

Alert

SEC Disclosure and Corporate Governance

Focus for Q2:

Practical Tips for “Self-Correcting” Non-GAAP Disclosure in Light of the SEC’s Updated Guidance

In the wake of its release on May 17, 2016 of updated Compliance and Disclosure Interpretations (“CDIs”) relating to the disclosure of non-GAAP financial measures, the SEC’s Division of Corporation Finance has indicated in no uncertain terms that now is the time for companies to review their non-GAAP measures and make any revisions called for by the new guidance. To assist companies in this review, we have attached, in Appendix A, a blackline of the new and revised CDIs against the previous version of the CDIs and, in Appendix B, excerpts from previous comment letters that serve as harbingers of things to come. In the Alert we discuss:

- The SEC Staff’s strong warnings to heed the updated guidance this quarter.
- Explanations and applications of the new guidance, including how to give appropriate prominence to the most directly comparable GAAP measure, the Staff’s views on “cherry picking” adjustments and other potentially misleading non-GAAP presentations, and revised “dos and don’ts” for non-GAAP per share measures.
- Practical illustrations of how companies can “self-correct” what, up to now, have been relatively common non-GAAP measures and presentations to comply with the new guidance.
- Recommended next steps to help companies capitalize on the lead time they have before their Q2 earnings call.

Highlights

- Companies should anticipate rigorous Staff scrutiny of this quarter’s earnings-related communications with investors and analysts.
- The SEC is acting forcefully and intentionally to address its concerns about the use (and perceived misuse) of non-GAAP measures – and promises a surge of comment letters.
- Companies and their Disclosure Committees have an opportunity now to use the new guidance to review and, where necessary, revise how non-GAAP measures are calculated and presented.

The SEC's Focus on Non-GAAP Measures: Last Clear Chance

With the new and revised CDIs, the SEC has delivered the latest in a series of increasingly strong warnings – previously made in remarks by the SEC Chair and senior Staff accountants – about the perceived misuse of non-GAAP measures.¹ Commenting on the updated CDIs at a public PCAOB advisory group meeting held the day after their publication, the Division's Chief Accountant Mark Kronforst encouraged companies to take the opportunity presented by the imminent close of the second fiscal quarter to review their disclosure practices in light of the latest set of non-GAAP CDIs and, if necessary, to “self-correct” before the anticipated “uptick” in critical Division comment letters directing companies to “curb some of the practices that [they are] seeing.”²

While most, if not all, of the changes made to the non-GAAP CDIs were previewed in recent comment letters issued by the Division (see Appendix B) and recent public remarks by the SEC Chair and senior Staff members,³ the prescriptive nature of some of the updated CDIs has taken observers by surprise. According to Mr. Kronforst, the “fairly strong language” of the amended interpretive guidance is “intentional.” It appears that companies have one last clear chance this quarter to reconsider their earnings disclosure practices and make any necessary modifications before the impending “uptick” in Division comment letters. Left unstated by Mr. Kronforst, but equally clear from his observations, is the prospect of referrals to the Division of Enforcement in the event of persistent use of non-GAAP measures identified in the updated CDIs as actually or potentially misleading.

In preparing the upcoming earnings releases and management presentations to investors and analysts as well as periodic reports, we recommend that companies follow the Staff's suggestion to review their non-GAAP disclosure practices carefully and take the opportunity to “self-correct.” We suggest applying the four basic questions outlined by the SEC Chair in her keynote address at the December 2015 AICPA conference to determine whether any changes are needed:

- Why are you using the non-GAAP measure, and how does it provide investors with useful information?
- Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules?
- Are your explanations of how you are using the non-GAAP measures – and why they are useful for your investors – accurate and complete, drafted without boilerplate?
- Are there appropriate controls over the calculation of non-GAAP measures?⁴

Given recurring reminders from the Chair and senior accounting staff of the importance of Audit Committee oversight in this area, we also recommend that the Audit Committee be briefed on the results of this review and any management-recommended changes.⁵

Understanding the Updated CDIs

Equal or Greater Prominence of Most Directly Comparable GAAP Measure

The new CDI that may have the greatest impact on companies' quarterly reporting is CDI 102.10, which sets forth a list of non-GAAP presentations that could run afoul of the requirement to present “the most directly comparable” GAAP financial measure with “equal or greater prominence” when disclosing a non-GAAP financial measure. This requirement applies to non-GAAP financial measures presented in filings with the SEC (through Item 10(e)(1)(i)(A) of Regulation S-K) and earnings releases furnished under Item 2.02 of Form 8-K.

Determining the relative prominence of a non-GAAP measure and the most directly comparable GAAP measure is typically fact-dependent. However, CDI 102.10 provides specific examples of non-GAAP disclosures that the Staff ordinarily would view as impermissibly “prominent”:

- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures.
- Presenting a non-GAAP measure before the most directly comparable GAAP measure (including in an earnings release headline or caption).
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure.
- Describing a non-GAAP measure as, for example, “record performance” or “exceptional,” without including at least an equally prominent descriptive characterization of the comparable GAAP measure.
- Providing tabular disclosure of a non-GAAP financial measure without preceding it with an equally prominent tabular disclosure of the comparable GAAP measure or including the comparable GAAP measure in the same table.
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the “unreasonable efforts” exception in Item 10(e)(1)(i)(B), which applies to earnings releases furnished under Item 2.02 of Form 8-K, without disclosing that fact and identifying the information that is unavailable and discussing its probable significance in a location of equal or greater prominence.
- Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures.
- Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location that has equal or greater prominence.

Application of the guidance outlined above is likely to lead to significant changes in the existing non-GAAP disclosure practices of many companies. First, the “most directly comparable” GAAP financial measure must appear before the non-GAAP measure in both the headlines and text of earnings releases and similar investor/analyst presentations. This restrictive interpretation may have an impact on companies that were including all of the appropriate GAAP disclosures, but placing them either adjacent to or following the non-GAAP measures.

Second, companies must provide a “similar” degree of discussion and analysis of the most directly comparable GAAP measure as they provide for the corresponding non-GAAP measure. This has been relatively uncommon. Given the broadening disparities between GAAP and non-GAAP results,⁶ this new interpretive position could attract heightened scrutiny from both investors and the SEC Staff.

Finally, companies that opt to dispense with GAAP reconciliation for forward-looking non-GAAP measures presented in earnings releases under the “unreasonable efforts” exception will have a number of additional required disclosures: the fact they are relying on the exception, the specific information that is unavailable, and the “probable significance” of the omitted GAAP number “in a location of equal or greater prominence” to the non-GAAP forecast or projection. This interpretive position of the SEC, which was first articulated in the 2003 adopting release but heretofore not repeated in the CDIs, has been honored more in the breach than in the observance in recent years.⁷

Self-Correcting Impermissibly Prominent Non-GAAP Measures
(Excerpted samples and fixes in tracked changes are illustrative suggestions.)

Beware non-GAAP measures in headlines and executive quotes – non-GAAP measure must be included and must come first. Also beware descriptive words for non-GAAP, but not GAAP measures:

XYZ Corp Reports ~~Solid~~ Second Quarter 2016 Results
GAAP measure increased 0.5%; Adjusted measure up 2.3%

John Doe, XYZ Corp Chief Executive Officer, commented, “While the GAAP measure showed a modest increase of 0.5% over the same period in 2015, ~~We~~ we are pleased that the Adjusted Measure went up by a solid 4.2%. ~~This exceptional~~ This growth can be attributed to the continued expansion of our business in new markets.”

