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BLOG

SEC Announces Enforcement Proceeding Against Public Company for Key Performance Indicators (KPI) Rule Violations

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On February 19, 2020, the SEC publicly announced charges against Diageo plc (Diageo) for “failing to make required disclosures of known trends relating to the shipments of unneeded products by its North American subsidiary to distributors.” The SEC alleges that employees at Diageo’s “largest and most profitable subsidiary” had pressured its distributors to buy unnecessarily large amounts of its alcohol “in order to meet internal sales targets in the face of declining market conditions…[which] enabled Diageo to meet performance targets and to report higher growth in key performance indicators that were closely followed by investors and analysts.” Diageo agreed to settle the charge, without admitting or denying the SEC’s findings, for a $5 million penalty.

This enforcement action comes after the SEC announced new guidance to registrants on disclosure considerations for key performance indicators and metrics disclosed in MD&A of financial condition and results of operation. In the new guidance, the SEC emphasized, that when it comes to key performance indicators, “the need to include such further material information, if any, as may be necessary in order to make the presentation of the metric, in light of the circumstances under which it was presented, not misleading.” The SEC noted that this guidance would apply to metrics like operating margin, same store sales, sales per square foot, total customers/subscribers, average revenue per user, daily/monthly active users, 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.

The SEC went on to state that they would generally expect the following disclosures to accompany the key performance metrics:

- A clear definition of the metric and how it is calculated;
- A statement indicating 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 guidance concluded by reminding registrants of the importance of maintaining effective disclosure controls and procedures, which are important “when disclosing material key performance indicators or metrics that are derived from the company’s own information.” If a key performance indicator or metric is material to an investment or voting decision, the SEC commented that companies “should consider whether it has effective controls and procedures in place to process information related to the disclosure of such items to ensure consistency as well as accuracy.”

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