and business landscape since the issuance of Regulation S-K.

The final rule is effective 30 days after its date of publication in the *Federal Register*.

¹ SEC Final Rule Release No. 33-10825, *Modernization of Regulation S-K Items 101, 103, and 105*.

² The SEC staff's report was issued under a mandate in the Fixing America's Surface Transportation Act (commonly referred to as the "FAST Act").

³ See Deloitte's April 18, 2016, [Heads Up](#) on the concept release.

⁴ SEC Proposed Rule Release No. 33-10668, *Modernization of Regulation S-K Items 101, 103, and 105*.

Key Amendments to Regulation S-K

The amendments to the disclosure requirements related to a registrant's description of its business and risk factors are intended to expand the use of a principles-based approach that gives registrants more flexibility to tailor disclosures. The amendments to the disclosure requirements related to legal proceedings continue to reflect the current, more prescriptive approach because those requirements depend less on a registrant's specific characteristics. Overall, the amendments in the final rule were issued substantially as proposed.

General Development of the Business

Amendments to the requirements in Regulation S-K, Item 101(a), "General Development of Business," include the following:

- *Eliminate the prescribed timeline* — Before these amendments, Item 101(a) required registrants to disclose a description of the general developments of the business for the past five years (or since inception, if that period is shorter). The amendments eliminate that timeframe and instead require registrants to focus on the "information material to an understanding of the development of their business, irrespective of a specific timeframe." A similar change was made to Regulation S-K, Item 101(h), "Smaller Reporting Companies," which had required a three-year timeline for disclosure.
- *Update the nonexclusive list of disclosure topics* — Before the amendments, Item 101(a)(1) required disclosure of information on matters such as the following:
 - "The year in which the registrant was organized and its form of organization."
 - "The nature and results of any bankruptcy, receivership or similar proceedings with respect to the registrant or any of its significant subsidiaries."
 - "The nature and results of any other material reclassification, merger or consolidation of the registrant or any of its significant subsidiaries."
 - "The acquisition or disposition of any material amount of assets otherwise than in the ordinary course of business."
 - "Any material changes in the mode of conducting the business."

The final rule removes the first and fifth items from the list above and adds "[a]ny material changes to a previously disclosed business strategy." The final rule also explicitly states that the list is "non-exclusive" and that "only information material to an understanding of the general development of the business" is required to be disclosed under this item.

- *Allow current-period updates with cross-references to disclosures in prior filings* — Before the amendments, registrants were required to provide a complete description of the general development of the business even if they had disclosed this information previously. The amendments permit a registrant to provide an update of Item 101(a) that includes (1) all material developments that have occurred since the most recent full discussion of the general development of its business disclosed in a previous filing and (2) one active hyperlink to the registrant's most recent full discussion of the general development of the registrant's business, which must point to a single document that was previously filed. If a registrant does not choose this option, it must disclose a complete description of the general development of the business.



Connecting the Dots

Because the amendments require the hyperlink to point to a "single" previously filed document, registrants may consider providing a full discussion every few years. Otherwise, the extent of disclosure necessary to update an aging full discussion could obviate the usefulness of cross-references to a prior filing.

Narrative Description of the Business

Before the amendments, Item 101(c), “Narrative Description of Business,” required a registrant’s description of the business to focus on its reportable segments. Item 101(c) included 12 items that, if material, had to be included in the registrant’s disclosures. In adopting the final rule, the SEC noted that the prescriptive list of “disclosure requirements may elicit disclosure that is not material to a particular registrant” and that the amendments are intended to reinforce the principles-based approach by updating the “list of specific items with a non-exclusive list of disclosure topic examples.” Accordingly, the amendments provide a revised list of topics about which disclosure is required if the topics are “material to an understanding of the registrant’s business taken as a whole.”

Notably, the new list expands the disclosure requirements related to human capital, which previously were limited to the number of a registrant’s employees, to include any “human capital measures or objectives that management focuses on in managing the business,” including those “measures or objectives that address the development, attraction and retention of personnel.” The SEC specifically noted that it did not adopt more prescriptive requirements because “the exact measures and objectives included in human capital management disclosure may evolve over time and may depend, and vary significantly, based on factors such as the industry, the various regions or jurisdictions in which the registrant operates, the general strategic posture of the registrant . . . and other conditions that affect human capital resources, such as national or global health matters.” Registrants must continue to disclose, to the extent such disclosure is material, the number of persons they employ.

