TheCorporateCounsel.net

"Non-GAAP Developments: Enhancing Your Policies and Procedures"

Thursday, July 20, 2023

Course Materials

<u>"Non-GAAP Developments: Enhancing Your Policies and Procedures"</u>

Thursday, July 20, 2023

2 to 3 p.m. Eastern [archive and transcript to follow]

Companies are increasingly using non-GAAP measures, but continue to struggle with non-GAAP compliance. With new CDIs, frequent comment letters and recent enforcement activity, this remains a high-priority area for the SEC. Join our panelists to hear about non-GAAP developments and how you should be revamping your related disclosures, policies, procedures and controls.

- **Michael Ben**, Partner, Honigman
- **Patrick Gilmore**, Partner, Deloitte
- **Amy Seidel**, Partner, Faegre Drinker
- **Matthew Franker**, Partner, Covington

Among other timely topics, this webcast will cover:

- Common Non-GAAP Mistakes and Comment Letter Trends
- The Most Recent Round of Non-GAAP CDIs
- The SEC's 2023 Non-GAAP Enforcement Action and Focus on Controls and Procedures
- Improving Non-GAAP Policies, Procedures and Controls
  - Reviewing and Approving Non-GAAP Adjustments
  - Involving the Disclosure Committee
  - Accuracy and Completeness of Descriptions of Non-GAAP Measures

“Non-GAAP Developments: Enhancing Your Policies and Procedures”

Course Outline/Notes

1. Common Non-GAAP Mistakes and Comment Letter Trends

2. The Most Recent Round of Non-GAAP CDIs

3. The SEC’s 2023 Non-GAAP Enforcement Action and Focus on Disclosure Controls and Procedures

4. Improving Non-GAAP Policies, Procedures and Controls

    a. Reviewing and Approving Non-GAAP Adjustments

    b. Involving the Disclosure Committee

    c. Accuracy and Completeness of Descriptions of Non-GAAP Measures

<u>“Non-GAAP Developments: Enhancing Your Policies and Procedures”</u>

Table of Contents — Course Materials

August 18, 2022

Corp Fin Comment Letters: Latest Trends

PwC recently published its annual roundup of comment letter trends – detailing the types of issues that Corp Fin has raised on company filings, from July 2021 through June 2022. Here's the "Top 10" – and how the comment volume is trending compared to last year at this time:

1. Non-GAAP – up
2. MD&A – up
3. Segment reporting – down
4. Risk factors: climate change matters – up
5. Revenue recognition – down
6. Fair value measurement – unchanged
7. Disclosure controls and ICFR – unchanged
8. Inventory and cost of sales – unchanged
9. Form compliance and exhibits – unchanged
10. Business combinations – unchanged

In terms of real-time trends, Dave recently blogged about continued inquiries about disclosure on the war in Ukraine, and John blogged about comments on inflation & supply chain pressures. We also just posted the latest edition of our "SEC Comment Letter Process Handbook" – 47 pages of practical insights to help you anticipate comments and navigate responses. Special thanks to Sidley's Sonia Barros and Sara von Althann for contributing their expertise to this resource, which helps our entire securities law community!

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.thecorporatecounsel.net/blog/2022/08/corp-fin-comment-letters-latest-trends.html

May 13, 2022

Non-GAAP: Adjustment for Public Co. Expenses Involves "Tailored Accounting"

Bass Berry's Jay Knight recently blogged about a comment letter exchange in which the Staff objected to a company's presentation of a non-GAAP measure adjusted for expenses incurred in transitioning to public company status. Here's an excerpt:

> We found particularly interesting this recent comment letter exchange (see here and here) where the SEC Staff took issue when a company, which had recently gone public, included an adjustment in its Adjusted EBITDA non-GAAP financial measure for "public company expenses" related to "additional headcount to build infrastructure and support the operations of a public company (i.e., public company directors & officers liability insurance, investor relation and public listing fees, additional legal and accounting fees, and additional independent board members)."

In the Staff's view, these expenses were normal, recurring expenses associated with public company status and efforts to back them out of Adjusted EBITDA involved inappropriate "tailored accounting." The company agreed to remove the adjustment in future filings.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2022/05/non-gaap-adjustment-for-public-co-expenses-involves-tailored-accounting.html

← Direct Listings: SCOTUS Grants Cert in Slack Technologies Case | Main | Today's CompensationStandards.com Webcast: "SEC Clawback Rules: What To Do Now" →

December 14, 2022

Corp Fin Issues New & Updated Non-GAAP CDIs

Yesterday, Corp Fin issued 7 Non-GAAP Financial Measures CDIs. Several of these CDIs update or replace the language of existing CDIs, while the remainder are new. Hanukkah and Christmas are just around the corner, so as a gift I'm going to do what the Staff doesn't & provide a markup showing the changes. Additions are in bold, while deletions are presented as strikethroughs:

> 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. Whether or not an adjustment results in a misleading non-GAAP measure depends on a company's individual facts and circumstances.
>
> **Presenting a non-GAAP performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business is one example of a measure that could be misleading.**
>
> **When evaluating what is a normal, operating expense, the staff considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment.**
>
> **The staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring. [December 13, 2022]**
>
> 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?~~ **Can a non-GAAP measure violate Rule 100(b) of Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP?**
>
> 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].~~ **Yes. By definition, a non-GAAP measure excludes or includes amounts from the most directly comparable GAAP measure. However, non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading. Examples the staff may consider to be misleading include, but are not limited to:**

– changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;

– presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse,

– presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and

– changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis. [December 13, 2022]

Question 100.05

Question: Can a non-GAAP measure be misleading if it, and/or any adjustment made to the GAAP measure, is not appropriately labeled and clearly described?

Answer: Yes. Non-GAAP measures are not always consistent across, or comparable with, non-GAAP measures disclosed by other companies. Without an appropriate label and clear description, a non-GAAP measure and/or any adjustment made to arrive at that measure could be misleading to investors. The following examples would violate Rule 100(b) of Regulation G:

- **Failure to identify and describe a measure as non-GAAP.**
- **Presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure, such as:**

– a contribution margin that is calculated as GAAP revenue less certain expenses, labeled "net revenue";
– non-GAAP measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as "Gross Profit" or "Sales"; and
– non-GAAP measure labeled "pro forma" that is not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X. [December 13, 2022]

Question 100.06

Question: Can a non-GAAP measure be misleading, and violate Rule 100(b) of Regulation G, even if it is accompanied by disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure?

Answer: Yes. It is the staff's view that a non-GAAP measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each adjustment would not prevent the non-GAAP measure from being materially misleading. [December 13, 2022]

Question 102.10

Question 102.10(a): 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:~~ **Yes. This requirement applies to the presentation of, and any related discussion and analysis of, a non-GAAP measure. 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 to be examples of non-GAAP measures that are more prominent than the comparable GAAP measures:**

- ~~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;~~ **Presenting an income statement of non-GAAP measures. See Question 102.10(c).**
- ~~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 or omitting the comparable GAAP measure altogether, including in an earnings release headline or caption that includes a non-GAAP measure.**
- **Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence.**
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font, etc.) that emphasizes the non-GAAP measure over the comparable GAAP measure.
- ~~A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);~~ **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.**
- Presenting charts, tables or graphs of a non-GAAP financial measures without presenting charts, tables or graphs of the comparable GAAP measures with equal or greater prominence, or omitting the comparable GAAP measures altogether.
- 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. [December 13, 2022]

Question 102.10(b): Are there examples of disclosures that would cause the non-GAAP reconciliation required by Item 10(e)(1)(i)(B) of Regulation S-K to give undue prominence to a non-GAAP measure?

Answer: Yes. The staff would consider the following examples of disclosure of non-GAAP measures as more prominent than the comparable GAAP measures:

- **Starting the reconciliation with a non-GAAP measure.**
- **Presenting a non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures. See Question 102.10(c).**
- **When presenting a forward-looking non-GAAP measure, a registrant may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)**

(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence. [December 13, 2022]

Question 102.10(c): The staff considers the presentation of a non-GAAP income statement, alone or as part of the required non-GAAP reconciliation, as giving undue prominence to non-GAAP measures. What is considered to be a non-GAAP income statement?

Answer: The staff considers a non-GAAP income statement to be one that is comprised of non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement. [December 13, 2022]

I'd have to check with Broc to be sure, but I think this may be the longest blog in the history of this blog. Anyway, Happy Holidays!

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2022/12/corp-fin-issues-new-updated-non-gaap-cdis.html

COVINGTON

Updated SEC Guidance on Non-GAAP Measures

ALERT DECEMBER 14, 2022

Updated SEC Guidance on Non-GAAP Measures

December 14, 2022, *Covington Alert*

The SEC's Division of Corporation Finance recently updated its Compliance & Disclosure Interpretations (**C&DI's**) regarding the use of non-GAAP financial measures. Non-GAAP measures are numerical measures of performance, financial position or cash flows that are not calculated in accordance with generally accepted accounting principles ("GAAP"). The new interpretive guidance reflects an ongoing focus by the SEC and its staff on public companies' use of potentially misleading non-GAAP financial measures.

Background

Pursuant to the directives of the Sarbanes-Oxley Act, in 2003 the SEC adopted two rules regarding the use of non-GAAP financial measures: Regulation G and Item 10(e) of Regulation S-K.

> Regulation G applies whenever a company discloses a non-GAAP financial measure (including outside of SEC filings) and prohibits such use without complementary disclosure of the most directly comparable GAAP financial measure and a reconciliation of the two measures. In Rule 100(b), Regulation G also prohibits the use of materially misleading non-GAAP financial measures.
>
> Item 10(e) of Regulation S-K applies to non-GAAP financial measures used in SEC filings, and requires the same complementary and reconciling presentation as Regulation G. However, Item 10(e) also requires that the presentation of the most directly comparable GAAP measure be of equal or greater prominence than the corresponding non-GAAP financial measure, and that a statement be included explaining why management believes each non-GAAP financial measure is useful to investors, as well as a second statement about the additional purposes (if any) for which management uses each measure. Item 10(e) also prohibits the use of certain specific non-GAAP financial measures.

Updated Guidance

Over the years, the SEC's Division of Corporation Finance has published a number of C&DIs regarding the use of non-GAAP financial measures. On December 13, 2022, the Division of Corporation Finance updated certain of these C&DIs, focusing on disclosures that the staff considers to be potentially misleading or in violation of the equal or greater prominence requirement of Item 10(e). The discussion below summarizes a number of key updates.

Use of Potentially Misleading Non-GAAP Financial Measures

Update to Question 100.01. This interpretation has long expressed the SEC staff's view that certain adjustments, although not explicitly prohibited, may result in a non-GAAP financial measure that is misleading. The interpretation notes, for example, that presenting a performance measure that excludes normal, recurring cash operating expenses necessary to operate a registrant's business could be considered misleading. The updated C&DI revises this guidance in two respects:

The staff has clarified that an operating expense that occurs repeatedly or occasionally, including at irregular intervals, is considered recurring. This will make it more difficult to justify excluding certain cash operating expenses that may not be regular but could still be considered recurring.

The staff has explained that when evaluating what is a normal, operating expense, it will consider the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment.

Update to Question 100.04. This question addresses individually tailored revenue recognition and measurement methods. Its focus has been broadened, and now states the general principle that a non-GAAP measure could be considered misleading under Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP. In the staff's view, non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading. The updated C&DI cites several examples the staff may consider to be misleading for this reason, including:

changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;

presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse, presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and

changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis.

New Question 100.05. This new C&DI says that a non-GAAP measure can be considered misleading if it, and/or any adjustment made to the GAAP measure, is not appropriately labeled and clearly described. The staff notes that non-GAAP measures are not always consistently defined and used across companies, and that appropriate labels and clear descriptions of how the non-GAAP measure is calculated can be key to preventing such disclosures from being misleading to investors. The interpretation cites the following examples of disclosures that would violate Rule 100(b) of Regulation G:

failure to identify and describe a measure as non-GAAP; and

presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure, such as:

- a contribution margin that is calculated as GAAP revenue less certain expenses, labeled "net revenue";
- a non-GAAP measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as "Gross Profit" or "Sales"; and
- a non-GAAP measure labeled "pro forma" that is not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X.

New Question 100.06. This new C&DI states that a non-GAAP measure can be considered misleading, and thus violate Rule 100(b) of Regulation G, even if it is accompanied by disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure. This interpretation does not cite any examples, and therefore leaves the staff ample room to exercise discretion in finding a particular use of a non-GAAP measure to be misleading. The interpretation notes the staff's view that a non-GAAP measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each adjustment would not prevent the non-GAAP measure from being materially misleading.

Prominence of Non-GAAP Measures in SEC Filings

Update to Question 102.10. This C&DI addresses Item 10(e)'s requirement that when a company discloses a non-GAAP measure it must present the most directly comparable GAAP measure with *equal or greater prominence*, and confirms the requirement in Item 2.02 of Form 8-K that Item 10(e) applies not only to documents filed with the SEC but also earnings releases furnished under that Item. This C&DI has now been expanded and divided into sub-parts.

Question 102.10(a) states that 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. It and the companion Question 102.10(b) give several examples of non-GAAP measures that are more prominent than the comparable GAAP measures. Certain of the examples have been updated, as follows:

> Presenting an income statement of non-GAAP measures, alone or as part of the required non-GAAP reconciliation, is an example of giving undue prominence to non-GAAP measures. Question 102.10(c) clarifies that the staff considers a non-GAAP income statement to be one that is comprised of non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement.
>
> Two existing examples that addressed earnings release headlines and captions have been combined and broadened – as revised, the example given is where a company presents a non-GAAP measure *before* the most directly comparable GAAP measure or *omits* the comparable GAAP measure altogether, including in an earnings release headline or caption that includes a non-GAAP measure.
>
> The existing example that discusses forward-looking non-GAAP financial measures has been clarified. The updated C&DI makes clear that when presenting a forward-looking non-GAAP measure without an accompanying quantitative reconciliation (because one is not available without unreasonable efforts), a measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exemption, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence
>
> The existing example of tabular disclosure of non-GAAP measures has been expanded to refer to disclosure of *charts, tables or graphs* of non-GAAP financial measures without presenting charts, tables or graphs of the comparable GAAP measures with equal or greater prominence, or omitting the comparable GAAP measures altogether.
>
> As a new example, the staff cites when a company presents a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence.
>
> As another new example, the staff cites starting the required non-GAAP reconciliation with a non-GAAP measure (as opposed to starting from the comparable GAAP metric).

