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SEC Disclosure Alert: Key Performance Metrics, Financial Reporting and Sustainability

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On January 30, 2020, the SEC issued guidance on the use of key performance metrics for public companies discussing their financial results and proposed amendments to certain financial reporting requirements. The published remarks of the SEC Chair Clayton and two other commissioners accompanying these actions show that there was also a dialogue about the role of the SEC in developing standards for reporting on environmental and climate-related issues, a topic not addressed in the guidance or proposals.

Key Performance Metrics

In Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), a company must disclose information that it believes is necessary to understand the company's financial condition, changes in financial condition and results of operations, even if the information is not otherwise specifically required by the rules. This discussion should include statistical data that in the company's judgment enhances a reader's understanding of the MD&A.

Key performance metrics are statistical data that reveal the particular circumstances of the company. Examples include 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, total energy consumed and data security measures (*e.g.*, number of breaches or customers affected by a breach).

The SEC's new guidance encourages companies to disclose and discuss their key performance metrics in MD&A but also outlines some significant conditions on their use. The SEC indicated that, based on the facts and circumstances, it would generally expect the following disclosures to accompany a performance metric:

- A clear definition of the metric and how it is calculated;
- A statement of 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.

The SEC also expects that generally the same metrics would be used from quarter to quarter and would be calculated and presented in the same way each quarter. Any changes in the way a metric was calculated or presented should be explained, with a discussion of the impact and the reason for the change. The company should consider whether there are estimates or assumptions underlying the metric or its calculation and determine whether disclosure of those estimates or assumptions should be made. If the metric involves a non-GAAP number, the company must follow the rules for non-GAAP numbers.

Companies must maintain disclosure controls and procedures that extend to the calculation and use of key performance metrics.

The guidance on key performance metrics applies broadly to U.S. companies and foreign private issuers that file reports with the SEC, as well as companies that report pursuant to the SEC's Regulation A. Companies should take care that their informal disclosures of key performance metrics in press releases or other media are consistent with their disclosures made in their SEC reports.

Financial Reporting Proposals

As part of its ongoing disclosure effectiveness review, the SEC proposed changes to Items 301, 302 and 303 of Regulation S-K, as well as Forms 20-F and 40-F for foreign private issuers. The proposals include:

- The elimination of the requirement to provide five years of selected financial data;
- The elimination of the requirement to provide two years of selected quarterly data;
- A required statement of the objective of MD&A;
- An enhanced disclosure of capital resources and cash requirements;
- The replacement of the required disclosure of off-balance sheet arrangements (Item 303(a)(4)) with an instruction to discuss such arrangements in the broader context of MD&A;
- The deletion of tabular disclosure of contractual obligations; and
- A revision to the interim reporting requirements (Item 303(b) of Regulation S-K) to permit companies to compare their most recent quarterly results to the then most recently completed quarter rather than the corresponding quarter of the prior year.

Sustainability

In the view of Commissioner Lee, the proposal to modernize financial reporting through the changes described above ignored the elephant in the room: the need for greater disclosure of climate risk and the demands of institutional investors and shareholder activists for more detailed, consistent and reliable reporting on sustainability issues. Under the SEC's existing guidance on climate change, dating from 2010, companies must disclose environmental and climate-related matters pertaining to their businesses where material under the existing SEC disclosure framework. This information tends to vary considerably from company to company. While companies often make voluntary, supplemental reports, the lack of a consistent set of standards is problematic for both the companies and investors. As noted by Commissioner Lee, various private initiatives to create sustainability reporting standards have thus far failed to provide the level of consistency or reliability sought by market participants.

In response to Commissioner Lee, Chair Clayton emphasized the complex, uncertain and forward-looking nature of climate-related disclosures and the SEC's continuing engagement with market participants and others on these issues. By contrast, Commissioner Peirce lauded the SEC's existing principles-based focus on materiality and doubted that additional sustainability information was actually material to investors.

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