Proskauer

SEC Issues Guidance on the Use of Key Performance Indicators and Metrics in MD&A

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On January 30, 2020, the Securities and Exchange Commission ("SEC" or "Commission") published interpretive guidance (the "Guidance") that companies should consider when disclosing key performance indicators ("KPIs") and other metrics in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"). The Guidance, which is consistent with staff comments in this area, describes the type of information that the Commission generally would expect to accompany a presentation of KPIs and other metrics. The Guidance builds on the existing disclosure requirements for MD&A, including the SEC's emphasis on disclosing critical variables that management uses to manage the business, and provides a framework for presenting KPIs and metrics in MD&A. Measurements that are subject to another disclosure framework, such as non-GAAP financial measures, should not be affected by the Guidance.

Takeaway. Companies should carefully review the new Guidance and consult with counsel in preparing MD&A disclosure in their annual reports for fiscal year 2019, as well as subsequent periodic filings and registration statements. Additional disclosure may be necessary to define the metric and explain why it is useful to management and investors. Although the Guidance does not address the use of KPIs and other metrics outside of MD&A, companies should consider whether similar disclosure is necessary to provide adequate context for KPIs and other metrics in different sections of their SEC filings, investor presentations, earnings releases and other materials.

Background. Item 303 of Regulation S-K requires a company's MD&A disclosure to include a discussion and analysis of statistical data that the company believes will enhance a reader's understanding of its financial condition. In previous guidance, the SEC has emphasized the importance of disclosing in MD&A "key variables" that are critical to understanding how a company manages its business. Staff comment letters have focused for some time on the use and presentation of KPIs and other metrics, often directing companies to provide additional context for such disclosure. The new Guidance reflects many of the disclosure issues raised by the staff through the comment process and may address some uncertainties about the type of information that should be disclosed with the presentation of metrics.

Scope of the Guidance. The Guidance reflects the Commission's views on the appropriate presentation of KPIs and other metrics within MD&A. Examples of metrics identified in the Guidance include: 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, total energy consumed and data security measures. The list of metrics cited by the Commission is not exhaustive and companies should be mindful that KPIs and other metrics differ from company to company and industry to industry. The Guidance also applies to environmental metrics that companies may voluntarily disclose.

The following table provides examples of operating metrics used by companies in certain industry sectors:

Sector	Examples of Operating Metrics
Healthcare	• Net revenues per patient served • Insured tests performed • Total samples processed • Net revenue per insured test • Direct costs per patient served • Direct costs per sample

Sector	Examples of Operating Metrics
Technology, Media & Telecommunications	• Daily active users • Monthly active users • Average bookings per user • Monthly unique users • Average revenue per user • Monthly sessions
Consumer / Retail	• Gross merchandise volume • Total orders • Active customers • Comparable sales • Comparable store inventory turnover • Payroll as a percentage of net sales • Client spend retention • Marketplace revenue • Average order value • Orders per customer • Percentage of orders placed from mobile devices

Sector	Examples of Operating Metrics
Financial Services	• Client dollars invested • Net new assets • Client assets under care • Loans-to-deposits ratio • Efficiency ratio • Return on average total tangible assets • Average customer loan balance • Number of new customer loans • Customer acquisition costs
Real Estate	• Rentable square feet • Consolidated weighted average square feet and occupancy • Annualized revenue per occupied square foot • Same store revenue • Rent coverage • Average sales volume per guest • RevPAR • Average Daily Rate • Turnover costs on leases commenced

The Guidance directly addresses the use of KPIs and other metrics in MD&A but does not discuss the use of such measures in other parts of a company's disclosure filing. Given that the Commission based its Guidance on broad principles of presenting disclosure in a manner that is not misleading, companies generally should consider providing similar disclosures in connection with the presentation of KPIs and other metrics outside of MD&A, including in the description of business and graphics. Companies should pay similar attention to KPIs and metrics presented outside of their SEC filings, such as investor presentations. However, metrics that are covered by other disclosure frameworks, such as U.S. GAAP or the SEC's rules applicable to non-GAAP financial measures (*i.e.*, Regulation G and Item 10(e) of Regulation S-K), should not be affected by the Guidance, regardless of whether they appear in MD&A or elsewhere.

Expected Disclosure. If a company includes metrics in its MD&A, the Commission generally expects certain disclosure to accompany the metric:

- **Additional Information Necessary to Understand the Metric.** The Guidance advises companies to consider what additional information may be necessary in order for an investor to understand the metric and to make the presentation of the metric, in light of the circumstances under which it is presented, not misleading. Such additional disclosures typically would include (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. Companies also should consider whether disclosing estimates or assumptions underlying the metric or its calculation would be necessary for the metric not to be materially misleading.
- **Changes in the Method of Calculating or Presenting the Metric.** The Guidance outlines disclosure considerations when a company changes the method by which it calculates or presents the metric from one period to another, including: (1) the differences in the way the metric is calculated or presented compared to prior periods, (2) the reasons for the changes, (3) the effects of any change on the amounts or other information being disclosed and on amounts or other information previously reported and (4) other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects. Companies also should evaluate whether it is necessary to recast prior metrics depending on the significance of the change.

Disclosure Controls and Procedures. The Guidance cites the requirements in Exchange Act Rules 13a-15 and 15d-15 to maintain effective disclosure controls and procedures and advises companies to consider these requirements when disclosing key performance indicators or metrics. Companies should pay close attention to this aspect of the guidance in preparing their upcoming Forms 10-K and 10-Q to ensure the accuracy of their disclosures about the effectiveness of the company's disclosure controls and procedures.

Takeaway. Disclosure of KPIs and other metrics gives companies an opportunity to tell their stories and share with investors the metrics by which a company measures its own success. The SEC's Guidance further clarifies how companies can provide the appropriate context when discussing their performance "through the eyes of management." The Guidance represents not a new turn in MD&A but confirmation that MD&A remains focused on enhancing a reader's understanding of the company's financial condition, changes in financial condition and results of operations.

If you have questions about how this new Guidance applies to your business or industry, please contact your Proskauer attorney or one of the capital markets attorneys listed on this alert.

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