

## Non-GAAP Financial Disclosures – Redux

Written by Paul Bork, Stacie S. Aarestad

June 2, 2016

Prefaced by public statements of SEC officials about improper use of non-GAAP financial measures, the Staff of the Division of Corporation Finance issued new and revised Compliance & Disclosure Interpretations (“C&DIs”) on May 17, 2016. The C&DIs represent the current view of the use of non-GAAP financial measures in financial reporting. Non-GAAP financial measures may still be utilized, as is customary in some industries. However, an issuer needs to review its use of non-GAAP financial measures in light of this new guidance to confirm compliance. The Staff has indicated that it expects issuers to engage in this review process and “self-correct” any non-complying disclosures in the next financial reporting period and that the Staff will be closely monitoring disclosures for compliance.

The new C&DIs provide as follows:

- Certain adjustments, although not expressly prohibited, can result in a non-GAAP financial measure that is misleading and thus a violation of Rule 100(b) of Regulation G – e.g. presenting a performance measure that excludes normal, recurring, cash operating expenses could be misleading.
- Non-GAAP financial disclosure can be misleading if presented inconsistently between periods. If there is a change between periods, such change should be disclosed and the reasons for it should be explained.
- Non-GAAP financial measures that exclude charges but not gains may be deemed misleading.
- The use of non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G, as may other measures that use individual tailored recognition and measurement methods for financial statement line items other than revenue.

Existing C&DIs were clarified:

- “Funds from operations” (FFO) may be used in earnings releases and materials that are filed with the SEC if (a) FFO is presented in compliance with the definition of such term provided by the National Association of Real Estate Investment Trusts or (b) any adjustments made to FFO are otherwise in compliance with Item 10(e) of Regulation S-K without violating Rule 100(b) of Regulation G.
- Non-GAAP liquidity measures that measure cash generated, such as “free cash flow,” cannot be presented on a per share basis, even if an issuer presents these measures solely as a performance measure.
- For a non-GAAP liquidity measure, it may be acceptable to adjust GAAP taxes to show taxes paid in cash. For a non-GAAP performance measure, however, the issuer should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. Further, adjustments to arrive at a non-GAAP measure should not be presented “net of tax”; rather, income taxes should be shown as a separate adjustment and clearly explained.
- If an issuer presents earnings before interest and tax (EBIT) or earnings before interest, tax, depreciation and amortization (EBITDA) as a performance measure, these measures cannot be presented on a per share basis.

The Staff, giving particular emphasis to the equal prominence requirement of Item 10(e)(1)(i)(A) of Regulation S-K, also provided examples of improper presentation of non-GAAP financial measures, generally a facts-and-circumstances determination:

- Presenting a full income statement of non-GAAP financial measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures; Omitting comparable GAAP financial measures

from an earnings release headline or caption that includes non-GAAP measures;

- Presenting a non-GAAP financial measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
- Having a non-GAAP financial measure precede the most directly comparable GAAP measure (including in an earnings release headline or caption);
- Describing a non-GAAP financial measure as, for example, “record performance” or “exceptional” without at least an equally prominent descriptive characterization of the comparable GAAP measure;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP financial measure in reliance on the “unreasonable efforts” exception in Item 10(e)(1)(i)(B) without disclosing that fact and identifying the information that is unavailable and its probable significance in a location of equal or greater prominence; and
- Providing discussion and analysis of a non-GAAP financial measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence.

An issuer should review its use of non-GAAP financial measures for compliance with the new and revised Staff interpretations. Because any public disclosure of a non-GAAP financial measure, whether in a press release, earnings call or SEC filing or on a website, will trigger SEC disclosure requirements, an issuer should also confirm that its disclosure controls and procedures are designed to ensure compliance across disclosure platforms. Audit Committee members should consider reviewing with management of the issuer the appropriateness of any non-GAAP financial measures used and compliance with the relevant rules.

#### RELATED INDUSTRIES

- [Investment Advisers & Private Funds](#)
- [Professional Services](#)

#### RELATED PRACTICES

- [Capital Markets](#)
- [Fund Formation](#)
- [Business Counseling](#)
- [Public Companies](#)
- [SBIC](#)

---

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.