Executive ALERT
Updates on issues vital to the practice of investor relations

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SEC Cracks Down on Non-GAAP Metrics

On May 17, the U.S. Securities and Exchange Commission issued new and revised Compliance & Disclosure Interpretations that relate to Regulation G and the reporting of non-GAAP financial measures by companies. The guidance, which will have a significant impact on earnings releases, gave several examples of adjustments and reporting practices that the SEC would view as misleading. This guidance follows speeches by Chair Mary Jo White and other SEC officials in recent months in which they voiced concern about the proliferation of non-GAAP numbers.

Specifically relevant for non-GAAP disclosures in press releases, earnings calls, investor presentations, stockholder reports, etc., NIRI has provided guidance concerning Regulation G in its Standards of Practice publications.

According to the latest SEC guidance:

- Certain adjustments may violate Regulation G because they cause the presentation of the non-GAAP measure to be misleading. For example, presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business could be misleading.
- A non-GAAP measure may be misleading if it is presented inconsistently between periods. For example, a non-GAAP measure that adjusts a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods could violate Regulation G unless the change between periods is disclosed and the reasons for it explained. In addition, depending on the significance of the change, it may be necessary to recast prior measures to conform to the current presentation and place the disclosure in the appropriate context.
- A non-GAAP measure may be misleading if the measure excludes charges, but does not exclude any gains.
- Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Regulation G.

The SEC also addressed the prominence of non-GAAP numbers in earnings releases. Under SEC rules, a company that presents a non-GAAP measure must also present the most directly comparable GAAP measure with equal or greater prominence. While the determination of prominence will generally depend on the facts and circumstances of the disclosures, the SEC staff said it would consider the following examples of non-GAAP disclosures as more prominent:

- 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;
- 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)(1)(i)(B) [of Regulation S-K] 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.

Resources

- SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations: Non-GAAP Financial Measures, updated May 17, 2016
- SEC Regulation G, Conditions for Use of Non-GAAP Financial Measures, March 28, 2003
- NIRI Regulations Library - Regulation G
- NIRI Standards of Practice for IR
- Cleary Gottlieb Client Update - SEC Releases New Guidance on Non-GAAP Financial Measures
- Debevoise & Plimpton Client Update - Non-GAAP Metrics in the Crosshairs: SEC Issues New Guidance

- Gibson Dunn Client Update - SEC Updates Guidance on Non-GAAP Financial Measures
- Goodwin Procter Client Update - SEC Issues Important Non-GAAP Interpretations

About the National Investor Relations Institute (NIRI)
Founded in 1969, NIRI (www.NIRI.org) is the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts and other financial community constituents. NIRI is the largest professional investor relations association in the world with more than 3,300 members representing 1,600 publicly held companies and $9 trillion in stock market capitalization.