

In June 2016, then Securities and Exchange Commission (“SEC”) Chair Mary Jo White, speaking at the International Corporate Governance Network’s Annual Conference in San Francisco, reiterated the SEC’s growing concern regarding the use by public companies of non-GAAP financial measures.<sup>1</sup> In her keynote address, Chair White lamented that “[i]n too many cases, the non-GAAP information, which is meant to supplement the GAAP information, has become the key message to investors, crowding out and effectively supplanting the GAAP presentation.”<sup>2</sup> While companies are allowed to present non-GAAP financial measures in their public disclosures to enable them to convey a clearer picture of their results of operations and “tell their own stories” to investors, Chair White voiced her concern that companies have been “taking this flexibility too far and beyond what is intended and allowed by our rules.”<sup>3</sup>

Chair White’s comments echoed a statement she made in a December 2015 speech that these non-GAAP financial measures may be a source of confusion<sup>4</sup> as well as similar sentiments expressed by senior SEC staff in early 2016, articulated in speeches and pronouncements by James Schnurr, the SEC’s then Chief Accountant; Wesley R. Bricker, the SEC’s then Deputy Chief Accountant; and Mark Kronforst, the Chief Accountant in the SEC’s Division of Corporation Finance.<sup>5</sup> In a March 2016 speech delivered at the 12<sup>th</sup> Annual Life Sciences Accounting and Reporting Congress, Mr. Schnurr pointed out that the staff of the SEC’s Division of Corporation Finance (the “Staff”) has observed a significant and “troubling increase” over the past few years in the use of non-GAAP financial measures, the nature of non-GAAP adjustments being made by companies, as well as the prominence being given by analysts and the media to these non-GAAP financial measures in their coverage.<sup>6</sup> In early May of 2016, Mr. Bricker noted that certain company practices related to non-GAAP financial measures have caused SEC concern for being potentially misleading to investors. These practices include, among others, apparent cherry picking adjustments within a non-GAAP financial measure; adjustments to remove normal, cash operating expenses; and the use of individually tailored accounting principles to calculate non-GAAP earnings.<sup>7</sup> In May 2016, Mr. Kronforst declared that there will be an “uptick” in the number of SEC comments to companies with respect to their non-GAAP financial measure disclosures and expressed the view that the next reporting quarter would be a great opportunity for companies to “self-correct” their disclosures.<sup>8</sup>

On May 17, 2016, the Staff issued updated Compliance and Disclosure Interpretations (“C&DIs”) on the use of non-GAAP financial measures (the “Updated C&DIs”).<sup>9</sup> The Updated C&DIs build on previous C&DIs issued by the Staff in 2011 and 2010, and the Frequently Asked Questions regarding the use of non-GAAP financial measures issued by the Staff in 2003, and provide further SEC guidance on Regulation G (“Regulation G”) under the Securities Act of 1933, as amended (the “Securities Act”), and Item 10(e) of Regulation S-K under the Securities Act (“Regulation S-K”), the two principal rules enacted by the SEC in 2003 to address the use of non-GAAP financial measures.

A copy of the Updated C&DIs, marked to show changes since the 2011 version of the C&DIs, is available at: <https://goo.gl/KqfRo8>.

We discuss below the nature of non-GAAP financial measures, the disclosure rules governing them, and the Updated C&DIs. We also look at some recent SEC comment letters addressing non-GAAP financial measures and offer some practical guidance for public companies to comply with the updated SEC guidance.

### **What Is a “Non-GAAP Financial Measure”?**

Regulation G and Item 10(e) of Regulation S-K define a “non-GAAP financial measure” as a numerical measure of historical or future financial performance, financial position, or cash flows, that:

- Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet, or statement of cash flows (or equivalent statements) of the issuer; or
- Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.

The SEC releases leading to the adoption of Regulation G and Item 10(e) of Regulation S-K in 2003 (the “SEC Releases”) further provide that the definition of a non-GAAP financial measure is intended to capture all measures that have the effect of depicting either:

- a measure of performance that is different from that presented in the financial statements, such as income or loss before taxes, or net income or loss as calculated in accordance with GAAP; or
- a measure of liquidity that is different from cash flow or cash flow from operations computed in accordance with GAAP.<sup>10</sup>

Hence, if a company takes a defined GAAP measure (such as GAAP net income) and thereafter “adjusts” for (i.e., excludes or includes) one or more expense or revenue items that are components of that GAAP measure (for instance, excluding a restructuring expense identified as “non-recurring”), then the resulting measure (called “adjusted net income,” for example) is a non-GAAP financial measure. In the same vein, EBITDA (earnings before interest, taxes, depreciation, and amortization) is another common and widely used non-GAAP financial measure. It is a non-GAAP financial measure because the company takes GAAP earnings (i.e., net income as presented in the statement of operations under GAAP) and then adjusts for interest, taxes, depreciation, and amortization components (which are elements derived from GAAP financial presentations) to arrive at a measure (EBITDA) that is not presented in accordance with GAAP.

Other common examples of non-GAAP financial measures include variants of EBITDA, such as EBIT (earnings before interest and taxes), EBITA (earnings before interest, taxes, and amortization), EBITD (earnings before interest, taxes, and depreciation) (which is also sometimes called PBDIT or profit before depreciation, interest, and taxes), EBITDAR (earnings before interest, taxes, depreciation, amortization, and restructuring or rent costs), adjusted EBITDA, core earnings, adjusted earnings, adjusted earnings per share, adjusted revenues, free cash flow, funds from operations (“FFO”), and Adjusted FFO (“AFFO”).

The definition of a non-GAAP financial measure, however, excludes:

- operating and other statistical measures (such as unit sales, number of employees, number of subscribers, or number of advertisers);
- ratios or statistical measures that are calculated using exclusively one or both:
  - financial measures calculated in accordance with GAAP (such as operating margin, where GAAP revenue is divided by GAAP operating income); and
  - operating measures or other measures that are not non-GAAP financial measures (such as sales per square foot or same store sales, assuming that the sales figures were calculated in accordance with GAAP); and
- financial measures required to be disclosed by GAAP, SEC rules, or a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant (such as measures of capital or reserves calculated for regulatory purposes).<sup>11</sup>

### **Why Do Companies Use Non-GAAP Financial Measures?**

A company often uses non-GAAP financial measures in the “Management’s Discussion and Analysis” (“MD&A”) section of its periodic reports, as well as in its earnings releases, investor presentations, and other communications in order to supplement its GAAP financial presentations and to provide investors with a better understanding of the company’s performance, liquidity, and financial position. Often, non-GAAP operating measures are used by research analysts, rating agencies, and other financial professionals in evaluating or comparing the performance of comparable companies. For instance, EBITDA is commonly found in debt covenants, widely utilized by analysts in valuing businesses (e.g., often times the enterprise value of a company is calculated as a multiple of its EBITDA) and making financial projections, and frequently used as a proxy or estimate for a company’s operating cash flow or cash available to service its debt. Non-GAAP financial measures are allowed by the SEC in order for a registrant to convey information to investors that the registrant believes is relevant and useful in understanding its performance or liquidity. Non-GAAP financial measures also enable management to convey a picture of

how they see the company's financial condition or results of operations in a manner that GAAP results alone may not be able to convey.

