

SEC Provides Guidance on Disclosing Metrics in MD&A and Proposes Amendments to Financial Disclosure Requirements

February 5, 2020

On January 30, the U.S. Securities and Exchange Commission (SEC) issued [interpretive guidance](#) on disclosure of key performance indicators (KPIs) and other metrics in Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A). The guidance will become effective upon publication in the *Federal Register*, meaning companies should consider it when preparing the MD&A for their upcoming Form 10-K and Form 20-F filings.¹

Concurrently, in connection with its ongoing disclosure effectiveness initiative, the SEC [proposed amendments](#) to modernize, streamline and enhance certain financial disclosure requirements in Regulation S-K. The proposed amendments would eliminate Item 301 (Selected Financial Data), Item 302 (Supplementary Financial Information) and Item 303(a)(5) (Tabular Disclosure of Contractual Obligations in MD&A). They would also amend several MD&A disclosure requirements in Item 303 as described in the table below.

The proposed amendments are intended to improve the quality of MD&A disclosures, reduce duplicative disclosures and reduce the compliance burden on companies. The proposed amendments were informed by input from public comment letters and the SEC's Division of Corporation Finance's disclosure review process. They are also responsive to changes in GAAP requirements and technologic advancements since the adoption of Regulation S-K in 1977, particularly the availability of financial statements and other disclosures previously filed on EDGAR. The SEC will accept public comments on the proposal for 60 days following its publication in the *Federal Register*.

New Interpretive Guidance on Key Performance Indicators and Metrics in MD&A

Item 303(a) of Regulation S-K requires disclosure of key variables and other qualitative and quantitative factors that the company believes are necessary to an understanding of its financial condition, changes in financial condition and results of operations. This may require disclosure of KPIs and other metrics in MD&A.

The SEC's new interpretive guidance provides that:

- Companies should be mindful of existing MD&A requirements; for example, a company should provide a narrative that allows investors to see the company "through the eyes of management," meaning that metrics disclosed should be consistent with the metrics management uses in running the business and strategic decision-making.
- When a company discloses metrics, it should consider whether additional material disclosures may be necessary to make the presentation of the metric, in light of the circumstances under which it is presented, not misleading.
 - The company should consider the extent to which an existing regulatory disclosure framework applies (e.g., GAAP, Regulation G, Item 10 of Regulation S-K).

¹ While the interpretive guidance and proposed rule amendments refer primarily to the rules governing U.S. domestic issuers, they are also intended to apply, with certain modifications, to the rules governing the disclosure requirements relating to foreign private issuers. See note 1 to *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-10751 (Jan. 30, 2020), available [here](#), and Section II.D.1 of *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, Release No. 33-10750 (Jan. 30, 2020), available [here](#).

- The company should consider what additional information may be necessary to give investors sufficient context to understand the metric presented.
- The SEC would generally expect the following disclosures to supplement the metric:
 - A clear definition of the metric and how it is calculated.
 - A statement giving the reasons why the metric provides useful information to investors.
 - A statement explaining how management uses the metric in managing or monitoring the performance of the business.
- The company should consider whether there are estimates or assumptions underlying the metric or its calculation that should be disclosed for the metric not to be materially misleading.
- If a company changes the method by which it calculates or presents a metric from one period to another or otherwise, the company should consider the need to disclose, 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.
 - 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.

If the change in methodology and results is significant, the company should consider the need to recast prior metrics to conform to the current presentation and place the current disclosure in an appropriate context.

- When KPIs and metrics are material to an investment or voting decision, a 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 and accuracy.

The SEC provided several examples of metrics to which the new guidance is intended to apply.

Examples of Metrics To Which the Interpretive Guidance is Intended To Apply			
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	Data security measures (e.g., number of data breaches or number of account holders affected by data breaches)

Proposed Amendments to Modernize and Enhance Financial Disclosures

The most significant proposed amendments to modernize, streamline and enhance certain financial disclosure requirements in Regulation S-K are summarized below.

Disclosure Requirement	Summary of Proposed Amendment and Rationale
Selected Financial Data <i>Regulation S-K Item 301</i>	Item 301 currently requires companies to furnish selected financial data in comparative tabular form for each of the company's last five fiscal years and any additional fiscal years necessary to keep the information from being misleading. The purpose of the disclosure is to provide in a convenient format

