KIRKLAND & ELLIS

Kirkland Alert

SEC Issues Guidance and Proposed Rules on MD&A

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On January 30, 2020, the U.S. Securities and Exchange Commission ("SEC") provided guidance on the disclosure of key performance indicators ("KPIs") in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"). This guidance will become effective on the date of its publication in the Federal Register, which is expected shortly, and will be applicable to annual reports on Form 10-K and Form 20-F and quarterly reports on Form 10-Q.

As companies prepare for the 2020 annual reporting season, here are practice pointers based on the SEC's guidance:

KPIs: KPIs should be disclosed in MD&A if necessary to an understanding of the company's financial condition or results of operations, or if KPIs enhance a reader's understanding of MD&A. In particular, any KPIs that a company already includes in earnings releases should also be considered for inclusion in the company's MD&A. The SEC highlighted the following as examples of KPIs to which this guidance applies:

- operating margin
- average revenue per user
- total impressions
- number of memberships
- same store sales
- net customer additions
- active customers
- traffic growth
- total energy consumed
- total customers/subscribers
- daily/monthly average users/usage
- comparable customer transactions increase
- voluntary and/or involuntary employee
- percentage breakdown of workforce (e.g., active
- data security measures (e.g., number of data

turnover rate	workforce covered under the collective bargaining agreements)	breaches of number of account holders affected by data breaches)

- sales per square foot

Accompanying Disclosure: Each KPI should be accompanied by:

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

GAAP vs. Non-GAAP: Specify whether the KPI is a GAAP or non-GAAP measure or an operating or statistical metric. If the KPI is a non-GAAP measure, it should be accompanied by the disclosure required by Regulation G and Item 10 of Regulation S-K.

Estimates/Assumptions: The estimates and/or assumptions underlying the KPI or its calculation should be disclosed if necessary for the metric not to be materially misleading.

Methodology/Presentation Changes: If the company changes its presentation of, or calculation methodology for, KPIs, it should consider disclosing:

- The differences in the way the metric was calculated or presented compared to prior periods;
- The reasons for the changes;
- The effects of any change on the amounts or other information being disclosed and on amounts or other information previously reported; and
- Any other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects.

The SEC advised companies that they should consider whether they should recast KPIs disclosed in prior periods to conform to any new presentation or calculation methodology if the changes were significant.

Disclosure Controls: KPIs should be subjected to disclosure controls and procedures to ensure consistency and accuracy.

Third Year Comparison

The 2020 annual reporting season will be the first annual reporting season in which companies are permitted (but not required) to omit a discussion of the earliest of three years of their financial statements ("Third Year Comparison") in MD&A, so long as the discussion was included in an earlier SEC filing and there is a statement in the MD&A identifying the location of the discussion in the prior filing.[1]

On January 24, 2020, the SEC issued Compliance and Disclosure Interpretations (C&DIs) with guidance for companies intending to omit the Third Year Comparison in MD&A.

When Should a Company Continue to Include a Third Year Comparison in MD&A? The SEC advised companies that they are not permitted to omit the Third Year Comparison if the company believes it would be necessary to understand the company's financial condition, changes in financial condition and results of operations.

Should a Third Year Comparison Be Incorporated By Reference into MD&A? The SEC also advised that a statement in MD&A identifying the location of an omitted Third Year Comparison in a prior SEC filing will not have the effect of incorporating the Third Year Comparison into a 10-K (or any registration statement that incorporates the 10-K by reference). A company needs to expressly incorporate the Third Year Comparison by reference if it wants to include it in the 10-K. While a company is not required to include a Third Year Comparison in MD&A, it may choose to incorporate it by reference if it believes the Third Year Comparison would be necessary to understand the company's financial condition, changes in financial condition and results of operations.

Proposed MD&A Rules

On January 30, 2020, the SEC proposed rules intended to eliminate duplicative disclosures, and otherwise modernize and simplify disclosure requirements in MD&A. The proposed rules are open for comment, and following adoption, there is expected to be a transition period of 180 days according to the SEC's proposing release, in which case the proposed amendments are not expected to apply before the second half of 2021.

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1. For more information, see prior *Kirkland Alert* "SEC Scales Back Disclosure Requirements."↩

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