SEC Issues Disclosure Guidance on Key Performance Indicators and Metrics in MD&A

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On January 30, the Securities and Exchange Commission released **interpretive guidance** for companies regarding disclosure of key performance indicators (KPIs) and other metrics in Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The guidance was released in conjunction with the release of a **proposal** by the SEC to significantly streamline and enhance MD&A disclosure (which will be the subject of a separate client memo.)

While not materially altering current disclosure requirements, the guidance seems to encourage the disclosure of KPIs and other metrics as a way of facilitating the SEC's goal of allowing investors to see a company "through the eyes of management." At the same time, the guidance is as a reminder to companies to accurately define and disclose any metrics.

In line with the SEC's emphasis that the MD&A should provide a narrative that enables investors to see a company from management's viewpoint, the guidance provides that KPIs and other metrics included in the MD&A generally should not deviate materially from the metrics used to manage operations or make strategic decisions. Further, in presenting KPIs and other metrics in MD&A, companies should consider whether disclosure of any further material information, including any estimates or assumptions underlying the metric or its calculation, is necessary for the metric not to be materially misleading.

The guidance states that, based on the facts and circumstances, the following disclosures should accompany any 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 business.

If a company has changed the method by which it calculates or presents the metric, it should consider disclosing to the extent material:

- The differences in the way the metric is calculated or presented compared to prior periods;
- The reasons for such changes;
- The effects of any such change on the amounts or other information being disclosed and on amounts or other information previously reported; and
- Such other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects.

The guidance also advises companies to consider whether it has effective controls and procedures for material KPIs and metrics.

Examples of metrics to which the guidance would apply include operating margin, same store sales, sales per square foot, total customers or subscribers, average revenue per user, daily or monthly active users or usage, active customers, net customer additions, total impressions, number of memberships, traffic growth, comparable customer transactions increase, voluntary 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).

However, the SEC's guidance does not override other existing regulatory disclosure frameworks, such as Generally Accepted Accounting Standards (GAAP) for GAAP measures, and the SEC's rules for non-GAAP measures. Thus, when presenting KPIs and other metrics in their MD&A, companies should first consider whether they are GAAP measures, non-GAAP measures or otherwise metrics that are subject to another such disclosure framework.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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