On point.

Understanding the Requirements Related to the Use of Non-GAAP Financial Measures

It is no secret that the use of non-GAAP financial measures, which are financial measures that are neither calculated nor presented in accordance with U.S. generally accepted accounting principles ("GAAP"), has been a focus of attention for the U.S. Securities and Exchange Commission ("SEC"). In December 2015, the then SEC Chair Mary Jo White called this an area that "deserves close attention, both to make sure that our current rules are being followed and to ask whether they are sufficiently robust in light of current market practices."[1] Wesley R. Bricker, then the SEC's chief accountant, observed in a speech in May 2016 that certain company practices related to the use of non-GAAP financial measures have raised concerns and may be potentially misleading to investors.[2] On May 17, 2016, the SEC's Division of Corporation Finance (the "Staff") provided guidance on the use of non-GAAP financial measures in the form of new and updated Compliance and Disclosure Interpretations ("C&DIs").[3] Since that time, the use of non-GAAP financial measures has become one of the most cited issues in Staff comment letters. In addition, since the release of said C&DIs, there have been SEC enforcement actions and a criminal action brought by the U.S. Attorney's Office for the Southern District of New York that have culminated in a securities fraud conviction relating to the use of non-GAAP financial measures.

In this guide, we discuss the nature and purpose of non-GAAP financial measures and the rules governing the use of such financial measures. We also examine recent SEC comment letters and discuss areas of concern identified by the Staff. Last, we look at recent pronouncements that provide guidance on best practices for companies and offer some practical guidance.

What is a non-GAAP financial measure?

The SEC adopted the term "non-GAAP financial measures" in order to identify information targeted by the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), which sought to eliminate the manipulative or misleading use of what the Sarbanes-Oxley Act referred to as "pro forma financial information" and enhance the comparability with GAAP financial measures. In 2003, the SEC adopted Regulation G and Item 10(e) of Regulation S-K ("Item 10(e)"), which both define a non-GAAP financial measure as a numerical measure of a company's historical or future financial performance, financial position, or cash flows, that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with U.S. GAAP (or in the case of foreign private issuers ("FPIs") whose primary financial statements are prepared in accordance with non-U.S. generally accepted accounting principles, references to GAAP also include the principles under which those primary financial statements are prepared) in the statement of income, balance sheet, or statement of cash flows (or equivalent statements) of the issuer; or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.

[1] See Mary Jo White, "Keynote Address at the 2015 AICPA National Conference: 'Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility,'" December 9, 2015, available at https://www.sec.gov/news/speech/keynote-2015-aicpa-white.html.
[2] *See* Wesley R. Bricker, "Remarks before the 2016 Baruch College Financial Reporting Conference," May 5, 2016, available at http://www.legalexecutiveinstitute.com/wp-content/uploads/2016/09/22.-Bricker-May-Speech-Baruch-College-Financial-Reporting-Conference.pdf.
[3] *See* Compliance & Disclosure Interpretations on Non-GAAP Financial Measures, *available at*: https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

In addition, the SEC's releases leading to the 2003 adoption of Regulation G and Item 10(e) (the "SEC Releases") explain that the non-GAAP financial measure definition is intended to capture all measures that have the effect of presenting:

- a measure of performance that is different from that presented in the financial statements, such as income or loss before taxes, or net income or loss as calculated in accordance with GAAP; or
- a measure of liquidity that is different from cash flow or cash flow from operations computed in accordance with GAAP.[4]

The following are excluded from the definition of a non-GAAP financial measure:

- operating and other statistical measures such as unit sales, number of employees, subscribers or advertisers;
- ratios or statistical measures that are calculated using exclusively one or both:
    - financial measures calculated in accordance with GAAP. For example, operating margin derived from GAAP revenue divided by GAAP operating income would not be considered a non-GAAP measure; and
    - operating measures or other measures that are not non-GAAP financial measures such as measures calculated in accordance with GAAP (i.e., sales per square foot or same store sales);
- financial information that does not have the effect of providing numerical measures that are different from the comparable GAAP measure such as:
    - disclosure of amounts of expected indebtedness, including contracted and anticipated amounts;
    - disclosure of amounts of repayments that have been planned or decided upon but not yet made;
    - disclosure of estimated revenues or expenses of a new product line, so long as such amounts were estimated in the same manner as would be computed under GAAP; and
    - measures of profit or loss and total assets for each segment required to be disclosed 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.[5]

Examples of commonly used non-GAAP measures include "adjusted net income" or EBITDA. If a company takes a GAAP measure like net income and adjusts that by excluding or including one or more expense or revenue items which are "non-recurring," the resulting measure, or "adjusted net income" as it is sometimes presented, would be considered a non-GAAP measure. Companies that use EBITDA derive this non-GAAP measure by taking GAAP earnings, such as GAAP net income as presented in the statement of operations, and adjusting for interest, taxes, depreciation, and amortization components, which are elements derived from GAAP financial presentations. Other common examples of non-GAAP financial measures include variations of EBITDA, such as EBIT (earnings before interest and taxes), EBITA (earnings before interest, taxes, and amortization), EBITD (earnings before interest, taxes, and depreciation or sometimes called PBDIT or profit before depreciation, interest, and taxes), EBITDAR (earnings before interest, taxes, depreciation, amortization, and restructuring or rent costs), adjusted EBITDA, core earnings, adjusted earnings, adjusted earnings per share, adjusted revenues, free cash flow, funds from operations ("FFO"), and Adjusted FFO ("AFFO").

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[4] *See* SEC Release No. 33-8145, Proposed Rule: Conditions for Use of Non-GAAP Financial Measures (Nov. 4, 2002), available at: https://www.sec.gov/rules/proposed/33-8145.htm (hereinafter, the "Proposing Release"), and SEC Release No. 33-8176, Final Rule: Conditions for Use of Non-GAAP Financial Measures (Jan. 22, 2003), available at: https://www.sec.gov/rules/final/33-8176.htm (hereinafter, the "Final Rule Release" and, together with the Proposing Release, the "SEC Releases").

[5] Regulation G, Rule 101(a)(2) and (3); Regulation S-K, Item 10(e)(4) and (5); *see also* Final Rule Release.

Do non-GAAP measures serve a purpose?

Companies usually present non-GAAP financial measures in order to supplement GAAP financial presentations and to provide investors with a better illustration of their performance, liquidity, and financial position. Non-GAAP financial measures often enable a company's management to present a company's financial condition or results of operations and provide meaningful performance measures in a manner that GAAP results alone may not properly convey. The SEC allows the presentation of non-GAAP financial measures in order to provide information to investors that a registrant believes is relevant and useful in understanding its performance or liquidity. When used, non-GAAP financial measures are typically disclosed in the "Management's Discussion and Analysis" ("MD&A") section of periodic reports, earnings releases, investor presentations, and other company communications. In addition, research analysts, rating agencies, and other financial professionals often use non-GAAP operating measures to evaluate or compare the performance of comparable companies. For example, EBITDA is commonly found in debt covenants and used in financial projections and assessments of a company's operating cash flow or cash available to service its debt. Analysts also use EBITDA in the valuation of businesses, including a company's enterprise value which is usually calculated as a multiple of EBITDA.

