Concurrent Session: SEC Financial Standards

Friday, March 24th
9:30am – 10:45am
La Quinta Resort & Club, La Quinta, California

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July 20, 2016

Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. S7-06-16
Business and Financial Disclosure Required by Regulation S-K

Dear Office of the Secretary:

This letter is the response of BDO USA, LLP to the Concept Release referred to above.

We support the Commission's efforts to analyze the disclosure regime of Regulation S-K and consider ways to improve the requirements for the benefit of investors. We provide our comments based on our experience working with registrants on their filings and from our perspective as auditors. However, we believe that companies and investors are best positioned to provide feedback on the issues raised in the Release, and we urge the Commission to place the most weight on the feedback they provide.[1]

From a broad perspective, we support a principles-based approach to disclosure outside the financial statements. We believe that using a principles-based approach would promote disclosure of information that is most meaningful and relevant. To implement this approach, we believe Regulation S-K should (a) clearly articulate disclosure objectives, (b) provide a list of related topics a registrant should consider discussing and (c) make it clear that the disclosure is only required to the extent necessary to achieve the disclosure objectives. We believe this approach would help preparers assess whether their disclosures are necessary and adequate. For example, a revised disclosure requirement related to a registrant's description of its business could lay out the overall objective of the business section and provide examples of topics to be addressed when relevant and material to the issuer's business (e.g., people, facilities, contracts, regulatory, etc.). We believe this objectives-based approach is likely to result in more useful disclosure than the line item or "check the box" type approach we observe many registrants taking in response to the current S-K disclosure regime. In the same vein, we support the Commission's outreach related to the level of investor sophistication that should be assumed for purposes of disclosure. We believe that clarifying the investor (whether sophisticated or novice) will also help registrants better assess and guide their disclosures.

[1] We also urge the Commission to weigh the comments of investors who own securities more heavily than those of other users, since those investors ultimately pay the cost of providing the information they say they want.

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Our comments and recommendations related to specific S-K disclosure items are discussed below.

Item 101 Description of Business

As noted above, we believe the most useful approach to Item 101 would be to identify the overall objective of the disclosure and to provide examples of items that should be discussed to the extent they are relevant to the registrant, such as employment practices, properties, and service contracts that are material to operations, regulatory environment, competitive environment, etc.

In addition, Item 101(c)(viii) requires disclosure of the dollar amount of backlog orders as of a recent date and as of a comparable date in the preceding fiscal year. In many cases, registrants comply with this requirement with one line item in the business section stating such amounts. Given what we perceive is the intent of the requirement, i.e., to provide information about the prospects for the future (not just the size of the backlog, which an investor might use to make assumptions about how it affects the way the business is run), it appears more logical that backlog disclosure and corresponding discussion of its impact on the expected results of the company would appear in management's discussion and analysis when it's relevant and material. We also believe the discussion should be provided for items that are conceptually similar to backlog but described using different terminology.

Item 301 Selected Financial Data

The SEC staff generally expects that all periods presented in selected financial data will be presented on a basis consistent with the annual financial statements, including information for the fourth and fifth back years.[2] We have observed that retrospective application of new accounting standards is required, or at least permitted, in a growing number of circumstances. Depending on the accounting standard, it can be very difficult for registrants to revise amounts for the fourth and fifth back years. Given the difficulties and lower perceived importance of those back years, we recommend providing relief when appropriate. We would support an approach that generally requires recasting unless doing so would require significant effort or expense. If the fourth and fifth back years are not recast, a registrant should ensure there is clear and appropriate disclosure about the difference in presentation (via footnote to the table or otherwise).

Additionally, the Release questions whether auditor involvement should be required for the disclosures contained in selected financial data. We note that the auditing standards (AS 2710[3]) require the auditor to read the information contained in the table and consider whether it, or its manner of presentation, is materially inconsistent with the information contained in the audited financial statements. We also note that an auditor may report on selected financial data in accordance with AS 3315.[4] Accordingly, the current standards already provide an avenue for auditor reporting on selected

[2] Division of Corporation Finance *Financial Reporting Manual* paragraph 1610.1.
[3] PCAOB AS 2710, Other Information in Documents Containing Audited Financial Statements
[4] PCAOB AS 3315, Reporting on Condensed Financial Statements and Selected Financial Data

financial data. However, in our experience, engagements of this nature are very rare and we perceive little to no demand for this level of auditor involvement.

Item 302(a) Selected Quarterly Financial Data

The Release questions whether the Commission should retain the requirement to disclose selected quarterly financial data (SQFD) and, if so, whether it should modify the requirements. Our sense is that investors find the SQFD useful. We sense that investors find it useful to see fourth quarter results presented discretely, rather than having to infer them based on the annual results and the interim results through the third quarter. When the data is changed from that previously reported, presenting the revised data in the annual report enables investors to understand the effects of the changes sooner than if the changed data was not required to be communicated until it is presented for comparative purposes in subsequent quarterly reports. Even when the data is not changed, our sense is that investors find it useful to see the quarterly results presented sequentially. A sequential presentation is not required in quarterly reports, which report only current quarter and year-to-date results. In that regard, we note that since management's discussion and analysis in quarterly reports only discusses the operating results reflected in the financial statements, there is no specific requirement to discuss results for the current quarter as compared to the preceding quarter. We wonder whether this results in unanswered questions for investors, particularly when the sequential data is presented in the annual report, and suggest that the Commission consider whether some sort of discussion of quarterly results as compared to the preceding quarter, especially when there are material variations, should be required.

The Release also questions whether auditor involvement should be required for the disclosures contained in SQFD. For periods other than the fourth quarter, we note that SQFD is derived from financial information contained in Form 10-Q, the rules of which require auditor involvement via an AS 4105[5] review of the interim period financial statements. In addition, the auditing standards require an auditor to perform a review of the fourth quarter financial information even though it does not appear in a Form 10-Q. Since we perceive that there is a high level of interest in registrants' quarterly results, we believe this level of auditor involvement in such information is warranted.

Item 303 Management's Discussion and Analysis and Item 503(c) Risk Factors

Consolidation of MD&A Guidance

As highlighted in the Release, there are various sources of Commission and staff guidance on MD&A disclosure. Considering the volume of guidance and that MD&A is generally considered one of, if not the most, important disclosures in a periodic report or registration statement, we recommend consolidating the guidance appearing in the Commission releases, sections of the Financial Reporting Manual, and Compliance and Disclosure Interpretations into a single source. We believe that doing so may better facilitate compliance with the guidance and result in improved MD&A disclosure.

[5] PCAOB AS 4105, Reviews of Interim Financial Information

Executive-Level Overview

The Release questions whether the Commission should require an executive-level overview in MD&A. We believe that the need for an overview should be left to the discretion of registrants. If an overview is required, we expect that it will often add little to the filing but redundancy, which would be an undesirable outcome.

Risks and Uncertainties

Item 503(c) requires disclosure of factors that make an *offering* risky, while Item 303(a) requires disclosure of known trends and uncertainties that are reasonably likely to affect the registrant's liquidity, capital resources or results of operations in a material way. Consequently, elements of a registrant's risk-related disclosure are often required to be addressed in both Item 503 risk factor disclosure and Item 303 MD&A disclosure. In our experience, while risk factor disclosures are fairly comprehensive, registrants sometimes struggle with disclosing known trends and uncertainties in MD&A, especially when the disclosures are redundant with risk factor disclosures. We encourage the Commission to consider ways to possibly reduce the redundancy caused by the overlapping objectives of risk factor and MD&A disclosures.

Item 503(c) requires disclosure of factors that make an *offering* risky, e.g., a lack of an operating history or profitable operations. We suggest that much of what is typically disclosed in response to this requirement is already obvious and does not provide investors with meaningful insight to use in making an investment decision. We suggest that risk factor disclosure that is most useful is the disclosure that focuses on *business* risks and encourage the Commission to rewrite the instruction to elicit disclosure of *business* risks.

We also suggest that simply communicating a risk does not tell an investor all that he or she would like to know. After reading about a risk, an investor's next questions are likely to be, "What is the company doing to mitigate the risk," and "How successful does the company expect to be?" We understand the concerns about competitive harm to which the Commission refers in the Release and believe the Commission should respect those concerns if it decides to change the disclosure requirements related to risk mitigation strategies. However, we believe the benefits of discussing risk mitigation strategies outweigh concerns that such discussion could dilute investors' perception of the magnitude of the risk.

We also note that the disclosure in MD&A of a known trend or uncertainty is based on assessment of whether it is "reasonably likely to occur," a threshold that we believe is not interpreted uniformly by preparers. Preparers sometimes interpret "reasonably likely to occur" to mean "more likely than not," which we understand is not the intended threshold for disclosure. We suggest that it would be helpful to clarify the definition of "reasonably likely to occur" to elicit appropriate and more consistent disclosure across registrants.

Liquidity and Capital Resources

Some preparers interpret the term "capital resources" differently or find the disclosure requirement, as written in S-K 303(a)(2), to be confusing. Some preparers interpret the words to require disclosure of the registrant's sources of capital, while others interpret them to require disclosure of the sources of capital assets used in the registrant's business. We suggest the Commission revise the instruction to more clearly communicate what is required.

We have observed that some registrants focus only on short-term liquidity needs (i.e., funding sources for the next fiscal year) in their liquidity disclosures. We sense that this is due, at least in part, because registrants aren't clear on what is supposed to be said about meeting long-term liquidity needs, particularly in cases where they face significant short-term liquidity challenges and addressing longer term liquidity issues is a far lower priority. While the need to discuss liquidity on a long-term basis is mentioned in the instructions to Item 303, we suggest that the Commission rewrite the instruction to more clearly communicate this objective and provide examples of how to address the objective. We also suggest that the Commission revise the instructions to Item 303 to call for the short-term liquidity discussion to focus on the period covered in ASU 2014-15[6] for which GAAP requires a similar evaluation, i.e., the period that ends one year after the date the financial statements are issued. As discussed below, we also suggest that moving the table of contractual obligations into the discussion of liquidity would help to improve disclosures about long-term liquidity.

The Release questions whether the S-K requirements elicit adequate disclosure of short-term borrowings. In our experience, registrants appropriately assess and discuss short-term liquidity in their filings so we do not believe that additional short-term borrowing disclosure requirements are necessary. We note that the Commission proposed, but did not adopt, short-term borrowings disclosure rules in 2010. Our impression is that the lack of disclosures called for by that proposal has not created a deficiency in registrants' discussion of liquidity.

Auditor Involvement

The Release questions whether auditor involvement in MD&A should be required. We note that the auditing standards (AS 2710) require the auditor to read the information contained in MD&A and consider whether it, or its manner of presentation, is materially inconsistent with the information contained in the audited financial statements. We also note that an auditor may examine or review MD&A in accordance with AT 701.[7] Such engagements are very rare and we do not get the impression there is a demand for this level of auditor involvement in MD&A.

Contractual Obligations

We recommend that the Commission consider moving the table of contractual obligations into the discussion of liquidity. As we believe the table is intended to be an

[6] ASU 2014-15, Presentation of Financial Statements – Going Concern

[7] PCAOB AT 701, Management's Discussion and Analysis

element of a registrant's discussion of its liquidity, integrating the disclosure requirement within liquidity may facilitate enhanced discussion of liquidity, particularly longer-term liquidity needs as discussed above.

We also recommend that the Commission revise the rule requiring purchase obligations to be disclosed in the table. There are obligations for which there is more than one reasonable way to present them in the table. Our sense is that generally practice has evolved to the point where as long as the approach used provides investors with the information they need, the use of alternative approaches does not harm investors or create practice problems. We believe, however, that improvements should be made in the way purchase obligations are presented. Some companies include some, but not all, of the obligations that have already been incurred and are reflected as liabilities on the balance sheet. Most include only obligations that are not yet reflected as liabilities. We recommend revising the definition to make it clear that purchase obligations include only obligations for executory contracts. Further, we question the usefulness of presenting purchase obligations related to essentially non-discretionary operating expenses. We suggest that it may be more meaningful to define purchase obligations as amounts to be paid under executory contracts for purchases of assets.

Critical Accounting Estimates

In our experience, many registrants struggle with disclosures related to critical accounting estimates. We suspect that this may be because they struggle to envision what should be disclosed or try to cover too many estimates, rather than just the most material ones. We suggest that disclosure might improve if the requirement was stated within Item 303 and, as discussed above, the instruction clearly communicated the objective of the disclosure and provided examples of how to address the objective.

Materiality Judgments

We do not believe a registrant should be required to disclose materiality judgments that form the basis for disclosure. Materiality is different for all registrants and may vary from period to period. Similarly, we do not believe a registrant should be required to disclose its assessment immaterial errors that were not recorded. Such a disclosure would be contrary to the overall notion that registrants should address matters which are material to their business and would likely provide useless information.

Item 305 Quantitative and Qualitative Disclosures about Market Risk

In our view, the disclosure requirements within Item 305 are lengthy and overly complex for non-financial services registrants. Many registrants find the requirements to be confusing and our impression is that the related disclosures are not as relevant for non-financial services registrants. We believe the Commission should consider restricting these requirements to financial services registrants. Consistent with our view expressed above, the Commission should also consider taking a principles-based approach to disclosures of market risk for all other registrants, including incorporating that discussion into MD&A.

Exhibits

Duplicative and Outdated Disclosures

Certain exhibits call for disclosures that duplicate disclosures required by GAAP (e.g., the computation of earnings per share required by Item 601(b)(11)) or disclosures that we perceive to be outdated (e.g., the ratio of earnings to fixed charges required by Item 503(d) and the related exhibit required by Item 601(b)(12)).We agree with the approach the Commission is taking in the rule amendments it proposed in Release 33-10110, *Disclosure Update and Simplification*.

Preferability letters –

When the Commission amended Form 10-Q in 1975 to require an accountant's letter stating whether a change in accounting principle is, in the accountant's judgment, preferable, an auditor's review of a registrant's interim period financial statements included in Form 10-Q was not required. Accordingly, the requirement to file a preferability letter in a Form 10-Q caused registrants to involve their independent auditors when making voluntary changes in accounting principles during interim periods. However, in 2000, the Commission adopted rules requiring independent auditor review of quarterly financial statements. Hence, auditors now evaluate the preferability of changes in accounting principles when they perform these reviews. Moreover, as referenced in the Concept Release, there are now more prescriptive accounting and auditing standards such as ASC 250[8] and AS 2820.[9]

In light of these developments and improvements in the consideration and reporting of voluntary changes in accounting principles, the objective of the preferability letter is met by the requirements of GAAP and PCAOB reporting standards. When registrants change an accounting principle, they are already required to establish preferability and auditors are required to assess the change as part of their interim reviews and audits of the financial statements. Accordingly, we believe preferability letters are no longer needed.

Scaled Disclosures and Filer Categories

Over the years (as highlighted in the Release), the Commission has developed a disclosure system which provides for reduced disclosure requirements and different periodic reporting timetables for certain smaller registrants. We believe the proliferation of filer categories (e.g., smaller reporting company, non-accelerated filer, emerging growth company, etc.) has complicated the compliance process. Moreover, the transition rules related to a registrant's change in filing status are not consistent and appear more complex than necessary. For example, a company exiting non-accelerated filer status must do so at the time it files its next annual report. A company exiting smaller reporting company status is not required to comply with the larger reporting company disclosure requirements until the first quarter after the end of the fiscal year in which its status changed. Thus a calendar year-end smaller reporting company whose

[8] ASC 250, Accounting Changes and Error Corrections

[9] PCAOB AS 2820, Evaluating Consistency of Financial Statements

public float exceeded $75 million on June 30, 20X1 would be permitted to file its 20X1 annual report in accordance with the smaller reporting company scaled disclosure requirements but must file it within 75 days of December 31, 20X1 (i.e., the Form 10-K due date for accelerated filers). Further, the tests to determine whether a company is an accelerated filer are not made until year-end. Therefore, a company whose public float was less than $50 million as of the end of its second fiscal quarter cannot exit accelerated filer status until it files its next annual report. In contrast, a company entering smaller reporting company status may do so immediately. Thus a calendar year-end company whose public float dropped below $50 million on June 30, 20X1 would be permitted to file its June 30 and September 30, 20X1 Forms 10-Q in accordance with the smaller reporting company disclosure requirements but must file them within 40 days of quarter-end (i.e., the Form 10-Q due date for accelerated filers). We recommend harmonizing the requirements where possible, particularly at the dates when the requirements of a new filing status take effect.

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We appreciate this opportunity to express our views to the Commission. We would be pleased to answer any questions the Commission or its staff might have about our comments. Please contact Jeff Lenz, National Director – SEC Practice, at (312) 616-3944 or via email at jlenz@bdo.com, or Chris Smith, Accounting and Audit Professional Practice Leader, at (310) 557-8549 or via email at chsmith@bdo.com.

Very truly yours,

BDO USA, LLP

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THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: SEC

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SEC YEAR IN REVIEW

SIGNIFICANT 2016 DEVELOPMENTS

Much like last year, in 2016 the SEC's agenda related to financial reporting focused on Congressionally-mandated rulemaking (e.g., rulemaking required by the Dodd-Frank Act of 2010 and the Fixing America's Surface Transportation Act of 2015) and activities related to its Disclosure Effectiveness Initiative, a broad-based review of the SEC's disclosure rules designed to improve the disclosure regime for both companies and investors. The Commission completed all rulemaking required by the FAST Act in 2016, which included rules that permit emerging growth companies to omit certain historical periods from initial registration statements, allow smaller reporting companies to forward incorporate information by reference into Form S-1, and explicitly permit registrants to include a summary page in Form 10-K. In June, the Commission completed a final rule requiring resource extraction issuers to disclose payments made to the U.S. and foreign governments. Other than a proposal to amend the definition of a smaller reporting company, the majority of the other rulemaking and Commission activities related to the Disclosure Effectiveness Initiative. In addition to rule proposals which would eliminate outdated and redundant disclosure requirements, modernize mining company disclosures and require the use of hyperlinks in exhibits, the Commission issued a Concept Release on Regulation S-K and a Request for Comment on management, certain security holders and corporate governance disclosures. Furthermore, while not directly related to the Disclosure Effectiveness Initiative, the Commission issued a report to Congress in November which was required by

the FAST Act on how to modernize and simplify Regulation S-K.[1] The report includes recommendations that focus on both narrow procedural matters and more general matters, such as changing management's discussion and analysis to elicit a discussion that focuses more on trends and less on line-by-line comparisons.

There were several notable changes in key staff positions in 2016. Following a serious injury in 2016, the SEC's Chief Accountant, James Schnurr, announced his intent to retire from the agency in November. Wes Bricker, a Deputy Chief Accountant in the Office of the Chief Accountant (OCA) since 2015 and Interim Chief Accountant since July 2016, was appointed Chief Accountant in November. Also in November, Marc Panucci replaced Brian Croteau as the Deputy Chief Accountant in OCA who will lead the activities of the office's professional practice group. In December, the Director of Enforcement, Andrew Ceresney, and the Director of the Division of Corporation Finance, Keith Higgins, also announced their plans to depart the agency. Their announcements followed Chair White's similar announcement in November that she plans to leave the Commission at the end of the Obama administration in January after nearly four years of service. As 2016 came to a close, President-elect Trump has yet to nominate her replacement or other individuals to fill the two empty Commission seats, which were open for all of 2016. The two people President Obama nominated to fill the Commission seats in 2015 (Lisa Fairfax and Hester Peirce) were never confirmed by the Senate. As changes in the SEC Chair position, Commission seats, and key staff members typically accompany a change in Presidents, the turnover is not surprising. Moreover, these changes may also result in a change of the PCAOB Chair, as the term of the current Chair, James Doty, expired in October 2015. Chair White has expressed her belief that the appointment or reappointment of the PCAOB Chair should be left to a full Commission. This Commission will also need to appoint a replacement for Jay Hanson, who resigned from the PCAOB in December.

With respect to the focus areas of the Commission and staff in 2016, the use of non-GAAP financial measures has certainly been at the top of the list. In late 2015, Chair White and the Commission staff began highlighting non-GAAP measures as an area of focus given the extensive use of such measures and the overarching concern that these measures have served to supplant, not supplement, U.S. GAAP. Due to these concerns, the staff issued new non-GAAP Compliance and Disclosure Interpretations (C&DIs) in May and encouraged companies to "self-correct" their reporting of such information. The C&DIs address measures and adjustments which may be considered misleading, as well as examples of what it means to give "undue prominence" to non-GAAP measures.

The staff's other major focus area has been the implementation of and reporting issues associated with the new revenue accounting standard and other pending standards on leases, classification and measurement of financial instruments, and credit losses. In addition to the concern that many companies are not as far along as they should be in their implementation efforts (particularly as it relates to the new revenue standard), the staff is concerned that the disclosures related to the expected effects of adopting these significant new pending accounting standards have been inadequate. In light of these concerns, the staff made an announcement at the September meeting of the Emerging Issues Task Force (EITF) about its expectation for additional qualitative disclosures in registrants' upcoming 10-K filings. The staff also updated the Financial Reporting Manual (FRM) to answer various SEC-reporting questions that arise from the adoption of these new standards.

Both non-GAAP measures and implementing new accounting standards were key themes of the AICPA Conference on SEC and PCAOB Developments (the Conference) held in December. The other key theme of the Conference was the importance of effective internal control over financial reporting, as ICFR is such a critical element of financial reporting (especially in light of the significant changes in internal controls that may be required in order to implement the major new accounting standards). The staff continued to stress the importance of maintaining an open dialogue about these key focus areas among management, the auditor, and the audit committee.

The staff also issued guidance throughout the year to assist registrants and others with interpreting and complying with the SEC's rules and regulations. The staff also updated its C&DIs and the FRM for reporting matters unrelated to non-GAAP measures and new accounting standards.

Much of the Commission's rulemaking activity over the past few years has focused on adopting rules mandated by Congress. With the change in the administration and Congress, there may be mandates to revise or eliminate some of these rules. At the Conference in December, Keith Higgins suggested that proposals included in the Financial CHOICE Act[2] may be a good starting point when speculating about future SEC rulemaking. The Financial CHOICE Act calls for a repeal of certain Dodd-Frank-related disclosure rules (including those related to conflict minerals, resource extraction, mine safety, and pay ratios, among others), a narrowing of company personnel subject to the compensation clawback rules, and an expansion in the exemptions from audits of internal control over financial reporting. With Chair White's pending departure in January and two other open Commission seats, it is difficult to predict what activities will shape the Commission's agenda. We expect the staff to continue its scrutiny of non-GAAP measures and implementation and disclosure issues related to the significant new accounting standards and to continue to work on the Disclosure Effectiveness Initiative. How quickly the staff's work on the Disclosure Effectiveness Initiative will progress remains to be seen.