	<p>selected financial data that highlights significant trends in the company's financial condition and results of operations over time.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would eliminate Item 301 and no longer require tabular disclosure of five years of selected financial data. <p>Rationale:</p> <ul style="list-style-type: none"> • The financial data currently required by Item 301 can be accessed and compiled through prior filings readily available on EDGAR. • The original purpose of Item 301 has been supplanted by Item 303's requirement to provide a discussion and analysis of material trends in MD&A.
<p>Supplementary Financial Data</p> <p><i>Regulation S-K Item 302</i></p>	<p>Item 302(a) currently requires companies to disclose two years of selected quarterly financial data of specified operating results and variances in these results from amounts previously reported on a Form 10-Q. The purpose of the disclosure is to help investors understand the pattern of corporate activities throughout a fiscal period by disclosing trends over quarterly periods to reflect seasonal patterns.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would eliminate Item 302 and no longer require disclosure of two years of selected quarterly financial data. <p>Rationale:</p> <ul style="list-style-type: none"> • The financial data currently required by Item 302(a) (other than fourth quarter data) can be found in prior Form 10-Qs readily available on EDGAR. Fourth quarter financial information can be calculated from the Form 10-K and third quarter Form 10-Q. • MD&A requirements would still elicit the required disclosure of variances between periods if material.
<p>Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A) - Regulation S-K Item 303</p>	
<p>Objective of MD&A</p> <p><i>Proposed New Regulation S-K Item 303(a)</i></p>	<p>Item 303(a) currently requires companies to discuss their financial condition, changes in financial condition and results of operations for full fiscal years. The discussion must address liquidity, capital resources, results of operations, off-balance sheet arrangements, contractual obligations and any other information a company believes would be necessary to understand its financial condition, changes in financial condition and results of operations. Item 303(b) covers interim period disclosures and requires companies to discuss material changes in the items listed in Item 303(a), other than the impact of inflation and changing prices on operations and tabular disclosure of contractual obligations.</p> <p>Currently Instructions 1, 2 and 3 to Item 303(a) address the objectives of MD&A, which are for companies to provide disclosure regarding:</p> <ul style="list-style-type: none"> • Material information relevant to an assessment of the company's financial condition and results of operations, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. • The material financial and statistical data that the company believes will enhance a reader's understanding of the company's financial condition, changes in financial condition and results of operations. • Material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future

	<p>operating results or of future financial condition. This would include descriptions and amounts of matters that: (i) would have a material impact on future operations and have not had an impact in the past; and (ii) have had a material impact on reported operations and are not expected to have an impact on future operations.</p> <p>Under current Item 303(a), where a discussion of segment information and/or of other subdivisions (e.g., geographic areas) of the company's business would be appropriate to an understanding of the business, the discussion should focus on each relevant, reportable segment and/or other subdivision of the business and on the company as a whole.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would establish a new paragraph 303(a) that incorporates much of the substance of Instructions 1, 2 and 3 to emphasize the objective of MD&A at the outset. • Would codify guidance from the SEC's 2003 MD&A Interpretive Release by adding a statement in new Item 303(a) that a company must provide in MD&A a narrative explanation of the company's financial statements that allows investors to view the company from management's perspective. • Would add product lines as an example of a subdivision of a company's business (along with geographic areas) that should be discussed when the company believes necessary to understand its business. • Would renumber current Item 303(a) as Item 303(b). <p>Rationale:</p> <ul style="list-style-type: none"> • To remind companies as they prepare their MD&A that the goal is to provide both a historical and prospective analysis of the company's financial condition and results of operations, with particular emphasis on future prospects. • To emphasize a principles-based approach to MD&A to elicit more tailored and informative disclosure that would enable investors to better understand the company's business through the eyes of management. • To clarify the types of subdivisions of a company's business that may require separate disclosure.
<p>Capital Resources <i>Regulation S-K Item 303(a)(2)</i></p>	<p>Item 303(a)(2) currently requires a company to discuss its material commitments for capital expenditures as of the end of the latest fiscal period, and to indicate the general purpose of such commitments and the anticipated sources of funds needed to fulfill such commitments.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would expand this item to specifically require disclosure of known material cash requirements, including but not limited to commitments for capital expenditures. <p>Examples: Funds necessary to maintain current operations, complete projects underway and achieve stated objectives or plans; or commitments for capital or other expenditures.</p> <p>Rationale:</p> <ul style="list-style-type: none"> • To codify guidance from the SEC's 2003 MD&A Interpretive Release to elicit more informative disclosure about a company's ability to meet its material cash requirements.

