On June 27, 2016, 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.[1] 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."[2] 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 recently, companies have been "taking this flexibility too far and beyond what is intended and allowed by our rules."[3]

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[4] as well as similar sentiments expressed by senior SEC staff in the past few months, articulated in recent speeches and pronouncements by James Schnurr, the SEC's Chief Accountant, Wesley R. Bricker, the SEC's Deputy Chief Accountant and Mark Kronforst, the Chief Accountant in the SEC's Division of Corporation Finance.[5] In a March 2016 speech delivered at the 12th 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.[6] In early May of this year, 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.[7] Last mid-May, 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.[8]

On May 17, 2016, the Staff issued updated Compliance and Disclosure Interpretations (the "Updated C&DIs") on the use of non-GAAP financial measures.[9] The Updated C&DIs build on previous C&DIs issued by the Staff in 2011, 2010 and 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: http://www.mofo.com/~/media/Files/PDFs/160808UpdatedCDIsNonGAAPMeasures.pdf.

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 (or includes) amounts that are otherwise included in (or excluded from) the most directly comparable measure calculated and presented in the financial statements under generally accepted accounting principles ("GAAP").[10] Common examples of non-GAAP financial measures include EBIT (earnings before interest and taxes), EBITDA (earnings before interest, taxes, depreciation and amortization), Adjusted EBITDA, free cash flow, and funds from operations ("FFO").

The definition of a non-GAAP financial measure excludes:

- operating and other statistical measures (such as unit sales, number of employees, numbers 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).[11]

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, 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 equity research analysts, rating agencies, and other financial professionals in evaluating or comparing the performance of comparable companies. 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; non-GAAP financial measures enable management to convey a "clearer picture of how they see the company's results of operations in a way that GAAP results alone may not convey."[12]

Requirements under Regulation G

Regulation G contains a reconciliation requirement and a general disclosure requirement.[13] 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.[14]

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[15] 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 to 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.[16]

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 it is presented, not misleading.[17]

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.[18]

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 comply with the requirements under Regulation G and, in addition, 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 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.[19]

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; 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.

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;[20] and

- investment companies registered under Section 8 of the Investment Company Act of 1940, as amended.[21]

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 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, are 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 it 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 recently 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.[22]

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 are 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 or furnished with 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.

In addition, the Staff has recently stated it 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, the Staff has recently indicated that for now, it will be focused on analyzing the liquidity end of the spectrum.[23]

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 "funds from operations" or 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 as 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.

Last, 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 came out in mid-May 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 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.

- *Reconciliation to the Most Directly Comparable GAAP Measure*

Examples of SEC Comments:

- Please reconcile each non-GAAP measure presented to the most comparable GAAP measure in accordance with Item 10(e)(1)(i)(a) of Regulation S-K. Specifically, we did not note a reconciliation for (a) adjusted earnings per share from earnings per share, (b) the percentage increase in constant currency adjusted earnings per share over the prior year from the percentage increase in earnings per share; and (c) the percentage increase in constant currency segment income from the percentage increase in income from operations.
- 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 Comment:

- 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.

- *Equal or Greater Prominence*

Examples of SEC Comments:

- 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:

- 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.

- We have reviewed your response to our prior comment 2. You state that the non-GAAP measures are more reflective of your actual operating results. In this regard, your proposed disclosure of the reasons for these supplemental non-GAAP measures appears to give greater prominence for their use than the actual amounts in your GAAP financial statements. Please revise your proposed disclosure of how the non-GAAP measures are meaningful as supplemental information to the reported GAAP amounts.
- 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 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.
- 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.
- 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 systems conversion, 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 conversion, 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:

- 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 Comment:

- 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 Comment:

- 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 of Regulation G and Item 10(e) of Regulation S-K to Earnings Releases, Webcasts and Other Materials Posted to Websites

As noted above in the section entitled "Requirements under Regulation G," Regulation G applies to all public disclosures, whether in writing or made orally, by registrants that contain non-GAAP financial measures. Hence, public disclosures in the form of earnings releases, webcasts 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.[24]

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 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 C&DI Question 105.01, 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 of Regulation G and Item 10(e) of Regulation S-K to Foreign Private Issuers

In general, both Regulation G and Item 10(e) of Regulation S-K apply to foreign private issuers.

Under Rule 100(b) of Regulation G and under Item 10(e)(3), 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.

There is however an exception under Regulation G. Pursuant to Rule 100(c) of Regulation G, Regulation G shall 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 shall continue to apply notwithstanding the existence of one or more 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.

Moreover, a non-GAAP financial measure that would otherwise be prohibited by Item 10(e) will be permitted in a 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 or for distribution to its security holders.[25]

Liability for Using 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 of 1934, as amended (the "Exchange Act") or SEC Rule 10b-5 under the Exchange Act.

Issuers 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.[26]

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 carefully revisit the updated SEC guidance and their approach to non-GAAP financial measures disclosure.[27] Non-GAAP financial measures should merely supplement GAAP measures and not be a substitute for them.[28]
- 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[29] 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 nonrecurring expenses but also for nonrecurring 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 its 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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Endnotes:

[1] *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").

[2] *Id.*

[3] *Id.*

[4] *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 (hereinafter, "White December 2015 Speech").

[5] *See* James V. Schnurr, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the 12th 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 36th Annual Ray Garret Jr. Corporate and Securities Law Institute (Apr. 28, 2016).

[6] *See* Schnurr Speech, *supra* note 4.

[7] *See* Bricker Speech, *supra* note 4.

[8] *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.

[9] *See* Compliance & Disclosure Interpretations on Non-GAAP Financial Measures, *available at*: https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

[10] Regulation G, Rule 101(a)(1); Regulation S-K, Item 10(e)(2).

[11] Regulation G, Rule 101(a)(2) and (3); Regulation S-K, Item 10(e)(4) and (5); *see also* SEC Release No. 33-8176; 34-47226, *Conditions for Use of Non-GAAP Financial Measures* (Jan. 22, 2003) (hereinafter, "SEC Release No. 33-8176").

[12] *See* White December 2015 Speech, *supra* note 4; and White June 2016 Speech, *supra* note 1.

[13] *See* SEC Release No. 33-8176, *supra* note 11.

[14] Regulation G, Rule 100(a).

[15] *See* C&DI Question 102.05.

[16] *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.*"

[17] Regulation G, Rule 102; 17 CFR 244.100(b).

[18] Note to Regulation G, Rule 100.

[19] Regulation S-K, Item 10(e)(1)(i).

[20] Regulation G, Rule 100(d); Regulation S-K, Item 10(e)(6).

[21] Regulation G, Rule 101(c); Regulation S-K, Item 10(e)(7).

[22] *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 from Morrison & Foerster LLP partner David M. Lynn and WilmerHale LLP partner Meredith B. Cross 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. (subscription required).

[23] *Id*.

[24] Note to Regulation G, Rule 100.

[25] Note to Paragraph (e) under Item 10(e) of Regulation S-K.

[26] Regulation G, Rule 102; 17 CFR 244.100(b).

[27] *See* White June 2016 Speech, *supra* note 1.

[28] *See* Schnurr Speech, *supra* note 5.

[29] *See* White June 2016 Speech, *supra* note 1.