Takeaways

We expect the SEC staff to continue its heightened focus on non-GAAP financial measure disclosures, and it is reasonable to expect SEC staff scrutiny and comments on earnings releases and other public disclosures highlighting performance using non-GAAP measures. Non-GAAP measures may also continue to be a focus area for the Division of Enforcement and for potential shareholder litigation.

Public companies that make use of non-GAAP measures should continue to pay close attention to non-GAAP measure disclosures that could be viewed as potentially misleading under the updated guidance. Companies that exclude cash operating expenses in calculating non-GAAP financial measures should review the appropriateness of such exclusions in light of the updated guidance on what constitutes a recurring expense. Companies should also consider whether revisions to their non-GAAP disclosures are needed, in light of the new guidance, to ensure non-GAAP measures are appropriately labeled and clearly described. Finally, companies should review their non-GAAP presentations and reconciliations to ensure that non-GAAP measures are not more prominent than comparable GAAP metrics and that reconciliations begin with the most directly comparable GAAP measure.

If you have any questions concerning the material discussed in this client alert, please contact the members of our **Securities and Capital Markets practice**.

Related Professionals

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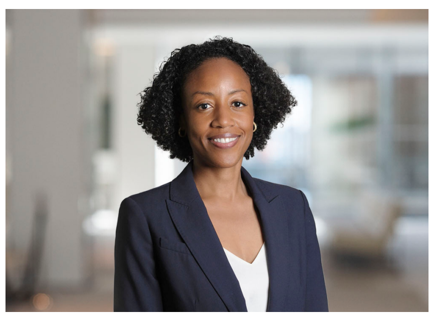

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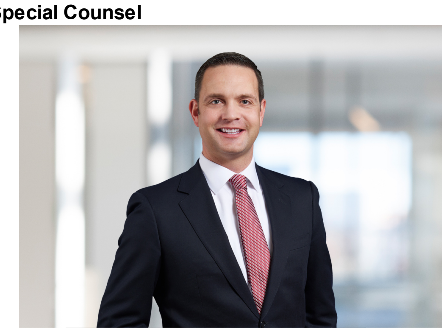

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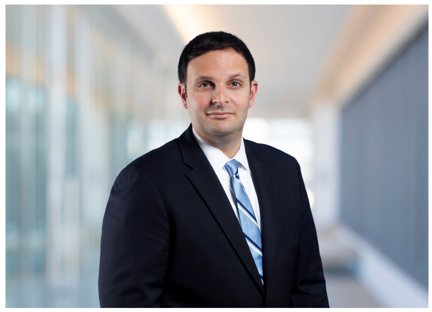

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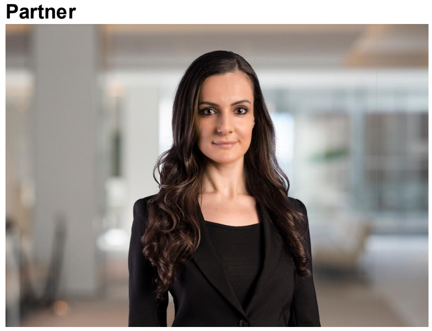

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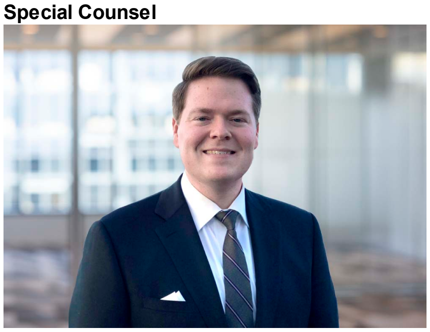

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PRESS RELEASE OCTOBER 11, 2022

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PRESS RELEASE MONDAY, OCTOBER 3, 2022

Covington Promotes 15 to Partner

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COVINGTON

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March 20, 2023

Non-GAAP: New SEC Enforcement Action Spotlights Disclosure Controls

It's been a couple years since we've had a non-GAAP enforcement action. Last week, the SEC reminded us that they're still watching for problems. The Commission announced charges against a company for allegedly misleading disclosures about its non-GAAP financial performance in multiple reporting periods from 2018 until early 2020.

One of the things that got the company in trouble was allegedly failing to adopt disclosure controls & procedures specific to non-GAAP measures. The SEC says that led to misclassifications of excluded expenses and misleading disclosures of what exactly had been excluded. Here's more detail from the 11-page order (also see this Cooley blog):

> The company also had insufficient processes to ensure that its business practices for classifying costs as TSI were consistent with the plain meaning of the company's own description of those costs in its periodic reports filed with the Commission and in its earnings releases. The absence of a non-GAAP policy and specific disclosure controls and procedures caused employees within the business units and in the Financial Planning & Analysis area ("FP&A") to make subjective determinations about whether expenses were related to an actual or contemplated transaction, regardless of whether the costs were actually consistent with the description of the adjustment included in the company's public disclosures. As a result, the company negligently misclassified certain internal labor costs, data center relocation costs that were unrelated to the merger, and other expenses as TSI costs.

Without admitting or denying the findings in the order, the company consented to a cease-and-desist order, to pay an $8 million penalty, and to undertake to develop and implement appropriate non-GAAP policies and disclosure controls and procedures. The SEC considered the company's cooperation and remedial actions in accepting the settlement offer.

I blogged a few weeks ago that "disclosure controls" enforcement actions are trending. We all need to pay attention to the link between disclosure controls & disclosure content – including for voluntary disclosures – because the SEC certainly is doing that. As Lawrence noted last week on PracticalESG.com, the SEC's interest in whether companies are accurately explaining what makes up the information they're providing could also translate to scrutiny of ESG disclosure controls in the future.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2023/03/non-gaap-new-sec-enforcement-action-spotlights-disclosure-controls.html

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 11166 / March 14, 2023

SECURITIES EXCHANGE ACT OF 1934
Release No. 97140 / March 14, 2023

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4391 / March 14, 2023

ADMINISTRATIVE PROCEEDING
File No. 3-21342

In the Matter of **DXC TECHNOLOGY COMPANY,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against DXC Technology Company ("DXC" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. This matter concerns material misstatements made by DXC in its reporting and disclosures of non-GAAP financial performance measures, including non-GAAP net income and non-GAAP diluted earnings per share ("EPS"), in multiple quarterly and annual Exchange Act reports and earnings releases. From the end of the company's fiscal year 2018 through the third quarter of its fiscal year 2020 ("relevant period"),[2] DXC disclosed that it excluded transaction, separation, and integration-related ("TSI") costs from its non-GAAP net income, non-GAAP EPS, and other non-GAAP measures. DXC described TSI costs as those "related to integration planning, financing, and advisory fees associated with" the merger that formed DXC, other acquisitions, and the spin-off of a business. But on a quarterly basis, DXC materially increased its non-GAAP earnings by negligently misclassifying tens of millions of dollars of expenses as TSI costs and improperly excluding them in its reporting of non-GAAP measures. As a result, in multiple periods, DXC failed to describe accurately the scope of expenses included in the company's adjustment for TSI costs in its disclosure, and therefore its non-GAAP net income and non-GAAP diluted EPS in periodic reports and earnings releases were materially misleading.

2. Throughout the relevant period, the company presented non-GAAP measures for the stated purpose of providing investors with meaningful supplemental financial information to evaluate its core operating performance, excluding one-time or non-recurring expenses. However, DXC did not have a non-GAAP policy or adequate disclosure controls and procedures in place specific to its non-GAAP financial measures. DXC also had insufficient processes to ensure that its business practices for classifying costs as TSI were consistent with the plain meaning of the company's own description of those costs in its periodic reports filed with the Commission and in its earnings releases. The absence of a non-GAAP policy and specific disclosure controls and procedures caused employees within the business units and in the Financial Planning & Analysis area ("FP&A") to make subjective determinations about whether expenses were related to an actual or contemplated transaction, regardless of whether the costs were actually consistent with the description of the adjustment included in the company's public disclosures. As a result, DXC negligently misclassified certain internal labor costs, data center relocation costs that were unrelated to the merger, and other expenses as TSI costs.

3. During the relevant period, DXC's controller's group ("controllership") was responsible for reviewing and approving TSI costs for inclusion in the company's quarterly and annual Exchange Act filings and earnings releases. However, the controllership was unable to perform adequate reviews concerning the classification of such costs as TSI, in part, because DXC had insufficient disclosure controls and procedures concerning the review, approval, and classification of TSI costs. In two quarters during the relevant period, the controllership was

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] DXC's fiscal year is three quarters ahead of the calendar year. For example, DXC's fiscal year 2018 ended on March 31, 2018, with the company filing its Form 10-K for that year on May 29, 2018.

unable to obtain supporting information about certain TSI costs from FP&A, yet DXC still issued its earnings releases and filed its Forms 10-Q that included those costs in its non-GAAP measures.

4. During the relevant period, DXC's controllership and disclosure committee negligently failed to evaluate the company's non-GAAP disclosures adequately, particularly concerning TSI costs, and failed to implement an appropriate non-GAAP policy and to maintain disclosure controls and procedures. TSI costs were, therefore, not identified, reviewed, approved, or disclosed in a manner consistent with a plain reading of the description of the TSI adjustment included in earnings releases and in periodic filings. As a result, DXC's non-GAAP disclosures did not comply with Rule 100(b) of Regulation G of the Exchange Act. Both the controllership and the disclosure committee failed even to recognize that, for years, DXC did not have a non-GAAP policy and adequate disclosure controls and procedures.

Respondent

5. DXC Technology Company, a Nevada corporation, with its principal executive offices in Ashburn, Virginia, is a multi-national information technology company. DXC stock is registered under Section 12(b) of the Exchange Act. In April 2017, DXC was created by the merger of Computer Sciences Corporation ("CSC") with most of the Enterprises Services ("ES") business of Hewlett Packard Enterprise Company ("CSC-ES Merger"). In June 2015, in a matter unrelated to the conduct at issue in this Order, CSC was charged with violating anti-fraud and other provisions of the federal securities laws, and ordered to cease and desist from future violations. Since the CSC-ES Merger, DXC stock has traded on the New York Stock Exchange under the ticker "DXC."

Facts

Background

6. After the completion of the CSC-ES Merger, most of CSC's then-senior executives, as well as the former controller, filled the same roles at DXC. Before the CSC-ES Merger, CSC had a practice of reporting non-GAAP measures, which excluded transaction and integration-related costs. Following the CSC-ES Merger, DXC continued that practice and adopted disclosure language concerning such costs that was similar to CSC's disclosures.

7. In May 2018, in reporting its fiscal year 2018 ("FY2018") results, DXC amended its TSI disclosure to include certain costs associated with the then-pending separation of its U.S. Public Sector business ("USPS"). As a result, during the relevant time period, DXC included the following description of TSI costs in its filings with the Commission and in its earnings releases:

> *Transaction, separation and integration-related costs* – reflects costs related to integration planning, financing, and advisory fees associated with the HPES Merger and other acquisitions and costs related to the separation of USPS.

8. DXC management understood that the non-GAAP measures, and the company's related guidance, were material to market participants when evaluating the company's earnings releases and results of operations. In its Commission filings and earnings releases, DXC noted

that management believed “these non-GAAP measures allow investors to better understand the financial performance of DXC exclusive of the impacts of corporate-wide strategic decisions. . . [and provide] investors with additional measures to evaluate the financial performance of our core business operations on a comparable basis from period to period.” DXC management also believed that “the non-GAAP measures provided are also considered important measures by financial analysts covering DXC, as equity research analysts continue to publish estimates and research notes based on our non-GAAP commentary, including our guidance around non-GAAP EPS.”

DXC’s Identification and Review of TSI Costs

9. After the CSC-ES Merger, DXC’s controllership recognized the need for a non-GAAP policy that included disclosure controls and procedures specific to non-GAAP reporting. During DXC’s FY2018, the controllership circulated numerous non-GAAP policy drafts internally and to DXC’s independent auditor. However, neither the controllership nor the disclosure committee approved or adopted a policy or disclosure controls and procedures specific to such non-GAAP measures.

10. During the relevant period, DXC had no formal guidance that employees could consult to determine which costs could be classified as TSI, to ensure that such costs were appropriate to exclude from its non-GAAP measures, and to ensure consistency with the company’s own disclosure language. Instead, DXC relied on an informal process under which expenses could be included as TSI costs even though they were beyond the scope of costs described in the company’s disclosures.

11. As described below, although DXC’s public description of TSI costs remained unchanged for two full years, the company had no process by which its employees evaluated whether proposed TSI costs were consistent with the description of TSI costs included in its non-GAAP disclosure. In turn, there was similarly no process by which the individuals and reviewers responsible for the TSI disclosure actually assessed the nature of specific TSI costs to determine whether the description in the disclosure matched DXC’s practices.

12. During the relevant period, DXC’s FP&A group was responsible for the initial approval of the classification of expenses that were proposed by the company’s business units as potential TSI costs, which were excluded from the units’ internal profit-and-loss figures. Thus, if FP&A approved a cost as TSI, that expense would be removed from a unit’s financial performance, thereby increasing the unit’s internally-reported profitability.

13. FP&A did not require the business units to document the basis on which a proposed expense might be classified as a TSI cost, how the expense related to a transaction or integration project, or the expected amount or duration of the cost. FP&A also did not consistently document the reason for its own approvals of TSI cost classification. Consequently, and because of turnover within business units and FP&A, previously-approved TSI cost classifications were not reassessed from year-to-year to determine if the continued classification was appropriate. It was unclear on what basis some costs had been approved as being TSI, when, or by whom; approved costs were coded as “integration” or related to a “transaction,” and the

expenses simply rolled up in FP&A's quarter-end aggregation of company-wide TSI costs that FP&A provided to the controllership.

14. In this process, FP&A did not evaluate whether the classification of such costs was consistent with the description of TSI costs in the company's public disclosures or if the costs otherwise should not have been included in the company's non-GAAP measures. In fact, some employees in FP&A who were responsible for initially approving the classification and aggregation of TSI costs believed that FP&A's role involved limited or no oversight and analysis, and that the controllership was responsible for determining which costs were appropriate to include as TSI in the company's filings with the Commission and in its public disclosures. Within the controllership, the individuals responsible for reviewing and approving the classification of TSI costs for non-GAAP reporting purposes believed that FP&A had more robust procedures than it actually did for analyzing and vetting the TSI costs before forwarding the aggregated costs to the controllership.