	<ul style="list-style-type: none"> The current disclosure requirement generally relates to physical assets which the SEC acknowledges may not fully reflect market developments since the rule was adopted in 1980. The proposed amendment would account for expenditures and cash commitments that are not capital investments in property, plant and equipment but relate to a company's key resources such as human capital or intellectual property.
Results of Operations – Known Trends and Uncertainties Regulation S-K Item 303(a)(3)(ii)	<p>Item 303(a)(3)(ii) currently requires a company to describe any known trends or uncertainties that have had or that the company reasonably expects will have a material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations. Furthermore, if a company knows of events (e.g., materials or price increases or inventory adjustments) that will cause a material change in the relationship between costs and revenues, it must disclose that change in the relationship.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> Would require disclosure of known events that are <i>reasonably likely</i> to cause (as opposed to <i>will</i> cause) a material change in the relationship between costs and revenues, such as known <i>or reasonably likely</i> future increases in costs of labor or materials or price increases or inventory adjustments. <p>Rationale:</p> <ul style="list-style-type: none"> To conform the language in this disclosure item to the “reasonably likely” threshold imposed in other MD&A disclosure requirements and the SEC’s interpretive guidance on forward-looking statements.
Results of Operations – Net Sales and Revenues, Line Item Changes Regulation S-K Item 303(a)(3)(iii) and Instruction 4 to Item 303(a) Proposed Regulation S-K Item 303(b)	<p>Item 303(a)(3)(iii) currently requires management to discuss certain factors, such as changes in prices or volume, that led to certain material increases in net sales or revenues. Instruction 4 to Item 303(a) currently requires a description of the causes of material changes from year-to-year in line items of the financial statements to the extent necessary to an understanding of the company’s business as a whole.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> Would require disclosure of “material changes” (rather than “material increases” as currently required) in net sales or revenue. Where there are material changes in a line item from period-to-period, even where such changes within a line item offset one another, would require a narrative discussion in MD&A of the “underlying reasons” for (rather than only the “cause” of) the material changes in quantitative and qualitative terms. Would incorporate a portion of Instruction 4 to Item 303(a) into proposed Item 303(b). <p>Rationale:</p> <ul style="list-style-type: none"> To codify existing SEC guidance that clarified that MD&A disclosure of results of operations should describe increases and decreases in any line item, including net sales or revenues, from period-to-period. To encourage companies to provide a more nuanced, informative discussion of what may be contributing to material changes in line items.
Results of Operations –	<p>Item 303(a)(3)(iv) and Instruction 8 to Item 303(a) generally require companies, for the three most recent fiscal years or for those fiscal years in which the company has been engaged in business, whichever period is shortest, to</p>

<p>Inflation and Price Changes</p> <p><i>Regulation S-K Item 303(a)(3)(iv) and Instructions 8 and 9 to Item 303(a)</i></p>	<p>discuss the impact of inflation and price changes on their net sales, revenues and income from continuing operations where material.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would eliminate Item 303(a)(3)(iv) and related Instructions 8 and 9 to Item 303(a). <p>Rationale:</p> <ul style="list-style-type: none"> • To reduce immaterial disclosure by eliminating the specific references to the impact of inflation and price changes which may not be material to most companies. • The proposed amendment would not result in a loss of material disclosure because a discussion of the impact of inflation or changing prices would still be required if part of a known trend or uncertainty that has had, or the company reasonably expects to have, a material favorable or unfavorable impact on net sales, revenues or income from continuing operations.
<p>Off-Balance Sheet Arrangements</p> <p><i>Regulation S-K Item 303(a)(4)</i></p>	<p>Item 303(a)(4) currently requires companies to disclose, in a separately-captioned section, off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would no longer require a separately-captioned section for off-balance sheet arrangements in MD&A. • Would replace current Item 303(a)(4) with a new principles-based instruction requiring companies to discuss commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have, or are reasonably likely to have, a material current or future effect on the company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements or capital resources. <p>Rationale:</p> <ul style="list-style-type: none"> • To prompt companies to integrate disclosure of material off-balance sheet arrangements within the context of their broader MD&A disclosures in furtherance of the principles-based nature of MD&A and with the goal of eliciting more meaningful discussion of the impact of these arrangements. • To reduce boilerplate disclosure that duplicates information in the financial statements or cross-references to the financial statements without providing sufficient context.
<p>Contractual Obligations</p> <p><i>Regulation S-K Item 303(a)(5)</i></p>	<p>Item 303(a)(5) currently requires companies (other than smaller reporting companies) to disclose in tabular format their known contractual obligations. This disclosure requirement does not contain a materiality threshold.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would eliminate current Item 303(a)(5) and no longer require a contractual obligations table in MD&A. <p>Rationale:</p> <ul style="list-style-type: none"> • To promote the principles-based nature of MD&A and reduce redundant disclosures because most of the information disclosed pursuant to Item