Beware non-GAAP guidance – it must be reconciled or accompanied by disclosure of reliance on the “unreasonable efforts” exception:

The Company also expects that its full year 2016 diluted earnings per share after adjustments will be \$2 - \$3 per share.*

*With respect to the Company’s full year guidance, the Company is not able to provide a reconciliation of the non-GAAP financial measures to GAAP because certain items that are included have not yet occurred or are out of the Company’s control and/or cannot be reasonably predicted. The reconciling information that is unavailable would include a forward-looking balance sheet prepared in accordance with GAAP. The probable significance of having a forward-looking GAAP balance sheet is estimated to be a variance of plus or minus 10 percent of the forward-looking earnings per share measures provided in this presentation.

Potentially Misleading Practices in Violation of Regulation G

Regulation G broadly applies to all public disclosures that include non-GAAP financial measures, whether made in writing, orally, by webcast or by other means. It requires the presentation of, and reconciliation to, the most directly comparable GAAP financial measure and also provides that a company may not include in any public statement a non-GAAP financial measure that contains a material misstatement or omits information needed to make the measure not misleading in the context of the accompanying disclosure. The updated CDIs provide clarity and specific examples of what the SEC would view as “misleading.”

Exclusion of Recurring Cash Operating Expenses

New CDI 100.01 expresses the Staff’s view that it is potentially misleading to use non-GAAP performance measures that exclude normal, recurring, cash expenses necessary to operate a registrant’s business. In addition, although the Staff left the substance of CDI 102.03 intact regarding the ability of registrants to exclude charges or gains – whether recurring or non-recurring – so long as properly described, the amended CDI 102.03 now includes a cross-reference to new CDI 100.01. This could be read to suggest that, even if the description of the non-GAAP measure is correct – meaning, for example, that a particular recurring expense is not improperly described as “non-recurring, infrequent or unusual” – there could be circumstances in which the non-GAAP disclosure nevertheless is misleading and therefore prohibited.

Inconsistent Presentation of Non-GAAP Measures

New CDI 100.02 provides that the inconsistent use of non-GAAP financial measures between reporting periods without accompanying disclosure of changes and an explanation of the reasons for such changes is potentially misleading. This practice involves, for example, adjusting for a particular charge or gain in the current period when other, similar charges or gains were not adjusted in the same manner for prior periods. Because this practice may undermine or subvert the comparability of non-GAAP financial results from period to period, it also may be necessary to recast previously disclosed non-GAAP presentations to conform to the current non-GAAP presentation, and to place it in context.

Excluding Non-Recurring Charges, But Not Non-Recurring Gains

New CDI 100.03 indicates that the use of non-GAAP measures that exclude non-recurring charges, but do not exclude non-recurring gains is potentially misleading. This particular practice was the subject of a settled SEC antifraud enforcement proceeding brought in 2002, prior to the SEC's adoption of the current non-GAAP regulatory scheme.⁸

Individually Tailored Recognition and Measurement Methods

New CDI 100.04 identifies as potentially misleading the substitution of individually tailored revenue recognition and measurement methods for GAAP measures as a baseline for calculating non-GAAP earnings – e.g., a non-GAAP performance measure that is adjusted to accelerate revenue that GAAP requires to be recognized ratably over time. The Staff indicated that other non-GAAP measures that involve individually tailored adjustments to GAAP-prescribed recognition and measurement methods for financial statement line items other than revenue also may be misleading.

The Staff's concern with this practice was previewed at length by SEC Deputy Chief Accountant Wesley Bricker in a speech given in early May 2016:⁹

On the use of individually-tailored accounting principles, consider a company that has a subscription-based business. The company bills for the full subscription at the outset, but since it will deliver over time, it earns and recognizes GAAP revenue over the same period. Now assume this company calculates non-GAAP revenue as though it had a different business. That is, it calculates what revenue it would have had, had it not sold a subscription, but rather had sold a product. * * * The effect of the [non-GAAP] measure is that the company accelerates revenue recognition to the billing date and proceeds to calculate earnings based on this non-GAAP revenue. At that point this company's GAAP results are based on revenues recognized as the service is provided and the non-GAAP results are based on revenues that are merely billed to the customer. * * * In this instance, the measure does not appear to help investors understand and analyze core operating results. Rather, it is a replacement of an important accounting principle [relating to the timing of revenue recognition] with an alternate accounting model that does not match the company's subscriptions business or earnings process, which is over time. * * * Revenue adjustments do more than just adjust from GAAP: they change the very starting point from which other performance analyses flow.

Mr. Bricker's discussion of impermissible GAAP revenue adjustments is particularly important because 2016 will be the first year for which those companies opting for the full retrospective approach upon adoption of the new FASB revenue standard (ASC Topic 606) for their 2018 fiscal year eventually will be recasting GAAP revenues reported in the 2016 audited financial statements filed as part of this year's Form 10-K. Mr. Bricker cautioned that, "...we will be looking to see if the reporting concepts within those standards are supplanted by any number of company-specific non-GAAP alternatives. For all of these reasons, if a company presents adjusted revenue, it will likely get a comment; moreover, companies can expect the Staff to look closely, and skeptically, at the explanation as to why the revenue adjustment is appropriate."

Some Revised "Do's and Don'ts" on Use of Non-GAAP Per-Share Measures

Non-GAAP Per-Share Liquidity Measures – Not Permitted Regardless of Management's Label

Item 10(e)(1)(ii) permits the use of non-GAAP per share performance measures because they can be meaningful from an operating perspective – so long as they are reconciled to GAAP-prescribed earnings per share. The same is not the case for per share liquidity measures. In newly revised CDI 102.05, the Staff indicated that it will look beyond company-assigned labels in determining whether a prohibited per share non-GAAP liquidity measure has been disclosed in documents filed with or furnished to the SEC.¹⁰ According to the revised CDI, "non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis in documents filed or furnished with the Commission, consistent with Accounting Series Release No. 142. Whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure." As the Division's Chief Accountant has emphasized, the Staff will no longer show deference to company descriptions of per-share measures as performance-based, as previously done during the comment process. Instead, companies should expect the Staff to focus on substance rather than form in this context, and to challenge management's characterization and use of a particular per share measure.

Free Cash Flow

Existing CDI 102.07 continues to provide that "free cash flow" is not barred by Item 10(e)(1)(ii). However, the CDI has been amended to add as a final sentence: "Also, free cash flow is a liquidity measure that must not be presented on a per share basis. See Question 102.05 [above]...." This CDI continues to caution that, because free cash flow has no uniform definition, a clear description of how this measure is calculated and the requisite reconciliation "should" accompany disclosure of this measure. The amended CDI also continues to state that "'free cash flow' should not be used in a manner that inappropriately implies that the measure represents the residual cash flow available for discretionary expenditures, since many companies have mandatory debt service requirements or other non-discretionary expenditures that are not deducted from the measure."

EBIT and EBITDA

Although the Staff has indicated that EBIT and EBITDA may be used as performance measures if properly reconciled to GAAP net income, amended CDI 103.02 makes very clear that "these measures must not be presented on a per share basis," citing amended CDI 102.05 (discussed above).

Self-Correcting Prominence Issues and the Use of Per Share Measures (Excerpted samples and fixes in tracked changes are illustrative suggestions.)

Q2 2016 Highlights:

- ~~Strong EBITDA of \$12 billion.~~
- Net earnings of \$5 billion.
- EBITDA of \$12 billion.
- Diluted earnings per share from operations of \$1.75.
- Adjusted earnings per share of \$3.
- ~~Diluted earnings per share from operations were \$1.75.~~
- Net cash from operating activities of \$220 million; ~~Free cash flow per share of \$200 million~~ 0.25.

Presentation of Income Tax Adjustments

New CDI 102.11 answers the two-pronged question of how income tax effects related to adjustments made to arrive at a non-GAAP measure should be calculated and presented. If the company is using a liquidity measure that includes income taxes, the CDI states that “it might” be acceptable to the Staff to adjust the GAAP taxes to show taxes actually paid in cash. If a tax-related adjustment is made to arrive at a non-GAAP performance measure, the company “should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability” and should not present adjustments “net of tax.” Instead, “income taxes should be shown as a separate adjustment and clearly explained.”