DXC Controllership Failed to Perform Adequate Reviews of TSI Costs

15. During the relevant period, DXC's controllership reviewed the company's various non-GAAP measures, including TSI costs, for accuracy and compliance with SEC requirements. After the end of each fiscal quarter, FP&A provided a large spreadsheet with tens of thousands of TSI cost line items for review and approval by the controllership before the inclusion of such costs in DXC's public non-GAAP measures. Given the sheer number of TSI cost line items, the lack of project and cost descriptions in the spreadsheets, and the limited period within which to scrutinize the costs, the controllership was unable to perform adequate reviews during the relevant period.

16. Further, some controllership employees, particularly the former Assistant Corporate Controller for External Reporting ("ACC"), questioned certain costs that had been characterized as TSI, but they either did not receive supporting documentation or, at times, were provided with inaccurate or incomplete information. Communications related to the controllership's questions about certain TSI costs were often addressed only orally, without adequate written records of how particular issues were resolved. In some periods, the former ACC also noted concerns about certain TSI cost issues in responding to the company's quarterly sub-certification surveys, though the former ACC ultimately certified, with comments, the company's financial reporting in those periods.

17. During the company's FY2019, DXC's former ACC questioned tens of millions of dollars in quarterly costs that were characterized as TSI and raised concerns to the former controller. During the review of TSI costs for Q2FY2019, for example, the former ACC emailed the former controller:

> I know I bring this up every quarter but it is concerning to see branding and other integration efforts included in non-gaap as add backs. They continue to include internal labor for which this quarter is $19 [million] of labor and $5.2 [million] of tax expense. We requested additional details and support on how these adjustments are in compliance with the SEC requirements and the breakdown by project.

18. The former ACC did not receive the requested additional details or the breakdown by project. In a sub-certification for Q2FY2019, which was executed after DXC issued its earnings release and the day before it filed its Form 10-Q, the former ACC noted:

> We have not received all supporting documentation surrounding non-gaap adjustments to assess appropriateness of adjustments in the financials but this would not impact GAAP numbers. [W]hen brought to the Controllers attention, [the Controller] agreed to require a thorough review of the process for the parties compiling the information and its compliance with SEC regs.

19. For the controllership's review of TSI costs for Q3FY19, the former ACC again questioned tens of millions in quarterly expenses that were included in FP&A's quarter-end TSI costs spreadsheet. The result was the same as in the prior quarter: the controllership did not complete an adequate review, and in a sub-certification executed after DXC issued its earnings release and the day before it filed its Form 10-Q, the former ACC wrote:

> I have asked again for supporting information to address the non-gaap adjustments and how they meet the CDI to ensure compliance with non-GAAP SEC Regs. I have not received responses and these non-gaap measures are heavily relied upon by investors. We simply require an explanation for the items as outlined in several requests to Management/FPA. I have provided this information to [the controller] for his assessment.

20. Beginning in Q4FY19, DXC enhanced the process to require earlier review of non-GAAP items, including more regular information exchanges between FP&A and the controllership. However, DXC still did not implement a policy for the classification of TSI costs or for non-GAAP disclosures. In addition, DXC's review and approval of the classification of TSI costs continued to be untethered from the plain language of the company's description of those costs in its public disclosures. Although FP&A provided the controllership with TSI cost spreadsheets before quarter-end, the data in those spreadsheets was insufficient to determine whether many costs were appropriately characterized as TSI.

21. In performing the controllership's review for Q4FY19, the former ACC again questioned the classification of tens of millions in TSI costs, including expenses that the former ACC had questioned—and did not receive adequate documentation for—in previous quarters. Although FP&A provided more timely responses for Q4FY19, the information on some costs was inaccurate, incomplete, or not consistent with the descriptions of work set forth in the actual vendor contracts and project descriptions. For example, DXC had hired a consulting firm to evaluate and calculate historic research-and-development tax credits so that DXC could amend its earlier tax returns to claim credits going back to 2015. FP&A informed the controllership that this work was to standardize the tax credit methodology for the merged company and, on that basis, included the costs as TSI. However, the contractual statement of work referred to identifying incremental tax credits, and contained no work related to policy or methodology standardization.

22. Other "integration" projects were included as TSI costs even though they were unrelated to the CSC-ES Merger, an acquisition, or the separation of USPS. In six consecutive

quarters during the relevant period, DXC included a total of over $38m in "integration" expenses – and thus, TSI costs – related to the closure of a legacy CSC data center and transition of its operations to a nearby legacy ES data center. However, before the merger, the landlord of the data center informed CSC that it was redeveloping the property and would not renew the lease. Thus, CSC—and, subsequently, DXC—was forced to relocate the data center and incur related expenses, regardless of whether the merger occurred. At some point in FY2018, FP&A approved the classification of the relocation expenses as TSI costs, though there was no documentation of a request, evaluation, or the bases for the approval.

23. In reviewing TSI costs during FY2019, the former ACC asked multiple times about the data center relocation costs and was informed that the costs were previously approved as an integration of two legacy facilities following the merger. Although this explanation was technically correct, it omitted the fact that, before the merger, the relocation expense was a known, future, operating cost that was required whether or not a merger or acquisition occurred. This information, if known to the former ACC, would have impacted the former ACC's assessment of including the relocation expenses as TSI costs.

24. In Q1FY20, DXC continued to classify recurring expenses from earlier quarters as TSI costs, including "special audit fees" (part of which were fees above a certain level paid to its independent accountant for the company's required integrated audit), costs for complying with a new GAAP leasing standard, and expenses in connection with potential divestitures that never closed. In Q1FY20, DXC also classified as a TSI cost a portion of a litigation settlement with a former executive who had been terminated. These costs were inconsistent with DXC's public disclosure of TSI costs.

DXC Made Material Misstatements

25. As a result of its negligence, DXC made materially misleading statements about its TSI costs during the relevant period by misstating the nature and scope of those costs. As DXC disclosed in its periodic reports to the Commission and in earnings releases issued during the relevant period, the company recognized that the non-GAAP measures were material because they allowed investors to better understand the core performance of the company.

26. DXC's misclassification of certain expenses as TSI costs materially impacted its reported non-GAAP net income for three quarters as follows: (1) *Q2FY19*: non-GAAP net income of $573 million overstated by at least $29 million; (2) *Q4FY19*: non-GAAP net income of $589 million overstated by at least $30 million; and (3) *Q1FY20*: non-GAAP net income of $472 million was overstated by at least $24 million.

27. Reasonable investors would have considered the foregoing information to have been material in deciding whether to purchase DXC securities during the relevant period.

DXC Offered and Sold Securities during the Relevant Period

28. During the relevant period, DXC offered and sold securities, including offering shares to employees in employee benefit plans, issuing restricted stock as compensation to certain employees under incentive plans, and public offerings of debt securities.

DXC's Disclosure Controls and Procedures Failures

29. Exchange Act Rule 13a-15(a) requires issuers such as DXC to "maintain disclosure controls and procedures . . . as defined in paragraph (e) of this section." Paragraph (e) defines disclosure controls and procedures to include, among other things, "procedures . . . designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the [Exchange] Act . . . is recorded, processed, summarized, and reported[] within the time periods specified in the Commission's rules and forms." As described above, DXC lacked company-wide disclosure controls and procedures to ensure that TSI costs were identified, reviewed, and approved for appropriate inclusion in the TSI adjustment in a manner consistent with their disclosure.

Violations

30. As a result of the conduct described above, DXC violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Section 17(a)(2) prohibits any person from obtaining money or property in the offer or sale of securities by means of an untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Section 17(a)(3) of the Securities Act prohibits any person from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. Negligence is sufficient to establish violations of Sections 17(a)(2) and 17(a)(3). *Aaron v. SEC*, 446 U.S. 680, 697 (1980).

31. As a result of the conduct described above, DXC violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13, and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual, current, and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

32. As a result of the conduct described above, DXC violated Rule 13a-15(a) of the Exchange Act, which requires that every issuer of a security registered pursuant to Section 12 of the Exchange Act maintain disclosure controls and procedures as defined in Rule 13a-15(e) of the Exchange Act.

33. As a result of the conduct described above, DXC violated Rule 100(b) of Regulation G of the Exchange Act, which prohibits registrants from making public a non-GAAP financial measure that contains an untrue statement of material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.

DXC's Cooperation and Remedial Efforts

34. In determining to accept DXC's Offer, the Commission considered the cooperation it provided during the Commission's investigation, as well as remedial measures undertaken by DXC.

35. Respondent provided substantial cooperation during the course of the investigation. Respondent voluntarily undertook a robust review of its TSI practices, voluntarily and promptly produced documents and made witnesses available, and compiled and presented information in the form requested by the staff on multiple occasions.

36. Respondent also undertook affirmative remedial steps in response to the issues identified during the investigation, which included reviewing and supplementing its procedures concerning non-GAAP adjustments and reporting, and proactively enhancing its disclosures of TSI costs. Subsequent to the relevant period, DXC also reduced the volume of its TSI costs in more recent quarters. DXC has replaced nearly all of its senior executive and financial leadership personnel who were present during the relevant period.

Undertakings

37. Respondent has undertaken to develop and implement policies and disclosure controls and procedures:

a. for the disclosure of its non-GAAP financial performance such that its non-GAAP financial measures, including expenses, are described accurately in future periodic filings and public statements, and that its non-GAAP disclosures are consistent with the company's actual processes for identifying, reviewing, and approving non-GAAP adjustments, including, but not limited to costs;

b. for its disclosure committee, or other charged committee, to review and document, on a periodic basis, the company's non-GAAP policy to assess consistency with its non-GAAP disclosures and its publicly-reported non-GAAP financial performance measures;

c. for controllership staff who are familiar with SEC reporting requirements and DXC's non-GAAP policy and non-GAAP disclosures to approve and document the classification of items included in non-GAAP adjustments; and

d. for timely reviewing, considering, and addressing negative Sub-Certification Survey comments relating to GAAP and non-GAAP financial results or disclosures, or that may impact Management's Discussion and Analysis of Operations.

38. DXC will comply with these undertakings within 120 calendar days from the entry of this Order. DXC will then certify, in writing, compliance with these undertakings. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Jeff Leasure, Assistant Director, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent DXC's Offer.

Accordingly, it is hereby ORDERED that**:**

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent DXC cease and desist from committing or causing any violations and any future violations Section 17(a)(2) and (3) of the Securities Act and of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, 13a-13, and 13a-15(a) thereunder, and Rule 100(b) of Regulation G.

B. Respondent shall comply with the undertakings enumerated in Section III, paragraphs 37 and 38, above.

C. Respondent shall, within 28 days of the entry of this Order, pay a civil money penalty in the amount of $8,000,000.00, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying DXC Technology Company as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Mark Cave, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-6561.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor

Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary

April 25, 2023

Do You Have a Non-GAAP Policy?

The SEC's most recent non-GAAP enforcement action has triggered new calls for companies to adopt non-GAAP policies if they haven't already. That's partly because, as John blogged, the SEC raised the company's alleged failure to adopt disclosure controls & procedures specific to non-GAAP measures. If you're looking to adopt a non-GAAP policy, or revamp your existing policy, consider these tips from Gibson Dunn's *Securities Regulation and Corporate Governance Monitor*:

> **Companies Should Have Disclosure Controls and Procedures in Place to Identify and Disclose Non-GAAP Adjustments.** It is crucial for accounting, legal and other personnel responsible for public reporting to be familiar with SEC reporting requirements as they pertain to non-GAAP measures, and the company's disclosure controls and procedure documentation should specifically address steps and controls in place to identify amounts relevant for non-GAAP adjustments and make non-GAAP disclosures. Employee determinations of non-GAAP adjustments should be guided by, and evaluated in light of, such disclosure controls and procedures and any other non-GAAP policies that a company determines may be appropriate to adopt. In addition, policies and procedures should be designed to help ensure the accounting and legal departments are able to engage in a thorough review and approval process of proposed non-GAAP adjustments, with a view to accuracy, consistency and overall compliance.
>
> **Descriptions of Non-GAAP Measures Should Be Kept Consistent with Actual Accounting Practices.** To be effective, companies' disclosure controls and procedures should include processes designed to help ensure that non-GAAP financial measures and adjustments are described accurately in periodic filings, earnings releases and other public statements. Companies should routinely assess whether the descriptions of non-GAAP measures used historically continue to be consistent with their actual accounting practices for identifying, reviewing and approving non-GAAP adjustments.
>
> **An Active and Engaged Disclosure Committee Should Be Part of the Control Environment.** An important lesson of the SEC's order is the need for coordinated oversight of non-GAAP and other disclosures across a company's various departments to promote a consistent and accurate disclosure control environment. An active and engaged disclosure committee should play a prominent role in reviewing and commenting on non-GAAP disclosures. The disclosure committee should also periodically review the disclosure controls and procedures with respect to non-GAAP disclosure to ensure they remain up-to-date, consistent with the company's actual business practices, and accurate overall.

As John noted, the first article in the March-April issue of "The Corporate Counsel" newsletter is "Non-GAAP Financial Measures: The Pendulum Swings." In my book, this is also required reading to prevent, to quote the article, non-GAAP "backsliding"!

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.thecorporatecounsel.net/blog/2023/04/do-you-have-a-non-gaap-policy.html

Deloitte.

What CFOs should know when using Non-GAAP measures

Benefits and challenges of non-GAAP reporting

Non-GAAP measures can be a powerful tool for communicating with investors and analysts. In a business climate marked by digital transformation, business innovation, and disruption—most recently COVID-19 and an uncertain economic environment —non-GAAP measures can play an important role in delivering a view of the company's financial or operational results to supplement what is captured in the financial statements.

While non-GAAP measures can help management provide further perspective on business performance, they have also been a focus area of the Securities and Exchange Commission (SEC) in recent years, and were one of the top areas of SEC comment during 2020. Therefore, CFOs need to be aware of the SEC's rules and interpretations regarding non-GAAP information.

With CFOs increasingly expected to develop and execute on business strategy, the ability to communicate with stakeholders has become a more central measure of CFO success. The ability to provide stakeholders with the key information that management uses to run and evaluate the business may result in CFOs deciding the use of non-GAAP measures presents an effective means of achieving this objective. Given the uncertain economic environment, and ongoing technology and business innovation, management may also determine that existing non-GAAP measures need adjustment, or no longer capture the current focus of management.

Across all industries and sectors, it's become clear that effective use of non-GAAP measures requires careful upfront and thoughtful planning. However, that investment, and evaluation of the applicable rules and regulations, can allow CFOs to effectively communicate management's perspective on your organization's financial position and/or performance.