	<p>303(a)(5) already appears in the notes to the financial statements pursuant to GAAP requirements.</p> <ul style="list-style-type: none"> Some of the information currently disclosed in response to this item about material contractual obligations, if material, may also be elicited by the proposed expansion of the capital resources disclosure requirement.
<p>Comparisons of Interim Periods</p> <p><i>Regulation S-K Item 303(b)</i></p> <p><i>Proposed New Regulation S-K Item 303(c)</i></p>	<p>Item 303(b) currently requires companies to provide MD&A disclosure for interim periods that enables market participants to assess material changes in financial condition and results of operations between certain specified periods.</p> <p>Proposed amendments:</p> <ul style="list-style-type: none"> Would allow companies more flexibility when comparing interim periods. Companies would be permitted to compare their most recently completed quarter to either the corresponding quarter of the prior year (as currently required) <i>or</i> to the immediately preceding quarter. If a company elects to discuss changes from the immediately preceding quarter, would require it to provide summary financial information that is the subject of the discussion for that quarter or identify the prior EDGAR filing that presents such information so investors have ready access to the relevant prior quarter financial information. If a company changes the comparison from the prior interim period comparison, would require it to explain the reason for the change and present both comparisons in the filing where the change is announced. <p>Example: If a company in its Q3 2020 Form 10-Q chooses to compare its results to the preceding quarter (Q2 2020) after the company had compared such quarter to the corresponding quarter of the previous year (Q2 2019) in its earlier report, the company would be required to present both comparisons (i.e., versus Q2 2020 and Q3 2019) in that Q3 2020 Form 10-Q and explain the reasons for the change in comparison.</p> <ul style="list-style-type: none"> Would renumber current Item 303(b) as Item 303(c) and eliminate certain instructions in Item 303(b) and provide cross-references to similar instructions in Item 303(a). <p>Rationale:</p> <ul style="list-style-type: none"> To give companies more flexibility regarding the interim period comparisons they discuss in MD&A to encourage them to provide analysis that is better tailored to their business cycles.
<p>Critical Accounting Estimates</p> <p><i>Proposed New Regulation S-K Item 303(b)(4)</i></p>	<p>Item 303(a) does not currently require companies to disclose critical accounting estimates. However, in its 2003 MD&A Interpretive Release, the SEC stated that when preparing MD&A disclosure, companies should consider whether they have made accounting estimates or assumptions where the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and the impact of the estimates and assumptions on financial condition or operating performance is material. The guidance further stated that if critical accounting estimates or assumptions are identified, a company should analyze, to the extent material, factors such as how it arrived at the estimate, how accurate the estimate/assumption has been in the past, how much the estimate/assumption has changed in the past, and whether the estimate/assumption is reasonably likely to change in the future. Any disclosure should supplement (rather than duplicate) the description of accounting policies disclosed in the notes to the financial statements, and provide greater insight into the quality and variability of information regarding financial condition and operating performance.</p>

	<p>Proposed amendments:</p> <ul style="list-style-type: none"> • Would clarify and codify the SEC's prior guidance by explicitly requiring disclosure of critical accounting estimates in MD&A. • Would define a critical accounting estimate as an estimate made in accordance with generally accepted accounting principles that involves a significant level of estimation uncertainty and has had or is reasonably likely to have a material impact on the company's financial condition or results of operations. • For each critical accounting estimate, would require companies to disclose, to the extent material, why the estimate is subject to uncertainty, how much each estimate has changed during the reporting period, the sensitivity of the reported amounts to the material methods, assumptions and estimates underlying the estimate's calculation. • Would add an instruction specifying that the disclosure of critical accounting estimates shall supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements. <p>Purpose:</p> <ul style="list-style-type: none"> • To provide more clarity to the disclosure requirement to: <ul style="list-style-type: none"> ○ Elicit more informative disclosure from companies about their estimates and assumptions to give investors greater insight into potential risks or uncertainties. ○ Promote more consistent disclosure practices providing investors with increased comparability across companies. • To reduce duplicative disclosures as many companies merely repeat the discussion of significant accounting policies from the notes to the financial statements in their MD&A.
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CONTACTS

Holly J. Gregory , Partner	+1 212 839 5853, holly.gregory@sidley.com
John P. Kelsh , Partner	+1 312 853 7097, jkesh@sidley.com
Thomas J. Kim , Partner	+1 202 736 8615, thomas.kim@sidley.com
Lindsey A. Smith , Partner	+1 312 853 2210, lindsey.smith@sidley.com
Rebecca Grapsas , Counsel	+1 212 839 8541, rebecca.grapsas@sidley.com
Andrea L. Reed , Counsel	+1 312 853 7881, andrea.reed@sidley.com
Sara M. von Althann , Counsel	+1 202 736 8715, svonalthann@sidley.com
Claire H. Holland , Special Counsel	+1 312 853 7099, cholland@sidley.com

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