



## **New SEC Staff CDIs Attempt To Reign in Problematic Non-GAAP Disclosure Practices**

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On May 17, 2016, the SEC Staff updated its non-GAAP Compliance and Disclosure Interpretations, as foreshadowed by recent statements by SEC Chair Mary Jo White and chief accountant James Schnurr, among others. Four new CDIs have been issued and eight others have been revised. Unlike in 2010, when the Staff loosened its non-GAAP interpretations, these changes are clearly designed to reign in disclosure practices in this area.

An attachment to this bulletin reprints in full the new CDIs and provides a redline of the revised interpretations. Many of the revisions merely codify positions we have seen in Staff comment letters for some time now and which are discussed in our Non-GAAP Financial Measures handbook published by The Corporate Counsel, for those of you who subscribe to their services. However, the following changes are noteworthy:

- **Earnings Release Disclosure is a Primary Staff Focus, and the Staff Has Clarified Its Position That Item 10's Equal Prominence Rule Applies Directly to the Earnings Release Furnished on Form 8-K.** There has always been some uncertainty regarding how to apply the "equal or greater" prominence requirement to earnings releases furnished with a Form 8-K. Because this requirement is not part of Regulation G, it is clear that it does not apply to earnings releases themselves prior to their being furnished with an 8-K. However, because the 8-K itself incorporates this requirement by reference to Item 10, the requirement becomes applicable when the 8-K is filed with the earnings release attached. Although Staff comments have frequently suggested that the Staff viewed the requirement as applying to the press release, as a technical matter it has been unclear whether additional disclosure set forth in the Form 8-K itself could satisfy the equal or greater prominence requirement when the press release does not meet that requirement when viewed alone. Although the new CDIs don't actually resolve this conflict, the Staff seems to have drawn a line in the sand in revised CDI 102.10, specifically stating that the equal or greater prominence requirement applies to earnings releases furnished pursuant to Item 2.02 of Form 8-K. As a result, it now appears less likely that the Staff would accept additional disclosure in the body of the Form 8-K in order to bring the entire filing into compliance with the equal or greater prominence requirement, although it remains an open question as to how they might react to revisions in the press release itself, which would be clearly marked as having been added for purposes of compliance with Item 10(e).

The Staff has codified some pre-existing positions about specific kinds of disclosures that will, in their opinion, per se cause a non-GAAP measure to be more prominent than its non-GAAP counterpart. These examples apply to earnings releases as furnished on Form 8-K as well as other SEC filings:

- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;

- A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);
- Describing a non-GAAP measure as, for example, “record performance” or “exceptional” without at least an equally prominent descriptive characterization of the comparable GAAP measure;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the “unreasonable efforts” exception in Item 10(e)(1)(i)(B) 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.

The list above contains a number of practices that some issuers have gotten comfortable with over the years, despite Staff comments, but the Staff has now signaled its formal disapproval. We expect issuers to review their practices in light of these clarified Staff positions and to potentially revise them accordingly. Those that continue with these practices can likely expect Staff comments and resistance to their continuation.

- **An Issuer’s Ability to Present Non-GAAP Financial Measures on a Per Share Basis Has Been Further Limited.** In revised CDI 102.05, the Staff upgrades its ban on per share liquidity measures in SEC filings and furnished documents from a “should not” to a “must not.” More importantly, though, the Staff states that whether or not the per share non-GAAP financial measure is prohibited will turn upon not the issuer’s characterization of it, but rather on whether or not the measure “can be used” as a liquidity measure, with the Staff focusing on the substance of the non-GAAP measure and not management’s characterization of it. As result, in CDI 102.07 and 103.02, respectively, the Staff clarifies that free cash flow, and EBIT and EBITDA, may not be presented on a per share basis. What remains to be seen, however, is the extent to which this second-guessing about what constitutes a performance vs. a liquidity measure for per share presentation purposes will spill over to the other Item 10 prohibitions that apply only to liquidity measures.
- **Non-GAAP Measures that Accelerate Revenue (as Though the Issuer Earned the Revenue When Customers Are Billed) is Prohibited in All Circumstances.** New CDI 100.04 clearly states the Staff position that such non-GAAP revenue measures are misleading under Rule 100(b) of Regulation G, which means that they are prohibited not only in documents filed with or furnished to the SEC, but also may not be made elsewhere, including on company websites. Although issues involving revenue recognition principles are what led to this CDI, the CDI does go on to state that other non-GAAP measures that use individually tailored recognition and measurement methods for financial statement line items other than revenue may also violate Rule 100(b) of Regulation G.
- **Adjustments to Arrive at a Non-GAAP Financial Measure May No Longer Be Presented Net of Tax.** In revised CDI 102.11, the Staff reversed its prior position that adjustments used to arrive at non-GAAP financial measures could be presented net of tax as long as certain alternative disclosures were made. Income taxes should now be shown as a separate adjustment and should be clearly explained.

## Conclusion

As noted above, the Commission and the Staff have recently signaled their concerns with current practices regarding the disclosure of non-GAAP financial measures. We believe these recent modifications of the Staff CDIs in this area are likely to serve as a precursor to increased Staff comments and potentially enforcement activity in this area. We urge all issuers to closely examine their disclosure practices in light of these recent interpretations and to consider modifications where appropriate.

Please click [here](#)<sup>1</sup> to view the new CDIs, which provides a redline of revised interpretations.

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<sup>1</sup> <http://www.agg.com:80/files/uploads/Summary of Non-GAAP CDI Revisions.pdf>.

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