



# Non-GAAP measures - expecting an SEC crackdown

## Quarterly Governance Review

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During the past few months, members of the SEC staff have been foreshadowing a renewed focus on enforcement of reporting of financial metrics and the use of “non-GAAP” financial measures by companies in the capital raising process, in quarterly earnings releases and on analyst calls. This renewed focus is leading to new policy statements on the regulatory front, and we expect it to lead to new enforcement actions, which could also impact risk in civil litigation.

The regulatory regime governing the use of non-GAAP financial measures has not changed much since the SEC adopted Regulation G and Item 10(e) of Regulation S-K in 2003. The SEC staff last clarified its interpretation of these rules in 2011. Regulation G applies to all companies that have a class of security registered under Section 12 of the Exchange Act of 1934, as amended and relates to the use of “non-GAAP financial measures” in any public disclosure of material information, whether in writing or orally. Under this regulation, public companies that disclose or release non-GAAP financial measures are required to include, in that disclosure or release, a presentation of the most directly comparable GAAP financial measure and a reconciliation of the disclosed non-GAAP financial measure to the most directly comparable GAAP financial measure.

Essentially, in addition to compliance with Regulation G, whenever one or more non-GAAP financial measures are included in a filing with the SEC, Item 10(e) requires the issuer to present with equal or greater prominence, the most directly comparable financial measure or measures calculated and presented in accordance with GAAP and provide a reconciliation of the differences between the non-GAAP financial measure disclosed with the most directly comparable financial measure calculated and presented in accordance with GAAP. In addition, the issuer is required to disclose the reasons why its 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.

Over the course of the past six months, the SEC staff has repeatedly voiced its concern that the increased use of non-GAAP measures may be confusing to investors and analysts. For example, in December 2015, SEC Chair Mary Jo White noted that issuers, along with their audit committees, should carefully monitor the use of these measures and consider the following questions:

- Why are you using the non-GAAP measures, and how does it provide investors with useful information?
- Are you giving non-GAAP measure no greater prominence than the GAAP measures, as required under the rules?
- Are your explanations of how you are using the non-GAAP measures – and why they are useful for your investors – accurate and complete, drafted without boilerplate?

- Are there appropriate controls over the calculation of non-GAAP measures?

SEC Chair White and several members of the SEC staff have indicated that the SEC may consider future rulemaking in this area.

On May 17, 2016, the SEC staff revised its C&DIs related to non-GAAP measures, by publishing four new interpretations and revising eight existing interpretations. The revised CD&Is can be found [here](#).

**Action items:**

- Consider how your disclosure controls and procedures apply to the disclosure of non-GAAP measures.
- Audit Committees should pay close attention to the non-GAAP measures used by an issuer, including the required related disclosures and the processes the issuer follows to consider both the appropriateness and reliability of the measure and whether the explanation for use should be updated or modified.
- Review the new C&DIs to determine the SEC staff's current thinking on the use of non-GAAP measures.

Find out more by contacting Sanjay Shirodkar, David P. Lewis, Louis Lehot or your regular DLA Piper lawyer.

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