### **Requirements under Regulation G**

Regulation G contains a reconciliation requirement and a general disclosure requirement.<sup>12</sup> The reconciliation requirement provides that whenever a registrant or a person acting on its behalf publicly discloses (whether in an SEC-filed report or in an earnings call or investor presentation) material information that includes a non-GAAP financial measure, it must accompany that non-GAAP financial measure with:

- A presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP; and
- A quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure.<sup>13</sup>

To illustrate, if a registrant presents EBITDA as a performance measure, then EBITDA should be reconciled to net income as presented in the statement of operations under GAAP<sup>14</sup> since, in this case, net income is the most directly comparable financial measure calculated and presented in accordance with GAAP.

A quantitative reconciliation is required for historical non-GAAP financial measures. For forward-looking information, however, a quantitative reconciliation is required only to the extent available without unreasonable efforts on the part of the registrant. In this latter case, however, the SEC has clarified that the registrant must: (i) disclose the fact that the GAAP financial measure is not accessible on a forward-looking basis; and (ii) identify the information that is unavailable and disclose its probable significance.<sup>15</sup>

In turn, the general disclosure requirement provides that a registrant, or a person acting on its behalf, should not make public a non-GAAP financial measure that, taken together with the information accompanying that measure, contains an untrue statement of a 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 the measure is presented, not misleading.<sup>16</sup>

Regulation G applies to all public disclosures and is not limited to the registrant's written public filings. If a non-GAAP financial measure is made public orally, telephonically, by webcast, by broadcast, or by similar means, then the reconciliation requirement under Regulation G would be satisfied if:

- the required information (i.e., the presentation and reconciliation) is provided on the registrant's website at the time the non-GAAP financial measure is made public; and
- the location of the website is made public in the same presentation in which the non-GAAP financial measure is made public.<sup>17</sup>

### **Requirements under Item 10(e) of Regulation S-K**

Item 10(e) applies to non-GAAP financial measures that are included in SEC filings. To comply with Item 10(e) of Regulation S-K, the registrant must include the following in its SEC filing:

- a presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP;
- a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure;
- a statement disclosing why the registrant's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and
- to the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure.<sup>18</sup>

The general requirements of Item 10(e) of Regulation S-K above are similar to the requirements in Regulation G, except that Item 10(e) of Regulation S-K also adds the “equal or greater prominence” requirement in the presentation and requires disclosure regarding management’s reasons and purposes for using the non-GAAP financial measure.

In addition, Item 10(e) of Regulation S-K contains a number of specific prohibitions. Item 10(e) prohibits:

- non-GAAP financial measures of *liquidity* that exclude charges or liabilities requiring cash settlement, other than EBIT and EBITDA;
- adjustments to non-GAAP financial measures of *performance* that eliminate or smooth items identified as “nonrecurring, infrequent or unusual,” when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years;
- the presentation of non-GAAP financial measures on the face of the registrant’s financial statements prepared in accordance with GAAP or in the accompanying notes;
- the presentation of non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; and
- the use of titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

According to the SEC Releases, these requirements for filed information are more extensive and detailed than those of Regulation G and are generally consistent with the Staff’s historical practice in situations where it has reviewed filings containing non-GAAP financial measures.

### **Exceptions for Proposed Business Combinations and Registered Investment Companies**

The requirements of Regulation G and Item 10(e) of Regulation S-K do not apply to:

- any non-GAAP financial measure included in a disclosure relating to a proposed business combination, the entity resulting therefrom or an entity that is a party thereto, if the disclosure is contained in a communication that is subject to the SEC’s communication rules applicable to business combination transactions;<sup>19</sup> and
- investment companies registered under Section 8 of the Investment Company Act of 1940, as amended (the “Investment Company Act”).<sup>20</sup>

According to the SEC Releases, registered investment companies are excluded from the application of Regulation G and Item 10(e) of Regulation S-K because Section 405 of SOX exempts investment companies registered under Section 8 of the Investment Company Act from Section 401 of SOX and any rules adopted by the SEC under Section 401 of SOX. In turn, non-GAAP financial measures included in proposed business combination disclosures are already subject to a separate set of SEC rules (e.g., Securities Exchange Act Rules 14a-12 and 14d-2, Securities Act Rules 165 and 425, and Item 1015 of Regulation M-A under the Securities Act (“Regulation M-A”).

In October 2017, the Staff issued two additional C&DIs on the use of non-GAAP financial measures in business combination projections. In the first C&DI, the Staff clarified that financial measures provided to a financial advisor, including financial measures included in forecasts used in connection with a business combination transaction, would be excluded from the definition of non-GAAP financial measures, and therefore not subject to Item 10(e) of Regulation S-K and Regulation G, if and to the extent: (1) the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and, (2) the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor’s analyses or substantive work. Therefore, assuming these two conditions are satisfied, the guidance should provide comfort to M&A deal participants that the disclosure of management projections in merger registration statements, proxy statements and tender offer statements would not be subject to Item 10(e) of Regulation S-K and Regulation G. In the second C&DI, the Staff clarified that the exemption from Item 10(e) of Regulation S-K and Regulation G for non-GAAP financial measures disclosed in communications relating to a business combination

transaction does not extend to the same non-GAAP financial measures disclosed in registration statements, proxy statements and tender offer statements.

### **Application of Paragraph (1)(i) of Item 10(e) of Regulation S-K to Item 2.02 of Form 8-K**

Instruction 2 to Item 2.02 of Form 8-K provides that the requirements of paragraph (1)(i) of Item 10(e) of Regulation S-K apply to disclosures made by a registrant under Item 2.02. Item 2.02 is captioned “Results of Operations and Financial Condition” and pertains to earnings release disclosures that are made by a registrant (either in the body of the Current Report on Form 8-K or as an exhibit thereto) and are furnished to the SEC. Under Item 10(e), a registrant must include, either in the body of the Form 8-K or in the earnings release exhibit to the Form 8-K:

- a statement disclosing why the registrant’s management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant’s financial condition and results of operations; and
- to the extent material, a statement disclosing the additional purposes, if any, for which the registrant’s management uses the non-GAAP financial measure.