1 The report is available **here**.

2 The Financial CHOICE Act has been passed by the House Financial Services Committee. The Executive Summary of the Act is available **here**, while the text of the Act can be found **here**.

This publication summarizes 2016 Commission rulemaking and activities, staff activities and guidance, and other practice issues covered at the Conference that affect financial reporting.[3] We discuss rulemaking, other activities and staff guidance first, followed by practice issues. While not the focus of this newsletter, we also discuss the relevant PCAOB 2016 standard-setting, related activities and common inspection findings.

SEC RULEMAKING

THE DODD-FRANK ACT

Disclosure of Payments by Resource Extraction Issuers (Release No. 34-78167)

In June, the SEC adopted amendments to Exchange Act Rule 13q-1 and Form SD. The rule and form require resource extraction issuers to disclose information about certain payments made to United States and foreign governments for the commercial development of oil, natural gas, and minerals. The requirements were originally adopted in 2012 pursuant to the Dodd-Frank Act but were vacated after they were challenged in a federal court. In response, the SEC rewrote the requirements. The SEC's press release announcing this rulemaking can be accessed **here**, and the final rule can be accessed **here**. The rule applies to "resource extraction issuers," defined as domestic and foreign issuers that are engaged in the commercial development of oil, natural gas, or minerals and required to file an annual report under the Exchange Act. The activities that constitute "commercial development of oil, natural gas, or minerals" include exploration, extraction, processing, export, or the acquisition of a license for any such activity.

Issuers are required to disclose on Form SD any payment (or series of related payments) to the U.S. government or foreign governments, including majority-owned entities of a foreign government, that is not de minimis (which the rule defines as equaling or exceeding $100,000 during a fiscal year) and has been made to further the commercial development of oil, natural gas, or minerals. The disclosures must be reported on a cash basis, do not need to be audited[4] and are not subject to officer certifications. Issuers must comply with the final rule for fiscal years ending on or after September 30, 2018. The disclosures will be filed annually in an XBRL-formatted exhibit to Form SD. The report will be due 150 days after the end of an issuer's fiscal year. Alternatively, issuers may use a report prepared for foreign regulatory purposes if the SEC deems the requirements of the foreign regime to be substantially similar to the Commission's requirements. An issuer may generally follow the due dates of the alternative regime.

The final rule is substantially consistent with the rule the SEC proposed in December 2015.[5] The most significant changes reflected in the final rule are:

- The final rule provides a transition period for reporting payments by recently acquired entities that were not previously subject to reporting and a one year delay in reporting payments related to exploratory activities.
- In a separate **order**, the Commission recognized two EU Directives, Canada's Extractive Sector Transparency Measures Act (ESTMA) and the U.S. Extractive Industries Transparency Initiative (USEITI), in their current forms as substantially similar disclosure regimes.
- Community and social responsibility payments required by law or contract were added to the comprehensive list of payments covered by the disclosure requirements.

THE FAST ACT

(Release Nos. 33-10003 and 34-77969)

In January, the SEC issued interim final rules to implement certain securities law amendments which were part of the Fixing America's Surface Transportation (FAST) Act.[6] The adopting release is available **here** on the SEC's website.

These rules:

- Revised the general instructions to Form S-1 and Form F-1 to reflect one of the FAST Act's self-executing changes which permits an emerging growth company conducting an initial public offering to omit historical periods from its financial statements if it reasonably expects that such periods will not be required at the time of the offering.[7] The preliminary prospectus distributed to investors must contain all financial information required by Regulation S-X.

3 We have historically published two separate reports – an *SEC Year in Review* (covering Commission rulemaking, activities, and staff guidance) and an *SEC Conference Report* (covering insights and practice issues addressed at the AICPA Conference on SEC and PCAOB Developments held annually in December). These publications were combined this year to provide a broader resource covering activities and focus areas of the Commission and staff.

4 Moreover, since Form SD does not include audited financial statements, auditors do not need to read the disclosures and consider whether they are materially inconsistent with the audited financial statements.

5 For further information about the rule proposed in 2015, refer to our SEC Year in Review newsletter on significant 2015 developments (available **here**).

6 For further information about the FAST Act, refer to our SEC Year in Review newsletter on significant 2015 developments (available **here**).

7 This applies to both confidentially submitted and filed registration statements.

- Revised Item 12 of Form S-1 (and make a conforming change to Item 512(a) of Regulation SK) to permit a smaller reporting company to forward incorporate information by reference. Only smaller reporting companies that are not blank check companies, shell companies (other than business combination related shell companies) or issuers in offerings of penny stock are eligible to take advantage of this provision. This rule became effective on January 25, 2016.

As part of its rulemaking, the SEC solicited feedback on whether the amendments should be extended to other registrants or other forms.[8] However, no further rulemaking to expand these amendments to other registrants or forms was conducted in 2016.

In June, the SEC issued another interim final rule to implement a FAST Act provision. The rule added Item 16 to Form 10-K and specifically permits issuers to voluntarily include a summary in Form 10-K. The adopting release is available **here** on the SEC's website. If an issuer elects to provide a summary, each item within the summary must include a cross-reference via hyperlink to the related, more detailed disclosure in Form 10K. Registrants have historically been permitted to voluntarily provide information, such as a summary, but the FAST Act required SEC rulemaking to specifically permit the summary and require the use of cross-referencing. Item 16 provides registrants with flexibility in preparing the summary and does not specify the summary's length (other than to say it should be brief), location, or disclosure items that should be covered. The summary may only cross-reference information or exhibits that are included in Form 10-K at the time the form is filed.

The rule became effective on June 9, 2016. The SEC also solicited feedback on whether it should provide further guidance on the preparation and content of the summary, limit its length or dictate its location (among other topics). However, no further rulemaking was conducted on this topic in 2016.

DISCLOSURE EFFECTIVENESS INITIATIVE

In 2016, the SEC made notable progress on its Disclosure Effectiveness Initiative, a broad-based review of the SEC's disclosure rules designed to improve the disclosure regime for both companies and investors. The progress made in 2016 follows the SEC's Request for Comment on the effectiveness of certain financial disclosure requirements of Regulation S-X, which was published in September 2015.[9] Activity in 2016 was in the form of rulemaking, a concept release, and a request for comment. Proposed rulemaking is discussed below, while other forms of activities related to the Disclosure Effectiveness Initiative are discussed in Other Commission Activities below.

Proposed Modernization of Disclosures for Mining Registrants (Release No. 33-10098)

In June, the SEC proposed rules to modernize property disclosures made by mining registrants. The revisions would amend Item 102 of Regulation S-K, rescind Industry Guide 7 and include mining property disclosure requirements in a new subpart of Regulation S-K.

The proposed rules would:

- Provide one standard requiring registrants to disclose mining operations that are material to the company's business or financial condition.
- Require a registrant to disclose mineral resources and material exploration results in addition to its mineral reserves.
- Permit disclosure of mineral reserves to be based on a preliminary feasibility study or a final feasibility study.
- Provide updated definitions of mineral reserves and mineral resources.
- Require, in tabular format, summary disclosure for a registrant's mining operations as a whole as well as more detailed disclosure for material individual properties.
- Require that every disclosure of mineral resources, mineral reserves and material exploration results reported in a registrant's filed registration statements and reports be based on, and accurately reflect information and supporting documentation prepared by, a "qualified person."
- Require a registrant to obtain a technical report summary from the qualified person, which identifies and summarizes for each material property the information reviewed and conclusions reached by the qualified person about the registrant's exploration results, mineral resources or mineral reserves.

The proposal can be found **here** on the SEC's website. Comments were due in September.

Proposed Elimination of Outdated and Redundant Disclosure Requirements (Release No. 33-10110)

In July, the SEC proposed amendments to eliminate redundant and outdated disclosure requirements. While the proposal is consistent with the goal of the Disclosure Effectiveness Initiative, the amendments were also proposed in response to a FAST Act mandate

8 At the March meeting of the Center for Audit Quality's SEC Regulations Committee (which can be found **here** on the CAQ's website), the SEC staff noted that it is unable to extend the reporting relief described above to registrants other than emerging growth companies and to forms other than Form S-1 or Form F-1.

9 Further information regarding the Request for Comment can be found in our SEC Year in Review newsletter on significant 2015 developments (available **here**). Our comment letter can be found **here**.

which requires the SEC to eliminate provisions of Regulation S-K that are duplicative, outdated, or unnecessary disclosures.

The proposal acknowledges that certain disclosure requirements in Regulations S-K and S-X have become outdated, redundant, overlapping or superseded in light of developments in U.S. GAAP, IFRS, other SEC disclosure requirements, and changes in the information environment. The changes are intended to simplify the overall compliance process but not change the mix of information provided to investors. For example, some of these proposed changes include:

- Eliminating the income tax rate reconciliation disclosure requirement in S-X 4-08(h)(2) as such disclosure is required by ASC 740-10-50-12.
- Eliminating the requirement to provide a computation of earnings per share in S-K 601(b)(11) as such disclosure is required by ASC 260-10-50-1a.
- Deleting S-K 101(b) which requires disclosure of segment financial information, restatement of prior periods when reportable segments change, and discussion of segment performance that may not be indicative of current or future operations. Such disclosures are similar to those required by Topic 280 and S-K 303(b).
- Deleting S-K 201(d) which requires disclosure of the securities authorized for issuance under equity compensation plans. Although the U.S. GAAP requirements are not identical to those contained in S-K 201(d), they provide disclosures about the nature and terms of equity compensation arrangements which results in reasonably similar disclosures.
- Eliminating the requirement in S-K 503(d) and related forms to provide a ratio of earnings to fixed charges when an offering of debt securities is registered. The Commission believes this requirement is no longer relevant and useful.

The proposal also solicits comments on:

- Certain disclosure requirements which may overlap with U.S. GAAP but provide incremental information. The SEC plans to use the feedback received on these areas to determine whether to retain, modify, eliminate, or refer them to the FASB for potential incorporation into U.S. GAAP.
- Where disclosures appear in an SEC filing. The proposal would result in the relocation of certain disclosures within a filing. The SEC is seeking feedback on how the relocations may affect the prominence or context of certain disclosures.

The proposal can be found **here** on the SEC's website. Comments were due in October.

BDO OBSERVATIONS:

We support the Commission's efforts to update its disclosure requirements, particularly its efforts to eliminate requirements that may be outdated, overlapping or superseded. With respect to requirements that may be redundant or duplicative, we believe it is important for the Commission to update them to ensure that any inconsistencies between these requirements and similar requirements in GAAP are intentional and not inadvertent. Moving forward, we encourage the Commission to establish a formal process for reviewing and updating its disclosure requirements in light of developments in U.S. GAAP, IFRS, and Commission guidance. Our specific recommendations as it relates to the proposal can be found in our comment letter (available **here**).

Proposed Requirement to use Hyperlinks (Release No. 33-10201)

In August, the SEC proposed a rule and form amendments that would require registrants to include a hyperlink to each exhibit listed in the exhibit index of their periodic and transactional filings. The intent is to facilitate easier access to these exhibits for investors and other stakeholders.

The proposal can be found **here** on the SEC's website. Comments were due in October.

OTHER RULEMAKING

Proposed Amendments to Smaller Reporting Company Definition (Release No. 33-10107)

In June, the Commission proposed rules which would increase the financial thresholds in the smaller reporting company[10] (SRC) definition. The proposal would expand the number of companies eligible for the scaled disclosures permitted by Regulation S-K and Regulation S-X. The financial thresholds in the definition of accelerated and large accelerated filer and the related filing requirements would remain unchanged.

Under the proposal, a company with less than $250 million of public float (or less than $100 million in annual revenues, if the company has no public float) would qualify as a SRC. The proposed financial threshold for re-entering SRC status is less than $200 million of public float (or less than $80 million in annual revenues, if the company has no public float). The following table summarizes the

10 The smaller reporting company definition excludes investment companies, asset-backed issuers and majority-owned subsidiaries of a parent that is not a smaller reporting company.

proposed amendments to the SRC definition, as compared to the current definition:

Registrant Category	Current Definition	Proposed Definition
Reporting Registrant	Less than $75 million of public float at end of second fiscal quarter	Less than $250 million of public float at end of second fiscal quarter
Registrant Filing Initial Registration Statement	Less than $75 million of public float within 30 days of filing	Less than $250 million of public float within 30 days of filing
Registrant with No Public Float	Less than $50 million of revenues in most recent fiscal year	Less than $100 million of revenues in most recent fiscal year
Re-entering SRC Status Based on Public Float	Less than $50 million of public float at end of second fiscal quarter	Less than $200 million of public float at end of second fiscal quarter
Re-entering SRC Status Based on Revenues (No Public Float)	Less than $40 million of revenues in most recent fiscal year	Less than $80 million of revenues in most recent fiscal year

The current definitions of accelerated and large accelerated filer contain a provision that excludes registrants that qualify as SRCs. The proposal would eliminate that provision, while maintaining the financial thresholds in the definitions of accelerated filer (i.e. $75 million of public float) and large accelerated filer (i.e. $700 million of public float). Therefore, companies with public floats of $75 million or more, but less than $250 million,[11] that qualify as SRCs under the amended definition, would still be subject to the accelerated filing requirements, including the accelerated timing of filing periodic reports and the requirement to provide the auditor's attestation on management's assessment of internal control over reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002. However, those companies would be allowed to take advantage of the scaled disclosure system available to SRCs.

Rule 3-05 of Regulation S-X requires financial statements of businesses acquired or to be acquired. Rule 3-05(b)(2)(iv) allows registrants to omit such financial statements for the earliest of three fiscal years required if the net revenues of the business acquired or to be acquired are less than $50 million. The Commission has not proposed to amend this threshold.

11 Or less than $200 million of public float, if re-entering the SRC status.

The proposal can be found **here** on the SEC's website. Comments were due in September.

BDO OBSERVATIONS:

Overall, we support expanding the number of registrants that qualify as smaller reporting companies and thereby benefit from scaled disclosure requirements. We believe that doing so is consistent with the Commission's goals of promoting capital formation and reducing compliance costs for smaller registrants while maintaining investor protections. We also believe that the proposed public float and revenue thresholds are reasonable. However, while we agree with the Commission that the threshold for requiring audits of internal control over financial reporting should not be changed, we would like to see the Commission go further by providing more time for these same smaller registrants to file their periodic reports. Our comment letter on the proposal which includes these observations, among others, is available **here**.

OTHER COMMISSION ACTIVITIES

DISCLOSURE EFFECTIVENESS INITIATIVE

Concept Release on Regulation S-K (Release No. 33-10064)

In April, the SEC published a concept release on Regulation S-K. The release is part of the Disclosure Effectiveness Initiative described above. The release focuses on the business and financial disclosures that Regulation S-K requires in companies' periodic reports, many of which have not changed since they were first adopted over 30 years ago. The release seeks input from investors and registrants in the following areas:

- The overall disclosure framework (e.g., the concept of materiality)
- Information intended for investment and voting decisions, including:
  - Core company business information (e.g., narrative description of business)
  - Company performance, financial information, and future prospects (e.g., selected financial data and management's discussion and analysis)
  - Risk and risk management (e.g., risk factors)
  - Securities of the registrant (e.g., description of capital stock)
  - Industry guides (e.g., Guide 3 for bank holding companies)

- o Public policy and sustainability matters (e.g., environmental, social and governance concerns)
- o Exhibits (e.g., material contracts)
- o Scaled requirements for certain registrants (e.g., smaller reporting company and emerging growth company reporting relief)

- Presentation and delivery of important information (e.g., the use of hyperlinks or cross-referencing)

The concept release can be found **here** on the SEC's website. Comments were due in July.

BDO OBSERVATIONS:

We support the Commission's efforts to analyze the disclosure regime of Regulation S-K and consider ways to improve the requirements for the benefit of investors. From a broad perspective, we support a principles-based approach to disclosure outside the financial statements. We believe that using a principles-based approach would promote disclosure of information that is most meaningful and relevant. To implement this approach, we believe Regulation S-K should (a) clearly articulate disclosure objectives, (b) provide a list of related topics a registrant should consider discussing and (c) make it clear that the disclosure is only required to the extent necessary to achieve the disclosure objectives. We believe this objectives-based approach is likely to result in more useful disclosure than the line item or "check the box" type approach we observe many registrants taking in response to the current S-K disclosure regime. Our comments and recommendations related to specific S-K disclosure items can be found in our comment letter (available **here**).

Request for Comment – Management, Certain Security Holders, and Corporate Governance Disclosure Requirements (Release No. 33-10198)

In August, the SEC published a request for comment on the disclosure requirements of Subpart 400 of Regulation S-K, which relate to management, certain security holders and corporate governance matters. This request is a part of the Disclosure Effectiveness Initiative, though it is also intended to inform the Commission's study on Regulation S-K, which is required by the FAST Act.

The request for comment can be found **here** on the SEC's website. Comments were due in October.

SEC ORDER PERMITTING THE USE OF INLINE XBRL

(Release No. 34-78041)

In June, the SEC issued an order permitting issuers to voluntarily embed XBRL data directly in their financial statements using a format known as Inline XBRL in lieu of providing tagged data in a separate exhibit. The order is available **here** on the SEC's website.

Issuers have been required to provide XBRL data in an exhibit to their filings. Consequently, issuers copy their financial statement information into a separate document and tag it in XBRL. By allowing issuers to instead embed tags directly into the financial statements, this voluntary program is intended to reduce preparation costs and increase the quality of the data, thereby increasing its use by investors and other market participants.

The order permits issuers to voluntarily use Inline XBRL in their periodic and current reports through March 2020.

STAFF GUIDANCE

FINANCIAL REPORTING MANUAL

The staff of the SEC's Division of Corporation Finance published two updates to the Financial Reporting Manual (FRM) in 2016.[12] As updates are published, the staff includes a summary immediately following the FRM cover that describes the nature of the changes and lists the paragraphs that were updated. The staff also annotates the FRM to communicate the date a paragraph was most recently updated.

The staff added Topic 11 to the FRM in 2016 to address reporting issues related to the adoption of certain significant new accounting standards. The guidance summarizes the available adoption dates, transition methods for public and nonpublic business entities and other reporting guidance for the following standards:

- **The New Revenue Standard (Topic 606)** – Section 11100 was added to address reporting issues related to the adoption of the new revenue standard. The March and November updates addressed the following specific matters:
  - o *Selected Financial Data* - When reporting selected financial data, a registrant adopting the new revenue standard using a full retrospective approach need not apply the new standard to periods prior to those presented in its retroactively-adjusted financial statements (refer to FRM paragraph 11100.1).

12 The FRM is an internal SEC staff reference document that provides general guidance covering several SEC reporting topics. While the FRM is not authoritative, it is often a helpful source of guidance for evaluating SEC reporting issues. The FRM, along with other helpful guidance, can be accessed from the Division of Corporation Finance home page, which is located **here**.

However, companies are reminded to provide the information required by Instruction 2 to S-K Item 301 regarding comparability of the data presented, if applicable and material.

- *Emerging Growth Companies* - Paragraph 11100.2 was added to communicate that a calendar year-end EGC that elects to adopt the new revenue standard for the annual period beginning on January 1, 2019 and for interim periods beginning on January 1, 2020 (i.e., the effective date for nonpublic entities) is not required to accelerate application of the standard to interim periods presented in the 2019 Form 10-K (i.e., pursuant to Item 302 of Regulation S-K). The staff noted that the EGC could provide disclosures it deems appropriate to explain why the sum of the 4 quarterly figures for 2019 presented in the annual report do not agree to the corresponding annual amount.
- *Pro Forma Financial Statements* - Paragraph 11120.4 addresses the presentation of pro forma financial information associated with a significant acquired business in the year of adoption. If a registrant adopts Topic 606 on a full retrospective basis on January 1, 2018 and acquires a significant business in 2018, it is not required to apply the new revenue standard to pro forma financial information for periods prior to adoption (e.g., the pro forma income statement for the year ending December 31, 2017).

- **The New Leasing Standard (Topic 842)** – Section 11200 was added to address reporting issues related to the adoption of the new leasing standard. A calendar year-end registrant is required to adopt the standard on a modified retrospective basis on January 1, 2019, with an initial application date of January 1, 2017. Paragraph 11210.1 specifies that companies are not required to also retrospectively revise their 2016 financial statements if they file a registration statement on Form S-3 in 2019.[13] The guidance indicates that the reissuance of the financial statements in the Form S-3 only accelerates the requirement to recast the 2017 and 2018 financial statements, but it does not change the initial date of the standard's application.
- **The New Disclosures about Short-Duration Contracts for Insurance Entities Standard (Topic 944)** – Section 11300 was added to address reporting issues related to the adoption of ASU No. 2015-09, *Disclosures about Short-Duration Contracts*. Similar to the sections on other new standards above, the guidance summarizes the adoption dates and transition methods. Paragraph 11310.1 was added to address the disclosure requirements related to claims development tables. ASU 2015-09 requires disclosure of disaggregated claims development tables for each reportable segment which reflect re-estimates of claims by accident year for up to ten years. Consequently, the guidance indicates that Property and Casualty insurers are no longer required to separately present the consolidated ten-year loss reserve development table required by Securities Act Industry Guide 6 and Exchange Act Industry Guide 4 in their filings.

The March update amended paragraph 2410.8, which provides guidance on measuring significance of equity method investees under Rules 3-09 and 4-08(g). Previously, when a registrant retrospectively applied a new accounting principle, it was required to recompute the significance of equity method investees in prior years and redetermine the reporting requirements under Rules 3-09 and 4-08(g) when filing its next Form 10-K. This could trigger the need for investee financial statements and/or summarized financial data for prior years that had not previously been required. Under the revised guidance, registrants are no longer required to recompute significance after a change in accounting principle. Registrants should continue to recompute significance under Rules 3-09 and 4-08(g) for prior periods after a discontinued operation.