"As the impacts of COVID-19 continue to reverberate, non-GAAP reporting may help CFOs provide investors with better insights into the unique, uncertain circumstances COVID-19 has created."

Continued SEC scrutiny and guidance on non-GAAP reporting

While the SEC has issued rules and interpretive guidance on non-GAAP measures since 2001, several factors heightened SEC scrutiny in 2015:

- Increased use and prominence of non-GAAP reporting
- Potential for non-GAAP measures to be misleading
- Progressively larger differences between the amounts reported for non-GAAP and GAAP measures

In 2016, the SEC released updated Compliance and Disclosure Interpretations (C&DIs) that clarify SEC guidance on non-GAAP reporting. The C&DIs, along with additional public statements from SEC staff have helped establish a more clear understanding of the SEC's views: The SEC permits the use of non-GAAP measures to help management "tell their story," as long as the appropriate SEC guidance is applied and disclosures are provided.

In response, many companies have modified their approach to disclosures, particularly to address SEC guidance on the prominence of non-GAAP measures in press releases and filings. However, companies should be prepared for the SEC to remain focused on the following five key areas.

- Undue prominence of non-GAAP measures
- Enhancement of disclosures related to the purpose and use of non-GAAP measures
- Clear labeling of non-GAAP measures
- The potential for adjustments to be misleading or represent tailored accounting
- Presentation of tax impact of non-GAAP adjustments

Integrity and consistency are essential in making use of non-GAAP reporting. The SEC has also emphasized that companies should have controls and processes in place to provide timely information to management to allow for timely decisions regarding required disclosures.

Common non-GAAP financial measures

- Operating income that excludes one or more expense items
- Adjusted revenues, adjusted earnings, and adjusted earnings per share
- EBIT and EBITDA, and adjusted EBIT and EBITDA
- Core earnings
- Free cash flow
- Funds from operations
- Net debt, which could be calculated as borrowings less cash and cash equivalent or borrowings less derivative assets used to hedge the borrowings
- Measures presented on a constant-currency basis, such as revenues and operating expenses

Non-GAAP reporting in the current economic environment, and COVID-19 impacts

Following the emergence of COVID-19, one of the key areas of focus for the SEC was the impact the pandemic might have on non-GAAP reporting for public companies. As the impacts of COVID-19 continue to reverberate, recent non-GAAP reporting of companies has indicated that COVID-19 has not resulted in significant changes in terms of the types of adjustments used by management in developing non-GAAP measures. For instance, impairments, restructuring changes, and other unusual or non-cash gains and losses have historically been commonplace within non-GAAP reconciliations.

However, the impact that COVID-19 has had on the overall economy has resulted in some companies adjusting non-GAAP measures to reflect new circumstances that have become focus areas of management and stakeholders. For example, companies may have redefined non-GAAP measures to include or exclude certain adjustments related to cash flows that were not previously included such as dividends or certain classifications of capital expenditures. Companies may also determine that new non-GAAP measures are more relevant than non-GAAP measures used in the past due to the evolving focus of the users of financial statements, such as a heightened attention to liquidity. Accordingly, a company may begin to report a liquidity based non-GAAP measure that was not a focus in previous years.

> "Analysts and investors often look at non-GAAP measures to compare to peer companies."

Although the total number of instances remains small, as outlined in our recent Financial Reporting Alert 20-5, in the quarter ended June 30, 2020, an increased number of companies provided non-GAAP measures that included COVID-19-related adjustments. Notwithstanding that increase, some companies chose not to provide such non-GAAP measures because of concerns regarding (1) judgments related to which COVID-19-related costs were in fact "unusual or incremental" and objectively quantifying those costs and (2) creating potential negative comparisons in future periods to the extent that certain COVID-19-related costs (or a portion thereof) become recurring costs.

Of the companies that did incorporate COVID-19-related non-GAAP adjustments, many were associated with activities that are often included in non-GAAP adjustments but were described as being caused by or related to the impact of COVID-19. To a lesser degree, companies reported COVID-19-related adjustments that were described as incremental employee compensation or benefits, and incremental expenses associated with personal protective equipment, incremental cleaning, and sanitation efforts.

Why and when could you use non-GAAP measures?

Non-GAAP measures can be a meaningful way to supplement GAAP numbers for a complete picture of business operations and liquidity. Analysts and investors often look at non-GAAP measures for information utilized in their modeling, that is not easily or clearly captured from the financial statements. For instance, certain non-GAAP measures, such as EBITDA, may be used for assessing business valuations based on earnings multiples or comparable transactions. The added information can also show investors how management views the performance of the business and may facilitate peer comparisons.

Additionally, non-GAAP reporting might help companies convey helpful information for stakeholders when non-GAAP measures are the basis for management compensation and incentive plans, debt covenants or other requirements, or used by management in evaluating segment performance and resource allocation, and in the development of forecasts and budgets.

How can Deloitte help?

In addition to deep experience with SEC reporting, we offer CFOs a worldwide network of accounting advisors who can help guide you through the technical aspects of non-GAAP reporting. Through our understanding of business and financial statements, and how to communicate effectively with investors, and simultaneously comply with SEC guidelines, we can help you report measures you utilize to present the current state and future prospects of your company in a way that meets your objectives, while remaining in compliance with the SEC's rules and regulations.

Let's talk

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Additional resources

- A roadmap to non-GAAP financial measures
- A roadmap to SEC comment letter considerations, including industry insights (2019)
- SEC Reporting and Disclosures Involving COVID-19

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April 20, 2023

Non-GAAP: Audit Committee Disclosure Oversight

In a recent blog, Cooley's Cydney Posner discussed the implications for audit committees of the SEC's latest enforcement proceeding involving non-GAAP financial measures. This excerpt addresses some of the challenges confronting audit committees in providing oversight to their company's non-GAAP disclosures:

> Just what is the role of the audit committee when it comes to non-GAAP financial measures? The CAQ has characterized the audit committee's oversight role as an important one that positions the committee to "act as a bridge between management and investors," assessing whether "the measures present a fair and balanced view of the company's performance." But non-GAAP financial measures present challenges for audit committees: why is management using this measure? Is it consistent with the measures used by the company's peers? Is the disclosure adequate? In addition, to the extent that non-GAAP measures may be used in determining incentive compensation, audit committee oversight becomes even more critical.

Cydney pointed to a PwC memo as a source of guidance to boards on these and other issues implicated in providing appropriate oversight to non-GAAP disclosures.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2023/04/non-gaap-audit-committee-disclosure-oversight.html

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Non-GAAP Financial Measures: The Pendulum Swings

We often compare the Staff's approach to non-GAAP financial measures to a swinging pendulum — over the years there have been times when the Staff is more accommodating to companies when they present non-GAAP financial measures in their SEC filings and other communications, but then there are times when the Staff expresses significant concern with the presentation of non-GAAP financial measures through the comment process, enforcement actions and Staff guidance. Today, the pendulum has definitely swung toward the latter end of that spectrum, with a fresh round of more rigid interpretive updates and a new enforcement action being brought against a company for misleading non-GAAP financial measures and inadequate disclosure controls. In this issue, we take stock of these developments and how they will impact your disclosures going forward.

The Latest Pendulum Swing: Some Background

The Staff's current approach to the presentation of non-GAAP financial measures dates back over seven years now when, in May 2016, the Staff published guidance in the form of new Non-GAAP Financial Measures CDIs (see the May-June 2016 issue of *The Corporate Counsel* at page 1). The CDIs were issued at a time when there was an increased focus on the presentation of non-GAAP financial measures, as noted in speeches by the SEC Staff and former SEC Chair May Jo White, and as evidenced by an uptick in comments from the Corp Fin Staff. The guidance focused on some prevalent practices which the Staff believed could make non-GAAP financial measure disclosures potentially misleading, such as the lack of equal or greater prominence with respect to GAAP measures; the exclusion of normal, recurring cash operating expenses; the presentation of non-GAAP financial measures that were based on individually tailored accounting principles; an overall lack of consistency in the presentation; the practice of "cherry-picking"; and the presentation of liquidity measures on a per share basis.

At the time, the Staff was concerned that companies did not have sufficient controls in place to ensure compliance with the requirements of Regulation G and Item 10(e) of Regulation S-K, including oversight of the presentation of the non-GAAP financial measures by the Audit Committee, and the Staff strongly encouraged issuers to self-correct their disclosures in the next round of quarterly earnings announcements and SEC filings. Not long after the May 2016 CDIs were published, the Staff commenced a targeted review of non-GAAP financial measure disclosures. Over the course of that year, the Staff issued over 100 comment letters to companies, which addressed many of the topics highlighted in the Staff's CDIs.

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In early September 2016, some companies began receiving letters from the SEC's Division of Enforcement with the heading "Re: Certain Non-GAAP Financial Measure Disclosure Deficiencies" (see the July-August 2016 issue of *The Corporate Counsel* at page 1). In these letters, the Division of Enforcement requested information and documents principally related to compliance with the SEC's "equal or greater prominence" rules in earnings releases and SEC filings. These letters appeared to be part of a coordinated "sweep" effort by the SEC's Division of Enforcement. While we did see some enforcement actions come out of these efforts, it was not the avalanche of actions that some had feared.

The Staff certainly got people's attention with the CDIs, the comment letters and the enforcement sweep, and disclosure practices and controls around non-GAAP financial measures markedly improved, although non-GAAP financial measures still remain, to this day, at the top of the list of areas that the Staff comments on in filing reviews (see the November-December 2019 issue of *The Corporate Counsel* at page 7 and the September-October 2021 issue of *The Corporate Counsel* at page 7). For those who advise companies on non-GAAP financial measures, the Staff's CDIs and the threat of enforcement action helped make the advice that companies often did not want to hear about the presentation of their non-GAAP financial measures more convincing, and more attention and oversight has been dedicated to these disclosures.

With all of that said, if there is one thing that we have learned in the 20 years that the SEC has been regulating non-GAAP financial measures (see the July-August 2003 issue of *The Corporate Counsel* at page 1), it is that some level of backsliding is inevitable when it comes to the presentation of non-GAAP financial measures.

Despite the relatively clear regulatory contours of Regulation G, Item 10(e) of Regulation S-K and Item 2.02 of Form 8-K, as well as the Staff's 20 years of guidance and comment letters interpreting these provisions, we always seem to find ourselves with some non-GAAP financial measure presentation that is either blatantly out of compliance with the rules or somehow pushing the envelope of what the SEC intended.

While we sometimes scratch our heads trying to understand this phenomenon, we can certainly understand that there is always a lot of pressure to present financial information in a manner that is useful for investors and that presents the company's financial performance in the best possible light. Further, non-GAAP financial measures are typically used in communications outside of the SEC-filed documents (such as in earnings releases, earnings call scripts and investor presentations), where the controls around those types of communications may be somewhat lacking as compared to a Form 10-K or Form 10-Q. Whatever the reasons, we seem to have found ourselves in backsliding mode again, so much so that, in December 2022, the Staff released new and revised Non-GAAP Financial Measures CDIs that revisit (and in some cases, strengthen) the guidance that was presented way back in 2016.

Considering Equal or Greater Prominence

Item 10(e)(1)(i)(A) of Regulation S-K requires that when a company presents a non-GAAP financial measure, it must present the most directly comparable GAAP measure with "equal or greater prominence." While Item 10 of Regulation S-K is generally applicable to filings that are made with the SEC such as periodic reports, Item 10(e)(1)(i)(A) of Regulation S-K is also applicable to earnings releases because Instruction 2 to Item 2.02 of Form 8-K states that "the requirements of paragraph (e)(1)(i) of Item 10 of Regulation S-K … shall apply to disclosures under this Item 2.02."

As interpreted by the Staff, it is clear that the term "equal or greater prominence" should be read as meaning "greater or greater prominence," because the Staff expects the GAAP measure to be presented before the non-GAAP financial measure in any disclosures that are governed by Item 10(e) of Regulation S-K.

In Non-GAAP Financial Measures CDIs Question 102.10(a) (as the former Question 102.10 was revised in December 2022), the Staff notes that whether a non-GAAP financial measure is more prominent than the comparable GAAP financial measure generally depends on the facts and circumstances in which the disclosure is made. Examples of the presentation of non-GAAP financial measures as more prominent than the comparable GAAP measures are:

- Presenting an income statement of non-GAAP financial measures, as more fully described in Non-GAAP Financial Measures CDIs Question 102.10(c);
- Presenting a non-GAAP financial measure before the most directly comparable GAAP measure or omitting the comparable GAAP measure altogether, including in an earnings release headline or caption that includes a non-GAAP financial measure;
- Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence;
- Presenting a non-GAAP financial measure using a style of presentation (*e.g.,* bold, larger font, etc.) that emphasizes the non-GAAP financial measure over the comparable GAAP measure;
- 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;
- Presenting charts, tables or graphs of a non-GAAP financial measures without presenting charts, tables or graphs of the comparable GAAP measures with equal or greater prominence or omitting the comparable GAAP measures altogether; 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.

In the December 2022 updates, the Staff clarified that an equal or greater than prominence issue can arise when a company presents a ratio with a non-GAAP financial measure as the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure with equal or greater prominence. As the SEC noted in the adopting release for Regulation G and Item 10(e) of Regulation S-K, a ratio can be considered a non-GAAP financial measure if either the numerator or the denominator is not calculated in accordance with GAAP. Further, the December 2022 updates indicate that charts or graphs including non-GAAP financial measures should not be presented without also presenting charts or graphs including the comparable GAAP measures.

The December 2022 updates also expanded upon the situations that would violate the equal or greater prominence principle to include the reconciliations that companies provide in order to comply with Item 10(e) and Regulation G. In Non-GAAP Financial Measures CDIs Question 102.10(b), the Staff notes the following examples of reconciliation disclosures that give undue prominence to a non-GAAP financial measure:

- Starting the reconciliation with a non-GAAP financial measure.
- Presenting a non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures, which, in Non-GAAP Financial Measures CDIs Question 102.10(c), the Staff describes as a presentation that is comprised of non-GAAP financial measures and includes all or most of the line items and subtotals found in a GAAP income statement.
- When presenting a forward-looking non-GAAP measure, a company may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence.

While the Staff has been expressing concern about non-GAAP income statements for many years now, the application of the equal or greater prominence principle in the context of reconciliations and the presentation of forward-looking non-GAAP financial measures requires some renewed attention on the part of companies. It has been our experience that companies have not always considered the equal or greater prominence principle when constructing their reconciliation disclosure, so the Staff's new guidance may require companies to "flip" their reconciliation so that the GAAP measure appears at the top of the reconciliation rather than at the bottom (or on the left, if the adjustments are being made to in columns across the page).

