

## **NEW AND IMPROVED SEC GUIDANCE ON NON-GAAP FINANCIAL MEASURES**

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To Our Clients and Friends:

Earlier this year, the Securities and Exchange Commission (“SEC”) released new Compliance and Disclosure Interpretations (the “C&DIs”) on the use of non-GAAP financial measures. Since the 2003 adoption of Regulation G and Item 10(e) of Regulation S-K addressing the use of non-GAAP financial measures and the issuance of the related SEC guidance that same year (the “2003 FAQs”), many companies’ management, accountants and lawyers have spent at least a few hours puzzling over nuances flowing from the rules and crafting compliance disclosure. The C&DIs amend and supplement the 2003 FAQs and, in certain respects, simplify life with non-GAAP financial measures. We have summarized below the highlights of the C&DIs.

### **REVISIONS TO 2003 FAQ GUIDANCE**

**Use of Non-GAAP Financial Measures.** The C&DIs eliminate the 2003 FAQ guidance that led many issuers to conclude that they are prohibited from presenting non-GAAP financial measures unless the measures are actually used by management in the conduct of the business. The C&DIs affirmatively state that there is no prohibition against disclosing a non-GAAP financial measure that is not used by management in managing its business. Further, if an issuer’s management does use a non-GAAP financial measure to manage its business or for other purposes, such issuer needs to disclose the purposes for which management uses the non-GAAP financial measure only to the extent material.

**Adjustments for Recurring Items.** It is now safe for issuers to adjust non-GAAP financial measures for recurring charges or gains. Item 10(e) prohibits adjusting non-GAAP financial performance measures to eliminate or smooth items identified as non-recurring, infrequent or unusual if the nature of the charge or gain is such that it is reasonably likely to recur within two years or if there was a similar charge or gain within the prior two years. The related guidance in the 2003 FAQs has been viewed by many as a blanket prohibition on adjusting non-GAAP financial measures for recurring items even where such adjustments would have been appropriate for disclosure purposes. The C&DIs, however, make clear that the prohibition in Item 10(e) relates to the characterization of a specified item as non-recurring when it does not meet the specified criteria. As such, companies may adjust non-GAAP financial measures for recurring items as they deem appropriate as long as they are not characterized as non-recurring, infrequent or unusual.

**Non-GAAP Per Share Performance Measures.** The C&DIs eliminate the requirement to explain how a per-share non-GAAP performance measure that is included in documents filed or furnished with the SEC is used by management and the reason why it is meaningful to investors. Non-GAAP per-share performance measures must still be reconciled to GAAP earnings per share. Disclosure of non-GAAP liquidity measures, such as cash flows, on a per-share basis continues to be prohibited.

**EBIT and EBITDA.** Consistent with the new guidance regarding adjustments for recurring items, the C&DIs delete language from the 2003 FAQs that discouraged the use of EBIT and EBITDA as performance measures under the pretext that they exclude recurring items. In addition, without effecting any radical changes, the C&DIs simplify the guidance regarding MD&A disclosure of credit agreement covenants regarding non-GAAP financial measures, such as “Adjusted EBITDA,” and make clear that the presentation of such credit agreement related measures is not subject to the blanket prohibition of Item 10(e).

**Foreign Private Issuers.** Item 10(e) permits foreign private issuers to include in SEC filed documents non-GAAP financial measures that would otherwise be prohibited in such filings as long as such measures are required or “expressly permitted” by the home country regulator or standard setter. In addition to measures that are clearly and specifically identified as an acceptable measure by the GAAP standard setter in a foreign private issuer’s home country, the C&DIs indicate that non-GAAP financial measures may be expressly permitted if the primary securities regulator in the foreign private issuer’s home country jurisdiction or market has explicitly accepted the presentation. Such explicit acceptance would include: (i) published views of the regulator or members of the regulator’s staff or (ii) a letter from the regulator or its staff to the foreign private issuer indicating the acceptance of the presentation.

## NEW GUIDANCE

**Constant Currency Presentation.** Financial information presented in a constant currency by a company with operations in various foreign countries where the local currency is used to prepare financial statements that are later translated into the company’s reporting currency constitutes a use of a non-GAAP financial measure. A presentation of the historical amounts and the constant currency amounts with a description of the process for calculating the constant currency amounts and the basis of presentation would satisfy the reconciliation requirements of Regulation G and Item 10(e).

**Free Writing Prospectuses.** The C&DIs confirm that Item 10(e) applies to free writing prospectuses only if they are filed on a Form 8-K or if they are otherwise included or incorporated by reference into a registration statement filed with the SEC. Free writing prospectuses are, however, subject to Regulation G.

**Presentation of Full Non-GAAP Financial Statements.** The C&DIs indicate that it would be inappropriate to present a full non-GAAP income statement as a way to reconcile non-GAAP measures to GAAP measures, since doing so would attach an undue prominence to the non-GAAP information.

**Presentation of Adjustments “Net of Tax.”** The C&DIs indicate that a registrant may present an adjustment “net of tax” when reconciling a non-GAAP performance measure to the most directly comparable GAAP measure. In so doing, the registrant should either (i) disclose the tax effect of each reconciling item parenthetically or in a footnote to the reconciliation or (ii) present the tax effect in one line in the reconciliation and, in each case, disclose how the tax effect was calculated.

Finally, we understand that the SEC will be conducting selective reviews of earnings releases and other publicly available presentations with the objective of ensuring the consistent disclosure of material non-GAAP financial measures in disclosure furnished with the SEC (*e.g.*, earnings releases) or otherwise made available to the public and disclosure that is filed with the SEC (*e.g.*, annual reports). As such, we recommend that issuers undertake a review of their disclosure documents and consider whether conforming revisions are appropriate in this regard.

The C&DIs may be found at [www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm](http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm).

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Please feel free to contact any of us should you have any questions regarding this memorandum or the use of non-GAAP financial measures generally.

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