Disclosure topics before and after the amendments are as follows:

Item 101(c) Disclosure Topics — Before the Amendments

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|--|---|
| 1. Principal products produced and services rendered | 8. Dollar amount of backlog orders believed to be firm |
| 2. New products or segments | 9. Business subject to renegotiation or termination of government contracts |
| 3. Sources and availability of raw materials | 10. Competitive conditions |
| 4. Intellectual property | 11. The material effects of compliance with environmental laws |
| 5. Seasonality of the business | 12. Number of employees |
| 6. Working capital practices | |
| 7. Dependence on certain customers | |
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Item 101(c) Disclosure Topics — As Amended

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| 1. <i>Sales</i> — Revenue-generating activities, products or services (or both), and any dependence on revenue-generating activities, and key products, services, or product families or customers, including governmental customers | 5. <i>Seasonality</i> — Extent to which the business is or may be seasonal |
| 2. <i>Markets</i> — Status of development efforts for new or enhanced products, trends in market demand, and competitive conditions | 6. <i>Government regulation</i> — Material effects that compliance with government regulations, including environmental regulations, may have on the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries |
| 3. <i>Resources</i> — Resources material to a registrant’s business (such as sources and availability of raw materials and the duration and effect of all patents, trademarks, licenses, franchises, and concessions) | 7. <i>Human capital</i> — Description of the registrant’s human capital resources, including the number of persons it employs, and any human capital measures or objectives that the registrant focuses on in managing the business |
| 4. <i>Government contracts</i> — Description of any material portion of the business that may be subject to renegotiation of profits or termination of contracts or subcontracts at the government’s election | |
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Legal Proceedings

Amendments to the requirements in Item 103 include the following:

- *Allow the use of hyperlinks or cross-references* — To help registrants avoid duplicative disclosure, the amendments expressly allow the use of hyperlinks or cross-references to disclosures about legal proceedings that were included elsewhere in the document.
- *Update the disclosure threshold for environmental proceedings* — Before the amendments, for environmental proceedings to which the government is a party, Instruction 5.C. to Item 103 required disclosure if such a proceeding was expected to result in sanctions of \$100,000 or more. The final rule increases the quantitative threshold to \$300,000 but also permits the registrant to elect a higher threshold, limited to the lesser of \$1 million or 1 percent of its current assets on a consolidated basis, if the registrant determines that such threshold is more reasonably designed to result in the disclosure of material environmental proceedings. A registrant must disclose this alternative threshold in each annual and quarterly report.



Connecting the Dots

Entities often disclose legal proceedings, if material, in the footnotes to the financial statements in accordance with ASC 450.⁵ In such cases, registrants may wish to hyperlink or cross-refer to the description of legal proceedings in the financial statements or other areas where legal matters are described (e.g., risk factors); however, they may not refer *from* such financial statements to other areas outside them, such as Item 103 (unless doing so is specifically permitted by SEC rules, U.S. GAAP, or IFRS® Standards as adopted by the International Accounting Standards Board). This prohibition is intended to prevent confusion about whether such information is or has been subject to audit or review by the registrant’s external auditor (see Securities Exchange Act of 1934, Rule 12b-23(b), “Incorporation by Reference: Financial Information”).

Risk Factors

The amendments to the Risk Factors section of Regulation S-K are intended to address the historically “lengthy and generic nature” of disclosures currently provided by many registrants under Item 105. To this end, the amendments:

- Require registrants with more than 15 pages of disclosures in the Risk Factors section to provide a summary of such factors. The summary must be no more than two pages and consist of “a series of concise, bulleted or numbered statements summarizing the principal factors.”
- Replace the requirement for registrants to disclose the “most significant” risk factors with one to disclose the “material” risk factors.
- Require registrants to organize the risk factors under relevant headings and disclose any risk factors that generally apply to an investment in securities at the end of the Risk Factors section under a separate caption.

Looking Ahead

The amendments in the final rule demonstrate the SEC’s continued focus on improving disclosure effectiveness and represent a step toward modernizing the disclosure requirements in Regulation S-K. In January 2020, the SEC began the next step by proposing amendments to the requirements for MD&A and related financial disclosures. See Deloitte’s February 10, 2020, [Heads Up](#) for information about the proposed amendments.

⁵ FASB Accounting Standards Codification (ASC) Topic 450, *Contingencies*.

During the SEC's August 26, 2020, open meeting, the SEC commissioners discussed whether the final rule should have included more prescriptive requirements related to environmental, social, and governance (ESG) issues, and they exchanged observations regarding striking the right balance of principles-based and prescriptive disclosure regulations.



Connecting the Dots

The amendments do not specifically address ESG disclosures; however, an increasing number of S&P 500 companies have published some form of such disclosures. For additional information, see Deloitte's September 24, 2019, [*Heads Up*](#).

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