Further, we have noted that compliance with the requirement of Item 10(e)(1)(i)(B) of Regulation S-K with respect to forward-looking non-GAAP financial measures is often spotty. Item 10(e)(1)(i)(B) specifies that a quantitative reconciliation is required for forward-looking non-GAAP financial measures, but only to the extent it is "available without unreasonable efforts." The Staff has made clear that companies relying on this "unreasonable efforts" exception must clearly indicate reliance on that exception, specifically identify the information that is unavailable and its probable significance to the calculation. When this language is provided, it is not always provided in a place of equal or greater prominence, but often shows up in a very small font as a footnote to the forward-looking non-GAAP financial measure.

Misleading Adjustments

In Non-GAAP Financial Measures CDIs Question 100.01, the Staff notes that certain adjustments may violate Rule 100(b) of Regulation G because they cause the non-GAAP financial measure to be misleading, even though those adjustments are not explicitly prohibited by the non-GAAP rules. The Staff provides the example of presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a company's business. This interpretation targets those situations where non-recurring cash operating expenses are being excluded to improve the perception of the company's operating performance.

In the December 2022 updates to Question 100.01, the Staff notes that, when evaluating what constitutes a normal operating expense, it considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment. The Staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring.

The Staff further notes in Non-GAAP Financial Measures CDIs Question 100.02 that a non-GAAP financial measure can be misleading if it is presented inconsistently between periods, such as when an issuer presents a non-GAAP financial measure that adjusts for a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods, unless the change between periods is disclosed and the reasons for it explained. The Staff notes that, depending on the significance of the change, it may be necessary to recast prior non-GAAP financial measures to conform to the current presentation and "place the disclosure in the appropriate context." The Staff did not revisit this guidance in the December 2022 updates.

What's in a Name?

The Staff added new Non-GAAP Financial Measures CDIs Question 100.05 in the December 2022 updates to address the perennial problem of appropriately labeling non-GAAP measures. For as long as non-GAAP financial measures have been regulated by the SEC, the Staff has bemoaned the fact that companies label similar measures in different ways and sometimes in a manner that can be potentially misleading to investors. In Question 100.05, the Staff notes that a non-GAAP financial measure can be misleading if it, and/or any adjustment made to the measure, is not appropriately labeled and clearly described. The Staff notes that non-GAAP financial measures are not always consistent across, or comparable with, non-GAAP financial measures disclosed by other companies. Without an appropriate label and clear description, a non-GAAP financial measure and/or any adjustment made to arrive at that measure could be misleading to investors. The Staff notes the following examples of situations that would violate Rule 100(b) of Regulation G:

- Failure to identify and describe a measure as a non-GAAP financial measure;
- Presenting a non-GAAP financial measure with a label that does not reflect the nature of the non-GAAP financial measure, such as:
    - a contribution margin that is calculated as GAAP revenue less certain expenses, labeled "net revenue";
    - a non-GAAP financial measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as "Gross Profit" or "Sales"; and
    - a non-GAAP financial measure labeled "pro forma" that is not calculated in a manner consistent with the pro forma requirements specified in Article 11 of Regulation S-X.

Context May Not Be Enough

The Staff added new Non-GAAP Financial Measures CDIs Question 100.06 in the December 2022 updates to make the point that a company can't disclose its way around what is otherwise a misleading non-GAAP financial measure under Rule 100(b) of Regulation G. In Question 100.06, the Staff notes that a non-GAAP financial measure can be misleading, and therefore violate Rule 100(b) of Regulation G, even if it is accompanied by disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure. The Staff believes that a non-GAAP financial measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each adjustment would not prevent the non-GAAP measure from being materially misleading. The Staff's interpretation does not provide any examples of this situation.

Individually Tailored Accounting Principles Revisited

One of the more vexing non-GAAP financial measure issues that companies face today is the potential application of the Staff's individually tailored accounting principles position, which is articulated in Non-GAAP Financial Measures CDIs Question 100.04. As we have noted before (see the September-October 2016 issue of *The Corporate Counsel* at page 8; the November-December 2019 issue of *The Corporate Counsel* at page 7; and the September-October 2021 issue of *The Corporate Counsel* at page 7), determining whether a non-GAAP financial measure is calculated based on an individually tailored accounting principle sometimes feels like the oft-cited definition of obscenity articulated by the late Supreme Court Justice Potter Stewart — "I know it when I see it."

In general, the Staff has indicated that a non-GAAP financial measure can violate Rule 100(b) of Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP. By definition, a non-GAAP financial measure excludes or includes amounts from the most directly comparable GAAP measure; however, non-GAAP adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP would be considered individually tailored and may cause the presentation of a non-GAAP measure to be misleading.

While the original version of Question 100.04 provided examples of measures related to revenue, the Staff has made it clear over the years that the guidance is by no means limited to revenue measures. In the December 2022 updates to Question 100.04, the Staff take another step in trying to explain the individually tailored accounting principles concept by expanding the list of examples that may be considered misleading due to the use of individually tailored accounting principles:

- Changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;
- Presenting a non-GAAP financial measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse, presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and
- Changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis.

The examples provided in updated Question 100.04 are by no means an exhaustive list of situations where the Staff may invoke the individually tailored accounting principle concept to object to a non-GAAP financial measure through the comment process.

Monitoring SEC Enforcement Actions

Despite some occasional saber-rattling by the Staff and the concerns generated by the 2016 enforcement sweep letters, SEC enforcement actions involving non-GAAP financial measures remain relatively few and far between. With that said, no company wants to be the subject of an SEC enforcement action and have its non-GAAP financial measures scrutinized, so it is important to monitor enforcement activity in this area.

Following a lull of a couple of years, the SEC brought a non-GAAP financial measure enforcement action in March 2023 against a company called DXC Technology Company (SEC Release No. 34-97140 (March 14, 2023)). The SEC alleged that the company had made misleading disclosures about its non-GAAP financial performance in multiple reporting periods from 2018 to 2020. In particular, the Company is alleged to have misclassified expenses as non-GAAP adjustments related to so-called transaction, separation and integration-related ("TSI") costs and improperly excluded them from its reported non-GAAP earnings, as well as failing to accurately describe the scope of the expenses included in the company's non-GAAP adjustments resulting in materially misleading disclosures of non-GAAP net income and non-GAAP diluted EPS.

One of the most notable aspects of the SEC's action was that the SEC charged the company with violating the disclosure controls and procedures provisions of Exchange Act Rule 13a-15(a) because the company "lacked company-wide disclosure controls and procedures to ensure that TSI costs were identified, reviewed, and approved for appropriate inclusion in the TSI adjustment in a manner consistent with their disclosure."

Without admitting or denying the findings in the order, the company consented to a cease-and-desist order, to pay an $8 million penalty and to undertake to develop and implement appropriate non-GAAP policies and disclosure controls and procedures. The SEC considered the company's cooperation and remedial actions in accepting the settlement offer.

What Should You Do Now?

The latest swing of the non-GAAP financial measures pendulum should prompt companies to revisit their non-GAAP financial measures disclosures, as well as the disclosure controls and procedures implemented with respect to those non-GAAP financial measures. Specific steps should include:

- <u>Revisit your equal or greater prominence compliance.</u> For those communications that are subject to the equal or greater prominence requirements — including SEC filings and documents furnished pursuant to Item 2.02 of Form 8-K — companies should review the approach to make sure the presentation of GAAP measures and non-GAAP financial measures are consistent with the rules and the Staff's updated guidance. Particular attention should be directed to the presentation of non-GAAP ratios, the order of reconciliations and the disclosure surrounding forward-looking non-GAAP financial measures that are not reconciled based on the "unreasonable efforts" exception.
- <u>Revisit your non-GAAP financial measure labels.</u> In light of the Staff's updated guidance, companies should look closely at

the way they label their non-GAAP financial measures and the adjustments in those measures to avoid any conclusion that the labels render the measure misleading.

- Revisit your non-GAAP adjustments. The Staff's updated guidance highlights the need to revisit whether an adjustment might be viewed as a normal operating expense under the Staff's approach of considering the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment. This is particularly an area of concern for infrequently recurring expenses.
- Keep a sharp eye out for individually tailored accounting principles. The Staff's evolving guidance on the application of individually tailored accounting principles in the calculation and presentation of non-GAAP financial measures emphasizes the need to carefully evaluate any new or revised non-GAAP financial measures for the potential of being viewed as involving individually tailored accounting principles. It is useful to monitor Staff comment letters on this point, given that the Staff addresses in that context a wider variety of individually tailored accounting principles issues than what is described in the updated interpretation.
- Prevent backsliding! The Staff's latest round of updated non-GAAP guidance was undoubtedly triggered by some measure of backsliding on the part of companies. Just as we saw with the 2016 non-GAAP guidance and crackdown, the Staff observes a wide range of practices in the world of non-GAAP financial measures and believes that guidance (whether through CDIs, comment letters or enforcement actions) is an appropriate way of encouraging compliance. The best way to prevent backsliding is to adopt comprehensive disclosure controls and procedures that contemplate a careful vetting of non-GAAP financial measures, close scrutiny of those measures in all external communications and a documented approach for the disclosure process that prevents each quarterly earnings cycle from becoming a *tabula rasa* exercise when it comes to non-GAAP financial measures. The importance of effective disclosure controls and procedures is highlighted by the SEC's recent enforcement action against DXC Technology Company.

– DL

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Chapter 5

Non-GAAP Financial Measures

Practice Guide & Toolkit

Regulation G, Item 10(e) of Regulation S-K & Form 8-K's Item 2.02

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Table of Contents

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The SEC's order found that Koppers violated the antifraud provision of the federal securities laws of Section 17(a)(3) of the Securities Act, and the reporting provisions of Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-11 thereunder, and Rule 100(b) of Regulation G of the Exchange Act. Without admitting or denying the SEC's findings, Koppers consented to a cease-and-desist order and a civil penalty of $1.3 million.

12. DXC Technology Company

On March 14, 2023, the SEC announced settled charges against DXC Technology Company ("DXC") for misleading disclosures stemming from DXC's exclusion of transaction, separation and integration-related ("TSI") costs from certain of its non-GAAP measures, including non-GAAP net income and non-GAAP diluted earnings per share. According to the SEC's order, DXC misclassified "tens of millions of dollars of expenses" as these M&A-related adjustments and excluded them from its non-GAAP measures in various periodic reports and earnings releases, which resulted in materially increased non-GAAP earnings from 2018 to 2020. The order finds that DXC did not accurately disclose the scope of the expenses categorized as TSI adjustments, and its quarterly disclosures regarding non-GAAP net income and non-GAAP diluted EPS were materially misleading as a result. Moreover, DXC allegedly did not have a non-GAAP policy or adequate non-GAAP-related disclosure controls, the lack of which caused DXC's employees to make subjective determinations inconsistent with public disclosures of the TSI costs. According to the order, there were some controllership employees, including the former Assistant Corporate Controller for External Reporting, who questioned why certain costs were categorized as TSI costs, but in some cases, did not receive supporting documentation—and DXC continued to file periodic reports with those costs included in its non-GAAP measures. Per the SEC's order, "the controllership and the disclosure committee failed even to recognize that, for years, DXC did not have a non-GAAP policy and adequate disclosure controls and procedures." The order finds that DXC violated Sections 17(a)(2) and 17(a)(3) of the Securities Act; Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20 thereunder; Rule 13a-15(a) of the Exchange Act; and Rule 100(b) of Regulation G of the Exchange Act. Without admitting or denying the SEC's findings, DXC consented to the entry of a cease-and-desist order, agreed to pay an $8 million civil penalty and agreed to develop and implement non-GAAP policies and disclosure controls and procedures.

IV. Common Questions & Our Analysis

1. Applying Item 10(e)'s "Equal or Greater" Requirement to Earnings Releases

Question: Item 10(e)(1)(i) of Regulation S-K requires that SEC filings present GAAP numbers with "equal or greater" prominence as compared to the corresponding non-GAAP numbers. Instruction 2 of Item 2.02 of Form 8-K extends this requirement to Forms 8-K that are furnished pursuant to Item 2.02 (which requires that a copy of any earnings release be furnished with the Form 8-K as an exhibit). Regulation G, which applies to earnings press releases prior to their being furnished on Form 8-K, does not require "equal or greater" prominence for the GAAP

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number. Must issuers comply with the equal or greater prominence requirement in their earnings press releases in order to ensure that their Item 2.02 Form 8-K disclosure is compliant?

Answer: Although Item 10(e) does not apply to an earnings release when it is initially published, the Staff takes the position that the earnings release becomes subject to Item 10(e)(1)(i) when it is attached as an exhibit to an Item 2.02 Form 8-K. Although Item 10(e)'s utility and purpose statements may be placed in the body of the Form 8-K (and need not be included in the earnings release), the Staff has taken the position that the equal prominence rule applies to the body of the exhibit. Because it is awkward and difficult (and perhaps even impossible) to bring the earnings release into compliance with the equal prominence rule and the Staff's positions in CDIs 102.10(a) and (b) after publication, best practice is to make the earnings release fully comply with the equal prominence rule and relevant Staff positions at the time of publication. For further explanation and discussion, see above at Part III.D. ("Earnings Releases and Item 2.02 of Form 8-K").

2. Including Per Share Liquidity Measures in an Earnings Release

Question: In CDI 102.05, the Staff states that any non-GAAP financial measure that can be used as a liquidity measure is prohibited from being presented on a per share basis in documents filed with or furnished to the SEC. Since the earnings release must be furnished on Form 8-K, does this prohibition apply to the earnings release? Does it apply only at the time of furnishing, or does it also apply at the time of publication?

Answer: Many comment letters demonstrate that the Staff applies this prohibition to earnings releases furnished on Form 8-K. As discussed above under "How the Rules Work," the prohibition is motivated by a concern that such a presentation may be misleading and confusing for investors. Thus, although there is no express legal prohibition against presenting such a number generally, it is best to avoid use of such measures altogether if possible. Further, it is best practice (and Staff expectation) that such measures not be included in the earnings release at all. Including the measure in the release will make it impossible to comply with both Item 2.02's requirement to file the text of the earnings release and the Staff's unequivocal position that the measure is prohibited in all SEC filings and furnishings. Thus, best practice is to comply with the Staff position on per share liquidity measures in earnings releases at the time of publication. See above Part III.D. ("Earnings Releases and Item 2.02 of Form 8-K").