Which rules govern the use of non-GAAP measures?

Regulation G

Companies subject to the filing requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") must comply with Regulation G when publicly disclosing material information that includes a non-GAAP financial measure. This includes the use of non-GAAP financial measures in public disclosures such as a SEC-filed reports, earnings releases or investor presentations. In such public disclosures, a registrant must provide the following to accompany the non-GAAP financial measure:

- 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.[6]

For example, if a registrant presents EBIT or EBITDA as a non-GAAP performance measure, that measure should be reconciled to net income as presented in the statement of operations under GAAP as net income is the most directly comparable financial measure calculated and presented in accordance with GAAP. Even for companies where operating income is a GAAP financial measure, operating income would not be considered the most directly comparable GAAP financial measure because EBIT and EBITDA make adjustments for items that are not included in operating income.[7] Regulation G also requires registrants to provide quantitative reconciliation of forward-looking non-GAAP financial measures such as a schedule or other presentation detailing the differences between the forward-looking non-GAAP financial measure and the appropriate forward-looking GAAP financial measure. If the most directly comparable GAAP financial measure is not available on a forward-looking basis, the registrant must disclose that fact, explain why it is not available on a forward-looking basis, provide any reconciling information that is available without an unreasonable effort and disclose its probable significance.[8]

When using non-GAAP financial measures and presenting the required Regulation G information, registrants must be mindful that under Regulation G a registrant or a person acting on its behalf may not disclose a non-GAAP financial measure, which taken together with the required accompanying information, misstates a material fact or omits to state a

[6] Regulation G, Rule 100(a).
[7] *See* C&DI Question 103.02.
[8] *See* SEC Release No. 33-8176, *supra* note 4. *See also* C&DI Question 102.10.

material fact necessary to make the presentation of the non-GAAP financial measure not misleading, in light of the circumstances under which it is presented.[9]

Regulation G applies to the use of non-GAAP financial measures in all written and oral public disclosures by registrants, including SEC-filed reports, earnings releases, webcasts and broadcasts, investor presentations, and other materials posted to websites. When using non-GAAP financial measures in public communications, a registrant can comply with the Regulation G requirements by:

- Providing the Regulation G required information on the registrant's website at the time the non-GAAP financial measure is made public; and
- Making public the location of the website in the same presentation in which the non-GAAP financial measure is made public.[10]

Item 10(e) of Regulation S-K

Item 10(e) applies to disclosure of non-GAAP financial measures in SEC filings made by the registrant under the Securities Act of 1933, as amended (the "Securities Act") and the Exchange Act, including registration statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, free writing prospectuses (if included in an Exchange Act filing, or included or incorporated by reference into a registration statement),[11] proxy statements, and current reports on Form 8-K. Instruction 2 of Item 2.02 "Results of Operations and Financial Conditions" of Form 8-K ("Item 2.02") specifically references the requirements under Paragraph (1)(i) of Item 10(e), which requires the presentation of non-GAAP financial measures to be presented with equal or greater prominence as the most directly comparable GAAP financial measure.

When using non-GAAP financial measures in SEC filings, registrants must provide the following to comply with Item 10(e):

- a presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP;
- a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between the disclosed non-GAAP financial measure and the most directly comparable GAAP financial measure;
- a statement explaining the basis for which the registrant's management believes that the presentation of the non-GAAP financial measure would be useful to investors in understanding the registrant's financial condition and results of operations; and
- to the extent material, a statement disclosing the purpose, if any, for which the registrant's management uses the non-GAAP financial measure.[12]

The SEC recently reminded registrants of the importance of the "equal or greater prominence" requirement. On December 26, 2018, the SEC issued a cease and desist order and imposed a $100,000 civil penalty on a company for including non-GAAP financial measures (such as adjusted EBITDA, adjusted net income and free cash flow before special items) in two earnings releases without giving equal or greater prominence to the most directly comparable GAAP financial measures. The SEC's order specifically noted that the earnings releases' headlines presented a non-GAAP financial measure without mentioning the comparable GAAP financial measure. The order also pointed out that the bullet points in the highlights section on the first page of one of the earnings releases contained non-GAAP financial measures but did not include the comparable GAAP financial measures. According to the SEC order, although the comparable GAAP financial measures were contained later in the body of the earnings release, the failure to include them in the headlines

[9] Regulation G, Rule 100(b).
[10] Note 1 to Regulation G, Rule 100.
[11] *See* C&DI Question 102.08.
[12] Regulation S-K, Item 10(e)(1)(i).

and the highlights that contained the non-GAAP financial measures constituted a violation of the Exchange Act and the applicable rules thereunder.[13]

In addition to the prohibition on giving greater prominence to non-GAAP financial measures mentioned above, Item 10(e) also contains a number of specific prohibitions as set forth below:

- excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures other than EBIT and EBITDA;
- 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;
- presenting non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes;
- presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; and
- using 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.

Item 10(e) requirements are intended to be more extensive and detailed than those of Regulation G according to the SEC Releases.

Regulation G and Item 10(e) Exceptions

<u>Proposed Business Combinations</u>

Regulation G and Item 10(e) do not apply to non-GAAP financial measures included in disclosure relating to proposed business combinations, 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.[14] The SEC Releases noted that non-GAAP financial measures included in proposed business combination disclosures are already subject to a separate set of SEC rules (e.g., Exchange Act Rules 14a-12 and 14d-2, Rules 165 and 425 under the Securities Act and Item 1015 of Regulation M-A under the Securities Act ("Regulation M-A")).

In October 2017 and April 2018, the Staff issued four additional C&DIs on the use of non-GAAP financial measures in business combination transactions clarifying the following:

- Financial measures provided to a financial advisor, a company's board of directors or board committee, including financial measures in forecasts used in connection with a business combination transaction, would be excluded from the definition of non-GAAP financial measures, and therefore not subject to Item 10(e) and Regulation G, if and to the extent: (A) the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and, (B) the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor's analyses or substantive work. Such guidance should provide comfort to M&A deal participants that the disclosure of management projections in merger registration statements, proxy statements and tender offer statements would not be subject to Item 10(e) and Regulation G.
- If a registrant determines that to comply with the anti-fraud and other liability provisions of the federal securities laws forecasts exchanged between parties in a business combination transaction are material and disclosure of

[13] *See* https://www.sec.gov/litigation/admin/2018/34-84956.pdf.

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

such forecasts is required, such financial measures included in such forecasts would be excluded from the definition of non-GAAP financial measures and therefore not subject to Item 10(e) and Regulation G.

- The exemption from the requirements under Item 10(e) and Regulation G that applies to non-GAAP financial measures disclosed in communications relating to a business combination transaction do not extend to the same non-GAAP financial measures disclosed in registration statements, proxy statements and tender offer statements.