### **Recent SEC Guidance: The Updated C&DIs**

The Updated C&DIs issued by the Staff can be grouped into four main areas: potentially misleading non-GAAP financial measure practices; equal or greater prominence presentation of GAAP measures; non-GAAP financial measures of liquidity that are presented on a per share basis; and other C&DIs relating to FFO and income tax effects of adjustments. We discuss each of these in turn.

#### Potentially Misleading Non-GAAP Financial Measure Practices

Questions 100.01 through 100.04 of the Updated C&DIs illustrate certain practices concerning non-GAAP financial measures that the Staff believes could be potentially misleading and, therefore, are prohibited under Regulation G. The Staff’s guidance, along with its examples where adjustments to non-GAAP financial measures or their presentation could be potentially misleading, is summarized below:

- Certain adjustments, although not explicitly prohibited, may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP financial measure to be misleading. C&DI Question 100.01 provides, as an example, that presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant’s business could be misleading.
- A non-GAAP financial measure may be misleading if it is presented inconsistently between periods. As an example, C&DI Question 100.02 states that a non-GAAP financial measure that adjusts a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods, could violate Rule 100(b) of Regulation G, unless: (1) the change between periods is disclosed; (2) the reasons for the change are explained; and (3) if the change is sufficiently significant, the related non-GAAP financial measures presentation in the prior periods is recast to conform to the current presentation and to place the disclosure in the appropriate context.
- Non-GAAP financial measures that exclude charges but do not exclude any gains could violate Rule 100(b) of Regulation G for being misleading. As an example, C&DI Question 100.02 provides that a non-GAAP financial measure that is adjusted only for non-recurring charges when there were non-recurring gains that occurred during the same period could violate Rule 100(b) of Regulation G.
- Non-GAAP financial measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. As an example, C&DI Question 100.04 provides a situation where a registrant presents a non-GAAP performance measure that is adjusted to accelerate revenue recognized ratably over time in accordance with GAAP as though the registrant earned revenue when customers are billed. Aside from revenue, C&DI Question 100.04 also states that individually tailored recognition and measurement methods for other financial statement line items may also violate Rule 100(b) of Regulation G for being misleading.



With respect to C&DI Question 100.04, the Staff has stated that it would not object to a non-GAAP financial measure that adjusts revenue to reflect the upcoming change in revenue recognition accounting standards, and that these disclosures, which seek to “bridge” the old GAAP revenue measure with the new GAAP revenue measure, help investors understand the transition from the old to the new accounting standard.<sup>21</sup>

#### Equal or Greater Prominence Presentation of GAAP Measures

Question 102.10 of the Updated C&DIs presents the Staff’s prescriptive approach to the “equal or greater prominence” requirement under Item 10(e) of Regulation S-K. In order to comply with Item 10(e), the registrant must include in its SEC filing a presentation, with equal or greater prominence, of the most directly comparable GAAP measure. In Question 102.10 of the Updated C&DIs, the Staff provides examples where this requirement is not met, i.e., in the following instances, the non-GAAP financial measures may be considered to be more prominent than the GAAP measures, and therefore, such presentation does not comply with Item 10(e):

- 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;
- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
- Including 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;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the “unreasonable efforts” exception in Item 10(e) without disclosing that fact and identifying the information that is unavailable and its probable significance in a location of equal or greater prominence; and
- Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence.

While the Staff acknowledged that whether a non-GAAP financial measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, it did say that it would consider the above as examples where disclosure of non-GAAP financial measures is more prominent than GAAP measures.

#### Non-GAAP Financial Measures of Liquidity that Are Presented on a Per Share Basis

The Staff updated existing C&DI Questions 102.05, 102.07, and 103.02 to highlight the point that a non-GAAP financial measure that is used as a liquidity measure cannot be presented on a per share basis. SEC guidance under these questions may be summarized as follows:

- Non-GAAP per share performance measures may be meaningful from an operating standpoint and are allowed under Item 10(e). Non-GAAP per share performance measures should be reconciled to GAAP earnings per share.
- On the other hand, non-GAAP liquidity measures that measure cash generated must not be presented on a per share basis in documents filed with or furnished to the SEC, consistent with Accounting Series Release No. 142.

- Whether per share data is prohibited depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure. When analyzing these questions, the Staff will focus on the substance of the non-GAAP measure and not management's characterization of the measure.
- Free cash flow is a liquidity measure that must not be presented on a per share basis.
- EBIT or EBITDA must not be presented on a per share basis.

Mr. Kronforst stated the Staff utilizes a range or a spectrum in determining whether a particular measure is used as a liquidity measure or a performance measure: on the liquidity side of the spectrum, there is operating cash flow, and on the performance side of the spectrum, there is net income. While there are other measures in the middle of the spectrum, he said that the Staff has indicated that, for now, it will be focused on analyzing the liquidity end of the spectrum.<sup>22</sup>

#### Other C&DIs Relating to FFO and Income Tax Effects of Adjustments

The Updated C&DIs made certain updates to Questions 102.01 and 102.02 of the existing C&DIs that pertain to the use of the metric FFO, a non-GAAP financial measure traditionally used by the National Association of Real Investment Trust ("NAREIT"). The Staff stated that it continues to accept NAREIT's definition of FFO, in effect as of May 17, 2016, as a performance measure and does not object to such presentation on a per share basis. The Staff also stated that a registrant may present FFO on a basis other than as defined by NAREIT, provided that any adjustments made to FFO must comply with the requirements of Item 10(e) of Regulation S-K for a performance measure or a liquidity measure. Depending on the nature of the adjustments, if FFO is presented or adjusted as a liquidity measure, then the presentation of FFO on a per share basis is prohibited.

Finally, the Updated C&DIs updated Question 102.11. The SEC's guidance therein regarding the income tax effects related to adjustments is as follows:

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

In addition, adjustments to arrive at a non-GAAP measure should not be presented "net of tax." Rather, income taxes should be shown as a separate adjustment and clearly explained.

#### **Recent SEC Comment Letters**

An examination of comment letters issued by the Staff since the Updated C&DIs were released in May 2016 reveals the ongoing focus of the Staff on the use of non-GAAP financial measures by registrants in their filings. In what follows, we identify common themes or areas of concern identified by the Staff in the SEC comment letter/review process, as they relate to the use of non-GAAP financial measures, and we also reproduce excerpts from the actual comments issued by the Staff recently.