Anticipating the SEC’s Next Steps

As noted above, companies should be prepared for the sharp “uptick” in the number of non-GAAP-related comment letters to be issued by the Staff through the rest of 2016 (see Appendix B for recent non-GAAP comments). Moreover, if the SEC continues to perceive widespread misuse of non-GAAP measures in financial reporting (thus signaling a failure to review and “self-correct” usage of non-GAAP measures based on the updated CDIs), the agency may wield the ultimate double-barreled threat to which the Chair recently alluded: enforcement and rulemaking.¹¹

Critical media reports are also likely to keep this topic on the SEC’s front burner through the remainder of 2016,¹² as the Staff launches its heightened review process. Recent articles have reported on the widening disparity between GAAP and non-GAAP earnings, suggesting that they provide investors with a view of a company’s performance through rose-colored glasses and, in some instances, appearing to inappropriately “supplant” rather than “supplement” the disclosed GAAP results.¹³

What to Do Now

- **Reassess.** Step back and reassess the company’s current use of non-GAAP financial measures for consistency with the updated CDIs, both within and outside the four corners of SEC-filed reports. The Disclosure Committee, or a subset consisting of legal, finance and investor relations personnel, may be the appropriate forum for this. If so, we suggest adding a separate workstream needs to be added to the Committee’s agenda this quarter and commencing it early in light of the nature of the required review and the need to factor in IR considerations.

- **Determine Whether Change Is Needed.** Based on the reassessment process, determine whether any changes should be made to the company's non-GAAP disclosure practices. Change could include the elimination of particular adjustments to GAAP-prescribed recognition and measurement methodologies previously used to calculate non-GAAP measures (as to which the Staff has raised a red flag), reformatting of the presentation of the reconciliations of non-GAAP to GAAP results, and/or providing clearer descriptions of the adjustments and explanations of why and how they are used by the company. Even if management ultimately determines that no changes are needed on the basis of its review, we recommend briefing the Audit Committee on management's reassessment and conclusions.
- **Act Promptly.** Any changes to the company's use of non-GAAP measures resulting from the reassessment and review should be reflected in the company's next earnings release, investor presentation and periodic report.
- **Focus on the Company's Use of Non-GAAP Measures.** Companies should continue to focus on compliance with the rules regarding non-GAAP measures, as interpreted by the SEC or its Staff and as self-correcting practices develop among companies this quarter. In addition, companies should pay particular attention to non-GAAP measures that could trigger heightened scrutiny from the Staff, shareholder activists or proxy advisory firms, such as a measure that results in significantly higher executive compensation or that transforms a GAAP loss into a non-GAAP gain.¹⁴

If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of Weil's Public Company Advisory Group:

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We thank our colleague Kaitlin Descovich for her contribution to this alert.

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Appendix A

Updates to SEC Guidance

The marked text set forth below reflects the updates made to the SEC's Compliance and Disclosure Interpretations relating to Non-GAAP measures on May 17, 2016.

Non-GAAP Financial Measures

Last Update: ~~July 8~~ May 17, 20116

These Compliance & Disclosure Interpretations ("C&DIs") comprise the Division's interpretations of the rules and regulations on the use of non-GAAP financial measures. The bracketed date following each C&DI is the latest date of publication or revision.

QUESTIONS AND ANSWERS OF GENERAL APPLICABILITYSection 100. General**Question 100.01**

Question: Can certain adjustments, although not explicitly prohibited, result in a non-GAAP measure that is misleading?

Answer: Yes. Certain adjustments may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP measure to be misleading. For example, presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business could be misleading. [May 17, 2016]

Question 100.02

Question: Can a non-GAAP measure be misleading if it is presented inconsistently between periods?

Answer: Yes. For example, a non-GAAP measure that adjusts a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods could violate Rule 100(b) of Regulation G unless the change between periods is disclosed and the reasons for it explained. In addition, depending on the significance of the change, it may be necessary to recast prior measures to conform to the current presentation and place the disclosure in the appropriate context. [May 17, 2016]

Question 100.03

Question: Can a non-GAAP measure be misleading if the measure excludes charges, but does not exclude any gains?

Answer: Yes. For example, a non-GAAP measure that is adjusted only for non-recurring charges when there were non-recurring gains that occurred during the same period could violate Rule 100(b) of Regulation G. [May 17, 2016]

Question 100.04

Question: A registrant presents a non-GAAP performance measure that is adjusted to accelerate revenue recognized ratably over time in accordance with GAAP as though it earned revenue when customers are billed. Can this measure be presented in documents filed or furnished with the Commission or provided elsewhere, such as on company websites?

Answer: No. Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. Other measures that use individually tailored recognition and measurement methods for financial statement line items other than revenue may also violate Rule 100(b) of Regulation G. [May 17, 2016]

Section 101. Business Combination Transactions**Question 101.01**

Question: Does the exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications relating to a business combination transaction extend to the same non-GAAP financial measures disclosed in registration statements, proxy statements and tender offer materials?

Answer: No. There is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications subject to Securities Act Rule 425 and Exchange Act Rules 14a-12 and 14d-2(b)(2); it is also intended to apply to communications subject to Exchange Act Rule 14d-9(a)(2). This exemption does not extend beyond such communications. Consequently, if the same non-GAAP financial measure that was included in a communication filed under one of those rules is also disclosed in a Securities Act registration statement or a proxy statement or tender offer statement, no exemption from Regulation G and Item 10(e) of Regulation S-K would be available for that non-GAAP financial measure.

In addition, there is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed pursuant to Item 1015 of Regulation M-A, which applies even if such non-GAAP financial measures are included in Securities Act registration statements, proxy statements and tender offer statements. [Jan. 11, 2010]

Question 101.02

Question: If reconciliation of a non-GAAP financial measure is required and the most directly comparable measure is a "pro forma" measure prepared and presented in accordance with Article 11 of Regulation S-X, may companies use that measure for reconciliation purposes, in lieu of a GAAP financial measure?

Answer: Yes. [Jan. 11, 2010]

Section 102. Item 10(e) of Regulation S-K

Question 102.01

Question: What measure was contemplated by "funds from operations" in footnote 50 to Exchange Act Release No. 47226, Conditions for Use of Non-GAAP Financial Measures, which indicates that companies may use "funds from operations per share" in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K?

Answer: The reference to "funds from operations" in footnote 50, or "FFO," refers to the measure ~~as defined and clarified,~~ as of January 1, 2000, by the National Association of Real Estate Investment Trusts ([NAREIT](#)). NAREIT has revised and clarified the definition since 2000. The staff accepts ~~this~~ NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and ~~as a performance measure, it may be~~ does not object to its presentation on a per share basis. ~~[Jan. 11 May 17, 2010]~~ [May 17, 2016]

Question 102.02

Question: May a registrant present ~~"funds from operations"~~ FFO on a basis other than as defined ~~and clarified, as of January 1, 2000, by the National Association of Real Estate Investment Trusts~~ by NAREIT as of May 17, 2016?

Answer: Yes, provided that any adjustments made to ~~"funds from operations," as defined in footnote 50 of Exchange Act Release No. 47226,~~ FFO comply with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. Any adjustments made to ~~"funds from operations" as defined in footnote 50~~ FFO must comply with the requirements of Item 10(e) of Regulation S-K for a performance measure or a liquidity measure, depending on ~~how it is presented. If~~ the nature of the adjustments, some of which may trigger the prohibition on presenting this measure ~~is a performance measure, it may be presented~~ on a per share basis; if it is a liquidity measure, it may not be. ~~[Jan. 11. See Section 100 and Question 102.05. [May 17, 2010]]~~ [May 17, 2016]

Question 102.03

Question: Item 10(e) of Regulation S-K prohibits adjusting a non-GAAP financial performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual ~~when the nature of the charge or gain is such that~~ it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. Is this prohibition based on the description of the charge or gain, or is it based on the nature of the charge or gain?