Registered Investment Companies

Regulation G and Item 10(e) also do not apply to investment companies registered under Section 8 of the Investment Company Act of 1940, as amended (the "Investment Company Act")[15] and the SEC Releases note that registered investment companies are excluded from the application of Regulation G and Item 10(e) because Section 405 of the Sarbanes-Oxley Act exempts investment companies registered under Section 8 of the Investment Company Act from Section 401 of the Sarbanes-Oxley Act and any rules adopted by the SEC under Section 401 of the Sarbanes-Oxley Act.

Foreign Private Issuers

Although Regulation G generally applies to FPIs, there are limited exceptions. Use of non-GAAP financial measures by FPIs are not subject to Regulation G if the following conditions are satisfied:

- The FPI's securities are listed or quoted on a non-U.S. securities exchange or inter-dealer quotation system;
- The non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP; and
- The disclosure is made by or on behalf of the FPI, or is included in a written communication that is released by or on behalf of the FPI outside the United States.[16]

The Regulation G exemption for FPIs still applies in any of the following circumstances:

- The FPI releases a written communication in and outside of the United States and such 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 and U.S. journalists or other third parties have access to the information;
- Following the release or disclosure, the information appears on one or more websites maintained by the FPI, 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 on a current report on Form 6-K.[17]

In addition, the term "GAAP" as used in Regulation G and Item 10(e), for FPIs also includes the following:

- in the case of FPIs whose primary financial statements are prepared in accordance with non-U.S. GAAP or IFRS, "GAAP" shall refer to the principles under which those primary financial statements are prepared; and
- in the case of FPIs that include a non-GAAP financial measure derived from a measure calculated in accordance with U.S. GAAP, "GAAP" shall refer to U.S. GAAP for purposes of the application of the requirements of Regulation G or Item 10(e), as applicable, to the disclosure of that measure.

While Item 10(e) is also applicable to FPIs, if an FPI uses a non-GAAP financial measure in a Form 20-F filing that is otherwise prohibited by Item 10(e), such use would be permissible if the measure was expressly permitted under GAAP

[15] Regulation G, Rule 101(c); Regulation S-K, Item 10(e)(7).
[16] Regulation G, 100(c).
[17] *See* The SEC Releases, *supra* note 4.

used in the FPI's primary financial statements and was included in its annual report or financial statements used in its home country jurisdiction or market. In addition, a non-GAAP financial measure that would otherwise be prohibited by Item 10(e) will be permitted in a Form 20-F filing 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 for distribution to its security holders.[18]

Additionally, the SEC clarified in Question 106.04 of the C&DIs that neither Regulation G nor Item 10(e) applies to use of non-GAAP financial measures by Canadian issuers in annual reports on Form 40-F under the Multi-Jurisdictional Disclosure System.

SEC Guidance: The C&DIs

The C&DIs updated by the Staff in 2016 provide insight into what the Staff considers to be misleading use of non-GAAP financial measures and unacceptable prominence of a non-GAAP financial measure presentation. These C&DIs can be grouped into four main areas: (1) potentially misleading non-GAAP financial measure practices; (2) impermissible prominence of non-GAAP financial measures; (3) prohibitions on per share presentations of non-GAAP financial measures; and (4) income tax effects of adjustments.

Potentially Misleading Non-GAAP Financial Measure Practices

C&DIs Questions 100.01 through 100.04 address violations of the prohibition on misleading non-GAAP financial measures contained in Rule 100(b).

C&DI Question 100.01 makes it clear that, even if certain adjustments are not explicitly prohibited by Regulation G, they can result in a non-GAAP financial measure that is misleading and therefore a violation of Rule 100(b). To illustrate this point, this C&DI states that the presentation of a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a company's business could be misleading. The Staff cross-references this C&DI in C&DI Question 102.03, which discusses Item 10(e)'s prohibition on adjusting non-GAAP measures to eliminate or smooth out non-recurring items that are likely to reoccur or have occurred within two years.

C&DI Question 100.02 specifies that a non-GAAP measure can be misleading if it is presented inconsistently between periods, such as a measure that adjusts a particular charge or gain in the current period when other, similar charges or gains were not also adjusted in prior periods. According to this C&DI, 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. According to the Staff, a non-GAAP financial measure can be misleading if it excludes charges but does not exclude gains.

C&DI Question 100.03 notes that Rule 100(b) may be violated if a non-GAAP measure is adjusted only for non-recurring charges when non-recurring gains occurred during the same period.

C&DI Question 100.04 addresses the presentation of a non-GAAP performance measure that is adjusted to accelerate revenue recognized ratably over time in accordance with GAAP as though it earned the revenue when customers are billed. This C&DI concludes that such a measure cannot be presented in documents filed with or furnished to the SEC or provided elsewhere, such as on a company's website, because that type of non-GAAP measure substitutes individually tailored revenue recognition and measurement methods for GAAP methods, which could violate Rule 100(b) of Regulation

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

G. This C&DI also specifies that other measures that use individually tailored recognition and measurement methods for financial statement line items other than revenue may also violate Rule100 (b) of Regulation G. The Staff has stated that it would not object to a non-GAAP financial measures that adjusts revenue to reflect an upcoming change in revenue recognition accounting standards, and which help bridge old GAAP revenue measures with the new GAAP revenue measures allowing investors to understand the transition from the old to the new accounting standard.[19]

Impermissible Prominence of Non-GAAP Financial Measures

While noting that whether a non-GAAP financial measure presentation is more prominent than the comparable GAAP measure depends on the facts and circumstances, revised C&DI Question 102.10 provides the following eight examples of presentations in which the Staff would consider the non-GAAP disclosures to be impermissibly 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"exceptioninItem10(e)(1)(i)(B) 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.

Prohibitions on Per Share Presentations of Non-GAAP Financial Measures

C&DI Question 102.05 confirms that certain non-GAAP earnings per share measures may be permissible if they are performance measures that are reconciled to GAAP earnings per share but emphasizes that a non-GAAP liquidity measure that measures cash generated must not be presented on a per share basis in documents filed with or furnished to the SEC. This C&DI states that when the Staff analyzes the question of whether a financial measure can be reported on a per share basis, it will focus on the substance of whether the non-GAAP measure could be used as a liquidity measure and not management's characterization of it solely as a performance measure.

The Staff also clarified and updated C&DI Questions 102.07 and 103.02 in light of revised C&DI Question 102.05. C&DI Question 102.07 specifies that free cash flow is a liquidity measure that must not be presented on a per share basis. The Staff also updated C&DI Question 103.02, which discusses the GAAP performance measure to which EBIT or EBITDA should be reconciled, to specify that EBIT and EBITDA must not be presented on a per share basis. The C&DIs also address per share presentations in the context of FFO per share as a non-GAAP measure in earnings releases and materials

[19] *See "Non-GAAP Disclosures: The SEC Speaks!"* (July 6, 2016), a webcast sponsored by TheCorporateCounsel.net, where Mr. Kronforst, speaking in his personal capacity and not for the SEC nor for the Staff, answered specific questions regarding the 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).

that are filed with or furnished to the SEC. C&DI Question 102.01 accepts the FFO definition of the National Association of Real Estate Investment Trusts ("NAREIT") that was in effect as of May17, 2016, as a performance measure and does not object to a per share FFO presentation when FFO is presented based on the NAREIT definition. While C&DI Question 102.02 recognizes that FFO can be presented other than as defined by NAREIT, adjustments for such an FFO presentation must comply with the requirements of Item10(e) for a performance measure or a liquidity measure, and some of those adjustments may trigger the prohibition on presenting this measure on a per share basis.