- *No Reconciliation or Incorrect Reconciliation to the Most Directly Comparable GAAP Measure*

Examples of SEC Comments:

- Your presentations include non-GAAP measures but omit the most directly comparable GAAP measures. Please ensure that you include the most directly comparable GAAP measures in your discussions of non-GAAP measures in your next earnings release. See Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.
- Reference is made to the guidance you provide for AFFO for the upcoming year. We note that you provide projection guidance only on Non-GAAP information. Given the lack of similar GAAP information and quantitative reconciliation between the GAAP and Non-GAAP information, please clarify how your presentation satisfies the requirements outlined within Item 10(e)(1)(i)(A) of Regulation S-K. Reference is also made to Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.
- You refer to the non-GAAP measure free cash flow in your earnings call; however, we are unable to locate the reconciliation required by Regulation G in your press release or on your website. Please advise.
- We note that your non-GAAP measure, Core EBITDA, is reconciled to GAAP operating income. Please revise to reconcile this measure to net income as the most comparable GAAP measure. Please refer to Question 103.02 of the updated Non-GAAP Compliance and Disclosure Interpretations the Division issued on May 17, 2016.
- We note from your disclosure that you reconcile free cash flow to adjusted operating income (“AOI”). Given that non-GAAP measures should be reconciled to the most directly comparable GAAP measures, please revise to reconcile free cash flow to the most directly comparable GAAP measure. In this regard, we note from your definition of free cash flow and intended uses, that it appears you use this measure as a liquidity measure, indicating that the most comparable GAAP measure would be cash flow from operating activities.
- We note that you present the non-GAAP measures operating income and net loss excluding one-time items related to your facility relocation, but you have not provided the required reconciliations to the most directly comparable GAAP measures as well as the other disclosures required by Item 10(e)(i) of Regulation S-K. Please confirm that in future filings you will revise your presentations of non-GAAP measures to fully comply with that guidance. This comment also applies to your Forms 10-Q and your earnings releases on Form 8-K.
- Please revise your disclosure of your non-GAAP measure Net operating income in future filings to provide a reconciliation of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP.
- The discussion of quarterly results appearing on the earnings release provided under Exhibit 99.1 is based on non-GAAP “core earnings” and does not include a corresponding presentation and discussion of GAAP results. This is inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016, in particular C&DI 102.10. Please review this guidance when preparing your next earnings release.



- *Non-Recurring, Infrequent, or Unusual Items*

Example of SEC Comments:

- You state you exclude third-party business expenses, such as maintenance, ground handling and catering services for third parties, and fuel expense in reporting “CASM” because these expenses are not directly related to your core business. However, it appears these are normal, recurring operating expenses necessary to operate your business. Please explain to us and disclose what you consider to be your core business and why these expenses are not related to this. Also, explain to us how your treatment complies with Question 100.01 of staff’s Compliance and Disclosure Interpretations on Non-GAAP Financial Measures.
- We note your non-GAAP measure, Adjusted EBITDA, excludes management fees and transaction Fees/IPO Readiness costs. Given the historical occurrence of these costs, please explain why you believe their removal reflects a more accurate depiction of your ongoing operations.
- We note your non-GAAP financial measures, Adjusted EBITDA, Adjusted Net Income, and Adjusted Diluted EPS, appear to only exclude charges. Please more fully explain to us how you believe your measures comply with Question 100.03 of the updated Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2016. We note your non-GAAP financial measures exclude a court mandated settlement and acquisition integration costs but do not exclude income related to a settlement, the reduction of an earn-out liability for an acquired business, and gains on sales of equipment.
- We note that your non-GAAP measures exclude purchased intangible amortization, restructuring costs, assets impairments, acquisition-related costs, and income tax items and that you describe these items as infrequent or unusual although you have reported similar items for multiple fiscal years. Please note that Item 10(e)(1)(ii)(B) of Regulation S-K prohibits you from 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 reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. In addition, your non-GAAP measures appear to exclude certain normal, recurring, cash operating expenses which is inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please review this guidance when preparing your next earnings release.

- *Individually Tailored Recognition and Measurement Methods*

Examples of SEC Comments:

- In the Investor Relations section of your website, you have posted earnings slides, supplemental data, and shareholder update presentations that include a measure of non-GAAP gross profit, calculated as non-GAAP gross profit plus change in deferred revenues, less deferred domain expenses. We believe the presentation of a performance measure that substitutes individually tailored revenue recognition and measurement methods for those of GAAP violates Rule 100(b) of Regulation G. Refer to Question 100.04 of the Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016. Please remove these measures from future public presentations.
- We note your calculation of this measure includes development costs as incurred and excludes cost of sales - land under GAAP. Please explain how this does not represent a tailored accounting principle and how you considered Question 100.04 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.
- We note you add back contract amortization to arrive at Adjusted EBITDA. Please clarify for us why this adjustment was not initially reflected in amortization expense and therefore already captured within EBITDA. Further, please explain to us why you make this adjustment and how you considered the guidance in Question 100.04 of the Compliance and Disclosure Interpretation on non-GAAP measures issued May 17,

2016 that specifically states that non-GAAP measures that substitute individually tailored recognition and measurement methods for any financial statement line item for those of GAAP could violate Rule 100(b) of Regulation G.

- *Equal or Greater Prominence*

Examples of SEC Comments:

- Your non-GAAP measures of adjusted EBITDA and net adjusted EBITDA margin precede the GAAP measure. Please ensure that your non-GAAP measures do not precede the most directly comparable GAAP measures in your next earnings release.
- Please revise future filings to ensure that GAAP measures receive equal prominence in all cases, particularly when describing non-GAAP measures. The use of superlatives such as exceptional and substantial when describing non-GAAP measures appears to provide them prominence not afforded your GAAP measures.
- The presentation in your earnings release pertaining to your 2017 first quarter results, including the bullet points under Key Highlights, results in non-GAAP measures being presented with greater prominence than GAAP measures. See Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016, and review this guidance when preparing your next earnings release.
- We note your disclosure of free cash flow. Please note that when a non-GAAP liquidity measure is presented the prominent presentation of amounts for the three major categories of the statement of cash flows should be presented with the non-GAAP liquidity measure. Please revise your disclosure in future filings to comply with Item 10(e)(1)(i) of Regulation S-K and the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please note this comment also applies to earnings releases filed on Form 8-K.
- We note the headlines to your earnings release appear to give more prominence to non-GAAP measures. Please revise your disclosures as appropriate pursuant to Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.
- Please revise your reconciliation in future filings to begin with net income, the most directly comparable measure, ensuring that the non-GAAP measure does not receive undue prominence.
- Please balance your presentation by showing a GAAP gross profit percentage with equal or greater prominence to the incremental contribution margin percentage. In addition, please revise your reconciliation of the non-GAAP measure, incremental contribution, to begin with consolidated gross profit, the most directly comparable GAAP financial measure.
- Your forward-looking non-GAAP measures exclude a quantitative reconciliation in a location of equal or greater prominence. In your year-end earnings release you disclosed your reliance on the “unreasonable efforts” exception in Item 10(e)(1)(i)(B); however, we do not find such reference in the current earnings release. Please revise to comply with the guidance in Question 102.10 of the updated Compliance and Disclosure Interpretation Guidance on non-GAAP financial measures issued on May 17, 2016, in your next earnings release.
- We note you omit a quantitative reconciliation with respect to your forward looking non-GAAP guidance, adjusted diluted EPS. You state it is not practicable to provide reconciliation to a forward-looking reported diluted EPS, the most comparable GAAP measure, due to unknown variables and uncertainty related to future results. Please identify the information that is unavailable and its probable significance in a location of equal or greater prominence. Refer to the next to last bullet in Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016, in regards to Non-GAAP Financial

Measures (“C&DI”).