Answer: The prohibition is based on the description of the charge or gain that is being adjusted. It would not be appropriate to state that a charge or gain is non-recurring, infrequent or unusual unless it meets the specified criteria.

The fact that a registrant cannot describe a charge or gain as non-recurring, infrequent or unusual, however, does not mean that the registrant cannot adjust for that charge or gain. Registrants can make adjustments they believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K. ~~[Jan. 11, See~~
[Question 100.01. \[May 17, 2010\]](#)~~]~~

Question 102.04

Question: Is the registrant required to use the non-GAAP measure in managing its business or for other purposes in order to be able to disclose it?

Answer: No. Item 10(e)(1)(i)(D) of Regulation S-K states only that, "[t]o the extent material," there should be a statement disclosing the additional purposes, "if any," for which the registrant's management uses the non-GAAP financial measure. There is no prohibition against disclosing a non-GAAP financial measure that is not used by management in managing its business. [Jan. 11, 2010]

Question 102.05

Question: While Item 10(e)(1)(ii) of Regulation S-K does not prohibit the use of per share non-GAAP financial measures, the adopting release for Item 10(e), Exchange Act Release No. 47226, states that "per share measures that are prohibited specifically under GAAP or Commission rules continue to be prohibited in materials filed with or furnished to the Commission." In light of Commission guidance, specifically Accounting Series Release No. 142, [Reporting Cash Flow and Other Related Data](#), and Accounting Standards Codification 230, are non-GAAP earnings per share numbers prohibited in documents filed or furnished with the Commission?

Answer: No. Item 10(e) recognizes that certain non-GAAP per share performance measures may be meaningful from an operating standpoint. Non-GAAP per share performance measures should be reconciled to GAAP earnings per share. On the other hand, non-GAAP liquidity measures ~~, such as that measure cash flow, should generated must~~ not be presented on a per share basis in documents filed or furnished with the Commission, consistent with Accounting Series Release No. 142. ~~[Jan. 11, Whether per share data is prohibited depends on whether the non-GAAP measure~~
[can be used as a liquidity measure, even if management presents it solely as a performance measure. When](#)
[analyzing these questions, the staff will focus on the substance of the non-GAAP measure and not management's](#)
[characterization of the measure. \[May 17, 2010\]](#)~~]~~

Question 102.06

Question: Is Item 10(e)(1)(i) of Regulation S-K, which requires the prominent presentation of, and reconciliation to, the most directly comparable GAAP financial measure or measures, intended to change the staff's practice of requiring the prominent presentation of amounts for the three major categories of the statement of cash flows when a non-GAAP liquidity measure is presented?

Answer: No. The requirements in Item 10(e)(1)(i) are consistent with the staff's practice. The three major categories of the statement of cash flows should be presented when a non-GAAP liquidity measure is presented. [Jan. 11, 2010]

Question 102.07

Question: Some companies present a measure of "free cash flow," which is typically calculated as cash flows from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures. Does Item 10(e)(1)(ii) of Regulation S-K prohibit this measure in documents filed with the Commission?

Answer: No. The deduction of capital expenditures from the GAAP financial measure of cash flows from operating activities would not violate the prohibitions in Item 10(e)(1)(ii). However, companies should be aware that this measure does not have a uniform definition and its title does not describe how it is calculated. Accordingly, a clear description of how this measure is calculated, as well as the necessary reconciliation, should accompany the measure where it is used. Companies should also avoid inappropriate or potentially misleading inferences about its usefulness. For example, "free cash flow" should not be used in a manner that inappropriately implies that the measure represents the residual cash flow available for discretionary expenditures, since many companies have mandatory debt service requirements or other non-discretionary expenditures that are not deducted from the measure. ~~[Jan. 11, Also, free cash flow is a liquidity measure that must not be presented on a per share basis. See Question 102.05.~~
[\[May 17, 2010\]](#)~~]~~

Question 102.08

Question: Does Item 10(e) of Regulation S-K apply to filed free writing prospectuses?

Answer: Regulation S-K applies to registration statements filed under the Securities Act, as well as registration statements, periodic and current reports and other documents filed under the Exchange Act. A free writing prospectus is not filed as part of the issuer's registration statement, unless the issuer files it on Form 8-K or otherwise includes it or incorporates it by reference into the registration statement. Therefore, Item 10(e) of Regulation S-K does not apply to a filed free writing prospectus unless the free writing prospectus is included in or incorporated by reference into the issuer's registration statement or included in an Exchange Act filing. [Jan. 11, 2010]

Question 102.09

Question: Item 10(e)(1)(ii)(A) of Regulation S-K prohibits "excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA)." A company's credit agreement contains a material covenant regarding the non-GAAP financial measure "Adjusted EBITDA." If disclosed in a filing, the non-GAAP financial measure "Adjusted EBITDA" would violate Item 10(e), as it excludes charges that are required to be cash settled. May a company nonetheless disclose this non-GAAP financial measure?

Answer: Yes. The prohibition in Item 10(e) notwithstanding, because MD&A requires disclosure of material items affecting liquidity, if management believes that the credit agreement is a material agreement, that the covenant is a material term of the credit agreement and that information about the covenant is material to an investor's understanding of the company's financial condition and/or liquidity, then the company may be required to disclose the measure as calculated by the debt covenant as part of its MD&A. In disclosing the non-GAAP financial measure in this situation, a company should consider also disclosing the following:

- the material terms of the credit agreement including the covenant;
- the amount or limit required for compliance with the covenant; and
- the actual or reasonably likely effects of compliance or non-compliance with the covenant on the company's financial condition and liquidity. [Jan. 11, 2010]

Question 102.10

Question: Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence. This requirement applies to non-GAAP measures presented in documents filed with the Commission and also earnings releases furnished under Item 2.02 of Form 8-K. Are there examples of disclosures that would cause a non-GAAP measure to be more prominent?

Answer: Yes. Although whether a non-GAAP measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, the staff would consider the following examples of disclosure of non-GAAP measures as more prominent:

- ~~Question: Is it appropriate to~~ Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement ~~for purposes of~~ when reconciling non-GAAP measures to the most directly comparable GAAP measures?
- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;

~~Answer: Generally, no. Presenting a full non-GAAP income statement may attach undue prominence to the non-GAAP information. [Jan. 11, 2010]~~

Question 102.11

- **Question:** ~~May a registrant present an adjustment "net of tax" when reconciling a~~ non-GAAP performance measure ~~to that precedes~~ the most directly comparable GAAP measure ~~?(including in an earnings release headline or caption);~~

~~Answer: Yes, provided that the tax effect of each reconciling item is disclosed parenthetically or in a footnote to the reconciliation. Alternatively, the company can present the tax effect in one line in the reconciliation. Regardless of the format of the presentation, registrants should disclose how the tax effect was calculated. [Jan. 11, 2010]~~

- Describing a non-GAAP 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 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 measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence. [May 17, 2016]

Question 102.11

Question: How should income tax effects related to adjustments to arrive at a non-GAAP measure be calculated and presented?

Answer: A registrant should provide income tax effects on its non-GAAP measures depending on the nature of the measures. If a measure is a liquidity measure that includes income taxes, it might be acceptable to adjust GAAP taxes to show taxes paid in cash. If a measure is a performance measure, the registrant should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. In addition, 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. [May 17, 2016]

Question 102.12

Question: A registrant discloses a financial measure or information that is not in accordance with GAAP or calculated exclusively from amounts presented in accordance with GAAP. In some circumstances, this financial information may have been prepared in accordance with guidance published by a government, governmental authority or self-regulatory organization that is applicable to the registrant, although the information is not required disclosure by the government, governmental authority or self-regulatory organization. Is this information considered to be a "non-GAAP financial measure" for purposes of Regulation G and Item 10 of Regulation S-K?