Income Tax Effects of Adjustments

C&DI Question 102.11 specifies that companies should provide income tax effects on non-GAAP measures depending on the nature of the measures. For example, if a measure is a liquidity measure that includes income taxes, the C&DI specifies that it might be acceptable to adjust GAAP taxes to show taxes paid in cash. The C&DI indicates that if a measure is a performance measure, the company should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. C&DI Question 102.11 provides that 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.

What are the principal areas of concern identified in SEC comment letters?

The Staff's ongoing focus on the use of non-GAAP financial measures is clear from comment letters issued by the Staff since the 2016 release of the updated C&DIs. Below, we discuss common areas of concern identified in SEC comment letters as they relate to the use of non-GAAP financial measures.

Reconciliation to the Most Directly Comparable GAAP Measure

Issues related to reconciliation to the most directly comparable GAAP measure have generated a large number of Staff comments. In this regard, the Staff commented on registrants' practice of using non-GAAP financials in their disclosures without a presentation of the most directly comparable GAAP financial measure or the required quantitative reconciliation. These comments focus on the lack of or incorrect reconciliation and the need for separate presentation of each non-GAAP adjustment in the reconciliations. With respect to the "unreasonable efforts" exception for forward-looking guidance, Mr. Kronforst stated that it was never the Staff's intention to audit registrants, question the assertion of the "unreasonable efforts" exception or insist that a quantitative reconciliation was required. Rather, the Staff is focused on reminding registrants of the rule and where a registrant relies on this exception, it must both disclose the fact that such GAAP financial measure is not accessible on a forward-looking basis, and identify the information that is unavailable and its probable significance in a location of equal or greater prominence.[20]

Below are some sample comments on this topic:

- *We note your presentation of guidance ranges for 2018. Given the lack of quantitative reconciliation between the GAAP and non-GAAP information, please clarify how your presentation satisfies the requirements outlined within Item 10(e)(1)(i)(A) of Regulation S-K. Reference is also made to Question 102.10 of the Compliance & Disclosure Interpretations for Non-GAAP Financial Measures.*
- *Your reconciliations to GAAP amounts provided on [text omitted] appear to represent full non-GAAP income statements. Please revise your presentation in order to comply with the guidance provided in Question 102.10 of the updated Compliance and Discussion Interpretations. Your revised presentation should make it clear the nature of the adjustments being made to arrive at each of the non-GAAP amounts that you continue to present. For example, it is not clear what specific adjustments are being made to arrive at adjusted non-GAAP cost of sales and why these are being made.*

[20] *Id.*

- *We note your calculation of EBITDA contains adjustments for items other than interest, taxes, depreciation and amortization. Please revise in future filings to ensure that measures calculated differently from EBITDA are not characterized as EBITDA and have titles that are distinguished from "EBITDA", such as "Adjusted EBITDA". Reference is made to Question 103.01 of the Compliance & Disclosure Interpretations for Non-GAAP Financial Measures.*
- *We note [text omitted] you present a reconciliation of the non-GAAP measure Adjusted EBITDA to net income. Please revise to begin the reconciliation with the comparable GAAP measure, net income. See Item Question 102.10(1)(i)(A) of Regulation S-K and the SEC Staff's C&DI on Non-GAAP Financial Measures, updated April 4, 2018. Also, please revise your disclosure in your Form 10-Q reports as applicable.*
- *We note your Non-GAAP reconciliation for Adjusted Net Income on page. Please revise your disclosures, here and elsewhere throughout the registration statement, to show the tax effect of the corresponding adjustment as a separate line item. Refer to Non-GAAP C&DI Question 102.11.*
- *We note that you present the forward looking non-GAAP measure adjusted diluted earnings per share without providing the reconciliation to the most directly comparable GAAP financial measure or the statement that providing such reconciliation requires unreasonable efforts. Refer to Item 10(e)(1)(i)(B) of Regulation S-K and the guidance in Question 102.10 of the Compliance and Disclosure Interpretations on Non-GAAP Financial Measures and revise your future filings to provide the required information.*
- *Reference is made to the guidance you provide for AFFO for the upcoming year. We note that you provide projection guidance only on Non-GAAP information. Given the lack of similar GAAP information and quantitative reconciliation between the GAAP and Non-GAAP information, please clarify how your presentation satisfies the requirements outlined within Item 10(e)(1)(i)(A) of Regulation S-K. Reference is also made to Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.*
- *We note from your disclosure that you reconcile free cash flow to adjusted operating income ("AOI"). Given that non-GAAP measures should be reconciled to the most directly comparable GAAP measures, please revise to reconcile free cash flow to the most directly comparable GAAP measure. In this regard, we note from your definition of free cash flow and intended uses, that it appears you use this measure as a liquidity measure, indicating that the most comparable GAAP measure would be cash flow from operating activities.*
- *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.*

Equal or Greater Prominence in Presentation of Non-GAAP Measures

Equal or greater prominence of GAAP financial measures with non-GAAP financial measures also generated a substantial number of Staff comments. The Staff's comments addressed the content, formatting, sequence or ordering and labeling of non-GAAP financial measures disclosed in registrants' public disclosures. The Staff also addresses this topic in Question 102.10 of the C&DIs, where non-GAAP financial measures may be considered to be more prominent than comparable GAAP financial measures.

Below are some sample comments regarding this topic:

- *Reference is made to your disclosure of historical and expected free cash flow. Regarding both historical and expected free cash flow, please tell us your consideration of providing the disclosures prescribed by Item 10(e)(1)(i)(B)-(D) of Regulation S-K. Regarding your presentation of expected free cash flow, please tell us your consideration of disclosing expected operating cash flow with equal or greater prominence. Refer to Item 10(e)(i)(A) of Regulation S-K.*