- In the discussion of “net cruise costs,” “net cruise costs excluding fuel,” and “net yields.” you state you have not provided a quantitative reconciliation of projected amounts for these non-GAAP measures to the comparable projected GAAP measures due to the significant uncertainty in projecting the costs deducted to arrive at the non-GAAP measures. Please identify the information that is uncertain and its probable significance in a location of equal or greater prominence.
- We note that in your executive summary you focus on key non-GAAP financial measures and not GAAP financial measures which may be inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016 (specifically Question 102.10). We also note issues related to prominence within your earnings release. Please review this guidance when preparing your next earnings release.
- We note that you present here and within the appendix full non-GAAP (“Adjusted Pro Forma”) income statements for the three months ended March 31, 2016 and 2015. This disclosure is inconsistent with the updated non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016 (refer to 102.10). Please review this guidance when preparing your next earnings release and modify your non-GAAP disclosures accordingly.
- We note that Core (Non-GAAP) Diluted Earnings per Share precedes the most directly comparable GAAP measure in the headlines to the earnings release filed as Exhibit 99.1. In addition, we note that the adjustments to GAAP EPS to reconcile to Core EPS are presented net of tax. These presentations are inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please review this guidance when preparing your next earnings release.
- We note that you present non-GAAP operating income in the headline of your press release without also presenting GAAP operating income with equal or greater prominence, as required by Item 10(e)(1)(i)(A) of Regulation S-K. Please revise your future earnings releases filed on Form 8-K to fully comply with the guidance in Item 10(e)(1)(i)(A) of Regulation S-K.
- We note that you present non-GAAP EPS in the headline of your press release without also presenting GAAP earnings per share with equal or greater prominence, as required by Item 10(e)(1)(i)(A) of Regulation S-K. Similarly, you highlight a 5% non-GAAP constant currency sales growth in the first bullet and discuss other constant currency sales growth without discussing the corresponding change in GAAP sales. Your presentations appear to give greater prominence to the non-GAAP measures than to the comparable GAAP measures which is inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please review this guidance when preparing your next earnings release.

- *Usefulness to Investor of Non-GAAP Financial Measures*

Examples of SEC Comments:

- Please include a specific statement disclosing the reasons why you believe that the presentation of your non-GAAP financial measure provides useful information to investors as well as the additional purposes, if any, for which you use the non-GAAP financial measure. Refer to Instruction 2 to Item 2.02 of the Form 8-K. It does not appear that these specific statements were provided.

- We note that your non-GAAP measure, Adjusted EBITDA, includes an adjustment that deducts cash payments made for rent on the capital lease of your new headquarters and operations facilities. Please explain to us management's rationale for this adjustment. Tell us what the resulting non-GAAP measure is intended to convey to investors and how adjusting for these cash-rent payments meets that objective. Refer to Item 10(e)(1)(i)(C) of Regulation S-K.
- Please tell us why you believe the presentation of cash flow before share repurchases and change in debt provides useful information to investors and how management uses this non-GAAP measure, if at all. In this regard, we note that your current disclosures are fairly generic and do not address this specific measure; nor do they explain the purpose of this measure in enough detail that a reader can understand why the change in cash flows related to debt excludes the payments of capital lease obligations or why the change in cash flows related to common stock excludes the net proceeds from the sale of common stock.
- You believe Adjusted EBITDA provides investors with important information in evaluating the Company under the agreements governing its indebtedness. Please disclose the material terms in which this measure is used in the indenture for the 9.125% senior notes. For the debt covenants referenced in your response related to other indebtedness, please disclose for each period presented the actual computations, along with other information relevant to understanding the Adjusted EBITDA amounts presented. Please also disclose the amounts or limits required for compliance with each covenant. Refer to Non-GAAP Financial Measures Compliance and Disclosure Interpretation, Question 102.09.
- In addition, you did not provide disclosures in the Non-GAAP Financial Measures section on why it is useful to investors in terms of evaluating your performance. Please revise to provide such disclosures as required by Item 10(e)(i)(C) of Regulation S-K.
- Please expand your disclosures to provide substantive justification specific to your circumstances as to why each non-GAAP measure presented is useful to investors in accordance with Item 10(e)(1)(i)(c) of Regulation S-K. Please also refer to Instruction 2 to Item 2.02 of Form 8-K that indicates that the requirements of Item 10(e)(1)(i) of Regulation S-X apply to information furnished under Item 2.02 of Form 8-K and Question 102.10 of the Compliance & Disclosure Interpretations on Non-GAAP Financial Measures.
- For each non-GAAP measure presented in future filings, please provide a statement disclosing the reasons why your management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations. Please note that each measure should be discussed separately, and that boilerplate disclosure alone, e.g., measure is useful to analysts, is not sufficient.
- As previously requested, please expand your disclosures to provide substantive justification specific to your circumstances rather than boilerplate language included in your draft disclosure that clearly explains why each non-GAAP measure presented is useful to investors in accordance with Item 10(e)(1)(i)(c) of Regulation S-K.

- *Use of Titles or Descriptions of Non-GAAP Financial Measures that are the Same as, or Confusingly Similar to, GAAP Financial Measures*

Examples of SEC Comments:

