

January 29, 2021

Preparing for the 2021 Annual Report and Proxy Statement Season

By: [Bruce Newsome](#) and [Matt Fry](#)

A significant number of recent updates to SEC disclosure obligations will be effective for the 2021 Form 10-K and proxy statement season. Below is a list of important items that public companies should consider for the upcoming reporting cycle. Note that this list is limited to SEC-required updates and does not cover other updates that should be taken into consideration, such as ESG disclosure, board composition, state laws regarding virtual and hybrid annual meetings and voting guidelines of proxy advisory firms and institutional investors, which are beyond the scope of this alert.

SEC Modernization of Business, Legal Proceedings and Risk Factors

The SEC adopted several amendments to Items 101, 103 and 105 of Regulation S-K which are currently in effect:

Description of Business; Reg. S-K Item 101

Development of Business. The amendments create a more flexible, principles-based approach by replacing the previously prescribed five-year timeframe (and three-year timeframe applicable to smaller reporting companies) with a materiality framework that requires disclosure of information material to an understanding of the general development of the business. Disclosure of developments is required only to the extent material to an understanding of the general development of the company's business. Companies that have already made an initial filing of a registration statement are further permitted to provide only an update on – rather than a full discussion of – the general development of the business, if they incorporate by reference the full discussion and include a single hyperlink to the prior filing.

Human Capital Resources. The amendments also updated the non-exclusive list of topics that a company may disclose regarding its business. Perhaps most importantly, the amendments require that registrants, to the extent material to an understanding of an issuer's business, include a description of their human capital resources, including human capital measures or objectives that the registrant focuses on in managing the business. "Human capital" was purposefully left undefined because this concept will evolve over time and should be tailored to individual companies and industries. Companies are taking a wide variety of approaches on human capital resources disclosures as the human capital measures and objectives of each company vary significantly. Smaller reporting companies are not required to present human capital resources disclosure.

Legal Proceedings. Item 103 of Regulation S-K was amended to expressly permit information about legal proceedings to be provided by hyperlink or cross-reference to legal proceedings disclosure located elsewhere in the document (such as in the notes to the financial statements, the risk factors, or in the MD&A section) to avoid duplicative disclosure. The amendment also implements a modified disclosure threshold for environmental proceedings to which the government is a party by increasing the current threshold from \$100,000 to \$300,000. Alternatively, a company may select a different threshold that it determines is reasonably designed to result in disclosure of material environmental proceedings so long as the threshold does not exceed the lesser of \$1 million or one percent of the current assets of the registrant and its subsidiaries on a consolidated basis. If a company chooses to select a different threshold, it must disclose such threshold (including any change thereto) in each subsequent Form 10-K and Form 10-Q.

Risk Factor Summary. Where risk factor disclosures exceed 15 pages, the amendments now require a summary risk factor disclosure of no more than two pages. The risk factor summary disclosure must be in the form of bulleted or numbered statements that summarize the principal risk factors that make an investment in the registrant or the offering speculative or risky. This summary disclosure must appear at the forepart of the filing.

Focus on “Material” Risk Factors. The new rules now require disclosure of the “material” factors – rather than the “most significant” factors – that make an investment in the registrant or offering speculative or risky. The term “material” encompasses both investment and voting decisions and is defined under Rule 12b-2 of the Securities Exchange Act of 1934, as amended, and Rule 405 of the Securities Act of 1933, as amended. As the SEC has previously stated, the definition of “material” is consistent with the Supreme Court’s decision in *TSC Industries*, which held that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.

Risk Factor Subheadings. The amendments require registrants to organize risk factors under relevant headings, in addition to the sub-captions that are already required. With the addition of headings, the SEC stated that it is not requiring registrants to prioritize the order in which risk factors are presented. Any generic or boilerplate risk factors that could apply to any company or offering must appear at the end of the risk factor section under the caption “General Risk Factors.” The SEC encourages registrants to tailor risk factor disclosure, showing a specific relationship to the registrant, to avoid the need to include risk factors under the “General Risk Factors” heading.