Answer: Yes. Unless this information is required to be disclosed by a system of regulation that is applicable to the registrant, it is considered to be a "non-GAAP financial measure" under Regulation G and Item 10 of Regulation S-K. Registrants that disclose such information must provide the disclosures required by Regulation G or Item 10 of Regulation S-K, if applicable, including the quantitative reconciliation from the non-GAAP financial measure to the most comparable measure calculated in accordance with GAAP. This reconciliation should be in sufficient detail to allow a reader to understand the nature of the reconciling items. [Apr. 24, 2009]

Section 103. EBIT and EBITDA

Question 103.01

Question: Exchange Act Release No. 47226 describes EBIT as "earnings before interest and taxes" and EBITDA as "earnings before interest, taxes, depreciation and amortization." What GAAP measure is intended by the term "earnings"? May measures other than those described in the release be characterized as "EBIT" or "EBITDA"? Does

the exception for EBIT and EBITDA from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K apply to these other measures?

Answer: "Earnings" means net income as presented in the statement of operations under GAAP. Measures that are calculated differently than those described as EBIT and EBITDA in Exchange Act Release No. 47226 should not be characterized as "EBIT" or "EBITDA" and their titles should be distinguished from "EBIT" or "EBITDA," such as "Adjusted EBITDA." These measures are not exempt from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K, with the exception of measures addressed in Question 102.09. [Jan. 11, 2010]

Question 103.02

Question: If EBIT or EBITDA is presented as a performance measure, to which GAAP financial measure should it be reconciled?

Answer: If a company presents EBIT or EBITDA as a performance measure, such measures should be reconciled to net income as presented in the statement of operations under GAAP. Operating income would not be considered the most directly comparable GAAP financial measure because EBIT and EBITDA make adjustments for items that are not included in operating income. ~~[Jan. 11, 2010]~~ [In addition, these measures must not be presented on a per share basis. See Question 102.05. \[May 17, 2010\]](#)

Section 104. Segment Information

Question 104.01

Question: Is segment information that is presented in conformity with Accounting Standards Codification 280, pursuant to which a company may determine segment profitability on a basis that differs from the amounts in the consolidated financial statements determined in accordance with GAAP, considered to be a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No. Non-GAAP financial measures do not include financial measures that are required to be disclosed by GAAP. Exchange Act Release No. 47226 lists "measures of profit or loss and total assets for each segment required to be disclosed in accordance with GAAP" as examples of such measures. The measure of segment profit or loss and segment total assets under Accounting Standards Codification 280 is the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance.

The list of examples in Exchange Act Release No. 47226 is not exclusive. As an additional example, because Accounting Standards Codification 280 requires or expressly permits the footnotes to the company's consolidated financial statements to include specific additional financial information for each segment, that information also would be excluded from the definition of non-GAAP financial measures. [Jan. 11, 2010]

Question 104.02

Question: Does Item 10(e)(1)(ii) of Regulation S-K prohibit the discussion in MD&A of segment information determined in conformity with Accounting Standards Codification 280?

Answer: No. Where a company includes in its MD&A a discussion of segment profitability determined consistent with Accounting Standards Codification 280, which also requires that a footnote to the company's consolidated financial statements provide a reconciliation, the company also should include in the segment discussion in the MD&A a complete discussion of the reconciling items that apply to the particular segment being discussed. In this regard, see Financial Reporting Codification Section 501.06.a, footnote 28. [Jan. 11, 2010]

Question 104.03

Question: Is a measure of segment profit/loss or liquidity that is not in conformity with Accounting Standards Codification 280 a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Segment measures that are adjusted to include amounts excluded from, or to exclude amounts included in, the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance do not comply with Accounting Standards

Codification 280. Such measures are, therefore, non-GAAP financial measures and subject to all of the provisions of Regulation G and Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Question 104.04

Question: In the footnote that reconciles the segment measures to the consolidated financial statements, a company may total the profit or loss for the individual segments as part of the Accounting Standards Codification 280 required reconciliation. Would the presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote be the presentation of a non-GAAP financial measure?

Answer: Yes. The presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote would be the presentation of a non-GAAP financial measure because it has no authoritative meaning outside of the Accounting Standards Codification 280 required reconciliation in the footnotes to the company's consolidated financial statements. [Jan. 11, 2010]

Question 104.05

Question: Company X presents a table illustrating a breakdown of revenues by certain products, but does not sum this to the revenue amount presented on Company X's financial statements. Is the information in the table considered a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No, assuming the product revenue amounts are calculated in accordance with GAAP. The presentation would be considered a non-GAAP financial measure, however, if the revenue amounts are adjusted in any manner. [Jan. 11, 2010]

Question 104.06

Question: Company X has operations in various foreign countries where the local currency is used to prepare the financial statements which are translated into the reporting currency under the applicable accounting standards. In preparing its MD&A, Company X will explain the reasons for changes in various financial statement captions. A portion of these changes will be attributable to changes in exchange rates between periods used for translation. Company X wants to isolate the effect of exchange rate differences and will present financial information in a constant currency — e.g., assume a constant exchange rate between periods for translation. Would such a presentation be considered a non-GAAP measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Company X may comply with the reconciliation requirements of Regulation G and Item 10(e) by presenting the historical amounts and the amounts in constant currency and describing the process for calculating the constant currency amounts and the basis of presentation. [Jan. 11, 2010]

Section 105. Item 2.02 of Form 8-K

Question 105.01

Question: Item 2.02 of Form 8-K contains a conditional exemption from its requirement to furnish a Form 8-K where earnings information is presented orally, telephonically, by webcast, by broadcast or by similar means. Among other conditions, the company must provide on its web site any financial and other statistical information contained in the presentation, together with any information that would be required by Regulation G. Would an audio file of the initial webcast satisfy this condition to the exemption?

Answer: Yes, provided that: (1) the audio file contains all material financial and other statistical information included in the presentation that was not previously disclosed, and (2) investors can access it and replay it through the company's web site. Alternatively, slides or a similar presentation posted on the web site at the time of the presentation containing the required, previously undisclosed, material financial and other statistical information would satisfy the condition. In each case, the company must provide all previously undisclosed material financial and other statistical information, including information provided in connection with any questions and answers. Regulation FD also may impose disclosure requirements in these circumstances. [Jan. 11, 2010]

Question 105.02

Question: Item 2.02 of Form 8-K contains a conditional exemption from its requirement to furnish a Form 8-K where earnings information is presented orally, telephonically, by webcast, by broadcast or by similar means. Among other

conditions, the company must provide on its web site any material financial and other statistical information not previously disclosed and contained in the presentation, together with any information that would be required by Regulation G. When must all of this information appear on the company's web site?

Answer: The required information must appear on the company's web site at the time the oral presentation is made. In the case of information that is not provided in a presentation itself but, rather, is disclosed unexpectedly in connection with the question and answer session that was part of that oral presentation, the information must be posted on the company's web site promptly after it is disclosed. Any requirements of Regulation FD also must be satisfied. A webcast of the oral presentation would be sufficient to meet this requirement. [Jan. 11, 2010]

Question 105.03

Question: Does a company's failure to furnish to the Commission the Form 8-K required by Item 2.02 in a timely manner affect the company's eligibility to use Form S-3?