The staff also updated Topic 10 (Emerging Growth Companies) to the FRM in March to conform it to the FAST Act, which amended securities laws that impact emerging growth companies.[14]

The November update amended paragraph 10220.5, which addresses an emerging growth company's reporting requirements associated with financial statements of entities other than the registrant and pro forma financial information. An EGC is permitted to present only two years of financial statements for entities other than the registrant in its initial registration statement even if the application of the significance tests otherwise results in a requirement to present three years. Paragraph 10220.5(a) explicitly extends this relief to an EGC's acquired real estate operations under Rule 3-14. (The FRM had previously extended this relief to acquired businesses under Rule 3-05 and equity method investees under Rule 3-09.) Additionally, paragraph 10220.5(c) was amended to explicitly permit an EGC to omit pro forma financial information from its initial registration statement if it reasonably expects that such periods will not be required at the time of the offering. The guidance is consistent with securities law amendments included in the FAST Act which permit an EGC to omit historical periods from its financial statements if it reasonably expects that such periods will not be included in its effective registration statement.

The FRM is available **here** on the SEC's website.

13 Item 11(b)(ii) of Form S-3 requires companies to file restated financial statements if there has been a change in accounting principle and the change requires a material retroactive restatement of the financial statements.

14 For further information about the FAST Act, refer to our SEC Year in Review newsletter on significant 2015 developments (available **here**).

COMPLIANCE AND DISCLOSURE INTERPRETATIONS

The SEC staff updated its C&DIs several times during the year. Many of these updates were legal in nature and provide guidance on tender offers, Regulation A, Regulation AB, Regulation D, pay ratio disclosure and various Securities Act and Exchange Act rules and forms, among others. One notable interpretation relates to the financial statement requirements in a Regulation A offering. As noted above, securities law amendments included in the FAST Act permit an emerging growth company to omit historical periods from its financial statements if it reasonably expects such periods will not be included in its effective registration statement. One of the new C&DIs formally extends this reporting relief to Regulation A filers. An issuer conducting a Regulation A offering is permitted to omit financial information for historical periods (including financial information of other entities that may be otherwise required) if it reasonably expects those periods will not be required at the time Form 1-A is qualified by the SEC.

In May, the staff updated its C&DIs on non-GAAP financial measures. These updates and other staff communications related to non-GAAP measures are discussed below under Practice Issues.

PRACTICE ISSUES

In addition to the guidance discussed above, the SEC staff addressed various practice issues throughout the year. This section discusses those issues, including observations the staff made at the Conference.

NON-GAAP FINANCIAL MEASURES

As discussed in our overview, over the past year non-GAAP measures have been highlighted as an area of concern by Chair White and the SEC staff, given registrants' extensive use of them and the potential for confusion they may cause. The updates to the C&DIs referred to above primarily address the nature and presentation of adjustments or measures that may be considered misleading and therefore violate Regulation G or Item 10(e) of Regulation S-K. Specifically, the updates communicate that:

- Certain adjustments to GAAP measures may be misleading even if they are not expressly prohibited by the SEC's rules. For example, the exclusion of cash operating expenses that are normal and recurring items could be misleading.
- Non-GAAP measures can be misleading if they are presented inconsistently between periods. While a change between periods is not prohibited, the reason for any change should be clearly described and disclosed. Additionally, registrants may need to consider recasting historical non-GAAP measures to conform to the current period presentation.
- Non-GAAP measures that exclude non-recurring charges but do not exclude non-recurring gains may be misleading.
- Revenue measures that are calculated using revenue recognition and measurement methods that are different from those required by GAAP are generally not permitted. The same concept may also apply to other financial statement line items measured using tailored accounting principles. A registrant's non-GAAP adjustments and measures generally should not tailor GAAP or apply accounting methods/principles for which the registrant does not otherwise qualify under GAAP.
- While registrants may present non-GAAP performance measures on a per share basis, registrants are prohibited from presenting non-GAAP liquidity measures on a per share basis. Whether per share data is permitted depends on whether the non-GAAP measure can be used as a liquidity measure, even if management presents it solely as a performance measure. For this reason, non-GAAP measures such as EBIT and EBITDA may not be presented on a per share basis. Also, registrants should focus on the substance of the non-GAAP measure and not management's characterization of the measure to determine whether presenting the measure on a per share basis is permissible.
- If a company presents EBIT or EBITDA as a performance measure, the measure should be reconciled to net income (not operating income). Operating income is not the most directly comparable GAAP financial measure because EBIT and EBITDA make adjustments for items that are not included in operating income.
- Registrants are permitted to present a non-GAAP measure such as "free cash flow,"[15] though they should clearly describe how the measure was determined as it does not have a uniform definition across companies. Companies should not imply that the measure represents cash available to fund discretionary expenditures as the definition typically excludes debt-service and other expenditure requirements. Since it is a liquidity measure, free cash flow should not be presented on a per share basis.
- When reconciling between GAAP measures and non-GAAP measures, the income tax effects of non-GAAP measures should be reflected separately and clearly explained. Reconciling items should not be presented net of tax.

The updates also provide several examples that illustrate placing undue prominence on non-GAAP measures (which is prohibited by Item 10(e) of Regulation S-K).

15 Free cash flow is typically calculated as operating cash flows less capital expenditures.

These examples include, among others:

- Omitting comparable GAAP measures from an earnings release headline that includes non-GAAP measures;
- Presenting non-GAAP measures before the directly comparable GAAP measures;
- Describing a non-GAAP measure as “record performance” without an equally prominent description of the comparable GAAP measure; and
- Providing a discussion and analysis of the non-GAAP measures without a comparable discussion of the GAAP measures.

Furthermore, for registrants that present “funds from operations” (FFO), as defined by the National Association of Real Estate Investment Trusts (NAREIT), the staff clarified that it accepts NAREIT’s definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis. Additionally, registrants are permitted to present FFO on a basis other than as defined by NAREIT as long as the measure complies with Regulation G or Item 10(e) of Regulation S-K.

The C&DIs are available **here** on the SEC’s website.

Building on staff speeches throughout the year, non-GAAP measures were a prominent theme at the Conference. The staff acknowledged the substantial progress registrants made after the issuance of the C&DIs, particularly in the prominence with which they present them. However, the staff is still concerned about the appropriateness of measures that seem to eliminate normal recurring expenses and the effectiveness of the related disclosure controls and procedures.

The staff emphasized the following:

- When providing the required reconciliation of the differences between a non-GAAP measure and the most directly comparable GAAP measure, begin the reconciliation with the GAAP amount. Presenting the non-GAAP amount first gives it undue prominence.
- The C&DIs prohibit individually tailored accounting principles, such as acceleration of revenue recognition and proportionate consolidation. However, the staff may allow certain revenue adjustments in limited circumstances (e.g. adjustments to reflect the expected impact of adopting Topic 606). In those situations, registrants should discuss the presentation with the staff in advance.
- When a registrant presents non-GAAP information in an earnings release, it should consider also including non-GAAP disclosures in MD&A, given the perceived importance of the measure to investors.
- Audit committees should understand the non-GAAP measures being utilized as well as the procedures and controls in place around those measures.

NEW ACCOUNTING STANDARDS

Staff Announcement - Disclosures Related to the Adoption of New Accounting Standards

In 2016, reporting issues related to the adoption of new, significant accounting standards have been a significant SEC staff focus area. One of these reporting issues relates to Staff Accounting Bulletin 74 disclosures (which has been codified into SAB Topic 11.M). SAB 74 addresses disclosure of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period. Since the new revenue standard was issued, the SEC staff has communicated its expectation for these disclosures to evolve over time as registrants better understand the effects that the new standard will have on their financial statements.

At the September 22, 2016 EITF meeting, the staff made an **announcement** regarding its views about SAB 74 disclosures related to:

- ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606);
- ASU No. 2016-02, *Leases* (Topic 842); and
- ASU No. 2016-13, *Financial Instruments Credit Losses* (Topic 326): *Measurement of Credit Losses on Financial Instruments*.

The staff expects registrants that are not yet in a position to disclose the quantitative effects of these standards on their financial statements will make additional qualitative disclosures including:

1. The effect of the accounting policies that the registrant expects to apply (if determined) and a comparison to the registrant’s current accounting policies and
2. The status of its process to implement the new standards and the significant implementation matters yet to be addressed

Registrants should also consider making any additional qualitative disclosures necessary to help financial statement users under the impact of these new standards. At the Conference, the staff indicated that it will be looking for these disclosures in registrants’ upcoming 10-K filings and if they do not appear, companies should anticipate receiving a staff comment letter on the topic.

BDO OBSERVATIONS:

As the adoption date of the new revenue standard has drawn nearer, the staff has also expressed its concern about a perceived lack of preparedness among registrants due to lackluster SAB Topic 74 disclosures – e.g., continued disclosure that states, "We are currently evaluating the effect of the standard on our financial statements." We believe the staff announcement in September requesting additional qualitative disclosure is intended, at least in part, to get the ball rolling for registrants who have not otherwise devoted significant time and attention to the impact that the standard will have on their financial statements. Examples of such qualitative disclosures for the new revenue standard may be as follows:

- **For a software company that has begun its assessment:** "We have formed a committee to evaluate the standard's effect on our financial statements. We have historically deferred revenue for certain deliverables in our multiple-element arrangements due to a lack of vendor specific objective evidence (VSOE) for those deliverables. Our preliminary analysis indicates that we will recognize revenue for these arrangements earlier under Topic 606 than under Topic 605 due to the elimination of the VSOE requirement."
- **For a company that has historically elected to expense all contract costs under SAB 104:** "Our historical accounting policy for contract costs is to expense all costs as incurred, as permitted under SAB 104. Under Topic 606, we will be required to capitalize certain contract costs for all contracts greater than one year and amortize them as we transfer goods or services to our customers. Accordingly, we expect to recognize a deferred charge for such costs on in-process contracts upon adoption."
- **For a company that is just getting started on its evaluation:** "We are in the initial stages of evaluating the effect of the standard on our financial statements and continue to evaluate the available transition methods.

Form S-3 Considerations

Item 11(b) of Form S-3 requires a registrant to recast its annual financial statements in a new or amended registration statement after retrospective adoption of a new accounting principle, if the change is material. Consequently, a registrant that elects to adopt the new revenue standard on a full retrospective basis may be required to recast its financial statements for an additional year if it files a new or amended registration statement in 2018. For example, a registrant with a calendar year end that adopts the revenue standard on a full retrospective basis on January 1, 2018 and does not file a registration statement in 2018 would be required to recast its 2017 and 2016 financial statements for purposes of its 2018 Form 10-K. However, if the registrant files a registration statement on Form S-3 in 2018 after it has filed its first quarter Form 10-Q, it would be required to restate its 2017, 2016 *and* 2015 financial statements. However, the staff communicated[16] that registrants may consider the impracticability exception included in ASC 250-10-45-9 if, for example, a company is unable to apply the requirement to recast all periods presented in its financial statements after making every reasonable effort to do so. While not required, the staff has indicated that a registrant may wish to consult with OCA if it has concluded it would be impracticable to present one or more comparative periods.

With respect to shelf takedowns (i.e., offers made using an already effective registration statement) in 2018, the staff indicated at the Conference that it would not expect registrants to conclude that the adoption of a new accounting standard qualifies as a "fundamental change," which would trigger the need to file a post-effective amendment to the registration statement and the recasting of the financial statements for the additional year as described above.

Adoption Dates for Equity Method Investees

The FASB's definition of a public business entity (PBE) includes entities whose financial information or financial statements are included in a filing with the SEC. Consequently, entities that are otherwise privately-held may be considered PBEs solely because their financial information / statements appear in an SEC filing (e.g., financial statements of an acquired business under Rule 3-05 or an equity method investee under Rule 3-09, and financial information of equity method investees under Rule 4-08(g)).[17] The determination of whether an entity qualifies as a PBE is important, particularly because many accounting standards, including the major new accounting standards discussed in this letter, have different adoption dates for PBEs (which are typically one year earlier than non-PBEs). The staff discussed the application of the PBE definition to an insignificant equity method investee whose financial information is not included in the filing, but is used only for purposes of recording the registrant's share of the investee's earnings or losses. The staff indicated that this type of equity method investee would not be considered a PBE and therefore, would not be required to adopt the new accounting standards using the PBE adoption dates.

Revenue Recognition Standard

At the Conference, Chief Accountant Wes Bricker emphasized that revenue is "one of the single most important measures used by investors in assessing a company's performance and prospects" and

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16 Refer to Wes Bricker's remarks at the 2016 Baruch College of Financial Reporting Conference [here](#).

17 Paragraph BC12 in ASU 2013-12 specifically states that an entity whose summarized financial information is provided to comply with Rule 4-08(g) of Regulation S-X is considered a PBE.

"companies cannot afford to get the accounting wrong." Bricker's statements illustrate the importance of sufficient preparation, by all companies, to ensure successful implementation of the new principles-based revenue recognition standard. To date, the SEC staff has observed progress in readiness efforts. However, many registrants remain in the initial assessment phase. The staff encouraged registrants to discuss their current Topic 606 implementation status and ongoing activities with investors, audit committees, and auditors (while being mindful of auditor independence requirements).

While registrants prepare for the new standard, the staff is executing its own revenue implementation strategy. The staff actively monitors implementation efforts in order to understand areas of potential diversity and the types of judgments being made. Additionally, as registrants work through applying the standard, the staff continues to be available for consultations.

Bricker also provided insight into how the staff forms its views on specific transactions. The staff considers the nature, design and economic substance of the transaction by starting with the terms of the contract itself. The language in Topic 606 and the related basis for conclusions, implementation discussions such as those at the Transition Resource Group, and the objective of consistency and comparability are also contemplated. Prior to a consultation, the staff believes a registrant should fully understand their arrangements and be able to clearly articulate their basis for accounting under the new standard.

Based upon Topic 606 implementation consultations to date, the staff shared the following observations:

Definition of a contract – Certain companies may employ a loss leader pricing strategy, where they price one good or service at a discount in order to stimulate future sales of more profitable goods or services. While future sales may appear likely for economic or other reasons, the staff believes future contracts should not be accounted for as part of the existing revenue arrangement since a contract with enforceable rights and obligations does not exist.

Contract combinations –A company may enter two or more contracts at or near the same time with the same customer (or related parties of the customer). Under Topic 606, those contracts may be accounted for as a single contract, provided at least one of the following criteria is met:

- The contracts are negotiated as a package with a single commercial objective.
- The amount of consideration in one contract depends on the price or performance of the other contract.
- The goods or services that are promised in the contracts represent a single performance obligation.

The staff emphasized that the contract combination guidance should not be extended beyond the customer. For example, two interdependently priced contracts negotiated as a package at the same time would not meet the contract combination guidance unless the contracts were with the same customer.

Payments to customers – The staff noted that companies make payments to customers for a variety of reasons. To assess the accounting for such payments, a company must understand the economic reason(s) for the payments, the relevant terms of the contract, and how the payments are described to investors and other stakeholders. After gaining this understanding, the payment should be accounted for on a basis that is consistent with the substance of the transaction and the relevant accounting literature. The staff stated that the concept of "matching is not a determinative factor." Furthermore, classification of customer incentives in the income statement, particularly if a customer is not in the standard supply chain, requires judgment. The staff expects quantitative disclosures for material amounts reflected outside of revenues.

Gross versus net presentation – The control-based nature of the new revenue recognition standard may result in a change in the presentation of revenues. The staff urged registrants to take a fresh look at existing principal (gross) and agent (net) conclusions, stressing that no default or safe harbor exists under Topic 606. Rather, the specific facts and circumstances should drive the accounting conclusion.

Disaggregated disclosures – Topic 606 requires certain disclosures of revenues on a disaggregated basis (e.g. by geography, type of good/service, etc.), similar to segment disclosures. While an impracticability exception exists for segment reporting, no such exception is available in the new revenue standard. The staff indicated they will review other investor communications, such as earnings releases and company websites, in order to assess whether a company makes appropriately disaggregated disclosures. This is consistent with the staff's approach for segment disclosures.

SAB Topic 13 – The staff noted that SAB Topic 13, Revenue Recognition, applies prior to the adoption of the new revenue recognition standard. Thereafter, registrants should evaluate revenue arrangements under Topic 606. The staff will assess any implementation related consultations under Topic 606 similarly, i.e., without regard to SAB Topic 13.

Disclosing the effects of adoption – The staff also indicated a registrant that adopts the new revenue standard on a modified retrospective basis may present as supplemental pro forma information in MD&A the amounts it would have reported if full retrospective adoption had been elected. This supplemental pro forma information would be considered non-GAAP financial information subject to the applicable requirements, including a prohibition on presenting a full supplemental pro forma income

statement. In addition to supplemental pro forma revenues disclosures, registrants should also disclose the impact on other financial statement line items, such as costs of sales.

Credit Losses Standard

The SEC staff commented that "virtually every registrant will be affected" due to the range of financial assets scoped into the new credit losses standard, including loans, debt securities and trade receivables. Furthermore, the staff noted that management must determine an estimate of expected credit losses that is most reflective of the company's expectations. Since Topic 326 does not require a specific method to estimate expected credit losses, each company must develop accounting principles and methodologies that can be applied consistently from one period to another. A systematic methodology consistent with the principles of the new standard should support management's expected credit loss estimates each period. The staff emphasized that detailed documentation of policies, procedures, methodologies and decisions will continue to be necessary. SAB 102, *Selected Loan Loss Allowance Methodology and Documentation Issues*, and Financial Reporting Release No. 28, *Accounting for Loan Losses by Registrants Engaged in Lending Activities* will continue to be relevant given the need to use reasonable and supportable forecasts in the new standard.

OTHER ACCOUNTING AND DISCLOSURE TOPICS

Share-Based Awards: Grant Dates

Topic 718, Compensation – Stock Compensation, defines a grant date as the date when a mutual understanding of the key terms and conditions of a share-based payment award is reached between the employer and employee. For an equity-classified service award, a company recognizes the grant date fair value of the award over the requisite service period. Compensation cost for services provided prior to the grant date is recorded based upon the fair value of the award at each reporting date, resulting in multiple valuation dates. The SEC staff highlighted the need for careful consideration with respect to the establishment of a grant date (i.e., whether a mutual understanding has been reached) when an award includes a key discretionary condition, such as a clawback provision. A company should consider its past practices and how they have evolved over time as part of the assessment. The staff also noted that appropriate ICFR is necessary to monitor past company practices used to support grant date judgments.

Defined Benefit Plan Considerations

The following approaches for developing pension benefit obligations (PBO) and the related interest costs for single employer defined benefit pension plans have been accepted by the SEC staff:

Approach	PBO	Interest Cost
Single weighted average	The plan sponsor determines the PBO at the measurement date by discounting the projected future benefit payments at the individual duration-specific rates forecast for the time of the projected payments. The single weighted average discount rate calculated by the plan sponsor represents the rate that discounts the projected benefits payments to a present value amount that equals the PBO.	The plan sponsors use this weighted average discount rate to determine the annual interest costs for defined benefit plan reporting.
"Spot rate" or yield curve	The plan sponsor determines the PBO in the same manner as in the single weighted average approach.	The plan sponsor uses the individual, duration-specific ("spot") rates from the yield curve to calculate annual interest costs.
Hypothetical bond portfolio	The plan sponsor determines the PBO by developing a hypothetical portfolio of actual bonds with cash flows that match the projected future benefit plan payments.	The plan sponsor uses the hypothetical bond portfolio to calculate the weighted average rate, and uses this rate to calculate annual interest costs.

The single weighted-average and the spot rate approaches result in the same PBO based on the use of an identical yield curve, but the annual interest costs differ. The hypothetical bond portfolio approach results in a different PBO. The staff stressed that the same approach must be used to calculate both the PBO and interest costs as the two calculations are integrated. Consequently, if a company utilizes the hypothetical bond portfolio matching approach to develop the PBO, the spot rate approach cannot be used to calculate the interest cost.

Insurance Company Disclosures: Short Duration Contracts

Topic 944, Financial Services – *Insurance*, requires presentation of a claims development table in the footnotes to the financial statements. The SEC staff noted that retrospective restatement of

the claims development tables to capture the effects of acquisitions and dispositions would be consistent with the objectives of Topic 944. Alternatively, separate prospective presentation of the claims information for the existing business as well as the liabilities of an acquired business might also meet the objectives of the standard. The staff believes a company may capture the impact of foreign currency exchange rates by using the current-period exchange rates for all years in the claims development tables or by including a separate claims development table for each functional currency.

Fair Value Option for Financial Instruments

For financial liabilities for which a fair value option has been elected under Topic 825, Financial Instruments, as amended by ASU No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, an entity must present separately, in other comprehensive income (OCI), the portion of the total change in the liability's fair value that results from a change in instrument-specific credit risk. The fair value option can also be elected under Topic 815, *Derivatives and Hedging*, for a hybrid financial liability (e.g., a debt obligation with an embedded derivative) for which the embedded feature otherwise would have been required to be bifurcated and accounted separately.

Under the new presentation guidance in ASU 2016-01, the SEC staff believes that similar to a fair value election under Topic 825, changes due to instrument-specific credit risk should be recorded in OCI even when an entity elects the fair value option under Topic 815. There is no requirement under GAAP to first evaluate whether an entity can elect a fair value option under the derivatives guidance in Topic 815, prior to electing a fair value option under Topic 825. Accordingly, an entity that elects a fair value option under either guidance for an eligible hybrid financial liability should follow the new presentation requirements in ASU 2016-01 regarding changes in instrument-specific credit risk.

Under the updated guidance, an entity may consider the portion of the total change in fair value that excludes amounts related to a base market risk (e.g., risk-free rate or benchmark interest rate) to be the result of a change in instrument-specific credit risk, which the staff referred to as the "base rate method." Alternatively, a company may use another method if it faithfully represents the portion of the total change in fair value resulting from a change in instrument-specific credit risk. The staff provided hypothetical examples to illustrate the judgment involved in the measurement of instrument-specific credit risk. In one scenario, payment of a nonrecourse financial liability, for which a company has elected the fair value option, is tied solely to the cash flows of the asset pledged as collateral. The staff believes that none of the change in fair value would relate to instrument-specific credit risk since the fair value is derived from the risks inherent in the collateral asset. Therefore, the entire change in the financial liability's fair value would be reflected in earnings. Under another scenario, the staff observed that the base rate method may not be appropriate for a company electing the fair value option for a debt obligation that is indexed to the price of gold and requires cash settlement since the price of gold impacts the change in fair value.

