SEC Issues MD&A Guidance

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Speed Read

The Securities and Exchange Commission (Commission) recently announced that it has issued guidance on key performance indicators and metrics in Management's Discussion and Analysis (MD&A). Although the guidance in the interpretive release may not significantly change current disclosure of performance indicators and metrics in many companies' MD&A, interpretive guidance formally issued by the Commission merits careful attention.

WHAT COMPANIES SHOULD BE DOING NOW

Companies should ensure that the disclosure committee is aware of the Commission guidance and has an opportunity to consider the possible impact of this guidance on both the company's current disclosures and the company's disclosure controls and procedures. Since many companies are preparing to file Form 10-K reports now, this would be an appropriate time to review this guidance. As described in more detail below, the principal areas for review would include disclosure that places the company's key performance indicators and metrics in context; providing disclosure about how the indicators and metrics are calculated and used by management and why management believes they are useful to investors; and including appropriate disclosure when there are changes in how the company calculates key performance indicators or metrics, or changes in which indicators or metrics the company discloses.

EXAMPLES OF KEY PERFORMANCE INDICATORS AND METRICS

As examples of key performance indicators and metrics to which the Commission guidance applies, the interpretive release specifically cites operating margin; same store sales; sales per square foot; total customers/subscribers; average revenue per user; daily/monthly active users/usage; active customers; net customer additions; total impressions; number of memberships; traffic growth; comparable customer transactions increase; voluntary and/or involuntary employee turnover rate; percentage breakdown of workforce (e.g., active workforce covered under collective bargaining agreements); total energy consumed; and data security measures (e.g., number of data breaches or number of account holders affected by data breaches). The interpretive release notes that this is not an exclusive list of these metrics.

EFFECTIVE DATE

The Commission guidance was effective upon publication in the *Federal Register* on February 25, 2020.

BACKGROUND

Key performance indicators and metrics have been a long-term focus of the Commission. The Commission released interpretive guidance on key performance indicators and metrics in 2003, and these disclosures have been the subject of numerous Commission staff comment letters in recent years. These disclosures have also been elements in four Commission enforcement actions during the last two years.

The interpretive release reminds companies that MD&A requires companies to disclose information that Item 303(a) of Regulation S-K specifically references if the company believes that the disclosure is necessary to an understanding of the company's financial condition and results of operations, and to disclose other statistical data that the company believes would enhance a reader's understanding of MD&A. The interpretive release also notes that the Commission has encouraged companies to "consider whether disclosure of all key variables and other factors that management uses to manage the business would be material to investors, and therefore required" in MD&A. Because the SEC intends that MD&A should enable investors to see the company through the eyes of management, the interpretive release states that "these metrics should not deviate materially from metrics used to manage [the company's] operations or make strategic decisions." These required disclosures, as well as voluntarily-disclosed financial and non-financial metrics – which can vary significantly from company to company and industry to industry, and may be either internal information about the company or external/macro-economic matters that affect a company or its industry, or a mixture of both – are the "key performance indicators and metrics" to which the Commission guidance applies.

COMMISSION GUIDANCE

The interpretive release provides guidance on several points relating to key performance indicators and metrics.

Additional Information May Be Necessary to Make Metrics Not Materially Misleading.

When a company includes a metric in its disclosure, it should consider including any additional material information that is necessary to make the presentation not misleading, in light of the circumstances in which the company presents the metric. When they do so, the Commission guidance states that companies should first consider the extent to which an existing regulatory disclosure framework applies. For GAAP metrics and financial measures, this would include GAAP standards. For non-GAAP metrics and financial measures included in SEC filings, this would include Regulation G and Item 10(d) of Regulation S-K. The Commission expects that the following disclosures would generally accompany these metrics, as appropriate under the facts and circumstances of the Company's disclosure of a key performance indicator or 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 company's business.

Companies should also consider whether disclosure of any estimates or assumptions underlying the metric or its calculation would be necessary to prevent the metric from being materially misleading.

Explain Changes in Calculation or Presentation of Metrics.

When a company changes the method by which it calculates or presents a metric from one period to another, the company should consider the need to disclose the following, if material:

- The differences in how the company calculates or presents the metric, compared to prior periods;
- The reasons for the change;
- The effects of the change on amounts or information currently disclosed compared to amounts or information previously reported; and
- Any other differences in methodology or results that would reasonably be expected to be relevant to an investor's understanding of the company's performance or prospects.

Companies should also consider whether it may be necessary to recast prior disclosures to conform to the current disclosure and allow investors to consider the current disclosure in an appropriate context.

Review Disclosure Controls and Procedures.

Finally, the interpretive release reminds companies that they must maintain effective disclosure controls and procedures, and that the company's principal executive officer and principal financial officer must make certifications regarding the maintenance and effectiveness of the company's disclosure controls and procedures. When key performance indicators or metrics are material to an investment or voting decision, the company should consider whether its disclosure controls and procedures will be effective to ensure consistency and accuracy in presentation of the performance indicators or metrics.

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