- We note your presentation of the non-GAAP measure titled “Operating Cash Flow.” We also note that your definition and computation of operating cash flows differs from the calculation of cash flows from operating activities in the statement of cash flows under U.S. GAAP. Accordingly, please revise the title “Operating Cash Flows” to provide a more appropriate description of this measure. Please comply with this comment in your next earnings release.
- We note your definition of EBITDA. Please note that measures calculated differently from EBITDA (as described in Exchange Act Release No. 47226) should not be characterized as EBITDA and their titles should be distinguished from EBITDA, such as Adjusted EBITDA. Reference is also made to Question 103.01 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures
- Given that free cash flow is typically calculated as cash from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures, please revise the title of this measure to something similar to “Adjusted Free Cash Flow” to alert your investors that it has been adjusted from the measure typically referred to as “Free Cash Flow.” Refer to Question 102.07 of the Compliance and Disclosure Interpretations of Non-GAAP measures issued on May 17, 2016.
- We note that you present a non-GAAP measure entitled “operating margin,” which appears similar to the U.S. GAAP terms “gross margin” and “operating income.” Please revise your presentation to better comply with Item 10(e)(1)(ii)(E) of Regulation S-K, which prohibits using titles for non-GAAP measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Make conforming changes, as necessary, to your earnings release.
- We note your presentation of the non-GAAP measure, core pre-provision earnings. Please revise future filings to change the name of this non-GAAP measure to more accurately reflect its content. In this regard, the use of the word “core” implies you are referring to your most central or essential operations and results. Removal of the provision for loan losses and other credit costs from net income to arrive at “core” earnings implies that credit losses are not an inherent part of your core operations. Thus, we believe it would be appropriate to use a more descriptive title to describe this non-GAAP measure, perhaps eliminating the use of the word “core” in its entirety
- We note that you have presented several non-GAAP measures that you refer to as pro forma, but it does not appear that these are pro forma measures in accordance with GAAP. Please rename these measures in future filings to avoid confusion.
- Refer to your discussion and tabular presentation of pro forma adjusted net income and pro forma adjusted net income per share data. Your presentation appears to be comprised of certain non-GAAP adjustments that are not pro forma adjustments pursuant to Article 11 of Regulation S-X. The tabular reconciliation appears to adjust your historical GAAP net income to a non-GAAP measure of net income. In this regard, please revise the titles of the line items ‘pro forma income taxes’ and ‘pro forma adjusted net income’ to ‘adjusted income taxes’ and ‘adjusted net income,’ respectively, or similar revised captions to reflect to proper nature of these measures.
- We note your discussion of “core net income” and “core total revenue” in this section. Please note that the use of the word “core” implies you are referring to your most central or essential operations and results. Removal of gains or losses on the sale of securities and charges for asset-write downs, banking system conversions, retention, and severance expenses from net income to arrive at “core” income implies that sales of investments and asset write-downs, banking system conversions, retention, and severance expenses are not an inherent part of your core operations even though you had net gains or losses on sale of securities and incurred charges for asset write-downs, banking system conversions, retention, and severance expenses over the last five years. We believe it would be appropriate to use a more descriptive title to describe the non-GAAP financial measure, perhaps by eliminating the use of the word “core” in the title. Please revise your disclosure in future filings accordingly.

- *Liquidity versus Performance Measures*

Example of SEC Comment:

- Your disclosures indicate that the non-GAAP measure Adjusted Free Cash Flow is a performance measure; however, the nature of the adjustments and the naming of the measure appear to represent a liquidity measure. Please explain to us in detail why you believe that Adjusted Free Cash Flow is useful as a performance measure and why the measure is titled Adjusted Free Cash Flow if it is not intended to be a liquidity measure.
- We note your presentation of distributable earnings per Adjusted Class A Share. Please tell us whether you consider this to be a liquidity measure and why you believe presenting it on a per share basis complies with Question 102.05 of the updated Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2016.
- We note that you present Adjusted FFO on a per share basis. It appears that due to the adjustments, including several non-cash adjustments and an adjustment for recurring capital expenditures, this measure can be used as a liquidity measure. We also note your disclosure that AFFO is useful to investors as a tool to further evaluate the ability to fund dividends. Please explain to us why you believe it is appropriate to present this measure on a per share basis. See Question 102.05 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.
- We note your disclosure that you consider EBITDA and Adjusted EBITDA to be indicators of your ability to generate cash to service debt, fund capital expenditures, and expand your business and you reconcile these measures to net income and cash provided by operating activities. We also note your disclosure that you do not consider these non-GAAP financial measures to be measures of your liquidity and they do not comply with the provisions of Item 10(e)(1)(ii)(A) of Regulation S-K. Please clarify or revise these inconsistencies
- Please ensure your disclosures appropriately characterize your non-GAAP measures as operating performance measures and/or liquidity or cash flow measures. For example, you appear to have characterized free cash flow as an operating performance measure. However, you reconcile free cash flow from net cash used for operating activities, which indicates free cash flow is a liquidity measure.

- *FFO*

Example of SEC Comments:

- In arriving at Funds from operations-NAREIT, you start with net income (loss) attributable to common stockholders and make an adjustment for noncontrolling interests. As a result, it appears Funds from operations-NAREIT and ultimately Normalized FFO, are attributable to common stockholders. Please clarify and/or revise the labeling of your non-GAAP financial measures in future earnings releases.
- Please provide us an explanation of the adjustments you make to arrive at “recurring funds from operations,” in particular the “taxable REIT subsidiary revocation election” adjustment. Please also tell us why management believes this non-GAAP measure provides useful information to investors and the additional purposes, if any, for which management uses the non-GAAP measure. See Item 10(e)(1)(i) (C) of Regulation S-K.



- *Income Tax Effects*

Example of SEC Comments:

- Please expand your disclosure here, and in earnings releases filed on Form 8-K, to more clearly explain how the tax effects of the non-GAAP adjustments are calculated. Refer to Question 102.11 of the updated Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2016.
- You state that the tax adjustment reflects the tax effect of the non-GAAP adjustments using the effective tax rate for the respective periods. Please explain to us in detail how you calculated the tax effects of your non-GAAP adjustments. Tell us what consideration you gave to disclosing how you computed the tax adjustments and how the tax rate applied to your non-GAAP adjustments relates to your GAAP effective tax rate. See Question 102.11 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.
- Please clarify whether you made the determination that the company is not and is not expected to be a taxpayer for the foreseeable future in certain jurisdictions, such as the U.S., based on your GAAP or non-GAAP net income (loss). In this regard, we note that you have reported cumulative non-GAAP net income of approximately \$784 million since fiscal 2014. Pursuant to Question 102.11 of the non-GAAP C&DIs, you should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. Please explain further your non-GAAP tax adjustments or revise as necessary.
- You disclose (a) the change in constant currency segment income and segment income without also presenting the comparable GAAP measure, and (b) you tax effect the adjustments to net income without a clear explanation for how the tax effect is calculated, which is inconsistent with the updated Compliance and Disclosure Interpretations issued on May 17, 2016. Please review this guidance when preparing your next earnings release.

### **Application to Earnings Releases, Webcasts, and Other Materials Posted to Websites**

As noted above, Regulation G applies to all public disclosures by registrants, whether in writing or made orally, that contain non-GAAP financial measures. Hence, public disclosures in the form of earnings releases, webcasts, investor presentations, and other materials posted to websites are within the scope of Regulation G. If a non-GAAP financial measure is made public orally, telephonically, by webcast, by broadcast, or by similar means, then the reconciliation requirement under Regulation G would be satisfied if:

- the required information (i.e., the presentation and reconciliation) is provided on the registrant's website at the time the non-GAAP financial measure is made public; and
- the location of the website is made public in the same presentation in which the non-GAAP financial measure is made public.<sup>23</sup>

In contrast, Item 10(e) of Regulation S-K applies to all filings by the registrant with the SEC under the Securities Act and the Exchange Act. These would include: registration statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, free writing prospectuses (if included or incorporated by reference into a registration statement), proxy statements, and Current Reports on Form 8-K.