- *We note that you disclose Segment operating income, a non-GAAP measure, and on page 30, you reconcile the measure to Income before income taxes. Please revise your reconciliation to present the GAAP measure before the non-GAAP measure to avoid undue prominence. See Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016. Your disclosure in 10-Qs, earnings releases furnished on Form 8-K as well as Appendix A in your annual proxy statement should be similarly revised.*
- *Your non-GAAP measures of adjusted EBITDA and net adjusted EBITDA margin precede the GAAP measure. Please ensure that your non-GAAP measures do not precede the most directly comparable GAAP measures in your next earnings release.*
- *Please revise future filings to ensure that GAAP measures receive equal prominence in all cases, particularly when describing non-GAAP measures. The use of superlatives such as exceptional and substantial when describing non-GAAP measures appears to provide them prominence not afforded your GAAP measures.*
- *Please revise your reconciliation in future filings to begin with net income, the most directly comparable measure, ensuring that the non-GAAP measure does not receive undue prominence.*
- *The presentation in your earnings release pertaining to your 2017 first quarter results, including the bullet points under Key Highlights, results in non-GAAP measures being presented with greater prominence than GAAP measures. See Question 102.10 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016, and review this guidance when preparing your next earnings release.*
- *We note the headlines to your earnings release appear to give more prominence to non-GAAP measures. Please revise your disclosures as appropriate pursuant to Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016.*
- *Please balance your presentation by showing a GAAP gross profit percentage with equal or greater prominence to the incremental contribution margin percentage. In addition, please revise your reconciliation of the non-GAAP measure, incremental contribution, to begin with consolidated gross profit, the most directly comparable GAAP financial measure.*
- *Your forward-looking non-GAAP measures exclude a quantitative reconciliation in a location of equal or greater prominence. In your year-end earnings release you disclosed your reliance on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B); however, we do not find such reference in the current earnings release. Please revise to comply with the guidance in Question 102.10 of the updated Compliance and Disclosure Interpretation Guidance on non-GAAP financial measures issued on May 17, 2016, in your next earnings release.*
- *We note you omit a quantitative reconciliation with respect to your forward looking non-GAAP guidance, adjusted diluted EPS. You state it is not practicable to provide reconciliation to a forward-looking reported diluted EPS, the most comparable GAAP measure, due to unknown variables and uncertainty related to future results. Please identify the information that is unavailable and its probable significance in a location of equal or greater prominence. Refer to the next to last bullet in Question 102.10 of the updated Compliance and Disclosure Interpretations issued on May 17, 2016, in regards to Non-GAAP Financial Measures ("C&DI").*
- *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.*

Potentially Misleading Non-GAAP Financial Measures

Staff comments covering misleading presentation or adjustments for non-GAAP financial measures have asked registrants to show that certain non-GAAP financial measures they used or particular adjustments they adopted were not misleading in light of the examples cited in Questions 100.01, 100.03, 100.04, and 102.03 of the C&DIs. The following are examples of potentially misleading practices relating to use of non-GAAP measures on which the Staff has commented.

Use of Non-GAAP Financial Measures with Titles or Descriptions that are the Same as, or Confusingly Similar to, GAAP Financial Measures

- *We note your presentation of the non-GAAP measure titled "Operating Cash Flow." We also note that your definition and computation of operating cash flows differs from the calculation of cash flows from operating activities in the statement of cash flows under U.S. GAAP. Accordingly, please revise the title "Operating Cash Flows" to provide a more appropriate description of this measure. Please comply with this comment in your next earnings release.*
- *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.*
- *Given that free cash flow is typically calculated as cash from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures, please revise the title of this measure to something similar to "Adjusted Free Cash Flow" to alert your investors that it has been adjusted from the measure typically referred to as "Free Cash Flow." Refer to Question 102.07 of the Compliance and Disclosure Interpretations of Non-GAAP measures issued on May 17, 2016.*
- *We note that you present a non-GAAP measure entitled "operating margin," which appears similar to the U.S. GAAP terms "gross margin" and "operating income." Please revise your presentation to better comply with Item 10(e)(1)(ii)(E) of Regulation S-K, which prohibits using titles for non-GAAP measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Make conforming changes, as necessary, to your earnings release.*
- *We note your presentation of the non-GAAP measure, core pre-provision earnings. Please revise future filings to change the name of this non-GAAP measure to more accurately reflect its content. In this regard, the use of the word "core" implies you are referring to your most central or essential operations and results. Removal of the provision for loan losses and other credit costs from net income to arrive at "core" earnings implies that credit losses are not an inherent part of your core operations. Thus, we believe it would be appropriate to use a more descriptive title to describe this non-GAAP measure, perhaps eliminating the use of the word "core" in its entirety.*
- *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.*
- *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.*

Adjustments for Non-Recurring, Infrequent, or Unusual Items

- *Please remove disclosure of the adjusted gross profit and margin measures as they exclude normal, recurring cash operating expenses. Refer to Question 100.01 of the Non-GAAP Compliance and Disclosure Interpretations.*
- *We note your estimated financial results for the three months ended March 31, 2018 include the favorable impact of a $10.6 million after-tax gain, related to what appears to be a non-recurring legal settlement, and this gain is*

included in your non-GAAP financial measure, Adjusted EBITDA. We also note, in other periods, you exclude certain unfavorable non-recurring losses in the determination of your non-GAAP financial measure, such as the loss on extinguishment of debt during the fiscal year ended September 30, 2017. It is not clear to us why you did not exclude the non-recurring favorable impact of the legal settlement from your preliminary non-GAAP financial measure or how you determined the current presentation complies with our response to Question 100.03 of the SEC's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures. Please clarify or revise.

- *Please explain further why sales and marketing expense is excluded from your calculation of non-GAAP recurring profit margin as this expense, or at least a portion thereof, appears to be normal, recurring cash operating expenses necessary to operate your subscription business. Refer to Question 100.01 of the Compliance and Disclosure Interpretations regarding Non-GAAP Financial Measures. Also, clarify further for us what this measure represents and revise to further explain why management believes this is useful information to investors regarding your financial condition and results of operations. To the extent material, disclose the additional purposes, if any, for which management uses this measure. Refer to Item 10(e)(1)(i)(C) and (D) of Regulation S-K.*
- *We note in your Non-GAAP measure Adjusted EBITDA you include adjustments for non-recurring costs. Tell us how these items meet the definition of non-recurring, infrequent or unusual as set forth in Item 10(e)(1)(ii)(B) of Regulation S-K. If they do not comply with the Item, please do not refer to adjustments as being non-recurring. See also Question 102.03 of the Compliance and Disclosure Interpretations related to Non-GAAP Financial Measures.*
- *We note your non-GAAP measure, Adjusted EBITDA, excludes management fees and transaction Fees/IPO Readiness costs. Given the historical occurrence of these costs, please explain why you believe their removal reflects a more accurate depiction of your ongoing operations.*
- *We note your non-GAAP financial measures, Adjusted EBITDA, Adjusted Net Income, and Adjusted Diluted EPS, appear to only exclude charges. Please more fully explain to us how you believe your measures comply with Question 100.03 of the updated Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2016. We note your non-GAAP financial measures exclude a court mandated settlement and acquisition integration costs but do not exclude income related to a settlement, the reduction of an earn-out liability for an acquired business, and gains on sales of equipment.*

