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## Preparing for the 2022 Annual Report and Proxy Statement Season

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A number of recent updates to SEC disclosure obligations are effective for the 2022 Form 10-K and proxy statement season. Below is a list of important updates that public companies should consider for this reporting cycle. Note that this list is limited to key SEC and stock exchange required updates and does not cover other updates that should be taken into consideration, such as 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 Regulation S-K

The SEC has enacted comprehensive changes to Items 301, 302 and 303 of Regulation S-K. Many companies early adopted a portion of these updates in 2021, but this will be the first Form 10-K filed by calendar-year companies that must comply with these rule changes, including those to MD&A.

Item 301 – Selected Financial Information – Item 301 of Regulation S-K has historically required companies to provide selected financial data in a comparative table for each of the last five fiscal years. SEC rule amendments have eliminated this disclosure requirement. In amending this rule, the SEC has encouraged companies to consider whether trend information for periods earlier than those reflected in the financial statements may be necessary to provide material information concerning the financial condition of registrants and their results of operations. Further, the SEC has encouraged registrants to consider whether a tabular presentation of financial information may help a reader's understanding of trends discussed in the MD&A section. In the updated Form 10-K made available by the SEC, Item 6 now reads as "Item 6. [Reserved]".

Item 302(a) – Supplementary Financial Information – Item 302(a) of Regulation S-K previously required tabular disclosure of two years of selected quarterly financial data and descriptions of unusual or infrequent items in a registrant's Form 10-K. New Item 302(a) replaces the Item with a principles-based disclosure requirement, with disclosure required if there are any material retrospective changes to the statements of comprehensive income for any of the quarters within the two most recent fiscal years or any subsequent interim period for which financial statements are included or required to be included that, in the aggregate, are material. If disclosure is required, registrants must provide an explanation of the reasons for the change and summarized financial information.

Item 303(a) – Purpose of MD&A – Item 303(a) of Regulation S-K is a new overview to MD&A and highlights the SEC's principles-based approach to MD&A disclosure, with a goal of enabling investors to view the registrant from management's perspective. Registrants should disclose matters that are reasonably likely, based on management's assessment, to have a material impact on future operations. This could include material information relevant to an assessment of the financial condition and results of operations of the registrant, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. Registrants must discuss material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or of future financial condition. Registrants should disclose the material financial and statistical data that they believe will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations.

Item 303(b) – Qualitative and Quantitative Reasons for Material Changes and Other Disclosures – Former Item 303(a) has become Item 303(b). New Item 303(b) updates the required disclosures concerning capital

resources, results of operations, off-balance sheet arrangements and contractual obligations. In addition, Item 303(a) now requires a discussion of “the underlying reasons for” material changes in both qualitative and quantitative terms, rather than a simple discussion of the “causes” for material changes. Instead of simply reciting changes, registrants should explain why changes have occurred in both qualitative and quantitative terms. Where reasons for material changes are interrelated, registrants should acknowledge and explain the interrelation of reasons to the extent possible. Below are specific key changes in the new Item 303(b).

- **Capital Resources** – The new rule expands the disclosure by requiring that registrants broadly disclose material cash commitments, including but not limited to capital expenditures. Registrants should broadly disclose material cash requirements including, but not limited to, commitments for capital expenditures, the anticipated sources of funds needed to satisfy such cash requirements and the general purpose of such requirements. “Requirements” encompass a broader range of significant cash commitments, such as IP and human capital, which may be as significant or more significant than capital expenditures on physical assets.
- **Known Trends or Uncertainties** – New Item 303(b) revised the standard for disclosure of known trends or uncertainties. Registrants must now disclose known events that “are reasonably likely” to cause a material change, as opposed to those events that “the registrant believes will” have a material impact. This lowers the threshold for disclosure, as the SEC specified that events are “reasonably likely” to cause a material change if a reasonable investor would consider the omission of such events as significantly altering the mix of information provided in a registrant’s disclosures. Registrants should evaluate how likely a particular event is to occur and the materiality of that event if it occurs.
- **Net Sales and Revenues** – As many registrants had already been disclosing, registrants must now disclose material “changes” in net sales or revenues and not just material “increases.”
- **Inflation and Price Changes** – Registrants are no longer required to specifically reference the impact of inflation and price changes on a registrant’s net sales, revenue and income from continuing operations, to the extent material. However, if material, registrants are still required discuss the impact of inflation or price changes if they are part of a known trend or uncertainty that has had, or is reasonably likely to have, a material favorable or unfavorable impact on net sales, revenue, or income from continuing operations.
- **Off-Balance Sheet Arrangements** – Off-balance sheet arrangements no longer need to be disclosed under a separately-captioned heading, and the disclosure is expected to be incorporated into the broader MD&A discussion of liquidity and capital resources. The updated rule provides for a “principles-based” approach to discussing 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 the registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources.
- **Critical Accounting Estimates** – For each critical accounting estimate, registrants must disclose (i) why the estimate is subject to uncertainty, (ii) to the extent such information is material and reasonably available, how much the estimate has changed during a relevant period, and (iii) the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation.