For more information concerning the updates to Items 101, 103 and 105 of Regulation S-K, see our [alert](#) published on September 14, 2020.

SEC Modernization of MD&A and other Financial Statement Disclosures

Following a similar principles-based approach, the SEC also adopted amendments to Item 301, 302 and 303 of Regulation S-K that will become effective February 10, 2021. Although registrants will not be required to comply with the amended rules until their first fiscal year ending on or after August 9, 2021 (the Form 10-K for the year-ended December 31, 2021, for calendar year-end filers), registrants may voluntarily comply with any amended item at any time after the amendments become effective, provided that they comply with such amended item in its entirety and continue to comply with such amended item in any applicable filings going forward. Accordingly, issuers filing their Annual Report on Form 10-K for the fiscal year ending December 31, 2020, on or after February 10, 2021, may choose to comply with any one or more of the amended items in full, such as by omitting selected financial data and/or supplementary financial information. A brief summary of these amendments follows.

Selected Financial Information; Reg. S-K Item 301

Selected financial data in comparative tabular form for each of the registrant’s last five fiscal years will be eliminated.

Supplementary Financial Information; Reg. S-K Item 302

Registrants will generally no longer be required to provide two years of tabular selected quarterly financial data and descriptions of unusual or infrequent items. However, issuers will be required to present such information if there are one or more retrospective changes that, in the aggregate, are material to the statements of comprehensive income for any of the quarters within the registrant’s two most recent fiscal

years and any subsequent interim period for which financial statements are included or required to be included.

MD&A; Reg. S-K Item 303

As amended, the new Item 303(a) emphasizes the principal objectives of MD&A and specifies information that registrants must disclose to allow investors to “view the registrant from management’s perspective.” The revisions are based upon a more principles-based approach. Among other things, the amendments to Item 303 also will require disclosure of (i) “capital commitments” broadly rather than commitments for capital expenditures and (ii) known trends and uncertainties that are “reasonably likely” to cause a material change, as opposed to those events that “will” have a material impact. The contractual obligations table will no longer be required.

For more information concerning the amendments to Items 301, 302 and 303 of Regulation S-K, including additional revisions to MD&A, see our [alert](#) published on January 13, 2021.

COVID-19 Disclosure

Most registrants have made disclosure regarding the COVID-19 pandemic in at least three periodic filings (potentially the 2019 Form 10-K and most likely the Form 10-Qs for the first three quarters of 2020). The SEC’s March 25, 2020, guidance stated that the “effects COVID-19 has had on a company, what management expects its future impact will be, how management is responding to evolving events, and how it is planning for COVID-19-related uncertainties can be material to investment and voting decisions.” The disclosure of the COVID-19-related impacts may be appropriate in the following areas:

- MD&A;
- Business;
- Risk factors;
- Legal proceedings;
- Disclosure controls and procedures;
- Internal control over financial reporting; and
- Financial statements.

The SEC’s follow-up guidance on June 23, 2020 provided additional disclosure considerations and recommended additional focus on the following:

- Operations, Liquidity and Capital Resources;
- CARES Act Governmental Assistance; and
- Ability to Continue as a Going Concern.

Both sets of guidance also include lists of questions registrants should consider when analyzing the impact of COVID-19.

Also, on June 23, 2020, the Office of the Chief Accountant provided supplements to its April 3, 2020, COVID-19 disclosure guidance. The Office of Chief Accountant recommended that registrants also focus on the following areas:

- Significant judgments and estimates,
- Internal control over financial reporting, and
- Ability to continue as a going concern.

It also stressed engaging with the audit committee on these issues.