Individually Tailored Recognition and Measurement Methods

- *Please tell us how you considered if the consolidated allowance for impairment losses calculated under the underlying basis represents a non-GAAP financial measure and if this measure uses an individually tailored recognition and measurement method which could result in a misleading financial metric that violates Rule 100(b) of Regulation G. Refer to Question 100.04 and Section 104 of the Compliance and Disclosure Interpretations.*
- *We note your comparison of 2017 net revenues to "gross cash generated from customer contracting activities." This measure, along with your presentation of "net cash generated from customer contracting activities, appear to be calculated using individually tailored revenue recognition and measurement methods. Please tell us how you determined that these non-GAAP measures comply with Question 100.04 of the Non-GAAP Compliance and Disclosure Interpretations.*
- *In the Investor Relations section of your website, you have posted earnings slides, supplemental data, and shareholder update presentations that include a measure of non-GAAP gross profit, calculated as non-GAAP gross profit plus change in deferred revenues, less deferred domain expenses. We believe the presentation of a performance measure that substitutes individually tailored revenue recognition and measurement methods for those of GAAP violates Rule 100(b) of Regulation G. Refer to Question 100.04 of the Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016. Please remove these measures from future public presentations.*

- *We note your calculation of this measure includes development costs as incurred and excludes cost of sales - land under GAAP. Please explain how this does not represent a tailored accounting principle and how you considered Question 100.04 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.*
- *We note you add back contract amortization to arrive at Adjusted EBITDA. Please clarify for us why this adjustment was not initially reflected in amortization expense and therefore already captured within EBITDA. Further, please explain to us why you make this adjustment and how you considered the guidance in Question 100.04 of the Compliance and Disclosure Interpretation on non-GAAP measures issued May 17, 2016 that specifically states that non-GAAP measures that substitute individually tailored recognition and measurement methods for any financial statement line item for those of GAAP could violate Rule 100(b) of Regulation G.*

Funds From Operations

- *In arriving at Funds from operations, you start with Net income available to common stockholders. As a result, it appears Funds from operations is actually Funds from operations attributable to just common stockholders instead of all equity stockholders. In future periodic filings please re-title "Funds from operations" to the more appropriate "Funds from operations attributable to common stockholders".*
- *We note that your funds from operations ("FFO") reconciliation adjusts for amortization of in-place leases and other intangibles, which is inconsistent with the FFO measure as defined by NAREIT. In future filings, please revise to remove this adjustment and confirm that your FFO measure is as defined by NAREIT. Alternatively, please rename your non-GAAP measure (e.g., adjusted FFO attributable to common shares and Common Units), and reconcile net income (loss) to FFO as defined by NAREIT and FFO to your adjusted measure.*
- *In arriving at Funds from operations-NAREIT, you start with net income (loss) attributable to common stockholders and make an adjustment for noncontrolling interests. As a result, it appears Funds from operations-NAREIT and ultimately Normalized FFO, are attributable to common stockholders. Please clarify and/or revise the labeling of your non-GAAP financial measures in future earnings releases.*
- *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.*

Why is the use of a non-GAAP financial measure helpful to investors?

There was a considerable increase in Staff comments requesting an explanation as to why a registrant's management believed the use of non-GAAP measures were useful to investors in understanding the registrant's financial condition and results of operations. The Staff commented that boilerplate statements and generic disclosures that the financial measures are useful to analysts should be replaced with more substantive and concise discussion specific to the circumstances addressing how non-GAAP financial measures were useful to investors and any additional purposes for which management uses the non-GAAP financial measures.[21]

Below are some sample Staff comments addressing this topic.

- *Please include a specific statement disclosing the reasons why you believe that the presentation of your non-GAAP financial measure provides useful information to investors as well as the additional purposes, if any, for which you use the non-GAAP financial measure. Refer to Instruction 2 to Item 2.02 of the Form 8-K. It does not appear that these specific statements were provided.*
- *We note that your non-GAAP measure, Adjusted EBITDA, includes an adjustment that deducts cash payments made for rent on the capital lease of your new headquarters and operations facilities. Please explain to us management's*

[21] *Id.*

rationale for this adjustment. Tell us what the resulting non-GAAP measure is intended to convey to investors and how adjusting for these cash-rent payments meets that objective. Refer to Item 10(e)(1)(i)(C) of Regulation S-K.

- *Please tell us why you believe the presentation of cash flow before share repurchases and change in debt provides useful information to investors and how management uses this non-GAAP measure, if at all. In this regard, we note that your current disclosures are fairly generic and do not address this specific measure; nor do they explain the purpose of this measure in enough detail that a reader can understand why the change in cash flows related to debt excludes the payments of capital lease obligations or why the change in cash flows related to common stock excludes the net proceeds from the sale of common stock.*
- *You believe Adjusted EBITDA provides investors with important information in evaluating the Company under the agreements governing its indebtedness. Please disclose the material terms in which this measure is used in the indenture for the 9.125% senior notes. For the debt covenants referenced in your response related to other indebtedness, please disclose for each period presented the actual computations, along with other information relevant to understanding the Adjusted EBITDA amounts presented. Please also disclose the amounts or limits required for compliance with each covenant. Refer to Non-GAAP Financial Measures Compliance and Disclosure Interpretation, Question 102.09.*
- *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.*

Liquidity versus Performance Measures

Whether a non-GAAP measure is a performance versus a liquidity measure is an important distinction as a non-GAAP financial measure that is used as a liquidity measure cannot be presented on a per-share basis. In analyzing whether a financial measure is a performance measure or a liquidity measure, the C&DIs provide that the Staff would focus on the substance of the non-GAAP financial measure and not on management's characterization of the measure.[22] In the Staff's comments addressing this topic, the Staff observed that registrants' characterization of non-GAAP financial measures as performance measures were actually used by registrants as liquidity measures. In such a case, the registrant was prohibited from presenting such measure on a per-share basis and should have presented such measure as a liquidity measure. The Staff also has noted the inconsistencies in registrants' disclosures with respect to characterization of the use of the non-GAAP financial measure as a performance measure or a liquidity measure.

Below are some sample Staff comments addressing the mischaracterization of non-GAAP measures.

- *On page 1 of your earnings release, you define Free Cash Flow as Cash Flow from Operations less capital expenditures. This definition is commonly understood to represent a liquidity measure. As such, please revise your disclosures to identify free cash flow as a liquidity measure rather than an operating performance measure as indicated on page 7 of your earnings release. Also, please ensure that your reconciliation to Free Cash Flow is*

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[22] *See* C&DI Questions 102.05, 102.07, and 103.02.

reconciled solely to its nearest US GAAP number, which in this case is Operating Cash Flows. As such, please remove the information that reconciles Income (loss) from operations as your starting US GAAP measure to arrive at Cash Flow From Operations on page 13. Refer to Question 102.07 of the Compliance and Disclosure Interpretations guidance on Non-US GAAP measures issued on May 17, 2016.

