

1. Focus on Key Indicators of Financial Condition and Operating Performance

As discussed, one of the principal objectives of MD&A is to give readers a view of the company through the eyes of management by providing both a short and long-term analysis of the business.²⁵ To do this, companies should “identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company.”²⁶

Financial measures generally are the starting point in ascertaining these key variables and other factors. However, financial measures often tell only part of how a company manages its business. Therefore, when preparing MD&A, companies should consider whether disclosure of all key variables and other factors that management uses to manage the business would be material to investors, and therefore required.²⁷ These key variables and other factors may be non-financial, and companies should consider whether that non-financial information should be disclosed.

Many companies currently disclose non-financial business and operational data.²⁸ Academics, authors, and

consultants also have researched the types of information, outside of financial statement measures, that would be helpful to investors and other users.²⁹ Such information may relate to external or macro-economic matters as well as those specific to a company or industry. For example, interest rates or economic growth rates and their anticipated trends can be important variables for many companies. Industry-specific measures can also be important for analysis, although common standards for the measures also are important. Some industries commonly use non-financial data, such as industry metrics and value drivers.³⁰ Where a company discloses such information, and there is no commonly accepted method of calculating a particular non-financial metric, it should provide an explanation of its calculation to promote comparability across companies within the industry. Finally, companies may use non-financial performance measures that are company-specific.

In addition, if companies disclose material information (historical or forward-looking) other than in their filed documents (such as in earnings releases or publicly accessible analysts’ calls or companion website postings) they also should evaluate that material information to determine whether it is required to be included in MD&A, either because it falls within a specific disclosure requirement or because its omission would render misleading the filed document in which the MD&A appears. We are not seeking to sweep into MD&A all the information that a company communicates. Rather, companies should consider their communications and determine what information is material and is required in, or would promote understanding of, MD&A.

Since we adopted the MD&A requirements, and even since the last comprehensive guidance on MD&A we released in 1989, there have been significant advancements in the ability to develop and access information quickly and effectively. Changes in business enterprise systems, communications and other aspects of information technology have significantly increased the amount of information available to management, as well as the speed with which they receive and are able to use

information.³¹ There is therefore a larger and more up-to-date universe of information, financial and non-financial alike, that companies have and should evaluate in determining whether disclosure is required. This situation presents companies with the challenge of identifying information that is required to be disclosed or that promotes understanding, while avoiding unnecessary information overload for readers by not disclosing a greater body of information, just because it is available, where disclosure is not required and does not promote understanding. Further, with advances in technology contributing to increasing amounts and currency of information, the factors relied upon by companies to operate and analyze the business may change. As this occurs, the discussion in MD&A should change over time to maintain an appropriate focus on material factors.

The focus on key performance indicators can be enhanced not only through the language and content of the discussion, but also through a format that will enhance the understanding of the discussion and analysis. The order of the information need not follow the order presented in Item 303 of Regulation S-K if another order of presentation would better facilitate readers’ understanding. MD&A should provide a frame of reference that allows readers to understand the effects of material changes and events and known material trends and uncertainties arising during the periods being discussed, as well as their relative importance. To satisfy the objectives of MD&A, companies also should provide a balanced view of the underlying dynamics of the business, including not only a description of a company’s successes, but also of instances when it failed to realize goals, if material. Good MD&A will focus readers’ attention on these key matters.

2. Focus on Materiality

Companies must provide specified material information in their MD&A,³² and they also must provide other material information that is necessary to make the required statements, in light of the circumstances in which they are

²⁵ See, e.g., Release No. 33-6711 (Apr. 24, 1987) [52 FR 13715 at 13717] (“an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company.”).

²⁶ 1989 Release, Part III.A (citing Release No. 33-6349 (Sept. 28, 1981) 23 SEC Docket 962 at 964 [Release not published in the *Federal Register*]).

²⁷ Examples of such other factors, depending on the circumstances of a particular company, can include manufacturing plant capacity and utilization, backlog, trends in bookings and employee turnover rates. See, e.g., *Quality, Transparency, Accountability*, Lynn E. Turner, Chief Accountant, Securities and Exchange Commission, Remarks before Financial Executives Institute (Apr. 26, 2001), available at www.sec.gov/news/speech/spch485.htm.

Companies should also consider disclosing information that may be peripheral to the accounting function, but is integral to the business or operating activity. Examples of such measures, depending on the circumstances of a particular company, can include those based on units or volume, customer satisfaction, time-to-market, interest rates, product development, service offerings, throughput capacity, affiliations/joint undertakings, market demand, customer/vendor relations, employee retention, business strategy, changes in the managerial approach or structure, regulatory actions or regulatory environment, and any other pertinent macroeconomic measures. Because these measures are generally non-financial in nature, we do not believe that their disclosure generally will raise issues under Item 10(e) of Regulation S-K [17 CFR 229.10(e)] or Item 10(h) of Regulation S-B [17 CFR 228.10(h)].

²⁸ See *Improving Business Reporting: Insights into Enhancing Voluntary Disclosures*, Steering Committee Report of the Business Reporting Research Project of the FASB (2001) available at www.fasb.org; the Jenkins Report; Financial

Accounting Series Special Report, *Business and Financial Reporting, Challenges from the New Economy* (FASB) (2001) (“Special Report on Improving Business Reporting”).

²⁹ See Special Report on Improving Business Reporting.

³⁰ See, e.g., the Jenkins Report; the Special Report on Improving Business Reporting.

³¹ See the Jenkins Report.

³² See, e.g., Item 303(a)(1) of Regulation S-K [17 CFR 229.303(a)(1)] (requiring the identification of “known trends or known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant’s liquidity increasing or decreasing in any material way”). See also Item 303(a)(2)(i) of Regulation S-K [17 CFR 229.303(a)(2)(i)] (requiring a description of registrant’s material commitments for capital expenditures).