Segment Reporting

Many of the principles and objectives within the segment reporting guidance highlighted in prior years were once again discussed at the Conference. The following segment reporting issues continue to receive a substantial amount of attention from the SEC staff.

- **Operating segments** – The staff views the availability of gross margins for a component as sufficient to conclude that discrete financial information is available. The allocation of shared operating costs is not required.
- **Aggregation of operating segments** – When considering aggregation of two or more operating segments, a registrant must consider whether: (a) aggregation is consistent with the objective and basic principles in the standard, (b) operating segments have similar quantitative economic characteristics, and (c) operating segments have similar qualitative characteristics. The staff reminded registrants that economic similarity (e.g., similar margins) does not matter if operating segments are qualitatively different. Economic similarities may be coincidental. As such, a registrant should also consider qualitative factors, including the nature of the entity's activities, when contemplating aggregation.
- **Entity-wide disclosures and other general information** – The staff cautioned registrants not to overlook other disclosure requirements in their segment reporting, such as enterprise-wide disclosures and the factors used to identify reportable segments (e.g., by geography, by product, regulatory environment, etc.).

Additionally, the SEC's rules prohibit the presentation of non-GAAP information within financial statements, except for the required disclosure of the segment financial measure used by the chief operating decision maker. The staff stated that registrants should not voluntarily disclose additional segment financial measures. GAAP does not require such additional disclosures, making them non-GAAP measures. For the same reason, a registrant with one reportable segment should not present segment financial measures.

Income Taxes

The SEC staff has historically stressed the need for continued improvement in income tax disclosures in both the footnotes to the financial statements and in MD&A. At the Conference, the staff specifically mentioned that additional comment letters will be issued this year if disclosures are not enhanced. Income tax

disclosures should help a reader understand a company's complete tax situation.

Undistributed foreign earnings - Topic 740, *Income Taxes,* creates a general presumption that undistributed foreign earnings will be repatriated, resulting in a tax liability when transferred to the parent entity. A registrant may overcome the general presumption if certain criteria are met and assert that foreign earnings are indefinitely reinvested. The staff has observed disclosures outside of the financial statements, such as in MD&A, which "call into question (or potentially contradict) assumptions relied upon in accounting for undistributed earnings." Consistent use of assumptions when making complex income tax accounting judgments requires coordination among multiple business functions within a company's global organization.

MD&A disclosures – The staff also expects registrants to explain reasons for changes in effective tax rates, the extent to which historical effective tax rates are an indicator of future rates (and why or why not), the effect of uncertain tax benefits, the amount of cash in foreign jurisdictions for which deferred income taxes have not been provided, and the liquidity impact of tax obligations. Furthermore, the staff emphasized that valuation allowance related disclosures must be relevant and specific, including the sources and amounts of taxable income that the registrant relies on to avoid a valuation allowance, while avoiding "boilerplate" language.

Accounting Policy Considerations

In accordance with Topic 250, *Accounting Changes and Error Corrections*, accounting principles should be applied consistently from period to period unless a company can justify that a change is preferable. The SEC staff reminded registrants that changes in accounting principles resulting from new accounting standards do not require an evaluation of preferability. Additionally, changes due to events or transactions that are clearly different in substance from past events or transaction do not necessitate an evaluation of preferability. The staff cautioned that "identifiable differences between certain transactions or events does not necessarily equate to a clear difference in substance." A company should consider the nature of the events or transactions that lead to the current documented accounting policy as part of the assessment.

Measurement Period Adjustments

Topic 805, *Business Combinations*, requires disclosure of provisional amounts when the initial accounting for a business combination is incomplete at the end of a reporting period. A company adjusts the provisional amounts based upon new information obtained during the measurement period about facts and circumstances that existed at the acquisition date. The SEC staff reiterated that the measurement period is not one year from the acquisition date. Rather, the measurement period ends "as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable" and cannot exceed one year. The staff also emphasized the difference between the timing of recognition of a measurement period adjustment (during the current reporting period) and a material error correction (restatement of prior periods) as well as the need for sufficient ICFR to identify and account for adjustments and errors separately.

Loss Contingencies

The staff continues to focus on loss contingency disclosures, specifically when "surprises" occur. The staff cited timely disclosure of accruals for loss contingencies and the reasonably possible range of loss, when applicable, as commonly omitted disclosures. When a company settles a loss contingency shortly after a reporting period, the staff may inquire about the absence of related disclosures in previous filings.

Joint Ventures, Strategic Alliances, and Other Collaborative-Type Arrangements

The growing prevalence of various types of strategic alliances and the increasing complexity of these arrangements may create issues across a number of accounting topics (e.g., consolidation, gain recognition, revenue recognition, derivatives, leases, etc.). As a result, careful consideration of the facts and circumstances surrounding an arrangement is essential.

Registrants should first determine whether the activities of the strategic alliance are conducted wholly or partially within a legal entity and, if so, whether that legal entity should be consolidated. The variable interest entity (VIE) and voting interest consolidation models require a thoughtful analysis regarding decision-making authority, including the determination of which activities most significantly impact the economic performance of a VIE. The SEC staff noted that conclusions on decision-making authority should be consistent with the substance of the arrangement as well as the consolidation guidance.

When a registrant conducts activities outside of a legal entity or does not consolidate a legal entity, a company must contemplate the applicability of other accounting guidance (e.g. joint ventures and collaborative arrangements). Additionally, certain arrangements where another party receives the outputs of an entity's ordinary activities may meet the definition of a contract with a customer within Topic 606.

INTERNAL CONTROL OVER FINANCIAL REPORTING

ICFR was a pervasive topic throughout the prepared remarks of many SEC representatives at the Conference, consistent with last year. Chief Accountant Wes Bricker echoed Chair White's comments from her 2015 keynote address stating, "It is hard to think of an area more important than ICFR to our mission of providing high-quality financial information that investors can rely on." Unidentified or unaddressed deficiencies can lead to lower-quality financial reporting and restatements. Bricker also relayed investor sentiment about the significance of strong and effective controls, including audits of such controls, in establishing the credibility necessary to raise capital.

The staff relayed key takeaways from an SEC enforcement action during the year, noting that management should 1) evaluate the severity of control deficiencies, report any material weaknesses promptly, and disclose the cause of any material weakness and its potential impact on the financial statements, 2) maintain competent and adequate accounting staff, complementing them with qualified external resources where necessary, and 3) take responsibility for its ICFR assessment, as it cannot be outsourced to third parties.

As a sign of improvement, the SEC staff observed that identification of material weaknesses in advance of restatements has improved at an increasing rate. Nevertheless, frequent identification of deficiencies in ICFR audits by the PCAOB indicate issues still exist. The staff reminded registrants that those findings may also indicate deficiencies in management's controls and assessments. Placing unwarranted reliance on controls that are not designed at a level of precision to address the risk of material misstatement or controls that are dependent on the effectiveness of other controls and obtaining evidence to support conclusions on the design and effectiveness of ICFR require the attention of registrants. The staff reiterated the importance of regular ongoing dialogue among registrants, auditors and audit committees about ICFR assessments, specifically when there are changes to previous risk assessments.

The staff stressed that effective design and operation of ICFR is necessary to support the inherent judgments needed for complex accounting matters, such as consolidations and identification of operating segments, as well as when implementing new accounting standards and policies. Existing controls may no longer be appropriate. Registrants may need to implement new or re-designed controls prior to the adoption of the new accounting standards for revenue recognition, leases, and credit losses.

IFRS FOR U.S. ISSUERS

In his Conference remarks, Chief Accountant Wes Bricker touched on the use of IFRS in the United States. While he believes that the FASB's independent standard setting process and GAAP will continue to serve the needs of investors for at least the foreseeable future, he expressed support for continued collaboration between the FASB and IASB to eliminate differences between their standards. He also indicated that the staff will continue to evaluate his predecessor's idea to permit domestic issuers to voluntarily provide IFRS-based information as a supplement to their GAAP financial statements without requiring a reconciliation of that information to GAAP.

SEC STAFF CONSULTATIONS AND COMMUNICATIONS

Registrants may wish to request a waiver, accommodation, or interpretation of SEC reporting requirements from the SEC staff (i.e., review of a pre-filing letter). The staff encourages such consultations, particularly for complex reporting matters. The staff reminded registrants that pre-filing letters should focus on the relevant facts and provide support for the proposed positions. Registrants should also ensure that the pre-filing letters are provided to their auditors for feedback and review prior to their submission.

In addition, the staff reminded registrants that the SEC comment letter process is intended to create a dialogue between the registrant and the staff. When the staff asks a question, registrants should not assume that a change in the filing is necessary. Furthermore, registrants should communicate whether a staff comment relates to an immaterial matter early in the comment letter process. The staff also cautioned registrants about analogizing to fact patterns in other companies' comment letters as each staff comment and its corresponding resolution are based on facts and circumstances which may not be apparent in the publicly-available letters.

PCAOB DEVELOPMENTS

FINAL AUDTING STANDARD AND AMENDMENTS

Disclosure of Certain Audit Participants on a New PCAOB Form AP and Related Amendments to Auditing Standards

In May, the SEC approved the PCAOB's adopted Rules 3210 and 3211 that require audit firms, beginning in 2017, to file a new PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*, within a specified number of days after the first time an audit report for each of the firm's issuer clients is included in a document filed with the SEC. The following information is required to be disclosed on Form AP:

Effective for auditor's reports issued on or after January 31, 2017:

- The name of the engagement partner, along with a unique 10 digit identifier for that partner.

Effective for auditor's reports issued on or after June 30, 2017:

- The names, locations, and extent of participation of other accounting firms that took part in the audit, if their work constituted five percent or more of the total audit hours; and
- The number and aggregate extent of participation of all other accounting firms that took part in the audit and that individually contributed less than 5 percent of the total audit hours.

A Form AP is required for each audit report issued for an issuer, employee benefit plan subject to PCAOB auditing standards (Form 11-K), and registered investment company. Form AP is not required by a registered public accounting firm that is referred to in an auditor's report by the principal auditor in accordance with AS 1205, *Part of an Audit Performed by Other Independent Auditors*.

The information on Form AP will be available in a searchable database on the PCAOB's website and will include unique ID numbers for both engagement partners and firms. Investors and other financial statement users will have access, in one location, to the names of engagement partners on all issuer audits. This will allow interested parties to compile information about the engagement partner, such as whether the partner is associated with restatements of financial statements or has been the subject of public disciplinary proceedings, as well as whether he or she has experience as an engagement partner auditing issuers of a particular size or in a particular industry.

Information provided on Form AP is also intended to help investors understand how much of the audit was performed by the accounting firm signing the auditor's report and how much was performed by other accounting firms. This information is expected to allow the public to determine other information about the firms identified in the form, such as whether a participating firm is registered with the PCAOB, whether it has been inspected and, if so, what the results were and whether it has any publicly available disciplinary history.

The SEC also approved the Board's adopted amendments to AS 3101, Reports on Audited Financial Statements, and AS 1205, that permit auditors to voluntarily disclose in the auditor's report the name of the engagement partner, information regarding other accounting firms, or both.

The rules and amendments are available **here**. Additionally the PCAOB recently published staff guidance, which is available **here**, to help firms comply with the requirements for filing reports on Form AP.

OTHER STANDARD-SETTING ACTIVITIES

Supervision of Audits Involving Other Auditors, and Proposed Auditing Standard, Dividing Responsibility for the Audit with Another Accounting Firm

In April, the PCAOB proposed for public comment a new auditing standard, along with related amendments, to strengthen the requirements that apply to audits that involve accounting firms and individual accountants outside the accounting firm that issues the audit report. Among other things, the proposed new standard and amendments would apply a risk-based supervisory approach, and would require more explicit procedures regarding the lead auditor's involvement in the work of other auditors through enhanced communication and more robust evaluation of the other auditors' qualifications and work.

The proposed new standard, AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*, would supersede AS 1205. Proposed AS 1206 would retain, with modifications, many of the requirements of AS 1205, including the requirement that a lead auditor disclose in its audit report which portion of the financial statements was audited by each other auditor. However, proposed AS 1206 would also require the lead auditor to:

- Obtain a representation from each referred to auditor that they are licensed to practice under the applicable laws of the relevant country or jurisdiction.
- Determine whether each of the referred to auditors that play a substantial role in the preparation or furnishing of the lead auditor's report is registered with the PCAOB.
- Disclose the name of the other auditor in the lead auditor's report.

The proposal would also modify existing PCAOB auditing standards as follows:

- Amend AS 1215, *Audit Documentation*, to require that the lead auditor document which specific working papers of other auditors the lead auditor has reviewed, but not retained.
- Amend AS 1220, *Engagement Quality Review*, to explicitly require the engagement quality reviewer to evaluate the engagement partner's determination of his or her firm's sufficiency of participation in the audit.

- Amend AS 2101, *Audit Planning*, to incorporate and update requirements of AS 1205 to specify that they be performed by the lead auditor. For example, the proposal would incorporate and revise requirements for determining the firm's sufficiency of participation in an audit that involves other auditors.
- Amend AS 1201, *Supervision of the Audit Engagement*, to provide additional direction to a lead auditor on how to apply AS 1201's requirements to supervising other auditors. Specifically, the proposed amendments would require certain procedures to be performed by the lead auditor in supervising the work of other auditors.

The proposed auditing standard and amendments can be accessed **here**. The comment period closed in July. The PCAOB staff is currently analyzing the comments received to determine its next steps.

BDO OBSERVATIONS:

In our comment letter, we supported the PCAOB's efforts to strengthen the auditing standards relating to audits in which other auditors participate. We also encouraged the PCAOB to monitor the activities of the IAASB relating to a similar project and align with the IAASB's standards when possible to minimize unnecessary differences. Additionally, our comment letter indicated that while we support enhancing guidance in situations in which other auditors participate in an audit, we believe such enhancements should incorporate a risk-based approach in order to allow the lead auditor to apply professional judgment in developing an audit strategy. Our comment letter is available **here**.

The Auditor's Report on an Audit of Financial Statements when the Auditor Expressses an Unqualified Opinion, and Related Amendments

In May, the PCAOB reproposed for public comment the standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and related amendments. The reproposed standard revises the PCAOB's initial proposal issued in 2013. Similar to the 2013 proposal, the reproposed standard would retain the existing "pass/fail" model in the auditor's report, but would provide additional information in the report, such as the communication of critical audit matters and new elements related to auditor independence and auditor tenure.

A "critical audit matter" (CAM), as defined in the reproposed standard, is any matter that is communicated or required to be communicated to the audit committee and that (1) relates to accounts or disclosures that are material to the financial statements, and (2) involves especially challenging, subjective, or complex auditor judgment. The auditor's report would identify the critical audit matter, describe the considerations that led the auditor to conclude that such matter is a critical audit matter, describe how it was addressed in the audit, and refer to the relevant financial statement accounts and disclosures.

The reproposed standard refines a number of aspects in the 2013 proposal, including:

- Limiting the source of potential CAMs to matters communicated or required to be communicated to the audit committee
- Adding a materiality component to the definition of a critical audit matter
- Narrowing the definition of a critical audit matter to only those matters that involved particularly challenging, subjective, or complex auditor judgment
- Revising the related documentation requirement to be consistent with the definition of a critical audit matter
- Requiring the auditor to describe in the audit report how the critical audit matter was addressed during the audit

The reproposed standard would also result in the following changes to the existing auditor's report:

- The auditor's report would include a statement regarding the requirement for the auditor to be independent.
- The phrase "whether due to error or fraud," would be added to the auditor's report when describing the auditor's responsibilities under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatements.
- A statement would be included in the auditor's report regarding the number of years the auditor has served as the company's auditor
- The opinion would be required to be the first section of the auditor's report
- Section titles would be required in the auditor's report, to help guide the reader

The 2013 proposal also included another new auditing standard, *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*, regarding the auditor's responsibilities for other information outside the financial statements. The Board has not reproposed this auditing standard but plans to determine next steps at a later date.

The reproposed standard would generally apply to audits conducted under PCAOB standards. Unlike the 2013 proposal, however, the requirements regarding CAMs would not apply to audits of brokers and dealers reporting under the Securities Exchange Act of 1934 Rule 17a-5; investment companies other than business development companies; and employee stock purchase, savings, and similar plans.

The reproposal is available **here**. The comment period closed in August. The PCAOB staff has evaluated the comments on the reproposal, and is currently drafting a final standard and an adopting release for the Board's consideration.

BDO OBSERVATIONS:

In our comment letter, we supported the PCAOB's efforts to modernize the auditor reporting model by enhancing the usefulness and informational value of the auditor's report. We also encouraged the PCAOB to align its proposed standard with the IAASB's revised suite of auditor reporting standards because of the interconnected nature of the global economy and the needs of investors for a consistent reporting framework. Additionally, we stated in our comment letter that we do not support disclosure of auditor tenure within the auditor's report, nor do we believe there is support for a regulatory requirement for such disclosure. Our comment letter is available **here**.

INSPECTIONS

The PCAOB staff noted several recurring inspection findings, especially with respect to ICFR (management review controls, reliance on controls that lack precision or controls that rely on other controls). Other audit areas that require improvement include the assessments of, and responses to, risks of material misstatement, accounting for estimates, including fair value measurements, and the implementation of AS 18 (related parties).

The staff indicated that the 2017 inspections will likely focus on the recurring audit deficiencies noted above, audit firm efforts related to the implementation of new accounting standards, including how independence is being maintained and monitored, audit areas impacted by economic trends and higher financial reporting risk (e.g., fluctuations in oil and gas prices), going concern evaluations, and multi-national audits, including mandatory auditor rotation, among other areas. Additionally, the staff indicated they will be gathering information related to auditor consideration of a registrant's non-GAAP measures.

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MESSAGE

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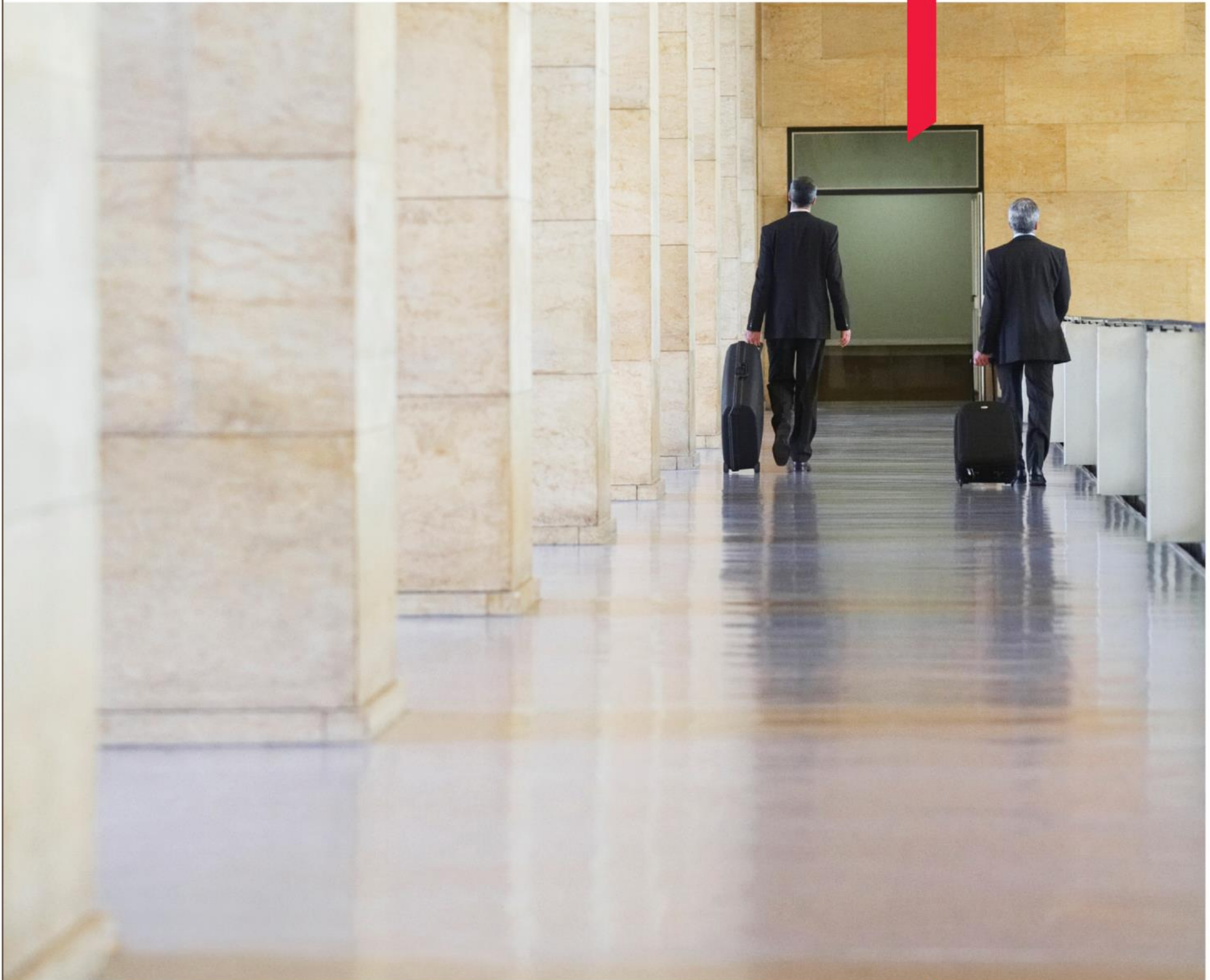
People who know, know BDO.[SM]

FOURTH QUARTER 2016

AN OFFERING FROM BDO'S NATIONAL ASSURANCE PRACTICE

SIGNIFICANT ACCOUNTING & REPORTING MATTERS



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FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)

FINAL FASB GUIDANCE

All final FASB guidance can be accessed on the FASB website located under the *Standards* tab, *Accounting Standards Updates*.

Accounting Standards Update 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*

Issued: December 2016

Summary: ASU 2016-12 amends the new revenue standard. The amendments do not alter the core principle of the standard, but clarify certain narrow aspects of the standard including contract cost accounting, disclosures, illustrative examples, and other matters.

For additional information, refer to BDO's Alert.

Effective Date: The effective date and transition requirements for ASU 2016-20 are the same as the effective date and transition requirements of Topic 606.