3. Placing GAAP Information First

Question: Item 10(e)(1)(i) of Regulation S-K requires that SEC filings present GAAP numbers with "equal or greater" prominence as compared to the corresponding non-GAAP numbers. Is it necessary always to place the GAAP number first to ensure compliance with this requirement?

Answer: Item 10(e) does not by its terms require that the GAAP number be placed first, nor does it require the GAAP number to be *more* prominent than the non-GAAP measure. However, the Staff has taken the position, in CDIs 102.10(a) and (b), that a non-GAAP measure that precedes

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the corresponding GAAP measure is more prominent than the GAAP measure and therefore violates the equal prominence requirement of Item 10(e). Although there may be circumstances where precedence does not necessarily create greater prominence, it is prudent and best practice to draft in accordance with the Staff CDIs, which means placing the GAAP number first.

Note that Regulation G contains no prominence requirement at all, other than what may be reasonably inferred from the prohibition against misleading use of non-GAAP measures. However, it is best practice, as discussed above, to draft earnings releases and other material that is destined to be filed or furnished under Item 2.02 of Form 8-K to comply with the equal prominence rule (and related Staff interpretations) at the time of publication. See above, Part III.D. ("Earnings Releases and Item 2.02 of Form 8-K").

4. Information Displayed by Third Party on Company Website

Question: An issuer contracts with a third-party service provider for the display of issuer financial information on its website. Although the issuer may customize the information provided, it may also contract to display a "standardized" set of financial disclosures that are calculated and automatically published by the provider, without prior review by the issuer. If the set of disclosures displayed on the website includes non-GAAP numbers, must the issuer comply with Regulation G with respect to this disclosure? Would the answer change if the issuer provides a disclaimer that the information is provided by the service provider and that the issuer does not endorse it and only provides it for informational purposes?

Answer: Regulation G generally applies when any registrant, or *a person acting on its behalf*, publicly discloses a non-GAAP financial measure. Because the issuer contracted the third party, the third-party provider is clearly acting on behalf of the issuer and Regulation G will apply. Thus, the issuer must also provide a reconciliation to the most comparable GAAP number and avoid misleading presentations. In evaluating whether these disclosures are misleading, Section 100 of the CDIs should be consulted. Particular attention should be given to CDI 100.04, which emphasizes its application to websites. Because the service is acting as the issuer's agent, it is difficult to see how a disclaimer could avoid application of the rule, absent some relief from the Staff.

5. Net Debt

Question: Is "net debt" a non-GAAP financial measure?

Answer: Yes. Net debt (usually defined as total debt, including current maturities, less cash and cash equivalents) is a non-GAAP financial measure, since it modifies "total debt" as presented on the balance sheet in accordance with GAAP. It is typically reconciled to the GAAP measure of total debt or consolidated debt presented on an issuer's condensed consolidated financial statements. Net debt is often presented as part of a ratio, such as net debt to total capitalization. As with all ratios, each component should be treated separately, with its own separate reconciliation.

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6. Percentage Changes in Non-GAAP Measures

Question: Would a statement in an earnings release that provides a percentage change in a non-GAAP performance measure (such as a percentage increase in net earnings, from the previous year to the current year, excluding the effect of non-recurring items in both periods) be a non-GAAP financial measure?

Answer: Yes, a percentage increase in net earnings over the prior year excluding the effect of non-recurring items in both periods would be a non-GAAP financial measure, because it is a numerical measure of the registrant's historical financial performance that excludes amounts included in the most directly comparable GAAP measure (the GAAP percentage change), and it does not qualify for any of the applicable exceptions or exclusions.

The percentage change in non-GAAP net earnings in this example is merely another way of expressing the ratio of current year non-GAAP net earnings to prior year non-GAAP net earnings. As noted elsewhere, the general principle is that when a non-GAAP financial measure is comprised of more than one component, each one should be analyzed and (where appropriate) reconciled separately. The Adopting Release explains how ratios and similar numbers should be reconciled:

> "In the case of ratios or measures where a non-GAAP financial measure is the numerator and/or the denominator in the calculation of that ratio or measure, the registrant must provide a reconciliation with regard to each non-GAAP financial measure used in the calculation. The registrant must also show the ratio or measure as calculated using the most directly comparable GAAP financial measure(s)."

Therefore, two reconciliations will be required: one for the current period non-GAAP net earnings and one for the prior period non-GAAP net earnings.

Because the non-GAAP net earnings numbers are performance measures, each one must be reconciled to GAAP net earnings. In addition, because Regulation G and Item 10(e) require you to also present the most comparable GAAP number, the issuer must present the percentage change in GAAP net earnings together with the percentage change in non-GAAP net earnings. Where Item 10 applies, the GAAP percentage must also comply with the equal prominence rule, described in more detail elsewhere in this handbook. The Staff believes that a presentation of a ratio calculated using one or more non-GAAP measures without a more prominent presentation of the corresponding ratio calculated using the most directly comparable GAAP measures would violate the equal or greater prominence requirements of Item 10(e)(1)(i)(A) of Regulation S-K. *See* CDI 102.10(a).

While it might be tempting to consider this type of growth figure to be a 'statistical measure' excluded from Regulation G and Item 10(e), a review of the Adopting Release shows this not to

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be the case. See “Operating and Other Statistical Measures” in the “How the Rules Work” discussion above.

7. Discussion of Non-GAAP Measure Without Accompanying Discussion of GAAP Measure

Question: Item 10(e) of Regulation S-K requires that the GAAP financial measure be presented with “equal or greater” prominence as compared to a related non-GAAP financial measure. We intend to include a table in our MD&A that begins with a GAAP number and then reconciles down to a non-GAAP number. We then intend to include a paragraph following the table that primarily discusses the non-GAAP number (because this is what management uses and looks at), and the paragraph does not discuss the GAAP number. Does this make the non-GAAP number more prominent than the GAAP number? Must the GAAP number always be discussed fully when a non-GAAP number is disclosed and discussed?

Answer: The Staff has taken the position in CDI 102.10(a) that in order to comply with the equal prominence rule, you must provide a similar discussion and analysis of the comparable GAAP measure—in a location of at least equal prominence—whenever you provide discussion and analysis of a non-GAAP measure. CDI 102.10(a) also states that the GAAP number must come first or the Staff will deem the non-GAAP number to be more prominent. Accordingly, the Staff is likely to take the position that the discussion and analysis of the GAAP number needs to precede the non-GAAP discussion and analysis.

8. Consistency in Discussion of Non-GAAP Measures Among SEC Filings & Other Disclosures

Question: We would like to include several non-GAAP financial measures in our earnings release, which we will of course furnish on Form 8-K. We do not intend to include these non-GAAP financial measures in our Form 10-Q for the related period. Is there any requirement that we include these non-GAAP financial measures in our Form 10-Q?

Answer: Unless a discussion of the non-GAAP numbers is necessary to explain changes in financial condition, liquidity or results of operations, or to identify material trends in them or otherwise in order to comply with Item 303 of Regulation S-K’s disclosure requirements for MD&A, there is no rule that requires the inclusion or discussion of non-GAAP numbers in periodic reports.

However, the Staff has made clear in several comment letters that it has a goal of encouraging more consistency between the presentation of information in earnings releases and in periodic reports. That does not necessarily mean that you have to present your non-GAAP measures in your periodic reports, but you certainly need to consider the trend shown by the non-GAAP measures in the earnings release and how those same trends are (or are not) described in the periodic reports.

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To the extent that you do not include the non-GAAP financial measures in your periodic reports, you may find yourself in the position of having to explain to the Staff why you believe that a non-GAAP measure was important enough, and useful enough to investors, to note in the earnings release, but is not relevant information for your MD&A in your periodic report.

Furthermore, if you include non-GAAP measures in your 10-Q which are similar to those contained in the earnings release, yet are not calculated in the same way, you should consider the guidance contained in CDI 100.02, concerning the use of inconsistently calculated non-GAAP information. Although CDI 100.02 addresses inconsistencies between periods, similar considerations will apply to inconsistencies between presentations, even of the same period.

9. Live-Tweeting of Non-GAAP Information

Question: Our CFO intends to "live-tweet" financial information during our next earnings call. Among the financial information that he intends to tweet will be our company's adjusted EBITDA for the quarter, which we view as a performance measure. Given Twitter's limitation on the number of characters that may be used, are we required to comply with Rule 100(a) of Regulation G with respect to the tweet? We will be unable to include the full reconciliation in the tweet and still convey the core financial information.

Answer: Rule 100(a) of Regulation G does apply to the tweet to the extent that it is publicly disseminated and contains material information and one or more non-GAAP financial measures. As discussed above in Part III.B.4.e. ("The Meaning of Accompany"), Regulation G does not appear to allow a written document to cross reference to another document for purposes of satisfying the requirement that the comparable GAAP number and reconciliation "accompany" the disclosure of the non-GAAP financial measure.

However, the Staff has provided informal guidance regarding a company's use of character-restricted social media in disclosing non-GAAP financial information, importing guidance provided in other areas. Specifically, the Staff has addressed compliance in character-limited situations with the legend and other disclosure requirements applicable to certain business combination disclosures, communications not deemed to be prospectuses and free writing prospectuses.

In those situations, the Staff opined that it would not object to the use of an active hyperlink to satisfy the applicable legend and other disclosure requirements in the following limited circumstances:

- The electronic communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included in the communication;
- Including the legend and other required statements in their entirety, together with the other information, would cause the communication to exceed the limit on the number of characters or amount of text; and

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- The communication contains an active hyperlink to the legend and required statements and prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

Where an electronic communication is capable of including the legend or required statements, along with the other information, without exceeding the applicable limit on number of characters or amount of text, the Staff stated that the use of a hyperlink to the legend or required statements would be inappropriate. See CDIs Questions 110.01, 110.02, 164.02, 232.15 and 232.16.

This approach has been informally endorsed by the Staff with respect to tweets that contain non-GAAP financial measures. Specifically, if the required reconciliation cannot be included in the tweet due to the limit on the number of characters, an issuer may include a hyperlink to the reconciliation, along with prominent explanatory information regarding the nature and importance of the reconciliation.

10. Hyperlink Use in Written Documents

Question: Regulation G requires that non-GAAP financial measures be accompanied by the most directly comparable GAAP measure as well as a related reconciliation. Can the requirement that the non-GAAP measure be accompanied by the GAAP measure and a reconciliation to it be satisfied by a hyperlink contained in a press release to the comparable GAAP number and reconciliation on the company's website?

Answer: Regulation G does not appear to allow a written document to cross reference to another document for purposes of satisfying the requirement that the comparable GAAP number and reconciliation "accompany" the disclosure of the non-GAAP financial measure. As explained in Part III.B.4.e. above ("The Meaning of Accompany"), Rule 100 of Regulation G provides that when a company releases non-GAAP financial measures orally, telephonically or by webcast, broadcast or other similar means, it may provide the Regulation G information and reconciliation by posting the information on the company's website and disclosing the location and availability of that information during the presentation. However, this would seem to imply that non-GAAP financial measures disclosed in other formats, such as press releases, may not utilize this method.

The Staff has informally declined to support a position that a document posted on an issuer's website that is not subject to limitations on the number of characters it contains may satisfy the requirements of Regulation G by including a hyperlink to the required information rather than including it in the document itself. As a result, although a hyperlink would arguably satisfy the Regulation G requirement that the required information "accompany" the non-GAAP measure, the conservative approach is to include the required GAAP measure and non-GAAP reconciliation in the body of the document itself that is posted on the website rather than to deliver it through a hyperlink.

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11. Adjusted EBITDA in SEC Filings

Question: Item 10(e)(1)(ii)(A) of Regulation SK prohibits a registrant from presenting a non-GAAP liquidity measure that excludes charges or liabilities that required or will require cash settlement (or that would have required cash settlement absent an ability to settle in another manner), other than EBIT and EBITDA. CDI 102.09, in the context of a debt covenant, states: "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." Does this mean that the Staff deems all uses of "adjusted EBITDA" to be liquidity measures subject to the prohibition?

Answer: No. The prohibition contained in Item 10(e)(ii)(A), by its plain terms, applies only when adjusted EBITDA is used as a liquidity measure. CDI 102.09 addresses adjusted EBITDA contained in a debt covenant, where the context makes it apparent that the metric is being used to measure liquidity. However, the term "adjusted EBITDA" is applied to a wide variety of measures, and it is often used (and fairly so) as a performance measure.

Whether adjusted EBITDA is a performance measure or a liquidity measure will depend upon the facts and circumstances. An issuer presenting adjusted EBITDA as a performance measure should take special care in its drafting not to make any statements that might create an implication that it has construed its adjusted EBITDA as a liquidity measure, for example, by referring to it as an indicator of the issuer's ability to cover its fixed debt or other payments.

Note that, as described in CDI 102.09, even when a use of adjusted EBITDA is generally subject to the Item 10(e)(1)(ii)(A) prohibition, it may nonetheless be included in an SEC filing under certain circumstances.

12. Alternative Measures of Free Cash Flow

Question: Item 10(e)(1)(ii)(A) prohibits excluding items that require cash settlement from liquidity measures. Does this prevent us from presenting an alternative measure of free cash flow in our Form 10-K? Our alternative measure would exclude additional charges that require cash settlement in addition to excluding capital expenditures. Would the answer be different if the modified free cash flow measure was contained in the annual report to stockholders, a press release or in another document that is not filed with the SEC?

Answer: CDI 102.07 provides that free cash flow is typically defined as cash flows from operating activities as presented in a statement of cash flows less capital expenditures. CDI 102.07 goes on to say that, despite the adjustment for capital expenditures, the Staff position is that the presentation of this standard measure of free cash flow does not violate the prohibition contained in Item 10(e)(1)(ii)(A).

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However, the Staff position by its terms appears to be limited to measures of free cash flow that deduct only capital expenditures and therefore seems unavailable for any other formulation that makes additional adjustments. Without relief, a modified free cash flow such as described above would clearly violate Item 10(e)(1)(ii)(A)'s prohibition on exclusion of cash settled items from liquidity measures.

Because the Item 10(e)(1)(ii)(A) prohibition applies only to SEC filings, it would not apply to the annual report to stockholders, press releases or any other document that is not filed with the SEC. However, any portions of those documents that are filed with the SEC, for whatever reason, will be subject to Item 10(e)(1)(ii)(A) and should be drafted with that in mind.