- *We note your disclosure that the use of adjusted EBITDA to measure operating and financial performance was limited by your revenue recognition criteria prior to 2017 and that the measure did not adequately match corresponding cash flows resulting from customer contracting activities. Based on this disclosure along with the adjustments made to arrive at Adjusted EBITDA, it appears that you may consider it to be a liquidity measure. Please revise to provide a reconciliation from the most directly comparable GAAP measure, Cash Flows from Operating Activities. Please also refer to Item 10(e)(1)(ii)(A) of Regulation S-K, which prohibits the exclusion of charges or liabilities that required, or will require, cash settlement from non-GAAP liquidity measures.*
- *Your disclosures indicate that the non-GAAP measure Adjusted Free Cash Flow is a performance measure; however, the nature of the adjustments and the naming of the measure appear to represent a liquidity measure. Please explain to us in detail why you believe that Adjusted Free Cash Flow is useful as a performance measure and why the measure is titled Adjusted Free Cash Flow if it is not intended to be a liquidity measure.*
- *We note your disclosure that you consider EBITDA and Adjusted EBITDA to be indicators of your ability to generate cash to service debt, fund capital expenditures, and expand your business and you reconcile these measures to net income and cash provided by operating activities. We also note your disclosure that you do not consider these non-GAAP financial measures to be measures of your liquidity and they do not comply with the provisions of Item 10(e)(1)(ii)(A) of Regulation S-K. Please clarify or revise these inconsistencies.*
- *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.*

Income Tax Effects on Non-GAAP Adjustments

The Staff has commented on the prohibition of "net of tax" adjustments to arrive at a non-GAAP financial measure.[23] In such comments, registrants were required to revise their disclosures and tabular presentations to separately present the income tax impact of their non-GAAP adjustments.

Below are some sample Staff comments addressing this topic:

- *Your presentation of adjusted net income presents special items on an after-tax basis. Please revise future filings and earnings releases to present the income tax effects of your non-GAAP adjustments as a separate adjustment and clearly explain how it was calculated. Refer to Question 102.11 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.*
- *Please expand your disclosure here, and in earnings releases filed on Form 8-K, to more clearly explain how the tax effects of the non-GAAP adjustments are calculated. Refer to Question 102.11 of the updated Non-GAAP Financial Measures Compliance and Disclosure Interpretations issued on May 17, 2016.*
- *You state that the tax adjustment reflects the tax effect of the non-GAAP adjustments using the effective tax rate for the respective periods. Please explain to us in detail how you calculated the tax effects of your non-GAAP adjustments. Tell us what consideration you gave to disclosing how you computed the tax adjustments and how the tax rate applied to your non-GAAP adjustments relates to your GAAP effective tax rate. See Question 102.11 of the updated Non-GAAP Compliance and Disclosure Interpretations issued on May 17, 2016.*

[23] *See* C&DI Question 102.11.

Liability for Misuse of Non-GAAP Financial Measures and SEC Enforcement Actions

Neither the requirements of Regulation G nor a person's compliance or non-compliance with the requirements of Regulation G in itself affects any person's liability under Section 10(b) of the Exchange Act ("Section 10(b)") or SEC Rule 10b-5 under the Exchange Act ("Rule 10b-5").[24] However, the Staff noted in the SEC Releases that Regulation G disclosure that is materially deficient may, in addition to violating Regulation G, give rise to a violation of Section 10(b) or Rule 10b-5 anti-fraud provisions where the use of non-GAAP financial measures 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.[25] The Staff also references Section 3(b) of the Sarbanes-Oxley Act, which provides that a violation of the Sarbanes-Oxley Act or the SEC's rules thereunder shall be treated as a violation of the Exchange Act and any failure to comply with Regulation G will subject an issuer and/or the person acting on its behalf to SEC enforcement action alleging violations of Regulation G. Additionally, if the facts and circumstances warrant, the SEC could bring an action under both Regulation G and Rule 10b-5.[26]

Following the release of the updated C&DIs in May 2016, the SEC's Enforcement Division contacted a number of registrants regarding their historical non-GAAP financial disclosures requesting documents and other information to determine if they may have violated Regulation G or Item 10(e). In September 2016, the SEC charged the former chief financial officer and chief accounting officer of a publicly traded real estate investment trust and alleged violations of Section 10(b) and Rule 10b-5, among other causes of action, for including in the registrant's 10-Q and 8-K filings purposely inflated AFFO, a key non-GAAP financial measure used by analysts and investors to assess the registrant. The SEC alleged in its complaint that the officers employed an improper hybrid method of calculating AFFO and AFFO per share despite repeated concerns raised by their accounting staff about the impropriety of the calculation method. The U.S. Attorney's Office for the Southern District of New York brought a parallel criminal action against the officers. The chief accounting officer eventually pled guilty to securities fraud and related charges and a federal jury convicted the chief financial officer of one count of conspiracy to commit securities fraud and other offenses, one count of securities fraud, two counts of making false filings with the SEC, and two counts of submitting false certifications along with required filings with the SEC. The securities fraud, false filings charges, and false certification charges each carry a maximum prison term of 20 years and the charge of conspiracy carries a maximum prison term of five years. In January 2017, the SEC brought an enforcement action for failure to comply with Item 10(e) against a registrant that presented a metric called "organic revenue growth." The metric represented the company's growth in revenue excluding the reconciling effects of acquisitions and foreign exchange impacts. However, from the second quarter of 2012 to the 2013 year end, the registrant adjusted for a third reconciling item into its calculation of the metric, which resulted in higher "organic revenue growth" results and failed to disclose the change to investors. In addition, despite repeated promises to the Staff that it would do so, the registrant also failed to give the GAAP metrics equal or greater prominence to its non-GAAP financial measures (e.g., EBITDA, EBITDA margin, and free cash flow) in its earnings releases. The registrant was ordered and agreed to cease and desist from such practices and paid a civil monetary penalty.

As discussed above, on December 26, 2018, the SEC issued a cease and desist order and imposed a civil penalty on a company for including non-GAAP financial measures in two earnings releases without giving equal or greater prominence to the most directly comparable GAAP financial measures.

Addressing the Use of Non-GAAP Financial Measures

Senior members of the Staff have emphasized that registrants should consider and establish appropriate and effective disclosure controls and procedures relating to the use of non-GAAP financial measures. Given the SEC's focus on the use

[24] Regulation G, Rule 102.
[25] *Id.*
[26] *See* The SEC Releases, *supra* note 4.

of non-GAAP financial measures, companies should take certain measures to ensure compliance with Regulation G and Item 10(e). Below are some practical considerations.

Oversight by the Audit Committee

A company should have its audit committee carefully oversee and monitor the use of non-GAAP financial measures and disclosures. A company's audit committee should include as a regular topic for discussion with the auditors the company's use of non-GAAP financial measures and ask management to explain the utility of non-GAAP financial measures in the company's public disclosures. The audit committee's charter should also expressly reference such responsibilities. Senior members of the Staff have continued to emphasize the importance of proper disclosure controls and procedures, particularly with respect to increasing audit committee involvement and dialogue with stakeholders regarding the use of non-GAAP financial measures. In December 2016, Mr. Bricker, speaking at the American Institute of Certified Public Accountants ("AICPA") conference in Washington, D.C., highlighted that the audit committee members play an important "critical gatekeeper" role in ensuring credible, reliable financial reporting and that the oversight of management's activities is crucial for investor protection.[27] Mr. Bricker stated that audit committee members should seek to understand management's judgments in the design, preparation, and presentation of non-GAAP financial measures and how those measures might differ from other registrants in the same sector.