- *Segment Reporting* – Registrants must discuss, to the extent relevant and necessary to understand the registrant's business, each relevant "product line" in addition to the requirement to discuss relevant segments and subdivisions (e.g., geographic areas).
- *Elimination of Contractual Obligations Table* – The requirement to include a contractual obligations table has been eliminated. Registrants must still discuss material cash requirements, including material contractual obligations, in the liquidity and capital resources discussion, and may choose to present this information through the continued inclusion of the table.

Item 303(c) – Interim Period Adjustments - Former Item 303(b) has now become new Item 303(c) and now permits registrants to compare their most recently completed quarter to either (i) the corresponding quarter of the prior year (as historically was required) or (ii) the immediately preceding quarter. This change aims to provide flexibility and a more tailored and meaningful analysis concerning business cycles.

## Updates to Risk Factors

For upcoming Form 10-Ks, public companies should be aware of a number of emerging trends that may impact risk factor disclosures. Although each company will need to evaluate its own material risks and tailor its risk factors to its particular set of circumstances, below are certain areas that companies should consider when assessing their risk factors.

Inflation – Some companies may elect to include a separate risk factor discussing risks from inflation while others may incorporate the discussion into a broader discussion of general economic risks or in MD&A.

Supply Chain Risks – Given that supply chain disruptions remain a pressing issue, companies should provide adequate disclosure regarding supply chain risk and the potential impact of that risk on their business. Companies experiencing supply chain issues should consider including a risk factor specifically addressing these considerations rather than incorporating a discussion of supply chain risks facing the company into a broader discussion of general economic conditions.

Labor Shortages and Wage Increases – Many companies are similarly facing labor shortages and wage increases. MD&A disclosure may be appropriate in addition to risk factor disclosure.

COVID-19 Risks – As the COVID-19 pandemic continues, companies should update their COVID-19 risk factor disclosures to ensure that the relevant language is not simply hypothetical. Instead, companies should address the extent to which these risks have already occurred and the impact they have actually had on the company. While some concerns originally raised in COVID-19 risk factors may no longer be relevant, the continued uncertainty regarding the length of the pandemic and the severity of potential outcomes may require additional details to address the full range of potential risks.

Cybersecurity Risks – Cybersecurity remains an area of SEC focus, and cybersecurity disclosure is on the SEC's rulemaking agenda. Cybersecurity risk factors should address the types of cybersecurity threats that a company faces and the extent to which the company has been impacted by actual breaches or other incidents. Cybersecurity disclosures should address preventative measures that may have been established for the purposes of addressing these risks and the risk that these measures may not be effective. Disclosures should address the extent to which cyber incidents incurred by third parties such as Solar Winds or Kronos might expose and/or did expose the issuer to adverse ramifications from such incidents. Disclosures should highlight the range of potential or actual consequences resulting from a cyber-attack, which might include things such as reputational harm, costs to remedy the impact of the attack and costs for implementing protective measures. While all risk factors should be reviewed to determine whether

it is necessary to update risks phrased in the hypothetical when the underlying risk has actually occurred, particular attention should be paid to cybersecurity risk factor updates.

## Other Form 10-K Considerations

LIBOR Transition – The forthcoming transition away from LIBOR continues to be an area of SEC focus. To the extent they have not already done so, companies should identify contracts dependent on the continued publication of LIBOR and, to the extent material, describe how the company, its business and contracts will be impacted by the termination of LIBOR. Disclosure may be appropriate in risk factors or MD&A.

Human Capital Management – Registrants were first required in Form 10-Ks for last year's annual reporting season to include disclosures about their human capital resources, including human capital measures or objectives that the registrant focuses on in managing the business. Companies took a wide variety of approaches on this disclosure, with variances in length and content, and trends arising within industries. Registrants should review and update their human capital management disclosures after reviewing human capital disclosures by peers and others within the market.