Answer: No. Form S-3 requires the company to have filed in "a timely manner all reports required to be filed in twelve calendar months and any portion of a month immediately preceding the filing of the registration statement." Because an Item 2.02 Form 8-K is furnished to the Commission, rather than filed with the Commission, failure to furnish such a Form 8-K in a timely manner would not affect a company's eligibility to use Form S-3. While not affecting a company's Form S-3 eligibility, failure to comply with Item 2.02 of Form 8-K would, of course, be a violation of Section 13(a) of the Exchange Act and the rules thereunder. [Jan. 11, 2010]

Question 105.04 [withdrawn]

Question 105.05

Question: Company X files its quarterly earnings release as an exhibit to its Form 10-Q on Wednesday morning, prior to holding its earnings conference call Wednesday afternoon. Assuming that all of the other conditions of Item 2.02(b) are met, may the company rely on the exemption for its conference call even if it does not also furnish the earnings release in an Item 2.02 Form 8-K?

Answer: Yes. Company X's filing of the earnings release as an exhibit to its Form 10-Q, rather than in an Item 2.02 Form 8-K, before the conference call takes place, would not preclude reliance on the exemption for the conference call. [Jan. 11, 2010]

Question 105.06

Question: Company A issues a press release announcing its results of operations for a just-completed fiscal quarter, including its expected adjusted earnings (a non-GAAP financial measure) for the fiscal period. Would this press release be subject to Item 2.02 of Form 8-K?

Answer: Yes, because it contains material, non-public information regarding its results of operations for a completed fiscal period. The adjusted earnings range presented would be subject to the requirements of Item 2.02 applicable to non-GAAP financial measures. [Jan. 11, 2010]

Question 105.07

Question: A company issues its earnings release after the close of the market and holds a properly noticed conference call to discuss its earnings two hours later. That conference call contains material, previously undisclosed, information of the type described under Item 2.02 of Form 8-K. Because of this timing, the company is unable to furnish its earnings release on a Form 8-K before its conference call. Accordingly, the company cannot rely on the exemption from the requirement to furnish the information in the conference call on a Form 8-K. What must the company file with regard to its conference call?

Answer: The company must furnish the material, previously non-public, financial and other statistical information required to be furnished on Item 2.02 of Form 8-K as an exhibit to a Form 8-K and satisfy the other requirements of Item 2.02 of Form 8-K. A transcript of the portion of the conference call or slides or a similar presentation including such information will satisfy this requirement. In each case, all material, previously undisclosed, financial and other statistical information, including that provided in connection with any questions and answers, must be provided. [Jan. 15, 2010]

Section 106. Foreign Private Issuers

Question 106.01

Question: The Note to Item 10(e) of Regulation S-K permits a foreign private issuer to include in its filings a non-GAAP financial measure that otherwise would be prohibited by Item 10(e)(1)(ii) if, among other things, the non-GAAP financial measure is required or expressly permitted by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission. What does "expressly permitted" mean?

Answer: A measure is "expressly permitted" if the particular measure is clearly and specifically identified as an acceptable measure by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission. The concept of "expressly permitted" can be also be demonstrated with explicit acceptance of a presentation by the primary securities regulator in the foreign private issuer's home country jurisdiction or market. Explicit acceptance by the regulator would include (1) published views of the regulator or members of the regulator's staff or (2) a letter from the regulator or its staff to the foreign private issuer indicating the acceptance of the presentation — which would be provided to the Commission's staff upon request. [Jan. 11, 2010]

Question 106.02

Question: A foreign private issuer furnishes a press release on Form 6-K that includes a section with non-GAAP financial measures. Can a foreign private issuer incorporate by reference into a Securities Act registration statement only those portions of the furnished press release that do not include the non-GAAP financial measures?

Answer: Yes. Reports on Form 6-K are not incorporated by reference automatically into Securities Act registration statements. In order to incorporate a Form 6-K into a Securities Act registration statement, a foreign private issuer must specifically provide for such incorporation by reference in the registration statement and in any subsequently submitted Form 6-K. See Item 6(c) of Form F-3. Where a foreign private issuer wishes to incorporate by reference a portion or portions of the press release provided on a Form 6-K, the foreign private issuer should either: (1) specify in the Form 6-K those portions of the press release to be incorporated by reference, or (2) furnish two Form 6-K reports, one that contains the full press release and another that contains the portions that would be incorporated by reference (and specifies that the second Form 6-K is so incorporated). Using a separate report on Form 6-K containing the portions that would be incorporated by reference may provide more clarity for investors in most circumstances. A company must also consider whether its disclosure is rendered misleading if it incorporates only a portion (or portions) of a press release. [Jan. 11, 2010]

Question 106.03

Question: A foreign private issuer publishes a non-GAAP financial measure that does not comply with Regulation G, in reliance on Rule 100(c), and then furnishes the information in a report on Form 6-K. Must the foreign private issuer comply with Item 10(e) of Regulation S-K with respect to that information if the company chooses to incorporate that Form 6-K report into a filed Securities Act registration statement (other than an MJDS registration statement)?

Answer: Yes, the company must comply with all of the provisions of Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Question 106.04

Question: If a Canadian company includes a non-GAAP financial measure in an annual report on Form 40-F, does the company need to comply with Regulation G or Item 10(e) of Regulation S-K with respect to that information if the company files a non-MJDS Securities Act registration statement that incorporates by reference the Form 40-F?

Answer: No. Information included in a Form 40-F is not subject to Regulation G or Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Section 107. Voluntary Filers**Question 107.01**

Question: Section 15(d) of the Exchange Act suspends automatically its application to any company that would be subject to the filing requirements of that section where, if other conditions are met, on the first day of the company's fiscal year it has fewer than 300 holders of record of the class of securities that created the Section 15(d) obligation.

This suspension, which relates to the fiscal year in which the fewer than 300 record holders determination is made on the first day thereof, is automatic and does not require any filing with the Commission. The Commission adopted Rule 15d-6 under the Exchange Act to require the filing of a Form 15 as a notice of the suspension of a company's reporting obligation under Section 15(d). Such a filing, however, is not a condition to the suspension. A number of companies whose Section 15(d) reporting obligation is suspended automatically by the statute choose not to file the notice required by Rule 15d-6 and continue to file Exchange Act reports as though they continue to be required. Must a company whose reporting obligation is suspended automatically by Section 15(d) but continues to file periodic reports as though it were required to file periodic reports comply with Regulation G and the requirements of Item 10(e) of Regulation S-K?

Answer: Yes. Regulation S-K relates to filings with the Commission. Accordingly, a company that is making filings as described in this question must comply with Regulation S-K or Form 20-F, as applicable, in its filings. As to other public communications, any company "that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934, or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934" must comply with Regulation G. The application of this standard to those companies that no longer are "required" to report under Section 15(d) but choose to continue to report presents a difficult dilemma, as those companies technically are not subject to Regulation G but their continued filing is intended to and does give the appearance that they are a public company whose disclosure is subject to the Commission's regulations. It is reasonable that this appearance would cause shareholders and other market participants to expect and rely on a company's required compliance with the requirements of the federal securities laws applicable to companies reporting under Section 15(d). Accordingly, while Regulation G technically does not apply to a company such as the one described in this question, the failure of such a company to comply with all requirements (including Regulation G) applicable to a Section 15(d)-reporting company can raise significant issues regarding that company's compliance with the anti-fraud provisions of the federal securities laws. [Jan. 11, 2010]

Section 108. Compensation Discussion and Analysis/Proxy Statement

Question 108.01

Question: Instruction 5 to Item 402(b) provides that "[d]isclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G and Item 10(e); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements." Does this instruction extend to non-GAAP financial information that does not relate to the disclosure of target levels, but is nevertheless included in Compensation Discussion & Analysis ("CD&A") or other parts of the proxy statement - for example, to explain the relationship between pay and performance?

Answer: No. Instruction 5 to Item 402(b) is limited to CD&A disclosure of target levels that are non-GAAP financial measures. If non-GAAP financial measures are presented in CD&A or in any other part of the proxy statement for any other purpose, such as to explain the relationship between pay and performance or to justify certain levels or amounts of pay, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K.