Accounting Standards Update 2016-19, *Technical Corrections and Improvements*

Issued: December 2016

Summary: ASU 2016-19 includes changes intended to clarify the FASB ASC, correct unintended application of guidance, or make minor improvements to the ASC that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities.

Effective Date: Most of the amendments do not require transition guidance and are effective upon issuance. Several amendments have specific transition requirements, and early adoption is permitted for those items.

Accounting Standards Update 2016-18, *Restricted Cash*

Issued: November 2016

Summary: ASU 2016-18 updates Topic 230[1] to require that restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total cash amounts shown on the statement of cash flows. Consequently, transfers between cash and restricted cash will not be presented as a separate line item in the operating, investing or financing sections of the cash flow statement. The ASU includes examples of the revised presentation guidance, and additional presentation and disclosure requirements apply.

For additional information, refer to BDO's Alert.

Effective Date: The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The amendments should be applied retrospectively to each period presented. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Accounting Standards Update 2016-17, *Interests Held through Related Parties That Are under Common Control*

Issued: October 2016

Summary: ASU 2016-17 amends the variable interest entity (VIE) guidance within Topic 810.[2] It does not change the two required characteristics for a single decision maker to be the primary beneficiary ("power" and "economics"),[3] but it revises one aspect of the related analysis. The amendments change how a single decision maker of a VIE treats indirect variable interests held through related parties that are under common control when determining whether it is the primary beneficiary of that VIE. The ASU requires consideration of such indirect interests on a proportionate basis, instead of being the equivalent of direct interests in their entirety, thereby making consolidation less likely.

For additional information, refer to BDO's Alert.

Effective Date: The amendments are effective for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year. Entities that have not yet adopted ASU 2015-02 are required to adopt ASU 2016-17 at the same time they adopt ASU 2015-02 and should apply the same transition method elected for ASU 2015-02. Entities that have already adopted ASU 2015-02 are required to apply ASU 2016-17 retrospectively to all relevant prior periods beginning with the fiscal year in which ASU 2015-02 initially was applied.

Accounting Standards Update 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*

Issued: October 2016

[1] Statement of Cash Flows

[2] Consolidation

[3] paragraph 810-10-25-38A

Summary: ASU 2016-16 eliminates from Topic 740[4] the recognition exception for intra-entity asset transfers other than inventory so that an entity's consolidated financial statements reflect the current and deferred tax consequences of those intra-entity asset transfers when they occur. For intra-entity asset transfers of inventory, recognition of current and deferred income tax consequences will continue to be deferred until the inventory has been sold to an outside party or otherwise left the consolidated group.

For additional information, refer to the following BDO resources:

- BDO Knows: ASC 740 – Intra-Entity Transfers of Assets Other than Inventory
- BDO Alert

Effective Date: The amendments are effective for public business entities for annual reporting periods beginning after December 15, 2017 and interim reporting periods within those fiscal years, and for entities other than public business entities for annual reporting periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. An entity may elect early adoption, but it must do so for the first interim period of an annual period if it issues interim financial statements.

PROPOSED FASB GUIDANCE

The following is a summary of significant proposed guidance that was issued for comment during the quarter. All proposed FASB guidance can be accessed on the FASB website located under the *Projects* tab.

Proposed Accounting Standards Update, *Distinguishing Liabilities from Equity (Topic 480): I. Accounting for Certain Financial Instruments with Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*

Issued: December 2016

Comment Deadline: February 6, 2017

Summary: The proposed amendments in Part I of the exposure draft would change the accounting for certain equity-linked financial instruments (or embedded features) with down round features. The proposed amendments would require that when determining whether certain financial instruments should be classified as liabilities or equity instruments, an entity would not consider the down round feature when assessing whether the instrument is indexed to its own stock. However, an entity would recognize the effect of the feature when triggered.

For financial instruments with down round features that have been triggered during the reporting period, an entity would disclose that the feature has been triggered, the value of the effect of the down round feature being triggered, and the financial statement line item in which that effect is recorded.

[4] Income Taxes

The proposed amendments in Part II of the exposure draft are a recharacterization of the indefinite deferral of certain provisions of Subtopic 480-10, which are currently presented as pending content in the Codification, to a scope exception. These amendments will not have an accounting effect.

Effective Date: For Part I, the Board will determine the effective date and whether the proposed amendments may be applied before the effective date after it considers stakeholder feedback. Part II would not require any transition guidance because those amendments do not have an accounting effect.

Proposed Accounting Standards Update, *Stock Compensation (Topic 718): Scope of Modification Accounting*

Issued: November 2016

Comment Deadline: January 6, 2017

Summary: The proposed amendments would clarify that an entity should apply modification accounting in Topic 718 when the terms or conditions of a share-based payment award are changed, unless all the following are the same immediately before and after the modification:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the award.
2. The vesting conditions of the award.
3. The classification of the award as an equity instrument or a liability instrument.

For additional information, refer to BDO's comment letter.

Effective Date: The Board will determine the effective date and whether the proposed amendments may be applied before the effective date after it considers stakeholder feedback.

Proposed Accounting Standards Update, *Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services*

Issued: November 2016

Comment Deadline: January 6, 2017

Summary: The proposed amendments would clarify Topic 853 to specify that the grantor (usually a governmental entity), rather than the third-party users of infrastructure, is the customer of the operation services in all cases for service concession arrangements. The amendments are intended to eliminate the diversity in practice regarding the customer determination for such operation services, and to reduce complexity and enable more consistent application of other aspects of the pending revenue standard (Topic 606), which are affected by this customer determination.

For additional information, refer to BDO's comment letter.

Effective Date: The effective date and transition requirements would depend on whether or not an entity has already adopted Topic 606 at the time this standard is finalized. Generally, entities would be required to apply this standard concurrently with application of Topic 606.

Proposed Accounting Standards Update, *Technical Correction to Update No. 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities—Endowment Reporting*

Issued: October 2016

Comment Deadline: November 11, 2016

Summary: The proposed amendments would clarify the minimum requirements for the reconciliation that a not-for-profit entity (NFP) is required to disclose if it has endowment funds. Specifically, it would remove the words "that contain no purpose restrictions" from paragraph 958-205-50-1B(e)(3), which were added by the amendments in ASU 2016-14.

For additional information, refer to BDO's comment letter.

Effective Date: The Board will determine the effective date after considering stakeholder feedback on the proposed amendments. Earlier application of the proposed amendments would be permitted at the beginning of any fiscal year before the effective date.

OTHER ACTIVITIES

The following section provides high level summaries of other relevant FASB publications and activities.

Emerging Issues Task Force

The Emerging Issues Task Force (EITF) met on November 17, 2016. The following conclusions reached by the EITF do not represent final or proposed guidance until they are ratified by the FASB.

Issue 16-B: Employee Benefit Plan Master Trust Reporting

Status: The Task Force reached a final consensus on the following Issue. The FASB ratified on November 30, 2016. A final ASU is expected early in 2017.

Summary: The final consensus affirmed that that a plan should present its interest in the master trust and the change in its interest in that master trust as single line items in the statement of net assets available for benefits and the statement of changes in net assets available for benefits, respectively. Some incremental disclosures will be required.

Effective Date: The final consensus is expected to effective for fiscal years beginning after December 15, 2018, with early adoption permitted. An entity that elects early adoption must adopt all of the amendments in the same period.

FASB Transition Resource Group for Credit Losses

Summary: The FASB established the Transition Resource Group (TRG) for Credit Losses early in 2016 to solicit, analyze, and discuss implementation issues that could arise when organizations implement ASU 2016-13. The group will then share their views with the FASB, which will help the Board determine what, if any, action is appropriate to address those issues. The TRG also will provide stakeholders with a forum to learn about the new standard from others involved with implementation. The TRG met on April 1, 2016 to discuss whether the measurement guidance of ASU 2016-13 clearly communicates the Board's decisions. Additional meeting dates have not yet been announced.

Background: The FASB issued ASU 2016-13 in June 2016 establishing the current expected credit loss (CECL) model, which requires entities to recognize upon inception and at each reporting date an allowance for the current estimate of contractual cash flows they do not expect to collect over an instrument's life. The model applies to financial assets measured at amortized cost (e.g., loans, trade receivables, debt securities) and certain off off-balance sheet credit exposures.

For more information, refer to BDO's archived **webinar** and BDO's **Alert** on the new Credit Losses standard.

FASB Transition Resource Group for Revenue Recognition

Summary: The TRG for Revenue Recognition met on November 7, 2016 to discuss the following issues:

- Over Time Revenue Recognition
- Capitalization and Amortization of Incremental Costs of Obtaining a Contract
- Royalty with Minimum Guarantee
- Payments to Customers

Also during the quarter, the FASB issued an ASU containing technical corrections and improvements to the revenue standard (see *Final FASB Guidance*, above).

Background: The TRG for Revenue Recognition was established in 2014 to solicit, analyze, and discuss stakeholder issues arising from implementation of the recently issued standard, ASU 2014-09 (Topic 606), *Revenue from Contracts with Customers*; to inform the FASB and IASB about those implementation issues, which will help the Boards determine what, if any, action will be needed to address those issues; and to provide a forum for stakeholders to learn about the new guidance from others involved with implementation.

For more information, or for resources on the new standard, refer to BDO's **Revenue Recognition Resource Center**. More information may also be found on the FASB **website**.

AICPA Financial Reporting Executive Committee

Summary: The Financial Reporting Executive Committee (FinREC) is the senior committee of the AICPA for financial reporting. It is authorized to make public statements on behalf of the AICPA on financial reporting matters. During the quarter, topics discussed by FinREC included:

Revenue Recognition – FinREC has issued several working drafts that provide industry-specific considerations and illustrative examples related to the implementation of ASU 2014-09, *Revenue from Contracts with Customers*. FinREC continued to issue working drafts for comment in 2016. Industries affected by the most recent working drafts include airlines, gaming, telecommunications and timeshares with comment periods ending February 1, 2017 or March 1, 2017.

In January 2017, the AICPA published the first edition of its *Audit and Accounting Guide: Revenue Recognition*. This edition addresses general accounting considerations, general auditing considerations, and accounting implementation issues in the aerospace & defense and asset management industries. The guide will be updated as additional implementation issues are finalized.

Complete details and additional AICPA resources are available **here**.

Accounting and Valuation Guide - FinREC continued deliberations on a new interpretive practice guide, Valuation of Portfolio Company Investments of Venture Capital and Private Equity Firms and Other Investment Companies. Deliberations included market participant assumptions, calibration and other valuation related matters.

Refer to the AICPA website at: **www.aicpa.org/interestareas/frc/accountingfinancialreporting/pages/finrec.aspx**.

SECURITIES AND EXCHANGE COMMISSION (SEC)

FINAL AND PROPOSED SEC GUIDANCE

All SEC Final Rules can be accessed on the SEC website located under the *Regulatory Actions* section, *Final Rules*.

(Note: The following pertains to significant accounting and reporting SEC releases. For a complete listing of SEC rules, please refer to the SEC website.)

The SEC did not issue any significant final or proposed guidance during the quarter.

OTHER ACTIVITIES

The following section provides high level summaries of other relevant SEC publications and activities.

2016 Conference on Current SEC and PCAOB Developments

Summary: The annual AICPA National Conference on Current SEC and PCAOB Developments was held in December 2016 in Washington, DC, where representatives of the SEC and the PCAOB shared their views on various accounting, reporting, and auditing issues. Areas of particular focus included implementation of new accounting standards, internal control over financial reporting, non-GAAP reporting, and other accounting, auditing, and disclosure matters.

For additional information, refer to BDO's **SEC Year in Review - Significant 2016 Developments** newsletter.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

FINAL AND PROPOSED PCAOB GUIDANCE

All final and proposed PCAOB guidance can be accessed on the PCAOB website located under the *Rules of the Board* tab.

The PCAOB did not issue any significant final or proposed guidance during the quarter.

OTHER ACTIVITIES

The following section provides high level summaries of other publications and activities related to PCAOB, auditing, and governance matters.

CAQ Audit Committee Tools and Resources

Summary: **During the fourth quarter, the Center for Audit Quality (CAQ) released three resources for audit committees:**

- Preparing for the New Revenue Recognition Standard

  The revenue tool addresses the following topics from an audit committee perspective:

  - Understanding the new revenue recognition standard – what is it?
  - Evaluating the company's impact assessment – how will revenue change?
  - Evaluating the implementation project plan – how do we need to prepare?
  - Other implementation considerations – what else do we need to consider?

- CAQ Non-GAAP Financial Measures: Continuing the Conversation

  The CAQ intends to use the questions in this tool in roundtables and panels in which management, investors, investment analysts, members of the legal community, audit committees, internal and external auditors, regulators, and academics can come together to share perspectives on non-GAAP financial measures.

- Anti-Fraud Collaboration Webinar

  The webinar examines the steps entities should take when fraud is identified or suspected in an organization, from conducting investigations to determining whether they should alert the SEC about a potential securities law violation and the risks and rewards of self-reporting.

INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB)

FINAL IASB GUIDANCE

All final IASB guidance can be accessed on the IASB website located under the *IFRS* tab, *Standards and Interpretations*.

Amendments to IFRS 40 *Investment Property*

Issued: December 2016

Summary: IAS 40 requires a property be transferred to, or from, investment property only when there is a change in use. The amendment clarifies that a change in management's intentions for the use of a property does not in isolation provide evidence of a change in use.

Effective Date: The amendment is effective for annual periods beginning on or after January 1, 2018.

IFRIC Interpretation 22 *Foreign Currency Transactions and Advance Consideration*

Issued: December 2016

Summary: IFRIC 22 addresses the exchange rate that should be used to measure revenue (or expense) when the related consideration was received (or paid) in advance. It requires that the exchange rate to use is the one that applied when the non-monetary liability (or asset) arising from the receipt (or payment) of advance consideration was initially recognized.

Effective Date: The interpretation is effective for annual periods beginning on or after January 1, 2018.

Annual Improvements to IFRS (2014-2016 cycle)

Issued: December 2016

Summary: The Annual improvements to IFRS (2014-2016 cycle) affect the following three standards:

- IFRS 1 *First-time adoption of IFRS* has been amended to remove the short-term exemptions dealing with IFRS 7 *Financial Instruments: Disclosures,* IAS 19 *Employee Benefits* and IFRS 10 *Consolidated Financial Statements*. The reliefs provided are no longer applicable and had been available to entities only for reporting periods that have now passed.
- IFRS 12 *Disclosure of Interests in Other Entities* has been amended to clarify the scope of IFRS 12 with respect to interests in entities within the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to clarify that entity are not exempt from all of the disclosure requirements in IFRS 12 with respect to interests in entities classified as held for sale or discontinued operations

- IAS 28 *Investments in Associates and Joint Ventures* has been amended to clarify that a venture capital organization, or a mutual fund, unit trust and similar entities (including investment-linked insurance funds) may choose, on an investment by investment basis, to account for its investments in joint ventures and associates at fair value or using the equity method.

Effective Date: The amendments are effective for annual periods beginning on or after January 1, 2018, except for the improvement to IFRS 12, which is effective for periods beginning on or after 1 January 2017.

PROPOSED IASB GUIDANCE

The following is a summary of all significant proposed guidance that was issued or was open for comment during the quarter. All proposed IASB guidance can be accessed on the IASB website located under the *Get Involved* tab, *Comment on a Proposal*.

The IASB did not issue any significant proposed guidance during the quarter.

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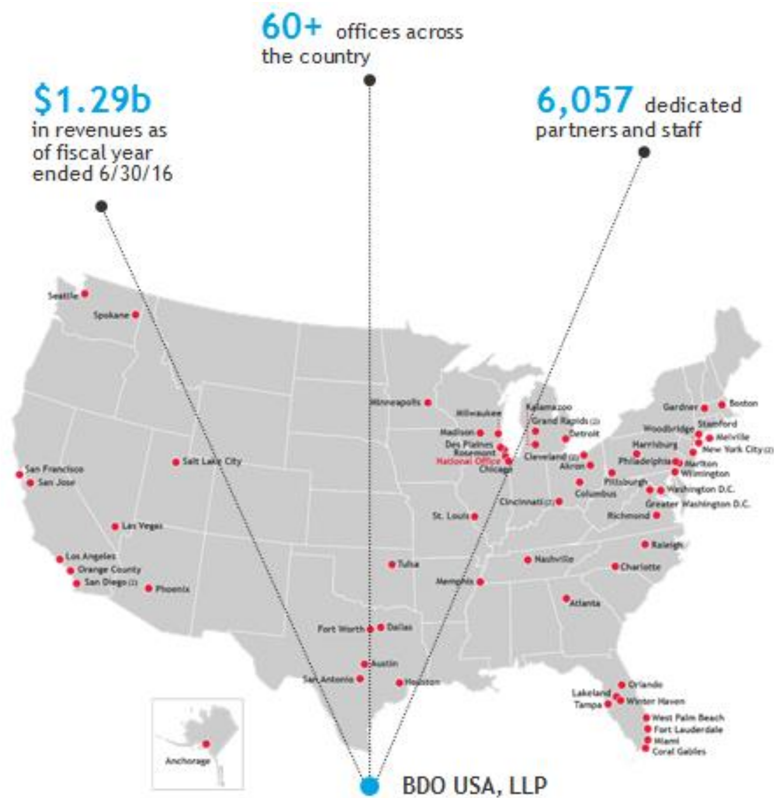

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EFFECTIVE DATES OF U.S. ACCOUNTING PRONOUNCEMENTS

This appendix was prepared with a calendar year-end company in mind. Therefore standards with an effective date in 2015 have been included since many companies applied them for the first time in 2016, e.g., the first interim or annual period beginning on or after December 15, 2015. Standards that do not require adoption before 2017 are highlighted in gray.

Also, refer to BDO's IFR Bulletin summarizing effective dates of IFRS pronouncements.

PRONOUNCEMENT	EFFECTIVE DATE - PUBLIC	EFFECTIVE DATE – NON PUBLIC
ASC 205, Presentation of Financial Statements		
ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*	Effective for all entities, unless they have adopted the liquidation basis of accounting under Subtopic 205-30. The new standard applies prospectively to annual periods ending after December 15, 2016, and to annual and interim periods thereafter. Early adoption is permitted.	Effective for all entities, unless they have adopted the liquidation basis of accounting under Subtopic 205-30. The new standard applies prospectively to annual periods ending after December 15, 2016, and to annual and interim periods thereafter. Early adoption is permitted.
ASC 225, Income Statement		
ASU 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.
ASC 230, Statement of Cash Flows		
ASU 2016-18, *Restricted Cash*	Effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.	Effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.
ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted.	Effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

ASC 260, Earnings Per Share		
ASU 2015-06, *Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions (a consensus of the Emerging Issues Task Force)*	Effective retrospectively for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted.	Effective retrospectively for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted.
ASC 323, Investments—Equity Method and Joint Ventures		
ASU 2016-07, *Simplifying the Transition to the Equity Method of Accounting*	The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the application of the equity method. Early adoption is permitted.	The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the application of the equity method. Early adoption is permitted.
ASC 326, Financial Instruments—Credit Losses		
ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*	For public business entities that are SEC filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.	For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.
ASC 330, Inventory		
ASU 2015-11, *Simplifying the Measurement of Inventory*	Effective prospectively for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted as of the beginning of an interim or annual reporting period. If an entity has previously written down inventory (within the scope of the ASU) below its cost, that reduced amount is considered the cost upon adoption. Upon adoption, the change from the lower of cost or market to the lower of cost and net realizable value for inventory within the scope of the ASU will be accounted for as a change in accounting principle	Effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted as of the beginning of an interim or annual reporting period. If an entity has previously written down inventory (within the scope of the ASU) below its cost, that reduced amount is considered the cost upon adoption. Upon adoption, the change from the lower of cost or market to the lower of cost and net realizable value for inventory within the scope of the ASU will be accounted for as a change in accounting principle

ASC 350, Intangibles—Goodwill and Other		
ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*	Effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively.	Effective for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption is permitted. An entity can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively.
ASU 2014-02, *Accounting for Goodwill (a consensus of the Private Company Council)*	Not applicable to public entities.	ASU 2016-03 removed the effective date of ASU 2014-02, thereby permitting an entity to apply the accounting alternative at any time without justifying that the use of the accounting alternative is preferable as described in paragraph 250-10-45-2.
ASC 405, Liabilities		
2016-04, *Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products*	Effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted.	Effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.
ASC 606, Revenue		
ASU 2014-09, *Revenue from Contracts with Customers* **ASU 2015-14,** *Revenue from Contracts with Customers: Deferral of the Effective Date* **ASU 2016-08,** *Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* **ASU 2016-10,** *Identifying Performance Obligations and Licensing* **ASU 2016-12,** *Narrow-Scope Improvements and Practical Expedients* **ASU 2016-20,** *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*	Effective for annual periods beginning after December 15, 2017, including interim periods therein. Entities may adopt using a retrospective approach (with certain optional practical expedients) or a cumulative effect approach. Under the this alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application (e.g. January 1, 2018) and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.	Effective for annual periods beginning after December 15, 2018. In addition, the new standard is effective for interim periods within annual periods that begin after December 15, 2019. The same transition alternatives apply. Early adoption is permitted as of either: ▸ An annual reporting period beginning after December 15, 2016, including interim periods within that year, or ▸ An annual reporting period beginning after December 15, 2016 and interim periods within annual reporting periods beginning one year after the annual period in which the entity first applies the new standard.

ASC 715, Compensation—Retirement Benefits		
ASU 2015-04, *Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*	Effective prospectively for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted.	Effective prospectively for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted.
ASC 718, Compensation—Stock Compensation		
ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*	Effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted.	Effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted.
ASU 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (a consensus of the FASB Emerging Issues Task Force)*	Effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost.	Effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this Update either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this Update as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. Additionally, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost.