With respect to earnings releases in particular, Item 10(e) applies to a registrant's Item 2.02 of Form 8-K, pursuant to which earnings releases are furnished to the SEC. In addition, Item 2.02 of Form 8-K contains a conditional exemption from its requirement to furnish a Form 8-K where earnings information is presented orally, telephonically, by webcast, by broadcast, or by similar means. Among other conditions, the company must provide on its website any material financial and other statistical information not previously disclosed and contained in the presentation, together with any information that would be required by Regulation G. In Question 105.01 of the Updated C&DIs, the Staff also stated that an audio file of the initial webcast would satisfy the requirement provided that (1) the audio file contains all material financial and other statistical

information included in the presentation that was not previously disclosed, and (2) investors can access it and replay it through the company's website.

### **Application to Foreign Private Issuers**

In addition to domestic registrants that are not registered investment companies, Regulation G and Item 10(e) of Regulation S-K generally apply to foreign private issuers, subject to the limited exceptions outlined below.

Pursuant to Rule 100(c) of Regulation G, Regulation G does not apply to a disclosure of a non-GAAP financial measure that is made by or on behalf of a registrant that is a foreign private issuer if the following conditions are satisfied:

- The securities of the registrant are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States;
- The non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with GAAP in the United States; and
- The disclosure is made by or on behalf of the registrant outside the United States, or is included in a written communication that is released by or on behalf of the registrant outside the United States.

Further, the exemption from Regulation G in favor of foreign private issuers will continue to apply, notwithstanding the existence of one or more of the following circumstances below:

- A written communication is released in the United States as well as outside the United States, so long as the communication is released in the United States contemporaneously with or after the release outside the United States and is not otherwise targeted at persons located in the United States;
- Foreign journalists, U.S. journalists, or other third parties have access to the information;
- The information appears on one or more websites maintained by the registrant, so long as the websites, taken together, are not available exclusively to, or targeted at, persons located in the United States; or
- Following the disclosure or release of the information outside the United States, the information is included in a submission by the registrant to the SEC made under cover of a Current Report on Form 6-K.

Under Regulation G and Item 10(e) of Regulation S-K, the term "GAAP" as used in such rules refers to the generally accepted accounting principles in the United States, except that, for foreign private issuers, the term "GAAP":

- in the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. GAAP or IFRS, shall refer to the principles under which those primary financial statements are prepared; and
- in the case of foreign private issuers that include a non-GAAP financial measure derived from a measure calculated in accordance with U.S. GAAP, shall refer to U.S. GAAP for purposes of the application of the requirements of Regulation G or Item 10(e) of Regulation S-K, as applicable, to the disclosure of that measure.

Hence, outside of the exceptions described above, a foreign private issuer that publicly discloses material information that includes a non-GAAP financial measure is subject to Regulation G.

If the foreign private issuer in turn makes a filing with the SEC (or incorporates by reference into a Form F-3 or any other registration statement a filing) that includes one or more non-GAAP financial measures, then Item 10(e) of Regulation S-K also applies, subject to a few exceptions outlined below.

A non-GAAP financial measure that would otherwise be prohibited by Item 10(e) of Regulation S-K will be permitted in a Form 20-F filing of a foreign private issuer if:

- The non-GAAP financial measure relates to the GAAP used in the registrant's primary financial statements included in its filing with the SEC;
- The non-GAAP financial measure is required or expressly permitted by the standard-setter that is responsible for establishing the GAAP used in such financial statements; and
- The non-GAAP financial measure is included in the annual report prepared by the registrant for use in the jurisdiction in which it is domiciled, incorporated, or organized for distribution to its security holders.<sup>24</sup>

Moreover, the SEC has clarified in Question 106.04 of the Updated C&DIs, that neither Regulation G nor Item 10(e) of Regulation S-K applies to Canadian companies that include non-GAAP financial measures in their annual report on Form 40-F under the Multi-Jurisdictional Disclosure System. Foreign private issuers that include non-GAAP financial measures in their annual report on Form 20-F are, however, subject to Item 10(e) of Regulation S-K as the SEC Releases also amended Form 20-F, to incorporate the requirements of Item 10(e) of Regulation S-K.

### **Liability for Wrongful Use of Non-GAAP Financial Measures**

Rule 102 under Regulation G provides that neither the requirements of Regulation G nor a person's compliance or non-compliance with its requirements shall in itself affect any person's liability under Section 10(b) of the Securities Exchange Act or SEC Rule 10b-5 under the Securities Exchange Act.

Registrants continue to be subject to the anti-fraud provisions of the federal securities law, in addition to the general disclosure requirement under Regulation G which provides that a registrant or a person acting on its behalf shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure, contains an untrue statement of a 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.<sup>25</sup>

In addition, the SEC Releases point out that Section 3(b) of SOX provides that a violation of that Act or the SEC's rules thereunder shall be treated for all purposes as a violation of the Securities Exchange Act. Hence, if an issuer, or any person acting on its behalf, fails to comply with Regulation G, the issuer and/or the person acting on its behalf could be subject to an SEC enforcement action alleging violations of Regulation G. Additionally, if the facts and circumstances warrant, the SEC could bring an action under both Regulation G and Rule 10b-5.

### **Recommendations**

With the recent SEC focus on the use by public companies of non-GAAP financial measures and the release of the updated SEC guidance in the form of the Updated C&DIs, registrants must be extra careful in their public disclosures and filings to ensure that they are complying with Regulation G and Item 10(e) of Regulation S-K. In what follows, we offer some practical guidance:

- Companies should revisit the updated SEC guidance and their approach to non-GAAP financial measures disclosure. Non-GAAP financial measures should merely supplement GAAP measures and not be a substitute for them.
- Appropriate controls on the use of non-GAAP financial measures should be considered and established by companies. The company's audit committee should carefully oversee and monitor the use of non-GAAP financial measures and disclosures, and this particular function of the audit committee should be expressly included in the audit committee's charter. The audit committee should include, as a regular topic for discussion with the auditors, the company's use of non-GAAP financial measures. The audit committee should ask management to explain the utility of non-GAAP financial measures in the company's public disclosures.
- Management should monitor the use of non-GAAP financial measures by comparable companies and financial professionals.
- Companies should ensure that the non-GAAP financial measures they use are neither misleading nor prohibited by the rules.