In these pay-related circumstances only, the staff will not object if a registrant includes the required GAAP reconciliation and other information in an Appendix to the proxy statement, provided the registrant includes a prominent cross-reference to such Appendix. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information. [July 8, 2011]

<http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>

Modified: ~~07/08/2011~~ 05/17/2016

Appendix B

Recent SEC Comment Letters Foreshadow Updated Guidance on Non-GAAP Measures and the Comment Letters that Will Follow

Many, if not all, of the updated CDIs have been foreshadowed by Division comment letters. During SEC Speaks on February 19-20, 2016, the Division of Corporation Finance staff identified non-GAAP financial measures as among the Division’s “perennial top three” categories of accounting comments. As the Staff explained, reviewers look for compliance with the “prominence” and GAAP reconciliation requirements, and may challenge a company’s use of a non-GAAP measure as potentially misleading under the relevant facts and circumstances. In recent years, the Staff has issued comments that focused on a company’s disclosure as to why their non-GAAP measures are useful, apparent “cherry picking” adjustments within a non-GAAP measure, and the exclusion of normal, cash operating expenses.¹⁵ The Division has also made it clear that it will use the review and comment process to “crack down” on perceived abuses going forward.

Set forth below is a table summarizing representative Staff comments on the use of non-GAAP measures that companies have received within the last year and company responses to further assist companies in their preparation for the application of the new and updated CDIs in the Division of Corporation Finance review and comment process.

<u>Updated CDI</u>	<u>Sample Comment</u>	<u>Summary of Response Provided¹</u>
Question 100.01 – Misleading Adjustments	In regard to your use of adjusted EBITDA as a performance measure, please explain to us, and clarify in future filings, why you included certain adjustments.	Explains why the adjustments are included based on the history of such adjustments in relation to the development of the business. Commits to providing such disclosure in future filings.
Question 100.02 – Misleading by Inconsistent Presentation of Non-GAAP Measures	Profit measures appear not to be comparable to prior periods. Please clarify for readers that current EBITDA and Adjusted EBITDA are not comparable to the corresponding prior period measures due to these effects and describe them.	Explains changes to billing programs and the recognition of the revenue and intention to include as additional reconciliation disclosure in future filings.
Question 100.03 – Misleading Exclusions of Charges, But Not Gains	Please tell us why you removed the impact of acquisition-related expenses and the amortization of intangible assets you acquire[d], as well as the impact of other fair value adjustments recorded under acquisition accounting in presenting your non-GAAP financial measures. <i>*The SEC Staff has not specifically addressed the inclusion of gains in this comment, but we expect more direct comments in light of the guidance.</i>	Explains that acquisitions are one element of the company’s growth strategy and as the size and number of transactions have varied, the costs are not factored into management’s evaluation of potential acquisitions or the company’s performance because they are not related to the company’s core performance. Also points to its reconciliation disclosures.
Question 100.04 –	Given that your strategy identified as critical to	Explains that the strategy identified by the Staff is one

¹ These responses offer a sample approach taken by a company in response to a comment from the SEC Staff. We note that the responses were provided prior to the issuance of the updated CDIs and may not all be acceptable to the SEC Staff in light of the guidance.

Individually Tailored Non-GAAP Revenue Recognition or Other Measures	achieving and maintaining growth in your business, please tell us why you remove the impact of those related expenses and amortization as well as the impact of other fair value adjustments recorded under acquisition accounting in presenting your non-GAAP financial measures. We believe revisions to your future earnings releases and investor materials are appropriate.	component of its operations and that the company believes the wide range of varied related charges are not related to core operating performance based on their variation. However, the company committed to revise its explanation in future releases because the strategy, as identified by the Staff, is directly attributable to the company's operations.
Question 102.01 – Clarification of Funds from Operations (“FFO”)	We note the use of Funds from Operations Applicable to the company, or FFO (NAREIT) in your earnings commentary and supplemental information. Please tell us whether you consider this measure to be a key performance indicator. To the extent this measure is considered a key performance indicator; in future periodic filings please include the measure as well as the required disclosures in accordance with Item 10(e) of Regulation S-K within your Management's Discussion and Analysis.	Explains importance of FFO as a performance indicator since the conversion to a REIT; commits to provide reconciliation in subsequent filings.
Question 102.02 – Presentation of FFO	We note that you present net operating income in your earnings releases as a non-GAAP measure. Please revise future earnings releases to include all of the disclosures required by Item 10(e)(1)(i) of Regulation S-K for this measure. In your response, provide an example of your proposed disclosure.	Confirms continuing use of net operating income in future press releases; commits to include all of the disclosures required by Item 10(e)(1)(i) of Regulation S-K for this measure and provides sample future disclosure including NAREIT's definition of FFO.
Question 102.03 – Description of Charge or Gain as “Non-Recurring, Infrequent or Unusual” Must Meet Criteria	Please tell us how you determined shareholder litigation expenses, investigation costs and equity related transaction costs met the criteria to be identified as non-recurring. Please refer to Item 10(e) of Regulation S-K and Question 102.03 of our Non-GAAP Financial Measures Compliance & Disclosures Interpretations.	Explains historical view that the shareholder litigation expense, investigation costs and equity related transaction costs related to unique one-time events that may or may not recur with similar materiality or impact to its results of operations. Notes that beginning in the first quarter of 2015, company removed the reference to the word “non-recurring” from the description of Adjusted EBITDA set forth in its Quarterly Reports on Form 10-Q and will exclude reference to the word “non-recurring” with respect to “special charges”, which includes shareholder litigation and investigation costs, from our future filings and earnings releases for at least the next two years and for so long as charges of that nature were incurred within the prior two years or the nature of the charge is reasonably likely to recur within two years.
Question 102.05 – Non-GAAP Per Share Performance Measures	We note you are presenting the non-GAAP measure free cash flow per share. Please explain to us why you believe this measure is a performance measure and not a liquidity measure. Discuss why you have reconciled a performance measure to “cash provided by operating activities.” Additionally please explain to us why you believe your	Explains that the company provides a regular report of free cash flow per share to its investors and its importance due to the nature of operations; however, states intention to discontinue reporting free cash flow per share upon further consideration of ASR 142 and Item 10(e) of Regulation S-K.

	presentation of free cash flow per share in your SEC filings is consistent with the guidance of ASR 142 and Item 10(e) of Regulation S-K. Refer to Q&A 102.05 of Compliance and Disclosure Interpretations on Non-GAAP Financial Measures available at our website.	
Question 102.07 – Reconciling Free Cash Flow	We note that you present free cash flow as a measure of your operating performance. Given that “free cash flow” is widely understood to be a liquidity measure, there is a concern that investors may not fully understand your basis for characterizing this non-GAAP measure as a performance measure. Also, the use of the words “cash flow” in the measure’s title is confusingly similar to the GAAP financial measures included in the Statements of Cash Flows. Further, we note your definition of this measure as starting with GAAP cash flow provided by operating activities. If you maintain that free cash flow is an operating performance measure in addition to a liquidity measure, then please provide an explanation as to why this measure is useful to investors as an operating performance measure in accordance with Item 10(e)(1)(i)(c) of Regulation S-K.	States the intention to present free cash flow as a liquidity measure and not as a performance measure and will continue to reconcile free cash flow to cash provided by operating activities and will not provide a reconciliation from net income.
Question 102.10 – Prominence	Please revise to give equal prominence to your GAAP financial measures. For example, although you disclosed GAAP earnings per share prior to non-GAAP earnings per share, you disclose the percentage increase in your non-GAAP earnings per share without disclosing that GAAP earnings per share declined from the prior year. Refer to Item 10(e)(1)(i)(A) of Regulation S-K and Instruction 2 to Item 2.02 of Form 8-K.	Commits to revise future filings in accordance with the comment and to include additional GAAP earnings per share information.
	We note you presented adjusted earnings per share guidance for the fourth fiscal quarter. Regulation G requires a schedule or other presentation detailing the differences between the forward looking non-GAAP financial measure and the forward looking GAAP financial measure. Regulation G requires a schedule or other presentation detailing the differences between forward looking non-GAAP financial measures and the forward-looking GAAP financial measures. If the GAAP financial measures are not accessible on a forward-looking basis, you should disclose that fact and provide reconciling information that is available without an unreasonable effort. In addition, you should identify information that is unavailable and disclose the probable significance.	Explains that the company previously justified not providing reconciling information because certain information was not ascertainable or accessible due to the difficulty in making accurate forecasts and projections and the uncertainty of future events. Notes that the company reviewed the information that it has available to utilize when making forward-looking projections and determined that it can, without unreasonable effort, provide a reconciliation to the most directly comparable GAAP measure in future filings.