Industry Guide 3 Modernization – Industry Guide 3, applicable to banking registrants, was codified into subpart 1400 of Regulation S-K. The new rules are applicable for fiscal years ending on or after December 31, 2021 (unless registrants elected to early adopt the new rules). The new rules made numerous minor changes from Guide 3 requirements as well as certain significant changes, including requirements to disclose the ratio of net charge-offs to average loans outstanding by category of loan and three new credit ratios: (i) allowance for credit losses to total loans, (ii) nonaccrual loans to total loans and (iii) allowance for credit losses to nonaccrual loans.

Industry Guide 7 Modernization – Industry Guide 7, applicable to mining companies, including royalty companies, was amended and codified into subpart 1300 of Regulation S-K, which is now effective. Item 1300 of Regulation S-K applies to each registrant that has mining operations that are material to the registrant's business or financial condition. Disclosure of mineral resources and mineral reserves is required based on information prepared by a "qualified person." For companies with a material property, a technical report summary must be filed as an exhibit to the Form 10-K for each material property.

New Item 9C - Holding Foreign Companies Accountable Act (HFCA) Disclosures – New Item 9C results from new disclosure requirements in the Holding Foreign Companies Accountable Act (the "HFCA Act"). Item 9C requires disclosure if the issuer has retained an auditor for financial statements included in the Form 10-K with a branch or office located in a foreign jurisdiction, and the PCAOB has determined it is unable to inspect the registered public accounting firm due to a position taken by an authority figure in the foreign jurisdiction. Similar changes were made to Forms 20-F and 40-F. Most issuers are not expected to be impacted by the HFCA Act, but all issuers should include the new Item 9C in their Form 10-K, with most issuers indicating that the item is not applicable.

## Climate Change

Renewed Focus Towards 2010 SEC Guidance – In February 2021, the SEC issued a [statement](#) directing the Division of Corporation Finance to renew its focus on climate-related disclosures in public company filings. This statement expanded upon the SEC's prior 2010 interpretive guidance (Rel. No. 33-9106 (2010)) on climate change matters. In the 2021 update, the SEC stated that it would take "immediate steps" to ensure that companies are complying with the existing rules discussed in the 2010 guidance and that it intended to update this existing guidance. Although it has not yet, the SEC aims to ultimately develop a "more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures." Please find our discussion of the 2021 update [here](#).

Climate Change Comment Letters – The staff issued comment letters to registrants and took the uncommon step of publishing a sample climate change comment letter in late 2021. These letters asked registrants to consider the effects of climate change on numerous matters, including their business, financial condition and results of operations as well as their major customers and suppliers. To the extent material, disclosure of the effects and risks of climate change may be appropriate in risk factors and MD&A. The impact of climate change varies greatly by company, industry and geographic region, and climate change disclosures should be tailored to each registrant.

## **Nasdaq Diversity Disclosure Updates**

Diversity Matrix – Under new Nasdaq Rule 5606, Nasdaq-listed companies must annually disclose self-identified board diversity data in a format substantially similar to Nasdaq's form Board Diversity Matrix. This disclosure can be made either in the proxy statement (or Form 10-K if no proxy statement is filed) or on the company's website. Companies may send a request to [drivingdiversity@nasdaq.com](mailto:drivingdiversity@nasdaq.com) for a determination as to whether their proposed matrix qualifies as being substantially similar to the Nasdaq form Board Diversity Matrix. Companies listed on Nasdaq when the rule was adopted are required to post an initial board diversity matrix to their website by August 8, 2022 if they have not first included the matrix in the proxy statement for their 2022 annual meeting of shareholders (or their Form 10-K or 20-F filed in 2022 if no proxy statement is filed).

Board Diversity Objective - Under new Nasdaq Rule 5605(f), each Nasdaq-listed company will soon be required to meet, or explain why it does not meet, certain diversity criteria with respect to its board composition. Though Nasdaq-listed companies are not required to make their first disclosures under this new rule until August 7, 2023, such companies may wish to review the diversity objectives in the rule during 2022 to prepare.

For further information on Nasdaq Diversity Disclosure updates, please find our alert on the topic [here](#).

For further information, please contact a member of the Haynes and Boone [Capital Markets and Securities Practice Group](#).