ASC 740, Income Taxes		
ASU 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*	Effective for annual reporting periods beginning after December 15, 2017 and interim reporting periods within those fiscal years. An entity may elect early adoption, but it must do so for the first interim period of an annual period if it issues interim financial statements.	Effective for annual reporting periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. An entity may elect early adoption, but it must do so for the first interim period of an annual period if it issues interim financial statements.
ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*	Effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted as of the beginning of any interim or annual reporting period.	Effective for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted as of the beginning of any interim or annual reporting period.
ASC 805, Business Combinations		
ASU 2015-16, *Simplifying the Accounting for Measurement-Period Adjustments*	Effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted.	Effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted.
ASU 2014-18, *Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)*	Not applicable to public entities.	ASU 2016-03 removed the effective date of ASU 2014-18, thereby permitting an entity to apply the accounting alternative at any time without justifying that the use of the accounting alternative is preferable as described in paragraph 250-10-45-2.
ASC 810, Consolidation		
ASU 2016-17, *Interests Held through Related Parties That Are under Common Control*	Effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year.	Effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year.
ASU 2015-02, *Amendments to the Consolidation Analysis*	Effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015.	Effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017.

ASU 2014-13, *Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity*	Effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted as of the beginning of an annual period. Entities may adopt using either a full or modified retrospective approach. The modified approach only impacts the annual period of adoption by recording a cumulative-effect adjustment to equity.	Effective for annual periods beginning after December 15, 2016, and interim and annual periods thereafter. Early adoption is permitted as of the beginning of an annual period. Entities may adopt using either a full or modified retrospective approach. The modified approach only impacts the annual period of adoption by recording a cumulative-effect adjustment to equity.
ASU 2014-07 *Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)*	Not applicable to public entities.	ASU 2016-03 removed the effective date of ASU 2014-07, thereby permitting an entity to apply the accounting alternative at any time without justifying that the use of the accounting alternative is preferable as described in paragraph 250-10-45-2.
ASC 815, Derivatives and Hedging		
2016-06, *Contingent Put and Call Options in Debt Instruments*	Effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year.	Effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted. However, if an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of that fiscal year.
2016-05, *Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*	Effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted.	Effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted.
ASU 2015-13, *Application of the Normal Purchases and Normal Sales Exception to Certain Electricity Contracts within Nodal Energy Markets*	Effective upon issuance and should be applied prospectively. An entity will have the ability to designate qualifying contracts that are entered into on or after the effective date of the ASU as normal purchases and normal sales (“NPNS”). Because an entity may elect the NPNS scope exception at contract inception or at a later date, it also will be able to designate qualifying contracts entered into before the effective date as NPNS, but only prospectively.	Effective upon issuance and should be applied prospectively. An entity will have the ability to designate qualifying contracts that are entered into on or after the effective date of the ASU as normal purchases and normal sales (“NPNS”). Because an entity may elect the NPNS scope exception at contract inception or at a later date, it also will be able to designate qualifying contracts entered into before the effective date as NPNS, but only prospectively.

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (a consensus of the FASB Emerging Issues Task Force)*	Effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015.	Effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.
ASU 2014-03 *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps - Simplified Hedge Accounting Approach (a consensus of the Private Company Council)*	Not applicable to public entities.	ASU 2016-03 removed the effective date of ASU 2014-03, thereby permitting an entity to apply the accounting alternative at any time without justifying that the use of the accounting alternative is preferable as described in paragraph 250-10-45-2.
ASC 820, Fair Value Measurement		
ASU 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) (a consensus of the Emerging Issues Task Force)*	Effective retrospectively for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted.	Effective retrospectively for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted.
ASC 825, Financial Instruments		
2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*	Effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Certain provisions of the ASU are eligible for early adoption.	Effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019 with early adoption permitted for fiscal years beginning after December 15, 2017 including interim periods within those years. Certain provisions of the ASU are eligible for early adoption prior to December 15, 2017.
ASC 835, Interest		
ASU 2015-15, *Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting)*	Effective upon issuance.	Effective upon issuance.

ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*	Effective retrospectively for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted.	Effective retrospectively for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption is permitted.
ASC 842, Leases		
2016-02, *Leases*	Effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. Specific transition requirements apply.	Effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted. Specific transition requirements apply.
ASC 915, Development Stage Entities		
ASU 2014-10, *Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation*	**DSE requirements** - Effective for annual reporting periods beginning after December 15, 2014 and interim periods therein. While the elimination of the DSE financial reporting requirements applies retrospectively, the new disclosures about related risks and uncertainties are required prospectively. Early adoption is permitted for financial statements that have not yet been issued or made available for issuance. **Consolidation update -** Effective for annual reporting periods beginning after December 15, 2015 and interim periods therein. The amendments apply retrospectively and also generally incorporate the transition provisions of Statement 167 to address situations in which it may not be practicable to obtain the necessary information for prior years. Early adoption is permitted for financial statements that have not yet been issued or made available for issuance.	**DSE requirements** - Effective for annual reporting periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. While the elimination of the DSE financial reporting requirements applies retrospectively, the new disclosures about related risks and uncertainties are required prospectively. Early adoption is permitted for financial statements that have not yet been issued or made available for issuance. **Consolidation update -** Effective for annual reporting periods beginning after December 15, 2016 and interim reporting periods beginning after December 15, 2017. The amendments apply retrospectively and also generally incorporate the transition provisions of Statement 167 to address situations in which it may not be practicable to obtain the necessary information for prior years. Early adoption is permitted for financial statements that have not yet been issued or made available for issuance.
ASC 944, Financial Services—Insurance		
ASU 2015-09, *Disclosures about Short-Duration Contracts*	Effective for annual reporting periods beginning after December 15, 2015 and interim reporting periods within annual periods beginning after December 15, 2016. Early adoption is permitted.	Effective for annual reporting periods beginning after December 15, 2016 and interim reporting periods within annual periods beginning after December 15, 2017. Early adoption is permitted.

ASC 958, Not-for-Profit Entities and Topic 954, Health Care Entities		
ASU 2016-14, ***Presentation of Financial Statements of Not-for-Profit Entities***	Not applicable.	Effective for annual financial statements issued for fiscal years beginning after December 15, 2017, and for interim periods within fiscal years beginning after December 15, 2018. Application to interim financial statements is permitted but not required in the initial year of application. Early adoption is permitted.
ASC 960, Defined Benefit Pension Plans		
ASU 2015-12, *(Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient*	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all parts individually or in the aggregate. Part II of the ASU should be applied retrospectively, while Part III should be applied prospectively.	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all parts individually or in the aggregate. Part II of the ASU should be applied retrospectively, while Part III should be applied prospectively.
ASC 962, Defined Contribution Pension Plans		
ASU 2015-12, *(Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient*	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all three parts individually or in the aggregate. Parts I and II of the ASU should be applied retrospectively, while Part III should be applied prospectively.	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all three parts individually or in the aggregate. Parts I and II of the ASU should be applied retrospectively, while Part III should be applied prospectively.
ASC 962, Health and Welfare Benefit Plans		
ASU 2015-12, *(Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient*	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all three parts individually or in the aggregate. Parts I and II of the ASU should be applied retrospectively, while Part III should be applied prospectively.	Effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for all three parts individually or in the aggregate. Parts I and II of the ASU should be applied retrospectively, while Part III should be applied prospectively.
Other		
ASU 2016-19, *Technical Corrections and Improvements*	Most of the amendments do not require transition guidance and are effective upon issuance. Several amendments have specific transition requirements, and early adoption is permitted for those items.	Most of the amendments do not require transition guidance and are effective upon issuance. Several amendments have specific transition requirements, and early adoption is permitted for those items.

ASU 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*	The amendments within Topics 605 and 932 are effective upon adoption of Topic 606. Paragraph 815-10-S99-3 is rescinded to coincide with the effective date of ASU 2014-16.	The amendments within Topics 605 and 932 are effective upon adoption of Topic 606. Paragraph 815-10-S99-3 is rescinded to coincide with the effective date of ASU 2014-16.
ASU 2015-10, *Technical Corrections and Improvements*	Transition guidance varies based on the individual amendments. The amendments that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments became effective upon issuance.	Transition guidance varies based on the individual amendments. The amendments that require transition guidance are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. All other amendments became effective upon issuance.

Non-GAAP Financial Measures

CENTER FOR AUDIT QUALITY

DECEMBER 2016

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The Need to Continue the Dialogue Around Non-GAAP Financial Measures

When non-GAAP financial measures are presented appropriately, the Center for Audit Quality believes they can provide additional insights about a company.

Financial statements—balance sheets, income statements, statements of comprehensive income, cash flow and equity statements, and the accompanying notes—provide information about an entity for a variety of stakeholders. Typically, public companies in the United States prepare their financial statements in accordance with U.S. Generally Accepted Accounting Principles (GAAP). GAAP information is useful for decision-making because it is both relevant and reliable. Companies that report under GAAP use a common framework to account for transactions, and auditors can audit information prepared in accordance with those common standards.

However, in recent years, the presentation of non-GAAP financial measures has increased, and regulators and others have expressed concerns that investors could be misled or confused by this information, if it is not presented appropriately.

When non-GAAP financial measures are presented appropriately, the Center for Audit Quality (CAQ) believes they can provide additional insights about a company's results of operations, financial position, or liquidity. The CAQ also believes that it is important that users have confidence in such non-GAAP financial information. No single stakeholder can create that confidence alone. To varying degrees, audit committees, the Securities and Exchange Commission (SEC), auditors, analysts, and others have a role to play.

The public company audit profession is in a unique position to foster a dialogue among all stakeholders about the relevance, presentation, reliability, and use of non-GAAP financial measures—and what could be done to enhance public confidence in these measures. The CAQ will use the questions in this paper in roundtables and panels in which management, investors, investment analysts, members of the legal community, audit committees, internal auditors, independent auditors, regulators, and academics can come together to share perspectives on non-GAAP financial measures.

Background Information

DEFINITION AND USE OF NON-GAAP FINANCIAL MEASURES

Non-GAAP financial measures are numerical measures of a registrant's historical or future financial performance, financial position, or cash flows that adjust GAAP amounts in some fashion.[1] Common non-GAAP financial measures include, among others, earnings before interest, taxes, depreciation and amortization (EBITDA), adjusted EBITDA, and adjusted earnings per share (EPS). The SEC has established regulations about the presentation of non-GAAP financial measures in SEC filings and other company communications, such as earnings releases and investor presentations. The spirit of these regulations is that the non-GAAP financial measure should be a relevant and meaningful measure that does not mislead investors.

A company has flexibility to choose which non-GAAP financial measures, if any, it reports, and how it presents them, subject to certain requirements and prohibitions. This means that companies can report different measures from what their peers, competitors, and companies in other industries report. This also means that various companies may report similarly titled non-GAAP financial measures, but calculate the measures differently from each other. These differences can make the measures susceptible to misinterpretation without proper context and explanation. There is also a risk that a company may take advantage of the flexibility of non-GAAP financial measures to present itself in a more favorable light, in particular if the non-GAAP financial measures are presented more prominently than the GAAP financial measures.

SEC staff has recently focused on companies' use of non-GAAP financial measures through speeches and comment letters,[2] and in May 2016 updated its interpretive guidance related to the use of such measures.[3] Their comments continue to focus on concerns related to (1) presenting non-GAAP financial measures with greater or equal prominence than the comparable

Non-GAAP financial measures should be relevant and reliable measures that do not mislead investors, and should not be more prominent than the related GAAP numbers.

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1 The SEC defines a non-GAAP financial measure as a numerical measure of a registrant's historical or future financial performance, financial position, or cash flow that (i) 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 GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or (ii) 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 (SEC Item 10(e)(2) of Regulation S-K, 17 CFR 229.10(e)(2) and Item 101 of Regulation G, 17 CFR 244.101).

2 Comment letters including comments on non-GAAP measures made public between December 1, 2015 and August 1, 2016 represented 22% of the comment letters versus 16% during the same period last year (http://blogs.wsj.com/cfo/2016/08/31/visa-inc-s-chief-accountant-on-receiving-and-sending-comment-letters/). Since May 2016, the SEC has issued over 150 comment letters on non-GAAP financial measures that have become publically available (http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/10/Updated-NonGAAP-Guidance-The-First-150-Comment-Letters-CM-101920163.pdf).

3 See the C&DIs released by the SEC on May 17, 2016 https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

Regulatory Oversight Activities Related to Non-GAAP Financial Measures

In January 2003, as a result of the Sarbanes-Oxley Act, the SEC issued rules on the Conditions for Use of Non-GAAP Financial Measures that cover the following:[1]

1. Public disclosure of non-GAAP financial measures (Regulation G)

2. Non-GAAP financial measures included in SEC filings (Regulation S-K Item 10(e))

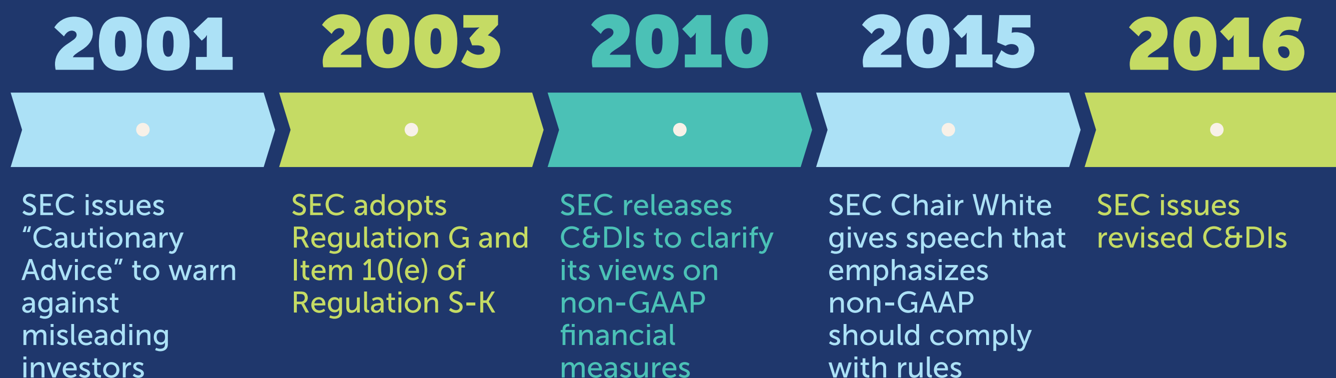
3. Requirement to furnish under Item 2.02 of Form 8-K earnings releases for quarterly or annual periods

The SEC focused on non-GAAP financial measures again in 2010. During this period, the SEC recognized that companies frequently use non-GAAP financial measures to communicate important information about their business to their stakeholders. Therefore, the SEC released Compliance and Disclosure Interpretations (C&DIs) to clarify their views on non-GAAP financial measures.

1 See SEC Release No. 33-8176.

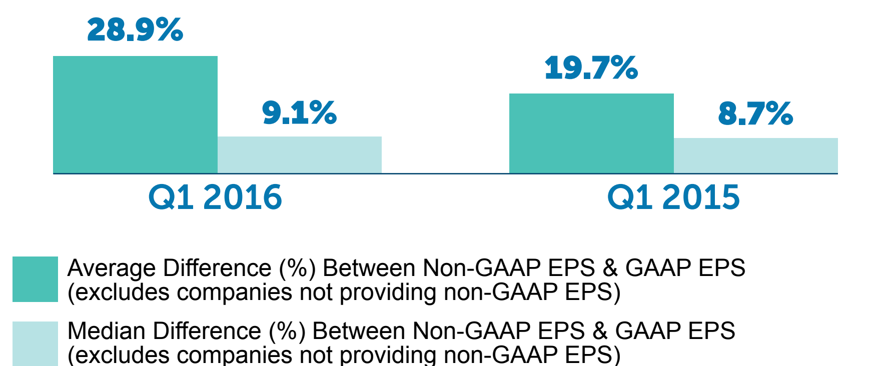
Today, non-GAAP financial measures are back in the spotlight. As noted earlier, companies have increased their use of non-GAAP financial measures, and the spread between non-GAAP results and their GAAP counterparts has been growing. This has sparked renewed public focus by the SEC and its staff and resulted in the SEC staff updating its interpretive guidance by releasing revised C&DIs in May 2016. The guidance offers insights into how the SEC staff will assess the appropriateness of non-GAAP financial measures in SEC filings and in information furnished to the SEC. The updated C&DIs address a range of issues. Subsequent to the release of the C&DIs, we have observed a change in the prominence companies are giving to GAAP information over non-GAAP. For example, among S&P 500 companies reporting results in July, 81 percent gave equal or greater prominence to the GAAP figures, an increase from 52 percent that did so when reporting first quarter results.[2]

2 See, *Wall Street Journal*, "Firms Say Goodbye to Prettied-Up Financial Reports" (August 29, 2016). Available at http://www.wsj.com/articles/companies-play-up-standard-accounting-figures-1472495965.



GAAP measure; (2) the need to tailor disclosures to describe the usefulness of non-GAAP financial measures; and (3) non-GAAP financial measures that may be misleading.

The growing use of non-GAAP financial measures—and the fact the measures sometimes tell a different story than GAAP measures—have been a subject of regular attention by the press and other observers. In March 2016, for example, *FactSet Insight* observed that in the first quarter of 2016, 19 of the 30 companies in the Dow Jones Industrial Average reported a non-GAAP EPS in addition to the GAAP EPS. The average difference between the non-



GAAP EPS and GAAP EPS was 28.9 percent, the median difference was 9.1 percent, and 15 of the 19 companies had a non-GAAP EPS that was higher than the GAAP EPS.[4] These differences were larger than in the first quarter of 2015, when the average difference was 19.7 percent and the median difference was 8.7 percent.[5]

SEC officials have indicated that companies should consider how their DCPs apply to the disclosure of non-GAAP financial measures.

Some stakeholders have stated that they value many non-GAAP financial measures when presented in the right context. The additional information may facilitate a broader understanding of a company. It may also provide insight into the financial results of the core business separate from amounts that management may consider unusual, infrequent, or not representative of underlying trends.

INTERNAL CONTROLS AND NON-GAAP FINANCIAL MEASURES

The preparation of non-GAAP financial measures generally does not fall under a company's system of internal control over financial reporting (ICFR). ICFR focuses on controls related to the reliability of financial reporting and the preparation of financial statements in accordance with GAAP, which would not include non-GAAP financial measures. Disclosure controls and procedures (DCPs) are more broadly defined by the SEC and pertain to all information required to be disclosed by a company. In speeches, SEC officials have indicated that companies should consider how their DCPs apply to the disclosure of non-GAAP financial measures, in addressing the application of the SEC rules.

CURRENT LEVEL OF AUDITOR INVOLVEMENT

The external auditor's opinion on the company's financial statements and, when required, the effectiveness of the company's ICFR, does not typically

4 See *FactSet Insight*, "Gulf Between Non-GAAP, GAAP EPS Estimates Grows" (March 20, 2016), available at http://insight.factset.com/2016/05/earningsinsight_05.20.16 Butters, John. FactSet Insight.

5 Ibid.

cover non-GAAP financial measures. These metrics are not included in the financial statements and, as noted above, generally are not covered by a company's ICFR. Therefore, they are not subject to the procedures an auditor employs regarding the financial statements or ICFR.

Non-GAAP financial measures are often included in other areas of a company's annual and quarterly filings that contain the financial statements. The auditor's professional standards indicate that auditors should read the other information in certain documents containing financial statements (such as annual reports) and consider whether the other information or the manner of its presentation is materially inconsistent with information appearing in the financial statements or a material misstatement of fact.[6] This inclusion within other areas of a company's filings leads to a misperception of the level of auditor involvement on the non-GAAP financial measures.

Furthermore, non-GAAP financial measures are often included in press releases, earnings calls, or other documents that do not include the financial statements. While auditors are generally not required to review these communications, in practice auditors often do review them as part of their risk assessment procedures.

Audit committees and management may consider using auditors as a sounding board when evaluating non-GAAP financial measures.

Though auditors do not audit non-GAAP financial measures, audit committees and management may consider using auditors as a sounding board when evaluating non-GAAP financial measures.

As part of the ongoing discussion among regulators, policymakers, investors, the public company audit profession, and others regarding what can be done to enhance the financial reporting system, some have suggested that the standards be changed to require greater auditor involvement with, and potentially assurance relating to, information outside of the financial statements, including non-GAAP financial measures. More recently, some market stakeholders have suggested including non-GAAP financial measures as supplemental information to the financial statements, for which the auditor's role is defined in Audit Standard 17 (AS 17): Auditing Supplemental Information Accompanying Audited Financial Statements (now codified as Audit Standard 2701).[7]

The auditing profession stands ready to address these and other options to increase confidence in non-GAAP financial measures. The profession also recognizes that additional consideration is needed to ensure that stakeholders find the reporting useful, to determine whether appropriate foundations for reporting are in place (in particular appropriate criteria by which to prepare and evaluate the non-GAAP financial measures), to consider the impact to currently used non-GAAP financial measures, and to conclude whether the benefits justify the additional costs.

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6 See PCAOB Audit Standard 2710: Other Information in Documents Containing Audited Financial Statements.

7 This was one of several recommendations noted at the PCAOB Investor Advisory Group Meeting on October 27, 2016. See, https://pcaobus.org/News/Events/Documents/102716-IAG-meeting/non-GAAP-WG-slides.pdf.

Stakeholder Engagement: Key Considerations and Questions

The CAQ believes non-GAAP financial measures that are transparent, calculated consistently, and comparable to other companies can help companies provide users with useful information.[8]

In today's increasingly complex markets, a variety of entities can have differing needs and uses for the information companies present about their performance. This variety poses a challenge for companies seeking to provide information that meets all users' needs.

In light of this challenge, all stakeholders should share their points of view on non-GAAP financial measures to assist companies in providing users with information that is relevant. Promoting both the relevance and reliability of non-GAAP financial measures will increase the public's trust in non-GAAP financial measures. To that end, we have compiled suggested questions for each stakeholder group to consider as it relates to non-GAAP financial measures. These broad questions cover a variety of topics as it relates to non-GAAP financial measures to facilitate open communication and exchange of each stakeholder's unique points of view.

MANAGEMENT

As the preparer of a company's non-GAAP financial measures, management has a responsibility to present non-GAAP financial measures that comply with applicable SEC requirements and do not mislead users of the information. Reasons why management may use non-GAAP financial measures could include the following:

- The information may provide meaningful insight into items affecting a company's performance and comparability of results.
- The information may provide insight as to how management evaluates the company's performance and determines how to allocate its resources.
- Management compensation and incentive plans may be based on non-GAAP financial measures.
- Debt covenants or other requirements may be based on non-GAAP financial measures.
- Certain non-GAAP financial measures, such as EBITDA, may be used for

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8 See the Center for Audit Quality's *Questions on Non-GAAP Measures: A Tool for Audit Committees* (June 28, 2016), available at http://www.thecaq.org/questions-non-gaap-measures-tool-audit-committees.

assessing business valuations in analyses of either earnings multiples or comparable transactions.