Even when the measure is not prohibited by Item 10(e), it is prudent to consider the antifraud provisions of Regulation G. Any presentation of a liquidity measure that excludes items that actually had a negative impact on cash position or liquidity could have the potential to mislead investors. Accordingly, additional disclosure about the impact of the excluded items may be called for.

13. Information for Second Half of Fiscal Year

Question: Would SG&A as a percent of net sales for the second half of a fiscal year as compared to SG&A as a percent of net sales for the first half of the fiscal year be a non-GAAP financial measure?

Answer: Pursuant to Rule 101(a)(2)(i) of Regulation G and Item 10(e)(4)(ii)(A), a ratio calculated using exclusively GAAP numbers is not a non-GAAP financial measure. As a result, as long as applicable GAAP does not prohibit a presentation of six-month results, and both SG&A and net sales for the applicable periods are calculated in accordance with GAAP, this should not be treated as a non-GAAP financial measure. In addition, the proposed measure is not intended or likely to be considered as a substitute for a GAAP measure and doesn't appear to have the effect of adding to or subtracting from a comparable GAAP number, reinforcing the conclusion that it is not a non-GAAP measure.

14. Per Share Presentation of Liquidity and Similar Measures

Question: May EBIT and/or EBITDA per share be presented in a document filed with or furnished to the Commission? What about other similar measures that are sometimes viewed as liquidity measures and sometimes viewed as performance measures?

Answer: The Staff takes the position that liquidity measures may never be presented on a per share basis in SEC filings and furnishings. Although the Staff's prior position was more flexible, as of May 2016, the Staff now takes the position that EBIT and EBITDA per share are always flatly prohibited, regardless of how the company characterizes those measures. See CDI 103.02. It appears that this is true even in situations where the Staff may allow the company to reconcile EBIT and/or EBITDA to net income.

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The Staff has also taken a tougher approach with other measures that are sometimes viewed as liquidity measures and sometimes viewed as performance measures. In newly revised CDI 102.05, the Staff stresses that it will not defer to the company's characterization of a measure, but rather will use its own judgment based on what it views as the "substance" of the presentation. The language used is very strong, and states that any measure that *can* be viewed as a liquidity measure will be subjected to the prohibition. It remains unclear exactly which measures may be deemed liquidity measures under this stricter view. For more discussion about determining when a measure is a liquidity measure rather than a performance measure, see Part III.B.4.d. ("Determining the Most Directly Comparable GAAP Measure"). See also Part III.C.2.b. ("Bright-line Prohibitions") and Part III.D. ("Earnings Releases and Item 2.02 of Form 8-K").

15. Reconciling Line Items in Financials

Question: A company discloses its adjusted operating margin, computed as adjusted operating profit divided by sales. Adjusted operating profit is computed by excluding a restructuring charge from GAAP operating profit. The excluded restructuring charge is itself a line item in the GAAP financials. Does the company still have to provide a reconciliation pursuant to Regulation G? In other words, if the reconciling information is available on the face of the financials, are you nonetheless required to provide a reconciliation?

Answer: Yes. The adjusted operating profit in this example is a non-GAAP financial measure because it was calculated by excluding a restructuring charge that GAAP requires to be included in the calculation of operating profit.

Therefore, the ratio obtained by dividing adjusted operating profit by GAAP sales is also a non-GAAP financial measure. The fact that the excluded amount is itself a GAAP number disclosed in the financial statements is not relevant to the determination of whether or not the adjusted number is a non-GAAP financial measure. An analogous non-GAAP financial measure would be EBITDA, which is calculated by adding GAAP interest, taxes, depreciation and amortization (each of which can usually be gleaned directly from the financial statements) to GAAP net earnings.

The Adopting Release clarifies that EBITDA is indeed a non-GAAP financial measure. Neither Regulation G nor Item 10(e) contains any exemption from the requirement that a quantitative reconciliation be provided simply because the numbers that would be included in the reconciliation can be found in the financial statements. In the present instance, in accordance with SEC guidance contained in the Adopting Release, the issuer should reconcile GAAP operating profit to adjusted operating profit and also present GAAP operating margin.

16. Slideshows

Question: Note 1 to Rule 100 of Regulation G provides that "if a non-GAAP financial measure is released orally, telephonically, by webcast, by broadcast, or by similar means, the registrant may provide the accompanying information required by Regulation G by: (1) posting that

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information on the registrant's website; and (2) disclosing the location and availability of the required accompanying information during its presentation." Would a slideshow presentation be a release "by broadcast, or by similar means," such that the reconciliation can be provided on the registrant's website? Would the answer change if the presentation slides are handed out to meeting attendees?

Answer: If the text of the slides is presented by webcast (or some other form of broadcast), then note 1 to Rule 100 of Regulation G should apply to that presentation. In addition, if the slides are presented at an investor conference and are not handed out, they should be deemed to be oral statements, and note 1 to Rule 100 should also apply.

However, the answer changes if paper copies of the presentation slides are handed out to attendees. If the slides are handed out (and the disclosure is public and contains material information), they must be accompanied by the required reconciliations.

17. Roadshows

Question: Is a roadshow presentation considered to be "public" for purposes of Regulation G?

Answer: There is no concrete definition of "public" for Regulation G purposes. As explained above, at Section III.B.2. "—What Constitutes a Public Statement?" the SEC rejected the notion that this term has the same meaning under Regulation G that it has under Regulation FD. This means that a communication may not be adequately "public" to meet the dissemination requirements of Regulation FD, yet still be "public" enough to trigger Regulation G.

In the absence of a definition, whether a particular disclosure is "public" for this purpose will be a facts and circumstances determination. It is certainly possible for some closed, limited-audience roadshows to be conducted in a way that avoids the roadshow being deemed "public" within the meaning of Regulation G. There are reports that some Staffers have agreed with this position.

However, there is no formal policy about roadshows, and each roadshow will need to be evaluated on a case-by-case basis. Of course, if Regulation FD applies, the information must be disseminated publicly, thus triggering the application of Regulation G.

Even if a roadshow presentation is not "public," it is still advisable as best practice to reconcile all non-GAAP financial measures to the comparable GAAP measures. At a minimum, the comparable GAAP number should be provided in order to avoid the risk that the presentation will be deemed misleading under Rule 10b-5 and other general antifraud provisions.

18. Employee Communications

Question: Is there an SEC Staff position that communications to employees only do not constitute "public" disclosure and therefore do not trigger Regulation G requirements if they contain non-GAAP financial measures?

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Answer: No, there is no formal Staff position on this precise issue. Further, the SEC Staff has avoided specifically defining precisely what is considered "public" for purposes of Regulation G.

Thus, a case-by-case analysis will be required. In a situation involving communications to employees, relevant factors to consider might include the number of employees, method of dissemination, the business reasons for the dissemination, and the steps taken to ensure that the information is not communicated beyond the employees. For example, where information is disseminated to a small, targeted group of employees with a valid business reason to receive the information, a valid argument can be made that the dissemination is not "public."

Regulation G also applies to communications by persons who are acting "on behalf of the issuer." In order to ensure that leaks are unlikely and that, if there are any, that it is clear that the disclosure was not made on behalf of the issuer, it would be prudent to ensure that all employees who receive the non-GAAP financial information are instructed that it is not to be disclosed other than to issuer employees and advisers with a need to know the information.

19. Ratios Using EBIT or EBITDA

Question: Does Item 10(e)(1)(ii) of Regulation SK (which states that a registrant must not exclude charges or liabilities that require, 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 EBIT and EBITDA) prohibit an issuer from including a debt to EBITDA ratio in the Liquidity section of the MD&A?

Answer: It does not appear to be the intent of Item 10(e) to prevent the use of liquidity ratios that utilize EBIT or EBITDA. Anecdotally, there is frequent use of such measures in SEC filings. As discussed elsewhere in this Handbook, the Adopting Release provides that you must separately analyze each component of a multi-component non-GAAP measure such as a percentage, fraction or ratio. You can see this reflected in the express exclusion from the definition of non-GAAP financial measure for ratios where each of the two numbers are computed in accordance with GAAP.

Therefore, it seems that the better view is that, in analyzing ratios such as debt to EBITDA, the numerator and denominator should be analyzed separately, and if neither is prohibited, then the ratio should also be permissible. In any event, discussion of the measure would be permissible in the registrant's MD&A if it were contained in a debt covenant and material to the issuer. See CDI 102.09.

20. Adjusted EBITDA Reconciliations

Question: The SEC Staff clearly requires EBITDA to be reconciled to net income when it is used as a performance measure. Does the same requirement apply to adjusted EBITDA?

Answer: First, it should be noted that this question assumes that adjusted EBITDA—a term which is applied to a wide variety of measures—is being presented as a performance measure.

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Practitioners should note that in light of the CDI revisions in May 2016, presentations of adjusted EBITDA as performance measures are likely to receive heightened scrutiny. In the case of the Staff's prohibition on the presentation of liquidity measures on a per share basis, the new CDIs make it clear that the Staff will not defer to management characterization, and it seems that the Staff may be inclined to err on the side of treating measures as liquidity measures. On the other hand, Staff have stated informally that even though EBITDA will always be deemed a liquidity measure for purposes of the per share prohibition, companies that use it as a performance measure may continue to do so for purposes of the reconciliation. What is unknown is whether this position will apply also to uses of adjusted EBITDA.

That said, in those cases where adjusted EBITDA is allowed to be presented and characterized as a performance measure, unless the adjustments are such that the adjusted measure is clearly more directly comparable to a GAAP financial measure other than net income, the Staff seems likely to require reconciliation of the adjusted measure to net income. The Staff has stated that operating income would not be considered the most directly comparable GAAP financial measure to EBITDA, because EBITDA makes adjustments for items that are not included in operating income. See CDI 103.02. A similar rationale may apply to adjusted EBITDA, again depending heavily on the nature of the adjustments.

21. Non-Numerical References to Non-GAAP Performance

Question: A company announced in its press release that it had "positive EBITDA" for its most recent fiscal period, without providing a dollar amount, although it had a net loss under GAAP for the same period. Is the company's claim that it had positive EBITDA subject to Regulation G? If so, how would it be reconciled?

Answer: The reference to "positive EBITDA" is clearly a reference to a non-GAAP financial measure, since EBITDA is a non-GAAP financial measure. However, in both Regulation G and Item 10(e) the definition of "non-GAAP financial measure" requires that the measure be "*numerical*," and to trigger the rule, the non-GAAP financial measure must be "included" in the public disclosure or filing, as the case may be. EBITDA certainly is a numerical measure, but it is unclear whether it has been sufficiently "included" in the disclosure for purposes of triggering the rules where it has been referenced without disclosing the number.

While this question may be debatable as an academic matter, it seems likely that the Staff would take a dim view of making such oblique references to non-GAAP numbers without complying with the clear purpose of the rules. It is fair to say that such a position would frustrate Congress's intent when it mandated the rules in the Sarbanes-Oxley Act, which was to ensure that issuers who choose to put non-GAAP information into the market will always present the GAAP number as well. Further, in May 2016 the Staff revised CDI 102.10 to provide that in disclosures subject to the equal prominence rule of Item 10(e), describing a non-GAAP measure as, for example, "record performance" or "exceptional" requires providing an equally prominent descriptive characterization of the comparable GAAP measure (this provision was moved to CDI 102.10(a) in 2022). This at least comes very close to implying that the Staff would deem the rules

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applicable to non-numerical references to non-GAAP financial measures, although it is not 100% clear.

It is probably best practice in this type of situation to disclose the numbers and fully comply with Regulation G and/or Item 10(e), as applicable. However, it is not yet entirely clear if this is legally required. Practitioners who choose to take the position that non-numerical references are not covered by the non-GAAP rules should still consider Rule 10b-5. Providing some comparable information with respect to GAAP earnings by, for example, adding the phrase "although we incurred a net loss on a GAAP basis," is probably the minimum required to avoid a potential Rule 10b-5 violation where there are underlying GAAP trends that diverge from the non-GAAP information presented. Depending upon the circumstances, the disclosure may be still be deemed misleading if it lacks a clear explanation of how the non-GAAP measure is calculated and what is excluded from it.

22. Reconciliation of Adjusted EBITDA as Both Performance & Liquidity Measure

Question: A company provides an adjusted EBITDA financial measure in its earnings release. Among the reasons given as to the usefulness of the measure are that it provides a clearer picture of the performance of the company's core operating results as well as providing additional information with respect to the company's ability to meet future debt service, capital expenditure and working capital requirements. To what GAAP financial measure should adjusted EBITDA be reconciled?

Answer: Because adjusted EBITDA is being presented as both a performance and a liquidity measure, it should be reconciled to both net income (unless, based on the adjustments to EBITDA, there is clearly a more comparable GAAP line item) and to cash flow from operations.

23. Change in Excluded Charge Previously Described as Non-Recurring

Question: A company excluded a consulting arrangement's cost from its non-GAAP adjusted net earnings, and believing the consulting arrangement to be a one-time arrangement, described the excluded cost as non-recurring in its filings with the SEC as well as in other documents and on its corporate website. As time has passed, however, that consulting arrangement has become more extensive than originally anticipated and now appears likely to recur over several years. Must the company now amend its prior filings to correctly categorize the nature of the consulting arrangement, in light of Item 10(e)(1)(ii)(B)? How should the company address the change in its future disclosures?

Answer: The company does not need to go so far as to amend past filings with the SEC, as long as the company's original assessment was reasonable and made in good faith. Item 10(e)(1)(ii)(B) prohibits adjusting a non-GAAP 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

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reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. Thus, so long as it was not "reasonably likely" to recur at the time the disclosure was initially made, the rule was not violated. Any future disclosure that references or excludes the charge should explain the change in the nature of the charge from non-recurring to recurring.

In addition, future disclosures should be undertaken only after consideration of CDIs 100.01 and 100.02. As explained in CDI 102.03, Item 10(e)(1)(ii)(B) does not flatly prohibit a registrant from excluding recurring costs in general, as long as the registrant does not *refer to them* as nonrecurring, infrequent or unusual. However, CDI 100.01 (a cross-reference to which has been appended to CDI 102.03) states that it "could" be misleading to present a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business. Compensation is a type of expense that the Staff has previously described as a kind of recurring expense that it may be inappropriate to exclude from a performance measure. Thus, this company needs to carefully assess how to apply CDI 100.01 to the exclusion of the consulting agreement. CDI 100.01, as revised in 2022, states that the Staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring.