In December 2016, the Center for Audit Quality ("CAQ"), a non-profit public policy organization affiliated with the AICPA, issued discussion questions regarding the preparation and use of non-GAAP financial measures for key stakeholder groups such as management, investors, investment analysts, securities counselors, audit committee members, internal auditors, independent auditors, regulators, accounting standard setters and academics.[28] The sample discussion questions were aimed to promote the transparency, consistency, and comparability of non-GAAP financial measures and to assist audit committees in assessing whether management is complying with SEC rules and related interpretations with respect to non-GAAP financial measures.[29] The CAQ noted that the audit committee has a responsibility to investors with its oversight of financial reporting process and can act as a bridge between management and investors. The audit committee can assess management's basis for presenting non-GAAP financial measures, evaluate whether these measures present a fair and balanced view of the company, and assess how the non-GAAP financial measures are used by analysts and reported by the financial press to the broader public.[30]

Reporting and Disclosure Practices

Companies should revisit the applicable rules and C&DIs to assess their approach or views on the presentation and use of non-GAAP financial measures. Mr. Bricker noted that good reporting practices place a premium on audit committee members' understanding of the company's non-GAAP policies, procedures, and controls. As an added measure, a disclosure committee should also review the company's public filings for non-GAAP financial measures. Below are some important considerations for use or disclosure of non-GAAP financial measures:

- Non-GAAP financial measures should supplement not substitute for GAAP measures and given the recent December 2018 cease and desist order, registrants should take extra care in presenting GAAP financial measures with equal or more prominence than the non-GAAP financial measures. Companies should also consider the examples given in the C&DI Question 102.10 and take care to avoid the following:

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[27] *See* Wesley R. Bricker, Deputy Chief Accountant, Securities and Exchange Commission, *Working Together to Advance High Quality Information in the Capital Markets* (Dec. 5, 2016), *available at*: https://www.sec.gov/news/speech/keynote-address-2016-aicpa-conference-working-together.html.
[28] *See* Center for Audit Quality, *Non-GAAP Financial Measures: Continuing the Conversation* (Dec. 5, 2016), *available at:* http://thecaq.org/non-gaap-financial-measures-continuing-conversation (hereinafter, "CAQ December 2016 Paper"). *See also* Center for Audit Quality, *Non-GAAP Measures: A Tool for Audit Committees* (June 28, 2016), *available at*: http://www.thecaq.org/questions-non-gaap-measures-tool-audit-committees (hereinafter, "CAQ June 2016 Paper").
[29] *See* CAQ June 2016 Paper, *supra* note 28, at 1.
[30] *See* CAQ December 2016 Paper, *supra* note 28, at 1.

  - Omitting the comparable GAAP measures from or presenting a non-GAAP measure that precedes the most directly comparable GAAP measure such as in an earnings release headline or caption that includes non-GAAP measures;
  - Presenting a non-GAAP measure in a format such as bold or larger font size to highlight the non-GAAP measure over the comparable GAAP measure; or
  - Using prominent descriptive characterization for non-GAAP measure such as "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable GAAP measure.
- Businesses operate in uncertain environments. If non-GAAP adjustments replace a business reality with smooth earnings over time, accelerate unearned revenues, or defer incurred expenses, those adjustments and disclosures should be evaluated closely under the C&DIs.
- Management should monitor the use of non-GAAP financial measures by comparable companies.
- Members of the law department, accounting, investor relations and public relations teams should be familiar with the applicable requirements relating to non-GAAP financial measures.
- Ensure that the use of non-GAAP financial measures is neither misleading nor otherwise prohibited by the rules.
- Understand and articulate the reasons for the use of non-GAAP financial measures and how such measures help investors better understand the company.
- Accurately define, describe, and label each non-GAAP financial measure and reconcile each non-GAAP financial measure to the directly comparable GAAP measure.
- Ensure that there is a reasonable basis for any adjustment being made to arrive at a non-GAAP financial measure and consider whether, although not necessarily dispositive, such adjustment is customary among peer companies to avoid the appearance of misleading presentation such as apparent cherry picking adjustments within a non-GAAP measure, adjustments to remove normal, cash operating expenses, and use of individually tailored accounting principles to calculate non-GAAP earnings. In addition, the presentation of non-GAAP financial measures are balanced and that there are adjustments for both non-recurring expenses and non-recurring gains. Companies should remember that presentation of the non-GAAP financial measure that can be misleading may violate Rule 100(b) of Regulation G even if such adjustments are not explicitly prohibited.
- Regulation G applies to all public disclosures, whether made orally or in writing. If a non-GAAP financial measure is made public orally, telephonically, by webcast or broadcast, Regulation G requires registrants to post the required non-GAAP presentation and reconciliation on their website at the time the non-GAAP financial measure is made public and announce the location of their website in the same presentation in which the non-GAAP financial measure is made public. Companies must pay close attention to presentation of non-GAAP financial measures in all public disclosures, including press releases, webcasts, investor presentations, earnings releases, conference calls, and other disclosures and should pay particular attention to earnings calls and scripts.
- Consider whether a non-GAAP financial measure is a performance measure or a liquidity measure. The Staff has said that it will focus on the substance of the non-GAAP measure and not management's characterization when reviewing non-GAAP financial measures as a performance versus liquidity measure.

Conclusion

The effective functioning of the capital markets requires consistent, transparent, and credible disclosures by registrants. Registrants can use non-GAAP financial measures to properly convey information to investors that they believe are relevant, meaningful, and useful in understanding their financial performance, financial position, or liquidity. The broad acceptance of non-GAAP financial measures and the use and attention accorded to such measures by the financial and business community, including analysts, rating agencies and financial professionals, demonstrate that non-GAAP measures have a legitimate, meaningful, and relevant purpose. However, the SEC has repeatedly noted that the use of non-GAAP financial measures is prone to misuse and abuse and can become tools to distort the truth of a company's actual performance and financial condition, confuse investors and be a means of outright fraud. The Staff has provided guidance on the proper use of non-GAAP financial measures through the C&DIs and other updated guidance. The important concept that the Staff has reminded registrants of is that non-GAAP financial measures should only supplement, and not substitute for, GAAP financial measures. Registrants should implement internal controls and measures to avoid use of misleading or prohibited non-GAAP financial measures in their disclosures and have their audit committees play a strong role in such internal controls. In addition, a company's management should have a reasonable basis for the use of such measures in the company's disclosures and disclose such basis in a specific and concise manner avoiding boilerplate or generic descriptions. Given the SEC's and SEC Staff's focus, companies also should consider the use of key performance indicators, the calculation of such key performance indicators, the usefulness to investors of such information, and the internal process undertaken in connection with verifying such amounts.

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