- Companies should understand and articulate the reasons for using non-GAAP financial measures in their presentation, including how they would be useful for investors.
- The company’s disclosure committee should review the company’s public filings for non-GAAP financial measures.
- Companies should ensure that each non-GAAP financial measure is accurately defined, described, and captioned and that reconciliation is made to the most directly comparable GAAP measure.
- Companies should ensure that the GAAP measures are presented with equal or more prominence than the non-GAAP financial measures. They should carefully observe the examples given by the Staff in Updated C&DI Question 102.10 where this requirement is not met. For instance, companies should refrain from the following practices:
  - Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
  - Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
  - Presenting a non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption); and
  - 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.
- Companies should ensure that the nature of adjustments being made to arrive at their non-GAAP financial measures has a reasonable basis and is customary among peer companies. The SEC has been focusing on apparent cherry picking adjustments within a non-GAAP measure, adjustments to remove normal, cash operating expenses, and the use of individually tailored accounting principles to calculate non-GAAP earnings.
- Companies should remember that certain adjustments, although not explicitly prohibited, may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP financial measure to be misleading. Companies should ensure that the non-GAAP financial measures they are presenting is balanced (i.e., it adjusts not only for non-recurring expenses but also for non-recurring gains).
- Because Regulation G applies to all public disclosures made by the Company, whether made orally or in writing, registrants must take a closer look at how and when they present non-GAAP financial measures in their press releases, webcasts, investor presentations, earnings releases, conference calls, and other disclosures. Companies should pay particular attention to earnings calls and scripts. Regulation G requires at the minimum that registrants post the required presentation and reconciliation on their website at the time the non-GAAP financial measure is made public and announce the location of their website in the same presentation in which the non-GAAP financial measure is made public.
- Companies must always be mindful whether they are using non-GAAP financial measures as a performance measure or as a liquidity measure. The presentation of a non-GAAP liquidity measure on a per share basis is prohibited. The Staff has said that, going forward, it will focus on the substance of the non-GAAP measure and not management’s characterization of the measure in making the performance versus liquidity determination.

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## Contacts

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## Endnotes:

<sup>1</sup> See Mary Jo White, Chair, U.S. Securities and Exchange Commission, *Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability* (June 27, 2016), available at: <https://www.sec.gov/news/speech/chair-white-icgn-speech.html> (hereinafter, "White June 2016 Speech").

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> See Mary Jo White, Chair, U.S. Securities and Exchange Commission, *Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility* (Dec. 9, 2015), available at: <https://www.sec.gov/news/speech/keynote-2015-aicpa-white.html>.

<sup>5</sup> See James V. Schnurr, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the 12<sup>th</sup> Annual Life Sciences Accounting and Reporting Congress* (Mar. 22, 2016), available at: <https://www.sec.gov/news/speech/schnurr-remarks-12th-life-sciences-accounting-congress.html> (hereinafter, "Schnurr Speech"); Wesley R. Bricker, Deputy Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the 2016 Baruch College Financial Reporting Conference* (May 5, 2016), available at: <https://www.sec.gov/news/speech/speech-bricker-05-05-16.html> (hereinafter, "Brickner Speech"); and Mark Kronforst, Chief Accountant, Division of Corporate Finance, U.S. Securities and Exchange Commission, *Remarks at the 36<sup>th</sup> Annual Ray Garret Jr. Corporate and Securities Law Institute* (Apr. 28, 2016).

<sup>6</sup> See Schnurr Speech, *supra* note 5.

<sup>7</sup> See Bricker Speech, *supra* note 5.

<sup>8</sup> See *SEC Tightens Crackdown on 'Adjusted' Accounting Measures*, Wall Street Journal (May 18, 2016), available at: <http://www.wsj.com/articles/sec-tightens-crackdown-on-adjusted-accounting-measures-1463608923>.

<sup>9</sup> See Compliance & Disclosure Interpretations on Non-GAAP Financial Measures, available at: <https://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>.

<sup>10</sup> See SEC Release No. 33-8145, *Proposed Rule: Conditions for Use of Non-GAAP Financial Measures* (Nov. 4, 2002), available at: <https://www.sec.gov/rules/proposed/33-8145.htm> (hereinafter, the "Proposing Release"), and SEC Release No. 33-8176, *Final Rule: Conditions for Use of Non-GAAP Financial Measures* (Jan. 22, 2003), available at: <https://www.sec.gov/rules/final/33-8176.htm> (hereinafter, the "Final Rule Release" and, together with the Proposing Release, the "SEC Releases").

<sup>11</sup> Regulation G, Rule 101(a)(2) and (3); Regulation S-K, Item 10(e)(4) and (5); see also Final Rule Release.

<sup>12</sup> See SEC Releases, *supra* note 10.

<sup>13</sup> Regulation G, Rule 100(a).

<sup>14</sup> See C&DI Question 102.05.

<sup>15</sup> See SEC Release No. 33-8176, *supra* note 11. Note that the Updated C&DIs added a new requirement that the required disclosure should now be "in a location of equal or greater prominence." See discussion in "Recent SEC Guidance: The Updated C&DIs--Equal or Greater Prominence Presentation of GAAP Measures."

<sup>16</sup> Regulation G, Rule 102; 17 CFR 244.100(b).

<sup>17</sup> Note to Regulation G, Rule 100.

<sup>18</sup> Regulation S-K, Item 10(e)(1)(i).

<sup>19</sup> Regulation G, Rule 100(d); Regulation S-K, Item 10(e)(6).

<sup>20</sup> Regulation G, Rule 101(c); Regulation S-K, Item 10(e)(7).

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<sup>21</sup> See also “*Non-GAAP Disclosures: The SEC Speaks!*” (July 6, 2016), a webcast sponsored by TheCorporateCounsel.net, where Mr. Kronforst, speaking in his personal capacity and neither for the SEC nor for the Staff, answered specific questions regarding the Updated C&DIs. A copy of the transcript and an audio archive for the webcast are available at: [http://www.thecorporatecounsel.net/member/Webcast/2016/07\\_06/transcript.htm](http://www.thecorporatecounsel.net/member/Webcast/2016/07_06/transcript.htm). (subscription required).

<sup>22</sup> See “*Non-GAAP Disclosures: The SEC Speaks!*” (July 6, 2016), a webcast sponsored by TheCorporateCounsel.net, where Mr. Kronforst, speaking in his personal capacity and neither for the SEC nor for the Staff, answered specific questions regarding the Updated C&DIs. A copy of the transcript and an audio archive for the webcast are available at: [http://www.thecorporatecounsel.net/member/Webcast/2016/07\\_06/transcript.htm](http://www.thecorporatecounsel.net/member/Webcast/2016/07_06/transcript.htm) (subscription required).

<sup>23</sup> Note to Regulation G, Rule 100.

<sup>24</sup> Note to Paragraph (e) under Item 10(e) of Regulation S-K.

<sup>25</sup> Regulation G, Rule 102; 17 CFR 244.100(b).

### About Morrison & Foerster

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