

SEC Releases New and Updated Guidance on Non-GAAP Financial Measures

December 14, 2022

On December 13, 2022, the staff of the Division of Corporation Finance of the Securities and Exchange Commission released seven new and updated Compliance & Disclosure Interpretations (“C&DIs”) relating to the use of non-GAAP financial measures. A summary of the updates is below, and the full text of the recently revised C&DIs is attached.

MISLEADING NON-GAAP MEASURES

- Adjustments that are not explicitly prohibited may nonetheless cause a non-GAAP measure to be misleading based on the company’s individual circumstances. In particular, the C&DIs state that normal, recurring, cash operating expenses that are necessary to the operation of the company’s business may be considered misleading based on the company’s operations, revenue generating activities, business strategy, industry and regulatory environment. The staff further clarifies that an expense is “recurring” even if it occurs occasionally, including at irregular intervals. (Q&A 100.01)
- Adjustments that have the effect of changing the recognition and measurement principles required to be applied in accordance with GAAP may also cause a non-GAAP measure to be misleading. (Q&A 100.04)
- A non-GAAP measure lacking an appropriate label and clear description, including failing to describe a measure as non-GAAP or utilizing a label that does not reflect the nature of the non-GAAP measure, such as “pro forma” when it is not calculated in a manner consistent with Article 11 of Regulation S-X, could be misleading. (Q&A 100.05)
- In certain circumstances, a non-GAAP measure could mislead investors even if accompanied by extensive, detailed disclosure about the nature and effect of each adjustment. (Q&A 100.06)

PROMINENCE OF NON-GAAP MEASURES VS. GAAP MEASURES

- The staff reminds companies that whether a non-GAAP measure would be considered more prominent than the corresponding GAAP measure depends on the facts and circumstances in which the disclosure is made, including a consideration of the related discussion and analysis of the non-GAAP measure. Disclosures of non-GAAP measures that the staff would consider more prominent now include presenting a ratio where a non-GAAP measure is a numerator and/or denominator, without also presenting the measure using the most directly comparable GAAP measures, and presenting charts, tables or graphs of non-GAAP measures, without such disclosures of GAAP measures being presented with equal or greater prominence. (Q&A 102.10(a))
- The staff further notes that a reconciliation may give undue prominence to a non-GAAP measure if it starts with the non-GAAP measure or, if presenting a forward-looking non-GAAP measure, the company does not disclose reliance on the exception to providing a quantitative reconciliation and identify the information that is unavailable and its probable significance in a location of equal or greater prominence. (Q&A 102.10(b))
- A so-called “non-GAAP income statement,” defined as an income statement comprised of non-GAAP measures and that includes all or most of the line items and subtotals found in a GAAP income statement, gives undue prominence to the non-GAAP measures. (Q&A 102.10(c))

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We are available to discuss these updates and other considerations related to non-GAAP financial measures. Please do not hesitate to contact us with any questions.



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NEW AND UPDATED C&DIS:**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: 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: 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:

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- 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
 - 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. [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. 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 an income statement of non-GAAP measures. See Question 102.10(c).
- 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.
- 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.

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- 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]