Questions management could consider:

1. *Do you maintain a formal policy regarding non-GAAP financial measures, and have you identified relevant DCPs?*

2. *During your internal financial reporting process, do GAAP or non-GAAP results receive more attention? If so, why? Which set of information is most relevant to your decision-making?*

3. *What measures are most commonly focused on by users of your financial information? What impact have recent comment letter or enforcement action trends had on your non-GAAP financial measures?*

4. *Would you find additional standardization of certain non-GAAP financial measures (e.g., which measures may be presented or how they are calculated) to be beneficial?*

INVESTORS

Investors are typically the primary audience of non-GAAP financial measures. Regulation S-K Item 10(e) requires disclosure of the reasons why a registrant believes that a non-GAAP financial measure provides useful information to investors. However, investors have differing levels of financial expertise and information needs. This can result in significantly different expectations regarding the nature of and disclosures about non-GAAP financial measures.

Questions investors could consider:

1. *In making investment decisions, are GAAP or non-GAAP results most relevant to your decision making, and why?*

2. *What do you find most helpful in the presentation and disclosure of non-GAAP financial measures? What concerns you most about the presentation of non-GAAP financial measures?*

3. *Would you find additional standardization of certain non-GAAP financial measures (e.g., which measures may be presented or how they are calculated) to be beneficial?*

4. *What is your current expectation of auditors regarding non-GAAP financial measures?*

5. *Do you think some level of additional auditor involvement with non-GAAP financial measures would be beneficial? If so, what would you expect that involvement to look like?*

INVESTMENT ANALYSTS

Investment analysts provide important services to the capital markets. Many analysts issue reports and recommendations on a company's publicly traded stock. They participate in many public company earnings calls and ask questions about management's use of non-GAAP financial measures. In some cases, the analysts' questions drive management's decisions about which non-GAAP financial measures to present.

Questions investment analysts could consider:

1. *How important is the use of non-GAAP financial measures to your understanding of a company's performance? Do you rely on the non-GAAP financial measures presented by companies or do you derive your own calculations?*
2. *Do you consider the nature of non-GAAP adjustments in assessing the quality of earnings of a company?*
3. *What distinguishes a useful non-GAAP financial measure from one that is not useful?*
4. *Would you find additional standardization of certain non-GAAP financial measures (e.g., which measures may be presented or how they are calculated) to be beneficial?*
5. *Some companies justify the use of non-GAAP financial measures by saying they are requested by analysts. Do you request such information if it is not provided?*
6. *Do you clearly distinguish between GAAP and non-GAAP financial measures in the information you release about a company?*

SECURITIES COUNSELORS

Securities counselors play an extremely important advisory role by helping a company to interpret and comply with securities laws related to non-GAAP financial measures, particularly regarding disclosure requirements. External securities counselors also work with underwriters or other financial intermediaries involved in the sales of securities, including advising them with respect to non-GAAP financial measures used as part of the sales process.

Questions securities counselors could consider:

1. *What impact have recent comment letter or enforcement action trends had on your interpretation of the rules and regulations on non-GAAP financial measures?*
2. *Has the progression of SEC staff interpretations made clearer what non-GAAP financial measures and disclosures are permitted?*

3. *What concerns do you have with non-GAAP financial measures? Would additional standards or auditor involvement address those concerns?*

4. *Does management consult with you on the design of DCPs specific to non-GAAP financial measures?*

AUDIT COMMITTEE MEMBERS

The audit committee has a responsibility to investors with its overall oversight of the financial reporting process. Given its role, the audit committee can act as a bridge between management and investors, including: (1) assessing management's reasons for presenting non-GAAP financial measures and the sufficiency of the related disclosures; (2) evaluating whether the measures present a fair and balanced view of the company; and (3) assessing how the measures are used by analysts and reported by the financial press to the broader public.[9]

Questions audit committee members could consider:

1. *Does management maintain a formal policy regarding non-GAAP financial measures, and have they identified relevant DCPs?*

2. *Do you confer with management, securities counselors, or auditors about the company's use of non-GAAP financial measures?*

3. *Would some level of additional auditor involvement be helpful to you in discharging your oversight of non-GAAP financial measures? If so, what would you expect that involvement to look like?*

INTERNAL AUDITORS

Internal auditors are an important part of a company's control structure, and by including procedures for non-GAAP financial measures in their control testing, internal auditors could help increase the reliability of and confidence in such measures.

Questions internal auditors could consider:

1. *Does your company have robust controls over its use of non-GAAP financial measures?*

2. *Do you test the disclosure controls for non-GAAP financial measures?*

INDEPENDENT AUDITORS

Independent auditors contribute to the reliability of a company's audited financial statements, and a company's ICFR, where applicable. The role of the independent auditor and whether it should evolve is a complex issue that has been examined periodically in light of changing market practices and

9 See *Questions on Non-GAAP Measures: A Tool for Audit Committees* for additional questions audit committees could consider asking when discussing non-GAAP financial measures with management. http://www.thecaq.org/questions-non-gaap-measures-tool-audit-committees.

investor information needs. For example, the auditor's role could evolve if stakeholders believe that their decision-making process could be enhanced as a result of some level of auditor involvement with non-GAAP financial measures.

Questions external auditors could consider:

1. *What are the most common questions management and audit committees are asking you about non-GAAP financial measures?*

2. *How often are audit committees asking audit teams to specifically look at non-GAAP financial measures? What types of procedures do you perform when requested?*

3. *If the market supported additional auditor involvement with non-GAAP measures, what level of involvement would be reasonable for auditors to perform? What would some of the more significant challenges be in developing an assurance model for non-GAAP financial measures?*

REGULATORS

REGULATORS–SECURITIES AND EXCHANGE COMMISSION

The SEC's responsibilities include protecting investors, facilitating capital formation, and maintaining fair, orderly, and efficient markets. As a result, the SEC rules and guidance on non-GAAP financial measures must strike a balance between the perceived usefulness of the information and the need to protect investors. The SEC's rules and staff guidance on non-GAAP financial measures have evolved over time and have primarily focused on the prominence of non-GAAP financial measures compared with their GAAP counterparts, the clarity of disclosures about non-GAAP financial measures, and the risk that non-GAAP financial measures may be misleading.

Questions regulators could consider:

1. *What are your concerns with non-GAAP financial measures?*

2. *Do you anticipate a market demand for future regulations or interpretations related to non-GAAP financial measures?*

3. *Do you believe the recent interpretations have been successful in achieving the desired outcome?*

4. *Would additional standardization of certain non-GAAP financial measures (e.g., which measures may be presented or how they are calculated) be beneficial?*

5. *Would some level of additional auditor involvement increase public trust in non-GAAP financial measures? If so, what would you expect that involvement to be?*

6. *What do you see as the potential implications of increased focus on non-GAAP financial measures? Do you have plans to address this issue with accounting standard setters?*

ACCOUNTING STANDARD SETTERS–FINANCIAL ACCOUNTING STANDARDS BOARD

The Financial Accounting Standards Board (FASB) has historically considered non-GAAP financial measures in the context of understanding the reasons why non-GAAP financial measures are used and whether the use of non-GAAP financial measures indicates that improvements are needed to GAAP.[10]

Questions accounting standard setters could consider:

1. *Do you have any concerns with non-GAAP financial measures? If so, what are those concerns?*

2. *Do you anticipate a market demand for future standard setting related to non-GAAP financial measures?*

3. *Is there a role for accounting standard setters to play in the dialogue about non-GAAP financial measures?*

4. *Will you consider the increased use of non-GAAP financial measures as part of your analysis of whether changes need to be considered in current and future GAAP standard setting?*

ACADEMICS

Members of the academic community conduct and publish valuable research that provides analysis on accounting, auditing, financial reporting, and more. This research assists stakeholders in thinking critically about complex issues and advancing conversations on topics of interest. Additionally, they play a vital role in financial reporting by educating students who go on to become stakeholders and participants in the financial reporting supply chain. They develop carricula that will prepare students for careers in the complex business environment of the future.

Questions members of the academic community could consider:

1. *Are you aware of academic research on the use of non-GAAP financial measures? What additional research questions could be addressed through academic studies?*

2. *What does the academic research show with respect to investors' use of non-GAAP financial measures?*

3. *Do college and university accounting and finance classes adequately address the benefits and challenges of using non-GAAP financial measures?*

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10 See the FASB's *Invitation to Comment – Agenda Consultation*, available at http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FNewsPage&cid=1176168356245.

GAAP, Non-GAAP, and KPIs: Distinctions that Matter

This paper, and dialogue, has focused on non-GAAP financial measures. However, there are also other commonly used performance metrics that may not meet the definition of a non-GAAP financial measure. For example, key performance indicators (KPIs) can be data points—such as number of stores or customers—or metrics calculated using GAAP amounts and a data point—such as sales per square foot. The distinctions among GAAP measures, non-GAAP financial measures, and KPIs are important because each has a different level of subjectivity, and different rules govern each type of measure.

While metrics that are not considered non-GAAP financial measures are not directly subject to the rules and interpretations discussed above, SEC staff has indicated that companies should provide certain disclosures about them, many of which are similar to those a company would provide for non-GAAP measures. At the "SEC Speaks in 2015" Conference, SEC staff noted that metrics should be discussed informatively since not all investors may be familiar with them.[1] Accordingly, a company should (1) clearly define the metrics used and how they are calculated, (2) describe any key assumptions and limitations (e.g., whether the metric is a "hard" amount or an estimate), (3) present a metric within a balanced discussion; and (4) clearly describe how a metric is related to current or future results of operations.

For example, a company may correctly claim it has 100 million users, and that the rate of user growth is expected to continue to increase.[2] "[This metric] certainly sounds good and it would seem to bode well for the prospects of the company – information that certainly could influence an investment decision," observed SEC Chair Mary Jo White in a November 2013 speech. "However, what if only a fraction of the users are paying customers?"[3]

While this paper focuses on non-GAAP financial measures, the issues and considerations we describe could also be used to evaluate how to enhance the relevance and reliability of KPIs and other performance metrics stakeholders may use for decision making.

1 See "Remarks at the Practicing Law Institute's 45th Annual Securities Regulation Institute," available at https://www.sec.gov/News/Speech/Detail/Speech/1370540284590.

2 See "Remarks at the Practicing Law Institute's 45th Annual Securities Regulation Institute," available at https://www.sec.gov/News/Speech/Detail/Speech/1370540284590.

3 Ibid

What's Next?

This document is intended to spark a dialogue among all stakeholders about the non-GAAP financial measures presented by companies, and how to enhance public trust in this information. While no one question is a silver bullet, collectively they can enhance stakeholders' understanding around what, if anything, can be done to enhance the relevance and reliability of non-GAAP financial measures. The CAQ plans to use the questions in this paper in roundtables and panels to further the dialogue on non-GAAP financial measures.

Appendix: Non-GAAP Financial Measure Disclosure Requirements

Disclosure	All disclosure of non-GAAP measures[11]	Press releases furnished to the SEC[12]	Filings with the SEC[13]
Most directly comparable GAAP measure	X	X	X
Reconciliation to GAAP measure	X	X	X
Equal or greater prominence of GAAP measure		X	X
Why management believes investors would find the non-GAAP financial measure useful		X	X
Management purpose, if any, of the non-GAAP financial measure		X	X

11 Regulation G applies to all disclosures of non-GAAP financial measures.

12 Regulation S-K Item 10(e)(1)(i) applies to press releases furnished under Item 2.02 of Form 8-K.

13 The entirety of Regulation S-K Item 10(e) applies to filings with the SEC. In addition to the disclosure requirements of Item 10(e)(1)(i), Item 10(e)(1)(ii) prohibits:

- Excluding charges or liabilities that require, or will require, cash settlement, or would have required cash settlement in the absence of 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 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 (prohibition is based on the description of the charge or gain that is being adjusted)
- Presenting non-GAAP financial measures on the face of the GAAP financial statements or in the accompanying notes
- Presenting non-GAAP financial measures on the face of any pro forma financial statements required to be disclosed by Regulation S-X, Article 11
- 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

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REITs
North America

Mysterious Ways

Alert: Clarity Around the SEC's Pro Rata Share Disclosure Rules

- **The Publication of "Pro Rata" Financial Statements is No Longer Allowed** — Statements made by a member of the SEC's Real Estate Group within the Corporate Finance division at a NAREIT conference earlier this week regarding the elimination of pro rata financial statements and other pro rata disclosure from supplemental packages caused an uproar among many REIT financial officers and members of the investment community. The issue relates not only to the elimination of this **crucial** disclosure that allows the investment community greater transparency into REIT performance (especially those with JVs and funds), but that the SEC is planning to enforce these rules with comment letters following Q3 earnings starting in the next few weeks. In follow-up, we've had several conversations with contacts at NAREIT, the SEC, and Goodwin Procter to better understand the new rules and offer our thoughts, potential solutions and need for more time to enforce. Following those conversations and a communication issued by NAREIT today, there is at least a short term solution to at least have the pro rata information in – just not totaled. That said, there will likely be items that evolve, and further discussions / stakeholder engagement will be necessary to not eliminate key information. We provide our thoughts and clarity around the guidance herein.

- **Some Background on the SEC's Guidelines** — In May 2016, the SEC's Division of Corporation Finance issued updated Compliance & Disclosure Interpretations (C&DIs) regarding the use of non-GAAP financial measures and prominence requirements. These changes came from the Corporate Finance Division's Office of the Chief Accountant – so the guidelines are SEC-wide and apply to all companies, not just REITs. Many REITs made changes to Q2 disclosure to comply, based on their interpretation of the guidance. This week, the further clarification around the C&DI was provided, extending to the **elimination** of pro rata financial statements. The SEC's primary concern with the presentation of these statements is the combination of consolidated GAAP information with non-GAAP pro rata adjustments – i.e. an income statement and/or balance sheet showing the total sum by line item (the combination of consolidated, minus non-controlling interest in consolidated, plus REIT share of unconsolidated). For REITs that disclose a full pro rata financial statement (ex: SPG, GGP, MAC, KIM, PLD, DLR, AKR, DDR and many others that have pro rata info), the primary issue is the showing the sum total of all. The concern surrounds the lack of control over JV assets, hence the equity method. We disagree with the elimination of this info, as it is critical to REIT analysis.

- **Near Term Solution** — While we voiced our displeasure with the decision, having come from the highest levels of the commission (not from the Real Estate group) it's not likely to be overturned anytime soon without significant discussions from financial statement users, preparers and creators. For now, based on NAREIT's memo – it appears at least the information can be included – just not totaled. *See further thoughts and details herein.*

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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- **Near Term Solution (continued)** — NAREIT responded with further clarification, suggesting that while the combination of GAAP and non-GAAP information cannot be presented as combined in the supplemental, that REITs can (on separate pages) provide the components for users to do the calculations themselves. For example, the consolidated GAAP income statement and balance sheets must stand alone, as always. Any presentation of non-controlling interest or pro rata share of JV adjustments can be presented by line item, but must be on a separate page and cannot be combined with the GAAP line items anywhere in the supplemental. So REITs are allowed to have separate pages showing a full JV IS and BS on a pro rata basis – the info cannot be presented alongside the GAAP financial statements. This allows financial statement users to do the pro rata math themselves by line item, which (while more work for us) is better than not having the information at all.
- **Beyond Financial Statements – Clarity, but Still Some Questions** — In addition to financial statement disclosure, this guidance also applies to any "combined" pro rata disclosure anywhere in the supplemental. For ex, the disclosure of a total pro rata debt number is not allowed – REITs can show total cons. debt in accordance with GAAP, but then any minority interest or JV share adjustments must be presented on a different page, and the "share of total debt" must not be disclosed at all. At the asset level, however, share of debt should be ok. Pretty much the rule of thumb is that non-GAAP pro rata adjustments can be disclosed, but that adjustment cannot be shown alongside or combined with a GAAP IS or BS line item. Here's where it gets fuzzy: Occupancy, ABR and releasing spreads are often shown on a pro rata basis – it's unclear whether the rules would apply there. SS NOI is not a GAAP number, but it's unclear if showing this on a pro rata basis is allowed. Net debt to EBITDA is also often provided on a pro rata basis – rightly so in our view given the tendency for higher leverage among JV assets – these types of ratios will not likely be allowed to be shown on a pro rata basis. Companies can provide the pieces for investors to get there themselves, but not likely the pro rata ratio. We asked many of these questions to the SEC, and we expect they will revisit and provide further clarity and guidelines around these and other performance metrics and non-GAAP disclosure in the coming months.
- **What About FFO and Calls?** —These pro rata disclosure rules do not apply to the reconciliations to FFO. According to the SEC, REITs' pro rata adjustments (i.e. pro rata D&A) in reconciling to "NAREIT FFO" are allowed to be presented as before. Additionally, for now at least, pro rata adjustments made in reconciling to "Core FFO" (i.e. pro rata debt extinguishment charges) are also allowed. It would appear that these rules do not apply to quarterly earnings calls. REITs are still allowed to discuss pro rata numbers as before – i.e. pro rata debt and EBITDA.
- **The Implications of a Comment Letter** — If the SEC finds that a company's disclosure is not compliant with SEC rules and guidelines including the most recent C&DI, it can issue a "comment letter" asking for added, changed, or removal of disclosure. There is then correspondence between the company and the SEC staff until the issue is resolved. It's our understanding after speaking with the SEC and Goodwin Proctor, that an outstanding comment letter relating to supplemental disclosure would not inhibit a REIT's ability to issue debt or equity under a shelf, given that REITs are accelerated filers and the 8-K supplemental furnished to the SEC is not incorporated into the S3 registration document (unlike the 10Q or 10K). The company's council may question whether it's a good idea to issue while a comment letter is still outstanding, but there's no restriction. The process would be a request for how the company plans to revise its disclosure under the new guidance – so in the case of a comment letter received following Q3 results, the SEC will not likely ask a company to revise its Q3 disclosure, but explain how the disclosure will change with Q4 results. Notably, these new rules apply whether or not a REIT furnishes its supplemental as an 8K with the SEC.

Appendix A-1

Analyst Certification

The research analysts primarily responsible for the preparation and content of this research report are either (i) designated by "AC" in the author block or (ii) listed in bold alongside content which is attributable to that analyst. If multiple AC analysts are designated in the author block, each analyst is certifying with respect to the entire research report other than (a) content attributable to another AC certifying analyst listed in bold alongside the content and (b) views expressed solely with respect to a specific issuer which are attributable to another AC certifying analyst identified in the price charts or rating history tables for that issuer shown below. Each of these analysts certify, with respect to the sections of the report for which they are responsible: (1) that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc. and its affiliates; and (2) no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in this report.

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REITs
North America

Survey Results on SEC Pro Rata Elimination

Survey Says: More Disclosure = Greater Transparency

- **We Conducted a Survey of Both Investors and REITs** — In light of the SEC's new guidelines to eliminate pro rata financial statements and other disclosure to take effect **this** earnings season (see our detailed note on the topic here), we surveyed investors and REIT management teams last week looking for their views on the change. Results showed that both groups overwhelmingly disagree with the SEC's new stance. It's clear through the responses that investors use and value this information, and the change will impact the supplemental disclosure of a large number of REITs. While most investors and many REITs do not intend to take direct action with the SEC on this issue, they see industry reps like NAREIT, auditors and us being able to represent their views. As such, we hope these survey results act as a conduit through which the SEC can hear opinions of financial statement users. The surveys had a good response rate with ~80 investors and ~60 corporates.

- **Impact and Relevance** — Over 90% of investors say that pro rata financial statements and other pro rata disclosure is important to their analysis of REITs and is used often. They also say they use full pro rata statements in their models for the REITs that provide them. 42% of REIT respondents publish full pro rata financial statements, consistent with the 38% who claim that the SEC's decision would be either "very" or "meaningfully" impactful to their supplemental disclosure. 36% of REITs say it will not impact them at all, reflective of those that have no JVs or funds.

- **Agreement and Action, A Stark Contrast** — Investors and REITs overwhelmingly disagree with the SEC's new guidelines to eliminate pro rata disclosure. Notably, more investors disagree (at 97%) than do REITs (at 92%). What this tells us is that generally regardless of whether investors use the data or REITs provide the data, they disagree with the decision to restrict the disclosure. However, we are surprised by how few investors (85%) and REITs (68%) intend to take action to try to change the SEC's decision. Our sense is that most believe action *should* be taken, but that NAREIT and the auditors should represent them and take action on this issue.

- **Our View** — As we wrote in our "Mysterious Ways" note a week ago, we disagree with the elimination of this info as we see pro rata disclosure as crucial, allowing financial statement users greater transparency into REIT performance (especially those with JVs / funds). We believe that the SEC, with a primary mission to "protect investors," fundamentally promotes transparency as well – which is why the decision was so surprising and confusing to us. Providing the components to calculate pro rata is a reasonable solution (92% of investors agree), and a better alternative than eliminating the info altogether. But we also see the point that this raises the level of "complexity" in analyzing REITs – something we are trying to avoid in an effort to attract more "generalist" investors to the space post the GICS change. In this regard, keeping the full pro rata disclosure would be ideal.

- **Survey Results & Comments Herein** — See the results and our analysis of the survey herein (p. 2-6), as well as direct comments from investors and REITs (p. 7).

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Question 1: Impact

Q (Investors): How important to your analysis of REITs is the disclosure of pro rata financial statements and other pro rata numbers and metrics (scale of 1 to 5)?

A: Over 90% say it's important: 5 – It's important to my analysis (75%) or 4 – I use it often (16%)

Q (REITs): How much does the SEC's new stance eliminating pro rata disclosure impact your supplemental disclosure (scale of 1 to 5)?