In light of the guidance from the SEC, we recommend the following considerations:

- Potential Operations Disclosures in MD&A
 - The disclosure should allow investors to evaluate the impact of COVID-19 on the company through the eyes of management; and
 - Any material COVID-19-related challenges that are specific to the company and its industry.
- Operations challenges from COVID-19, such as the following:
 - Transitions to and from remote workplaces, including related risks to internal controls;
 - Impact on supply chains and modifications resulting therefrom; and
 - Health and safety policies which have been implemented by the registrant.
- Potential Financial Resources and Liquidity Disclosures
 - Impact of COVID-19-related operational changes and changes in revenue on both short and long-term liquidity;
 - Financing arrangements, such as the following:
 - New arrangements, including draws on revolvers;
 - COVID-19's impact on access to traditional funding sources on similar terms as in previous periods or changes in the cost of capital;
 - Additional collateral, guarantees or equity provided to obtain funding and any financing terms that could limit the ability to obtain additional funding; and
 - Risks of default on current funding.
 - Contractual obligations such as material extensions of credit and/or extensions of payments terms to customers; and
 - Reductions in capital expenditures.
- CD&A. Discussion of the impact of, and compensation decision made in respect of, the pandemic.

- CARES Act Disclosure
 - Short and long-term impact of the CARES Act assistance on the registrant's financial condition, results of operation, liquidity and capital resources;
 - The material terms and conditions of any CARES Act loan and whether the registrant expects to be able to comply with the conditions;
 - Whether the registrant anticipates satisfying the loan forgiveness criteria; and
 - Whether the registrant is taking advantage of CARES Act tax relief and whether it expects a material tax refund for prior periods.
- Going Concern Issues. If COVID-19-related events raise substantial doubt as to a registrant's ability to continue as a going concern, and management's plans do not alleviate such doubt, the registrant should disclose the following:
 - The principal conditions giving rise to the substantial doubt;
 - Management's evaluation of the significance of those conditions relative to the registrant's ability to meet its obligations;
 - If applicable, management's plans that alleviated the substantial doubt; and
 - Additional disclosure if management's plans do not alleviate the substantial doubt.
- Risk Factors for Consideration.
 - Disruptions to business as a result of quarantines (employees, customers or suppliers) and closing of facilities (storefronts, restaurants, manufacturing, warehouses, etc.);
 - Impacts on customer spending and trends;
 - Negative publicity;
 - Credit covenants;
 - Impacts on outstanding material agreements (closing conditions, force majeure or material adverse effect clauses and termination rights); and
 - Impairments.

For more information concerning COVID-19 disclosures, see our [alert](#) published on July 13, 2020.

Cover Page of Form 10-K

The Form 10-K cover page has additional disclosure regarding whether an internal control over financial reporting attestation by the registrant's outside auditor is included in the filing. This was added due to the changes in the definitions of accelerated filer and large accelerated filer.

Key Performance Indicators and Metrics in Management's Discussion and Analysis

Late in the filing period for the 2019 Annual Reports, the SEC issued interpretive guidance on disclosure of key performance indicators and metrics ("KPIs") in MD&A. It was issued in connection with the proposed amendments to Item 303 of Regulation S-K, amendments which have now been adopted but are not required, except on a voluntary basis, until August 9, 2021, as described above.

The SEC is seeking disclosure of key variables and other factors that management uses to manage the business that would be material to investors. These variables and factors could include financial and non-financial metrics as well as other factors necessary to understand the registrant. The disclosure should provide the following:

- A clear definition of the KPI and how it is calculated, if applicable;
- Why the KPIs are useful to investors;
- How the KPIs are used by management in managing the business; and
- Any material estimates or assumptions that underlay the KPIs.

Updated Disclosure for Guarantors and Certain Affiliates

The disclosure requirements in Rule 3-10 and Rule 3-16 of Regulation S-X are amended to focus investors on material information. Condensed consolidating financial information has been replaced with summarized financial information and certain non-financial disclosures, and annual disclosures may be in the financial statements or outside them. In most cases, summary financial information of the issuer and the guarantor for the most recently ended fiscal year and year-to-date interim period may be combined. The description of the issuers and guarantors is required as well as the terms and conditions of the guarantees. The amendments became effective on January 4, 2021, although registrants had the option of early compliance.