If the company changes its calculation of the measure in response to this development, it should also consult CDI 100.02. CDI 100.02 gives as its specific example presenting in the current period a non-GAAP measure that reflects a particular kind of adjustment that was not reflected in prior periods. However, its concern with comparability applies equally to the reverse scenario—*i.e.,* presenting in the current period a non-GAAP measure that omits a particular kind of adjustment that was taken in prior periods. Thus, the company described in our question needs, consistent with CDI 100.02, to disclose and fully explain the reasons for the change in computation between periods. Also, as provided in CDI 100.02, the company should consider whether the change is significant enough that it needs to restate its prior measures to conform to the current presentation.

If the company changes its presentation, it also needs to update its website presentations (and other investor materials) accordingly. CDIs 100.01 and 100.02 are both based on Rule 100(b) of Regulation G, which applies to all public disclosures of non-GAAP financial measures, and not simply those which have been filed with or furnished to the SEC.

24. Non-GAAP Information Relating to Target

Question: A reporting company is acquiring another company and would like to disclose the target's EBITDA and adjusted EBITDA in connection with announcing the acquisition. The disclosure would be made in a press release, would likely be material to the acquirer but would not be subject to any of the exclusions of Regulation G that are available for certain business combination-related disclosures. Must the disclosure comply with Regulation G?

Answer: Regulation G defines "non-GAAP financial measures" as numerical measures of a *registrant's* historical or future financial performance, financial position or cash flows. If the

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target company is not a reporting company, it would not be a registrant for purposes of Regulation G, and thus Regulation G would appear to be inapplicable.

However, because the target is expected to become a part of the reporting company in the future, the Staff might take the position that the number is in fact being offered as an indication of the issuer's future performance. On the other hand, if the target is also a "registrant," the Staff may deem the disclosure, although made by the acquirer, to be made either by the target registrant or on its behalf by the acquirer. In that event, Regulation G would clearly apply (again, assuming that the target is itself a "registrant"). In any event, regardless of the applicability of Regulation G, strong consideration should be given to providing reconciling information in order to reduce the risk that the disclosure is later deemed misleading, as the disclosure will be subject to Rule 10b-5.

25. Guidance Immediately After Material Acquisition Announcement

Question: A reporting issuer has recently announced, concurrently with its first quarter earnings release, that it has entered into a definitive agreement to acquire a business. The acquisition is believed to be probable and is expected to close prior to the completion of the issuer's second fiscal quarter.

Assuming the closing occurs as expected, the issuer's revenues, expenses, net income and cash flows for the current fiscal year are expected to be materially impacted. The issuer normally provides quarterly guidance and would like to continue to do so despite the pending acquisition; however, it is unable to estimate the impact of the acquisition on expenses, net income and cash flows at the time of announcement.

Would oral guidance offered by the issuer with respect to the remainder of the fiscal year with respect to its current business, which guidance does not address the anticipated impact of the proposed acquisition, be subject to Regulation G? (For purposes of this question, the disclosure would not be subject to any of the exclusions of Regulation G that are available for certain business combination-related disclosures.)

Answer: Yes. Because the issuer's best estimate is that its actual, GAAP performance for the current fiscal year (including the anticipated impact of the proposed acquisition) will be much different from the guidance it proposes to offer (without that anticipated impact), guidance excluding the impact would constitute a forward-looking "non-GAAP financial measure." Item 101(a)(1) of Regulation G defines "non-GAAP financial measure" to include measures of future performance, financial condition or liquidity that otherwise meet the definition.

Although the guidance will constitute a "non-GAAP financial measure," Regulation G's relief for forward-looking non-GAAP measures will be available. Despite the fact that some sort of "reconciliation" to GAAP is always required, in the case of forward-looking non-GAAP numbers, if the reconciling information is unavailable without unreasonable efforts, the reconciliation need not be "quantitative."

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The Adopting Release describes the information to be conveyed in a non-quantitative reconciliation: If the GAAP financial measure is not accessible on a forward-looking basis, the issuer must disclose that fact and provide reconciling information that is available without an unreasonable effort. Furthermore, the issuer must identify information that is unavailable and disclose its probable significance.

Thus, in a situation such as that described, it seems reasonable that an issuer might conclude it is unable to accurately predict the impact of the acquisition on expenses, net income and cash flows. Regardless, the issuer will need to provide a narrative explanation of those reconciling items that it cannot provide without unreasonable effort, as well as their probable significance, and must provide all other reconciling items. Our example assumes that the guidance is provided orally, and therefore the narrative reconciliation may be provided in accordance with Note 1 to Rule 100. However, in the event that this guidance is filed with the SEC or included in an earnings release that is furnished in accordance with Item 2.02 of Form 8-K, the narrative disclosure will need to be placed in a location that is at least as prominent as the statement of the non-GAAP number, in accordance with CDI 102.10.

26. Pro Formas

Question: In a quarter after a transaction is consummated a company wants to provide investors a pro forma income statement item such as pro forma revenues or pro forma net income (showing how a transaction might have affected financial statements had the transaction occurred at the beginning of a period) so as to facilitate a better period to period comparison. Would such pro forma information constitute non-GAAP financial information subject to all of the requirements of Regulation G and/or Item 10(e) of Regulation S-K (as applicable)?

Answer: There is specific guidance for the presentation of pro forma information for transactions, in Article 11 of Regulation S-X and Topic 3 of the Staff Financial Reporting Manual. If you follow that guidance, your pro forma presentations will not be non-GAAP financial measures. If a registrant creates measures that are not specified in that guidance, then Regulation G and Item 10(e) will apply in accordance with their terms. In such an instance, the most directly comparable GAAP measure to be used for reconciliation may be a pro forma number prepared in accordance with Article 11. *See* CDI 101.05. Any such measures would have to satisfy the antifraud provisions of Regulation G as well as its reconciliation requirements. Non-GAAP measures that are labeled as "pro forma" but which are not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X are considered by the Staff to be misleading in violation of Rule 100(b). *See* CDI 100.05, which was added in 2022.

27. Adding GAAP Numbers Together

Question: If you add two GAAP numbers together (or subtract one GAAP number from another), is the resulting number potentially a non-GAAP financial measure for purposes of the application of Regulation G and Item 10(e)?

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Answer: Yes. If the resulting number meets the definition of a non-GAAP financial measure, then the mere fact that it was derived by adding two GAAP numbers together (or subtracting one from another) does not exempt it from the application of Regulation G or Item 10(e), as applicable. An example of such a non-GAAP financial measure would be EBITDA, which is often calculated by adding GAAP calculations of interest, taxes, depreciation and amortization to GAAP net earnings. The Adopting Release clarifies that EBITDA is indeed a non-GAAP financial measure.

V. History

Although the SEC rules addressing non-GAAP financial information are primarily contained in Regulation G and Item 10(e) of Regulation S-K, which were adopted in 2003, the SEC had struggled with the proper regulation of "pro forma financial information" for a number of years prior to their adoption. Set forth below is a summary of important developments in the federal regulation of the disclosure of "pro forma" or non-GAAP financial information:

- On March 15, 1973, SEC Accounting Release No. 142, "Reporting Cash Flow and Other Related Data," (Securities Act. Release No. 5377, Exchange Act Release No. 10041) [March 15, 1973] was issued, addressing the use of alternative financial measures beyond those called for by GAAP, and stating that per share data other than that relating to net income, net assets and dividends should be avoided when reporting financial results.

- On December 4, 2001, the SEC's interpretive release entitled "Cautionary Advice Regarding the Use of 'Pro Forma' Financial Information in Earnings Releases," (Release No. 33-8039, 34-45124, FR-59) [December 4, 2001], was issued, providing useful information as to the SEC's thinking regarding the presentation of "pro forma" or non-GAAP numbers and the contexts in which they may mislead. This release is discussed at Part III, How the Rules Work, above.

- On January 16, 2002, the SEC settled its enforcement action against Trump Hotels and Casino Resorts, Inc., *In the Matter of Trump Hotels and Casino Resorts, Inc.* (Release No. 34-45287) [January 16, 2002], discussed at Part III, How the Rules Work, above.

- On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 into law. Section 401(b) of Sarbanes-Oxley called for the SEC to implement rules requiring that any public disclosure or release of pro forma financial information by a company filing reports under Section 13(a) or 15(d) of the Exchange Act be presented in a manner that (a) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading; and (b) reconciles the pro forma financial information presented with the financial condition and results of operations of the registrant under GAAP.

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- On November 4, 2002, the SEC proposed the adoption of Regulation G, Item 10(e) of Regulation S-K and the predecessor to Item 2.02 of Form 8-K in its proposing release, “Conditions for the Use of Non-GAAP Financial Measures,” (Release No. 33-8145; 34-46788; File No. S7-43-02) [November 4, 2002].

- On March 28, 2003, the SEC adopted Regulation G, Item 10(e) and the predecessor to Item 2.02 of Form 8-K in the Adopting Release, “Conditions for Use of Non-GAAP Financial Measures,” (Release No. 33-8176; 34-47226; FR-65; File No. S7-43-02) [March 28, 2003]

- On June 13, 2003, the Staff issued its Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures (later transitioned to Compliance and Disclosure Interpretations), offering interpretive advice relating to Regulation G, Item 10(e) and the predecessor to Item 2.02 of Form 8-K.

- On November 12, 2009, the SEC settled its first enforcement action under Regulation G, *SEC v. SafeNet, Inc., et al.*, (Litig. Release No. 21,290) (Nov. 12, 2009), discussed further at Part III, How the Rules Work, above.

- On January 11, 2010, the Staff updated its Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures, relaxing certain previous positions, as discussed further at Part III, How the Rules Work, above.

- On May 17, 2016, the Staff updated its Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures, in order to attempt to rein in certain problematic disclosure practices, as well as to provide additional guidance, as discussed further at Part III, How the Rules Work, above.

- Around the beginning of September 2016, what has been referred to as an SEC “enforcement sweep” began. A number of issuers received letters from the SEC Division of Enforcement enquiring regarding their non-GAAP practices and compliance.

- In September 2016 the SEC charged two former accounting executives with overstating the financial performance of a large publicly traded real estate investment trust, American Realty Capital Properties, now known as VEREIT, Inc. (“ARCP”), by purposely inflating a key non-GAAP metric used by analysts and investors to assess ARCP’s performance.

- In January 2017 the SEC announced that the New York-based marketing company MDC Partners had agreed to pay a $1.5 million penalty to settle charges that it failed to disclose certain perks enjoyed by its then CEO and had separately violated non-GAAP financial measure disclosure rules.

- On October 17, 2017 and April 4, 2018, the Staff updated its Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures, primarily in order to provide relief for non-GAAP information contained in certain financial forecasts utilized in connection with business combination transactions.

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- On December 26, 2018, the SEC issued a cease and desist order against ADT Inc. ("ADT") arising out of ADT's violations of Section 13(a) of the Exchange Act and Rule 13a-11 thereunder relating to the "equal or greater prominence" disclosure requirements of Item 10(e)(1)(i)(A) of Regulation S-K.
- On August 1, 2019, the Securities and Exchange Commission charged Brixmor Property Group Inc., a publicly-traded real estate investment trust, and four former senior executives with fraud in connection with a scheme to manipulate a key non-GAAP metric relied on by analysts and investors to evaluate Brixmor's financial performance. In a parallel action, the U.S. Attorney's Office for the Southern District of New York announced criminal charges against the four former senior executives.
- On January 30, 2020, the SEC issued "Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations," (Release Nos. 33-10751; 34-88094; FR-87) (January 30, 2020)," which provided guidance on the use of certain key performance indicators and metrics in a registrant's MD&A. This guidance applies to indicators and metrics that may be required to be disclosed in a registrant's MD&A but which may not be non-GAAP financial measures that are subject to Regulation G or Item 10(e).
- In March 2020, the Staff issued "Coronavirus (COVID-19): Division of Corporation Finance Securities and Exchange Commission, CF Disclosure Guidance: Topic No. 9, March 25, 2020" ("Topic 9"). Among other things, Topic 9 provided interpretive advice with respect to non-GAAP financial measures that adjust for COVID-19 impacts, and a limited reconciliation exception with respect to non-GAAP financial measures used in connection with reporting earnings or other financial results, and that reflect the evolving impact of COVID-19 in light of unexpected nonrecurring charges and expenses.
- On July 31, 2020, the SEC announced that Bausch Health, formerly Quebec, Canada-based Valeant Pharmaceuticals, agreed to pay a $45 million penalty to settle charges of improper revenue recognition and misleading disclosures in SEC filings and earnings presentations, which included charges of misleading non-GAAP financial measures. Three former executives—the chief executive officer, chief financial officer, and controller—also agreed to pay penalties to settle charges against them.
- On September 30, 2020, the SEC announced settled charges against BGC Partners, Inc. for false and misleading disclosures concerning how it calculated a key non-GAAP financial measure. Without admitting or denying the SEC's findings, BGC consented to the entry of a cease-and-desist order and agreed to pay a $1.4 million civil penalty.

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- On December 9, 2020, the SEC announced that General Electric Company ("GE") had agreed to settle charges for disclosure failures in its power and insurance businesses. According to the SEC's order, GE misled investors by disclosing misleading non-GAAP financial measures. Without admitting or denying the order's findings, GE agreed to cease and desist from future violations of the charged provisions, pay a $200 million penalty, and report for a one-year period to the SEC regarding certain accounting and disclosure controls in its insurance and power businesses.
- On November 1, 2022, the SEC announced settled charges against Koppers Holdings Inc. ("Koppers") for failing to disclose material information about two non-GAAP financial measures the company highlighted regarding its debt reduction efforts. Specifically, the Commission's Order finds that Koppers failed to disclose that it achieved its debt reduction targets by withholding substantial past-due vendor payments in its 2019 fiscal year. Without admitting or denying the SEC's findings, Koppers consented to a cease-and-desist order and a civil penalty of $1.3 million.
- On December 13, 2022, the Staff updated its Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures, in order to attempt to, among other things, clarify when disclosures are deemed violative of Rule 100(b) and when disclosures and reconciliations are deemed to cause non-GAAP measures to be more prominent than corresponding GAAP measures, as discussed further at Part III, How the Rules Work, above.
- On March 14, 2023, the SEC announced settled charges against DXC Technology Company ("DXC") for misleading disclosures stemming from DXC's exclusion of transaction, separation and integration-related ("TSI") costs from certain of its non-GAAP measures, including non-GAAP net income and non-GAAP diluted earnings per share. Without admitting or denying the SEC's findings, DXC consented to the entry of a cease-and-desist order, agreed to pay an $8 million civil penalty, and agreed to develop and implement non-GAAP policies and disclosure controls and procedures.

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