SECURITIES CLIENT ALERT

SEC Treats Performance Metrics Much Like Non-GAAP Financial Measures
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On January 30, 2020, the U.S. Securities and Exchange Commission (the Commission) provided interpretive guidance (the Guidance) regarding the disclosure of key performance indicators and metrics used in the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of SEC filings. The Guidance became effective on February 25, 2020.

The Commission regularly focuses attention on key performance indicators and metrics. The Commission released interpretive guidance on key performance indicators and metrics in 2003, and more recently, these disclosures have been the subject of numerous Commission staff comment letters. These disclosures have also been elements in four Commission enforcement actions during the last two years.

According to the Commission, the Guidance is intended to apply to metrics, including, but not limited to: 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 Guidance does acknowledge that some companies "voluntarily disclose environmental metrics, including metrics regarding the observed effect of prior events on their operations." The Commission does confirm that the Guidance applies to several environmental, social and governance (ESG) metrics, such as: total energy consumed, percentage breakdown of workforce, voluntary and/or involuntary employee turnover rate, and data security breaches.

The Guidance re-emphasized that, when preparing MD&A, "companies should 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."

The Commission also reminds companies that, "when including metrics in their disclosure, they should consider existing MD&A requirements and the need to include such further material information, if any, as may be necessary in order to make the presentation of the metric, in light of the circumstances under which it is presented, not misleading." To that end, 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, based on the facts and circumstances, the following disclosures to accompany the metric:

1) A clear definition of the metric and how it is calculated;
2) A statement indicating the reasons why the metric provides useful information to investors; and
3) A statement indicating how management uses the metric in managing or monitoring the performance of the business.

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

1) The differences in how the company calculates or presents the metric, compared to prior periods;
2) The reasons for the change;
3) The effects of the change on amounts or information currently disclosed compared to amounts or information previously reported; and
4) 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.

Depending on the significance of the change(s) in methodology and results, 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.

The Commission ends the Guidance by reminding companies to maintain effective disclosure controls and procedures. When key performance indicators and metrics are material to an investment or voting decision, the company should consider whether it has effective controls and procedures in place to process information related to the disclosure of such items to ensure consistency as well as accuracy.

Next Steps - Review Disclosures and Disclosure Controls and Procedures

Companies should make sure that their disclosure committee is aware of the Commission Guidance and has an opportunity to consider the possible impact of the Guidance on both the company's current disclosures and the company's disclosure controls and procedures.

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