Critical Audit Matters (CAMs) Now Apply to All Registrants

Additional disclosure requirements under Auditing Standard 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, will now apply to all registrants. Under the standard, auditors are required to communicate critical audit matters, or CAMs, arising from the current period's audit in their audit report. CAMs are matters communicated or required to be communicated to the audit committee that (i) relate to accounts or disclosures that are material to the financial statements and (ii) involved especially challenging, subjective or complex auditor judgment. For each identified CAM, the auditor must describe in its audit report the principal considerations that led the auditor to determine that the matter was a CAM and how the CAM was addressed in the audit and refer to the relevant financial statement accounts or disclosures. In preparation for the new standard, companies that were not subject to CAMs last year should consider conducting "dry-runs" to determine what matters currently constitute CAMs, request drafts of CAM disclosures from their auditors and educate investor relations personnel about CAMs so they are prepared for investor questions. Common CAMs include:

- Goodwill;
- Revenue recognition;
- Business combinations; and
- Other intangibles.

Inline XBRL

Large accelerated filers and accelerated filers have already been required to transition to Inline XBRL, which requires embedding XBRL data into the filing, for financial statements information disclosures. All other filers must similarly transition for reports with fiscal periods ending on or after June 15, 2021. Once a registrant transitions to Inline XBRL, each Item 601(b)(101) exhibit in the exhibit index must include the word “inline” in its title description for the exhibit, and every Form 8-K that includes another exhibit must also include an Item 601(b)(104) exhibit, such as “Cover Page Interactive File (formatted as Inline XBRL).”

Proxy Statement CEO Pay Ratio Median Employee

Since the 2021 proxy statement will be the fourth proxy statement to include the CEO pay ratio, companies that have used the same median employee for the first three years of the CEO pay ratio will need to find a new median employee since the same median employee can only be used for three years. If a registrant is still in the three-year period, it could usually use the same median employee for 2021. However, Item 402(u) of Regulation S-K notes that a new median employee should be selected before the three-year term is over if there is a change in employee population or employee compensation arrangements to the extent that there would be a significant change in the pay ratio disclosure if the same median employee were to be used. Therefore, due to layoffs, furloughs, pay decreases due to COVID-19, etc., registrants in the middle of the three-year period should determine if last year’s median employee is still appropriate to be the median employee for 2021.

Proxy Statement Perquisite Disclosure Related to COVID-19 Adjustments

On September 21, 2020, the SEC issued Compliance and Disclosure Interpretation 219.05 of Regulation S-K regarding potential perquisites relating to employees working from home due to COVID-19. The SEC reiterated that its two-step perquisite analysis should be used to determine if COVID-19-related items which have been provided to executive officers should be considered as “All Other Compensation” in the Summary Compensation Table. The two-step process is the following:

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive’s duties; and
- An item that confers a direct or indirect benefit and has a personal aspect, even if it is provided for some business reason or convenience of the company, is a perquisite or personal benefit unless it is generally available on a non-discriminatory basis to all employees.

Examples the SEC noted for registrants to be on alert for are enhanced technology to permit the executive officer to work from home due to stay-at-home orders (generally not considered a perquisite or personal benefit) as compared to new health-related or personal transportation benefits provided to address new risks arising because of COVID-19 (considered a perquisite or personal benefit if they are not integrally and directly related to the performance of the executive’s duties unless such benefits are generally available to all employees).

When determining the Named Executive Officers for 2020 and the amounts to be included in the “All Other Compensation” section of the Summary Compensation Table, companies should look out for new benefits provided due to COVID-19 and their potential categorization as a perquisite or personal benefit.

Updated Nasdaq Family Member Definition

Although there are not many major updates for Director and Officer Questionnaires for 2021, in February 2020, Nasdaq updated its “Family Member” definition. Based on the timing, many companies already had their Director and Officer Questionnaires distributed and returned so Nasdaq companies may want to update this year’s questionnaires for the new “Family Member” definition. The updated definition excludes from the definition (i) step-children who do not share a director’s home; and (ii) domestic employees who do share a director’s home. Even with these exclusions from the “Family Member” definition, the Board of Directors will need to examine any such circumstances in case they do interfere with a board member’s independence.

For additional information regarding these and other proxy season updates, please contact any member of Haynes and Boone’s [Capital Markets and Securities Practice Group](#)