

SEC Issues Guidance for Key Performance Metrics in MD&A

January 31, 2020

Yesterday the Securities and Exchange Commission provided new guidance on the presentation of performance metrics in MD&A. The guidance will take effect immediately when it is published in the Federal Register, which will make it applicable to annual reports on Form 10-K and Form 20-F that are currently in preparation. This memo summarizes the impact of the new guidance.

The guidance is related to a major SEC proposal to amend its MD&A rules, which was also issued yesterday; our alert on the proposal is available [here](#). Also, prompted by the MD&A proposal, SEC Chair Clayton and Commissioners Lee and Peirce each issued statements on climate-related disclosures in SEC filings.

The guidance follows in the footsteps of the SEC's prior guidance and releases on MD&A disclosure, which emphasized that companies should consider "all key variables and other factors that management uses to manage the business," as well as the materiality of those factors to investors, when drafting disclosure.¹ Like the concurrent proposed amendments to the MD&A rules, the new guidance reiterates the SEC's long-standing view that a company should provide a narrative that allows investors to see the company "through the eyes of management." The guidance makes clear that this mandate encompasses metrics used by management, and that context is key when considering which metrics to disclose and how to disclose them.

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¹ Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operation, Release No. 33-8350 (Dec. 19, 2003) [68 FR 75056 (Dec. 29, 2003)].



The guidance provides a roadmap for what a company should consider in determining whether and how to include performance metrics in MD&A. It emphasizes “the need to include such further material information, if any, as may be necessary to make the presentation of the metric, in light of the circumstances under which it is presented, not misleading,” citing Securities Act Rule 408(a) and Exchange Act Rule 12b-20. A company should first consider any existing framework – if the metric is a financial measure, for example, the company should bear in mind the standards and regulations governing GAAP and non-GAAP measures – as well as any additional information necessary to provide adequate context for an investor to understand the metric.

The SEC also generally expects a company to provide the following disclosures to accompany the metric:

- a clear definition of the metric and its calculation;
- an explanation of why the metric is useful to investors; and
- an indication of how management uses the metric in managing or monitoring the company’s performance.

A company should consider these expectations based on its particular facts and circumstances. Additionally, it should consider whether it needs to disclose any underlying estimates or assumptions for the metric not to be misleading.

The guidance also states that if a company changes its calculation or presentation of a metric, it should consider whether disclosure is needed about the change. This disclosure, to the extent material, would need to include the difference between the new and prior calculation or presentation; the reasons for, and effect of, the change; and any other relevant differences in methodology and results. A company may also need to recast prior metrics, if context so requires. The recast consideration may be particularly relevant for a company that has decided not to include

the earliest year of MD&A disclosure in its trend discussion, as permitted by the SEC’s recent FAST Act amendments.

The guidance’s emphasis on context and facts-and-circumstances-based considerations is in line with the SEC’s continued focus on a principles-based approach to disclosure.

The guidance closes with a reminder that companies are required to maintain effective disclosure controls and procedures, and in particular, notes the importance of controls and procedures when disclosing metrics derived from internal company data. Much like the SEC’s 2018 interpretive release on cybersecurity disclosure, the guidance serves as another admonition that controls and procedures are essential not only in the context of *required* disclosure, but also for the collection and evaluation of other relevant information, including of “information *potentially* subject to required disclosure, or relevant to an assessment of the need to disclose developments and risks that pertain to the company’s businesses.”²

Takeaways

The guidance formulates positions that many companies and counsel would have taken anyway under existing rules and guidance. Still, it is a timely reminder that should be considered right away, including in the annual reports on Form 10-K and Form 20-F that many companies are now in the midst of preparing. In particular, each reporting company should ask itself:

- Do we use key performance metrics that we should be presenting in MD&A and have not included in the past? An obvious place to check would be the earnings release, but it may be worth checking other disclosures such as investor decks, and potentially even internal management information.
- When we present a performance metric, are we providing a clear and accurate definition

² Commission Statement and Guidance on Public Company Cybersecurity Disclosures, Release Nos. 33-10459; 34-

82746 (Feb. 16, 2018) [83 FR 8166 (Feb. 26, 2018)]. Emphasis added.

and disclosing any estimates or assumptions? And are we explaining how we use the metric and why we think it's important?

- If we have changed how we calculate a performance metric, have we explained the change? And have we considered recasting prior metrics to be consistent with the new presentation?
- Are we comfortable with our disclosure controls and procedures around performance metrics we present in MD&A and elsewhere?

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