Question 102.11 – Presentation of Income Tax Effects	<p>Tell us why the tax effect recorded in your non-GAAP performance measure for the period in the tables is x% of the pre-tax adjustments and the impact in the comparable period of the prior year is negative y%. These amounts are substantially different from the statutory tax rates in Country A and the U.S. and your consolidated effective tax rate. Please see Question 102.11 of the Compliance & Disclosure Interpretations associated with Non-GAAP Financial Measures.</p>	<p>Explains that the tax adjustments are a function of the difference between U.S. GAAP provision for income taxes for the period and the expected actual cash tax expense. The U.S. GAAP provision for income taxes for the period was \$xx million and the prior year period was \$yy million, driven mainly by the annualized mix of earnings worldwide, the adjustments associated with the filing of tax returns in the US and benefit for restructurings undertaken to streamline the Company's operations in Country B. Future filings will clarify that the adjustment to the provision for income taxes is the difference between the Company's U.S. GAAP provision for income taxes for the period and the expected cash tax expense.</p>
Question 103.02 – EBIT or EBITDA Per Share	<p><i>*We have not seen recent SEC Staff comments has not specifically commented on use of EBIT/EBITDA per share measures, but we expect more direct comments in light of the guidance.</i></p>	

ENDNOTES

¹ SEC Chair White indicated last December that the agency is taking steps “to make sure our current [non-GAAP] rules are being followed,” and to determine whether the rules are “sufficiently robust in light of current market practices.” See SEC Chair Mary Jo White, Keynote Address at the 2015 AICPA National Conference: “Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility” (Dec. 9, 2015), available at <https://www.sec.gov/news/speech/keynote-2015-aicpa-white.html> (“Chair White AICPA Keynote”); see also SEC Commissioner Kara M. Stein, Statement on the Commission’s Consideration of Public Company Accounting Oversight Board’s Proposed 2016 Budget and Accounting Support Fee (Mar. 16, 2016), available at <https://www.sec.gov/news/statement/stein-remarks-open-meeting-pcaob-031416.html>; SEC Chief Accountant James V. Schnurr, Remarks before the 12th Annual Life Sciences Accounting and Reporting Congress, Philadelphia, PA, March 22, 2016, available at <https://www.sec.gov/speech/schnurr-remarks-12th-life-sciences-accounting-congress.html> (“Schnurr Remarks”); Wesley R. Bricker, SEC Deputy Chief Accountant, Remarks before the 2016 Baruch College Financial Reporting Conference (May 6, 2016), available at <https://www.sec.gov/news/speech/speech-bricker-05-05-16.html> (“Bricker Remarks”); David M. Katz, SEC Leads Crackdown on Non-GAAP Measures, *CFO.com* (May 12, 2016) (quoting Division of Corporation Finance Chief Accountant Mark Kronforst), available at <http://www2.cfo.com/gaap-ifs/2016/05/sec-leads-crackdown-non-gaap-measures/>; Archive Webcast and Audio, Standing Advisory Group Meeting of Public Company Accounting Oversight Board (PCAOB) (May 18, 2016), available at <https://pcaobus.org/News/Events/Pages/SAG-meeting-May-2016.aspx> (“May 18 PCAOB Meeting Webcast”).

² See May 18 PCAOB Meeting Webcast, *supra*.

³ Division of Corporation Finance Chief Accountant Mark Kronforst indicated that recent SEC speeches foreshadowed all of the updated CDIs other than 102.10 regarding prominence during the May 18, 2016 PCAOB Meeting. See May 18 PCAOB Meeting Webcast, *supra*.

⁴ See Chair White AICPA Keynote, *supra*.

⁵ See Chair White AICPA Keynote, *supra*; Schnurr Remarks, *supra* (“The Chair cautioned last December that, “[w]hile [a company’s] chief financial officer and investor relations team may be quite enamored of non-GAAP measures as useful market communication devices, [the] finance and legal teams, along with [their] audit committees, should carefully attend to the use of these measures.”); Bricker Remarks, *supra* (“[A]udit committees should be paying close attention to the non-GAAP measures a company presents, including the required related disclosures, and the processes it follows to consider both the appropriateness and reliability of the measures.”).

⁶ See, e.g., David Michaels, *Fuzzy-Math Accounting Gets Fresh SEC Scrutiny*, BNA Corporate Law & Accountability Report, Wed., March 2, 2016; Justin Lahart, *Earnings: Not as Advertised*, Wall St. J., Thurs., Feb. 25, 2016, at p. C1.

⁷ See Final Rule: Conditions for Use of Non-GAAP Financial Measures, SEC Release No. 33-8176, issued by the SEC in connection with its adoption of Regulation G and Item 10(e) of Regulation S-K, on Jan. 22, 2003, available at <https://www.sec.gov/rules/final/33-8176.htm> (“2003 Release”). Some of the updated CDIs either repeat or flesh out authoritative SEC interpretive guidance presented in the 2003 Release, but not necessarily reflected in the plain language of the SEC’s non-GAAP rules: for example, new CDI 102.10 restates the requirement for companies to reconcile forward-looking non-GAAP measures quantitatively to the GAAP measure to the extent the necessary GAAP information is available without unreasonable effort, or otherwise disclose that fact, identify the information that is not available and its probable significance in a location of equal or greater prominence and revised CDIs 102.05, 102.07 and 103.02 include the prohibition against presentations of non-GAAP liquidity measures on a per-share basis.

⁸ See *In the Matter of Trump Hotels & Casino Resorts, Inc.*, Administrative Proceeding File No. 3-10680 (Jan. 16, 2002), available at <https://www.sec.gov/litigation/admin/34-45287.htm>.

⁹ See Bricker Remarks, *supra*.

¹⁰ This position dates back to the SEC’s 2003 non-GAAP adopting release. See 2003 Release, *supra*.

¹¹ See Chamber of Commerce 2016 Capital Markets Summit – Conversation with SEC Chair White (Mar. 16, 2016) available at <http://videos.uschamber.com/detail/videos/capital-markets-summits/video/4805706279001/2016-capital-markets-summit--conversation-with-sec-chair-white?autoStart=true>.

¹² See note 7, *supra*.

¹³ See Schnurr Remarks, *supra*.

¹⁴ Media attention has also turned to how companies are using non-GAAP measures to compensate senior management. For example, one article reported a 31% increase in the appearance of the term “non-GAAP” in proxy statements of S&P 500 companies in the last five years, and further notes that often this meant that the CEO was awarded higher pay than he or she would have received had compensatory performance targets had been based on GAAP results. See Justin Lahart, *CEO Bonuses: How Pro Forma Results Boost Them*, Wall St. J. (May 26, 2016), available at <http://www.wsj.com/articles/ceo-bonuses-how-pro-forma-results-boost-them-1464285447?mg=id-wsj>.

¹⁵ See Bricker Remarks, *supra*.