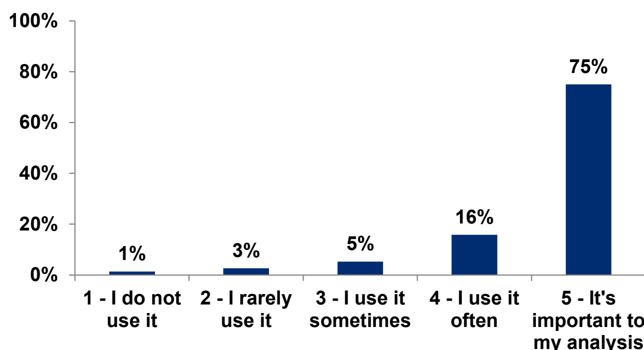
A: Mixed

Investors: Among investors – the financial statement users – the response was overwhelmingly in the camp that pro rata financial statements, numbers and metrics are an important part of their analysis of REITs (see Figure 1). A majority (at 75%) say it's important to their analysis while 16% use it often. Another 5% use it sometimes while only 4% of respondents don't or rarely use pro rata disclosure in REIT supplementals.

REITs: The distribution of REIT responses to the question of whether or not the SEC's change impacts their supplemental disclosure looked more like a barbell (see Figure 2). 36% of respondents claim it will have no impact at all – these are likely the REITs that have little to no assets held in JVs or funds. But on the other end of the spectrum, 38% of respondents claim that the change will be "very" or "significantly" impactful to the supplemental disclosure. These are likely the REITs that provide full pro rata financial statements (see Question 2). The remaining 26% claim they will have some modest impact – likely those REITs that disclose some pro rata information but not full pro rata financial statements. Notably, these proportions are similar to our experience with the disclosure of the ~80 REITs in our coverage universe. Some REITs do not have any JVs or funds, while among those that do, some provide full pro rata statements while others provide more limited pro rata information.

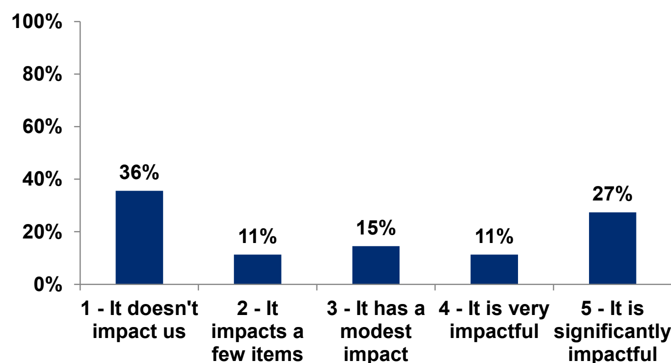
Overall, the decision appears to impact mostly ALL investors who look at REITs, and about half the corporates. Given the SEC's primary mission to "protect investors," we think all pro rata information should stay in.

Figure 1. Investors: How important to your analysis of REITs is the disclosure of pro rata financial statements and other pro rata numbers and metrics?



Source: Citi Research

Figure 2. REITs: How much does the SEC's new stance eliminating pro rata disclosure impact your supplemental disclosure?



Source: Citi Research

Question 2: Relevance

Q (Investors): For the REITs that publish them, do you use the full pro rata share financial statements (income statement and balance sheet) in your modeling and valuation analysis?

A: Yes (91%)

Q (REITs): Do you publish full pro rata financial statements (income statement and balance sheet) in your supplement?

A: 42% Yes / 58% No

Investors: While not all REITs provide these statements, the overwhelming majority of investor respondents to the survey (at 91%) do use the pro rata financial statements when they are provided – see Figure 3. These statements are used not only for financial statement analysis and more accurate forecasting, but for more precise Net Asset Value (NAV) calculations. As REIT stock performance has historically tended to correlate with NAV over time, precise calculations are vital.

REITs: Consistent with the REITs' answers to Question 1 about the impact to supplemental disclosure, 42% of REIT respondents DO publish full pro rata financial statements (vs. the 38% who claimed in Question 1 that it was either "very" or "meaningfully" impactful). See Figure 4. 58% of respondents DO NOT publish full statements, although we know that some proportion of those do provide some level of pro rata disclosure, including pro rata unconsolidated JV statements.

Figure 3. Investors: Do you use full pro rata share financial statements in your modeling and valuation analysis?

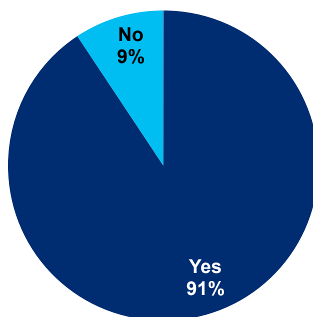


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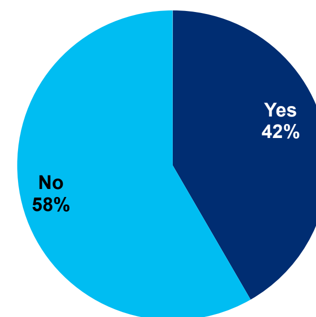
Figure 4. REITs: Do you publish full pro rata financial statements in your supplement?



Source: Citi Research

Question 3: Agreement

Q: Do you agree or disagree with the SEC's new guidelines to eliminate pro rata disclosure on the basis that it combines GAAP and non-GAAP numbers?

A (Investors): Disagree (97%)

A (REITs): Disagree (92%)

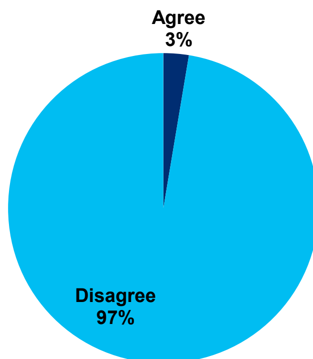
There was no confusion about the consensus view on this one – both investors and REITs overwhelmingly disagree with the SEC's new guidelines to eliminate pro rata disclosure (see Figures 5 and 6). Notably, more investors disagree (at 97%) than do REITs (at 92%).

Investors: What this tells us – when taken in context with the results from Questions 1 and 2 – is that regardless of whether or not an investor uses the data or it's important to their analysis, 97% disagree with the SEC's stance on eliminating pro rata disclosure from the supplementals. It's our view that the SEC believes that this change needs to be made to protect investors by eliminating confusion over GAAP vs. non-GAAP statements. **These results tell us that institutional investors are not confused, and understand the distinction**.

We acknowledge that these survey results are not representative of retail investors, and in that regard the issue over the "prominence" of disclosure comes into play. But within the REIT sector we've not seen any instances where pro rata statements are displayed more prominently than GAAP statements, or where the labeling of such statements is unclear and causes confusion.

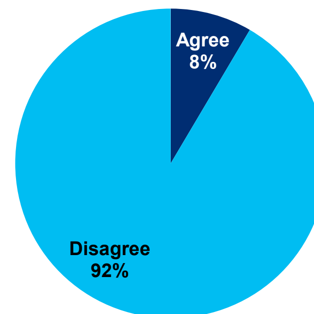
REITs: Similarly, it's telling to us that while 58% of REITs do not provide full pro rata financial statements and 36% say this change does not impact them at all (meaning they likely have no JVs or funds), a majority (at 92%) of the REIT respondents disagree with the SEC's decision to eliminate this disclosure.

Figure 5. Investors: Do you agree or disagree with the SEC's new guidelines to eliminate pro rata disclosure?



Source: Citi Research

Figure 6. REITs: Do you agree or disagree with the SEC's new guidelines to eliminate pro rata disclosure?



Source: Citi Research

Question 4: Solution

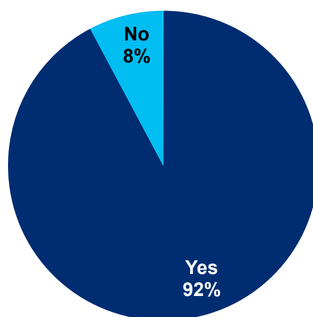
Q: If the disclosure of pro rata numbers and metrics is no longer permitted, do you believe that providing the components of the pro rata calculations on separate pages from the GAAP numbers is an appropriate solution?

> ***A (Investors): Yes (92%)***
>
> ***A (REITs): Yes (75%)***

Investors: A majority of investors (at 92%) believe that if pro rata disclosure is no longer permitted, then providing the components of the calculations would be an acceptable solution – see Figure 7. We agree with this view. Faced with not receiving the information at all – as long as we have the information to do the math ourselves, we're fine. Of course, we'd like for the REITs to be able to provide the pro rata information so that we don't have to go the extra step, but we'll live. However, we also point out that the more work investors have to do to get to the right answer, the less transparent the disclosure – still a step backwards in our view. The pro rata disclosure was always for the benefit of investors, to reduce the complexity of the REIT business model. As such, in a post-GICS change world, greater complexity doesn't help REITs attract more "generalist" investors to the space.

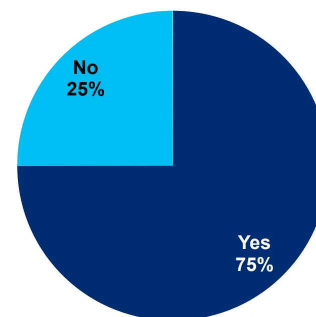
REITs: While still a majority, a lower percentage (at 75%) of REITs believe that providing the components on separate pages is a good solution – see Figure 8. Given that 92% of the REIT respondents disagree with the SEC's guidelines (Question 3) and some intend to take action (Question 5), we think the lower % on this question is reflective of those that still firmly believe that REITs should be able to provide the full statements on a pro rata basis and anything else is unacceptable.

Figure 7. Investors: If the disclosure of pro rata numbers and metrics is no longer permitted, do you believe that providing the components of the pro rata calculations on separate pages from the GAAP numbers is an appropriate solution?



Source: Citi Research

Figure 8. REITs: If the disclosure of pro rata numbers and metrics is no longer permitted, do you believe that providing the components of the pro rata calculations on separate pages from the GAAP numbers is an appropriate solution?



Source: Citi Research

Question 5: Action

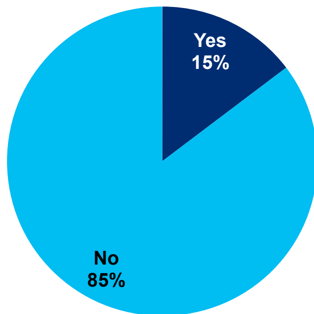
Q: Do you intend to take action to try to change the SEC's decision?

A (Investors): No (85%)

A (REITs): No (68%)

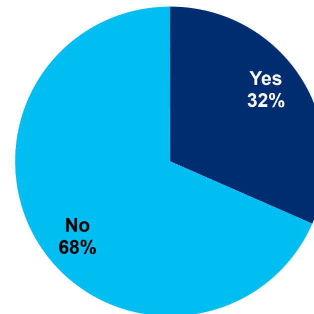
We were initially surprised by these results – how few investors (15%) and REITs (32%) intend to take action to try to change the SEC's decision (see Figures 9 and 10). However, our sense from the comments (see the next few pages), as well as our recent conversations with both investors and REITs on this topic, is that most believe that action should be taken on this issue. This is also evident in the results in Question 3 showing that most disagree with the SEC's decision. But the results to Question 6 likely reflect that many REITs and most investors believe that NAREIT and the auditors should and will represent them and take action on this issue.

Figure 9. Investors: Do you intend to take action to try to change the SEC's decision?



Source: Citi Research

Figure 10. REITs: Do you intend to take action to try to change the SEC's decision?



Source: Citi Research

Question 6: Additional Comments

In addition to the 5 questions above, we asked both groups to provide any additional comments they might have. Below we've included many of those comments. We've left out some of the more inflammatory ones, of which there were a few – it's clear that the removal of disclosure is a topic about which many in the REIT sector are passionate. Notably, we did not receive any comments in favor of the SEC's decision to eliminate pro rata disclosure or financial statements.

Investor Comments

- "Prefer requirement to show each – GAAP only and consolidated non-GAAP statements, as well as all components in line-by-line format to reconcile GAAP to non-GAAP – reporting needs to be consistent across companies."
- "This is very important for bond investors given the JV carve-out for bond unencumbered asset test."
- "Terrible move – understand focus on GAAP and comparable figures but pro rata #s are key to valuing many of our companies appropriately. Think it impacts the "complexity discount" if it stays in place – and thus impacts value creating opportunities for companies – hope to see it overturned and that the companies supply more than enough data to arrive at the pro rata #s. Please help with this endeavor as one of the REIT space's top thinkers."
- "Why eliminate more disclosure?"
- "Not only is this ruling unhelpful for investors, but also I honestly can't think of a single way in which this ruling would be helpful for investors."
- "NAREIT's accounting committee should put this item at the top of their agenda!"
- "The disclosure of pro-rata metrics is essential to building NAV models for REITs. My job will be more difficult and tedious without such disclosures."
- "More information is better than none."
- "It doesn't make sense why they are trying to limit disclosure."

REIT Comments

- "While providing the components will help, it is not the best answer. We should be able to mark these as unaudited and for informational purposes only and be able to provide the same info we have been."
- "Action by the investment community, as the end users of our disclosures, would be more compelling to the SEC than the opinions of registrants."
- "We believe that the current disclosure is more effective than the option provided in #4 above."
- "We have reached out to audit firm and NAREIT officials in support of their efforts to communicate with the SEC. We do not plan direct contact."
- "We oppose the SEC's bent on limited use of non-GAAP data, since GAAP information is inadequate to alone interpret performance and because we believe analysts and investors wish to see the non-GAAP numbers which strongly complement the GAAP financials."

- “Though this particular example does not impact us, the SEC's recent comments on non-GAAP measure disclosures may impact us. We supplementally provide non-GAAP measures in order to provide disclosures that investors and analysts find informative. I think the SEC should not undo disclosures that have been commonly accepted in an industry and that investors/analysts seek out.”
- “If the SEC has the goal of increasing transparency and communicating risks to investors, eliminating these metrics will not accomplish this goal.”
- “Simply put, the SEC got this one wrong. Shareholders are materially worse off without this disclosure in understanding true economic exposure for subject companies.”
- “These changes will hamper an investor's ability to value a company with minority JV interests.”
- “The decision to allow pro-rata calculations on separate pages is far from optimal but the best alternative that exists.”
- “Regarding #5 we would work with NAREIT to take action with the SEC to change disclosure limitations. We believe pro rata information is more relevant information for our investors.”
- “The pro-rata information is critical for the investment community to understand the true earnings and cash flow generation of the REIT. It needs to be included in some way, shape or form in a quarterly supplemental.”
- “…counterproductive to transparency from the REIT perspective and seems to have been released with one of the shortest potential "fuses" I can remember.”
- “The SEC is way off the mark on this one and has created yet another unnecessary complexity for the investing public to work through.”

Appendix A-1

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A Roadmap to Non-GAAP Financial Measures

2016

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Preface

September 6, 2016

To the clients, friends, and people of Deloitte:

We are pleased to present *A Roadmap to Non-GAAP Financial Measures*, our first Roadmap devoted exclusively to a discussion of non-GAAP measures.

The recent explosion of press coverage and SEC scrutiny of non-GAAP measures has resulted from concerns about the increased use and prominence of such measures, their potential to be misleading, and the progressively larger difference between the amounts reported for them and GAAP measures. These concerns led the SEC staff to issue new and updated Compliance & Disclosure Interpretations in May 2016 that clarify the SEC's guidance on non-GAAP measures. The C&DIs do not prohibit companies from using non-GAAP measures that comply with the SEC's existing rules; in fact, the SEC staff has acknowledged that in certain circumstances, non-GAAP measures may be useful. However, the updated guidance was intended to change certain practices about which the SEC has expressed concern. In remarks after the issuance of the C&DIs, the SEC strongly encouraged registrants to "self-correct" before the staff considers any further rulemaking or enforcement action related to non-GAAP measures.

For the 12 months ended June 30, 2016, non-GAAP measures ranked third in the top-ten list of topics frequently commented on by the SEC's Division of Corporation Finance as part of its filing review process, moving up from fourth place for the comparable prior year. For the three months ended June 30, 2016, non-GAAP measures rose to second place, after all sections of MD&A combined. Over the next year, we expect the number of SEC comments to continue to remain high and even increase until the guidance in the updated C&DIs has been fully incorporated into practice. The SEC staff's most recent comment letters have particularly focused on the use and prominence of non-GAAP measures in press releases. Comments on press releases and filed documents have also centered on disclosures, including reconciliation requirements and the purpose and use of such measures. In addition, we expect to see more comments about the use of misleading measures, including measures that use individually tailored accounting principles, and the tax impact of non-GAAP adjustments.

The guidance in this Roadmap is intended to help registrants assess the appropriateness of their non-GAAP measures. The body of the publication combines the SEC's guidance on non-GAAP measures with Deloitte's interpretation and examples in a comprehensive, reader-friendly format. The appendixes include questions for registrants to consider when disclosing such measures, highlights from recent remarks by SEC officials, and examples of comments on non-GAAP measures from completed SEC staff reviews.

We hope that you will find this publication a valuable resource when considering the guidance on non-GAAP measures.

Sincerely,

Deloitte & Touche LLP

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Chapter 1 — Background

1.1 Overview and History of the SEC's Guidance on Non-GAAP Measures

The SEC's written guidance on non-GAAP financial measures has been in existence for many years. During this time, the SEC staff has periodically issued new and updated guidance on the use and disclosure of such measures or informally communicated its views in speeches and comments at various forums. The chronology below provides details about these events.

In December 2001, the SEC issued cautionary advice[1] to registrants about including "pro forma" non-GAAP financial information in their press releases. The SEC reminded registrants that the antifraud provisions of the federal securities laws apply when pro forma information is contained in earnings releases.

The SEC's cautionary advice was followed by its adoption in 2003, pursuant to a mandate under the Sarbanes-Oxley Act of 2002, of the following rules (the "Rules") as outlined in its release (the "Release") of a final rule[2] on the conditions for use of non-GAAP financial information:

- Regulation G, which contains general rules requiring registrants to provide certain information whenever they disclose or release non-GAAP financial measures. Regulation G did not affect the applicability of the general antifraud standards to non-GAAP disclosure, and it established a separate basis in securities law for SEC enforcement actions.[3]
- Amendments to Regulation S-K, Item 10, and Exchange Act[4] Form 20-F, which provide guidance on non-GAAP measures included in SEC filings.
- Amendments that require registrants to furnish to the SEC, on Exchange Act Form 8-K, earnings releases or similar announcements, with furnished press releases also having to comply with Item 10(e)(1)(i).

The Rules and the Release are referred to frequently throughout this Roadmap. For guidance on how the Rules apply in specific circumstances, see Appendix D.

Also in 2003, the SEC staff published 33 FAQs[5] interpreting certain aspects of the Rules in an attempt to help registrants and others comply with and understand them.

1 SEC Release No. 33-8039, *Cautionary Advice Regarding the Use of "Pro Forma" Financial Information in Earnings Releases*.
2 SEC Release No. 33-8176, *Conditions for Use of Non-GAAP Financial Measures*.
3 Regulation G indicates that "[a] registrant . . . shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of 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."
4 Securities Exchange Act of 1934.
5 *Frequently Asked Questions Regarding the Use of Non-GAAP Measures* (superseded).

Several years later, the SEC staff announced at the 2009 AICPA Conference on Current SEC and PCAOB Developments (the "AICPA Conference") that it was revisiting its rules and FAQs to ensure that registrants were not omitting key information from their filings. While registrants frequently included non-GAAP measures in their press releases, the SEC staff was concerned that many had been reluctant to use them in filed documents because of restrictions specified in the FAQs. Although the SEC staff did not amend the Rules, in 2010, it replaced the interpretive guidance in the FAQs with the Compliance and Disclosure Interpretations (C&DIs)[6] that exist (as updated) today.[7]

The C&DIs were intended to give registrants more flexibility to disclose such measures in filings with the SEC. For example, one notable change was that the prohibition in Regulation S-K, Item 10(e), against adjustments to a non-GAAP performance measure for nonrecurring, infrequent, and unusual items would now be based on the description and labeling of the charge or gain rather than on the underlying nature of the amount.

After the issuance of the C&DIs, the SEC staff continued to question registrants about non-GAAP measures; however, the staff focused on clear labeling and descriptions of the measures and adjustments, nonboilerplate discussions of how management uses the measures, their usefulness to investors, and similar disclosures.

Beginning in late 2015, SEC officials started discussing non-GAAP measures at various public venues, prompted in part by concerns about companies' extensive use of these measures. Press coverage increased as well, sometimes focusing on a specific registrant's use of non-GAAP measures and other times concentrating more broadly on the propriety and usefulness of non-GAAP measures for a wide variety of industries.

The SEC renewed its focus on non-GAAP measures as a result of several factors, including (1) the increased use and prominence of such measures, (2) the nature of the adjustments, and (3) the increasingly large difference between the amounts reported for GAAP and non-GAAP measures. In a comment about the sharp rise in the use of non-GAAP measures, SEC Chief Accountant James Schnurr recently stated[8] that the SEC staff has observed a "significant and, in some respects, troubling increase over the past few years in the use of, and nature of adjustments within, non-GAAP measures" as well as their prominence.

In response to increasing concerns about the use of such measures, in May 2016, the SEC updated its C&DIs to provide additional guidance on what it expects from registrants when using these measures. The SEC staff noted its expectation that the updated C&DIs would promote changes in the use of non-GAAP measures, particularly related to potentially misleading measures and undue prominence placed on such measures, as well compliance with other presentation and disclosure requirements.

[6] C&DIs are not rules, regulations, or statements of the SEC; instead, they provide general guidance on the views of the SEC staff on a variety of issues.

[7] Topic 8, "Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth," of the SEC's Financial Reporting Manual (FRM) also discusses such measures.

[8] See Appendix B for more information on Mr. Schnurr's remarks and other remarks by SEC officials.

1.2 Prevalence of Non-GAAP Information

1.2.1 Who Uses Non-GAAP Measures?

Non-GAAP financial measures are used commonly not only by registrants but also by companies seeking to gain access to the U.S. capital markets through an initial public offering (IPO). Several recent studies provide insight into the prevalence of non-GAAP measures and how they differ from comparable GAAP measures.

A study published by Audit Analytics noted the following from data gathered from earnings releases during the third quarter of 2015:

- Approximately 88 percent of S&P 500 component companies use non-GAAP measures.
- Non-GAAP performance measures were greater than the nearest GAAP equivalent for about 82 percent of the S&P 500 companies that reported a non-GAAP adjusted net income metric.[9]

In addition, a study[10] published by FactSet determined that for 2015, 67 percent of the companies in the Dow Jones Industrial Average reported non-GAAP earnings per share and, on average, the difference between the GAAP and non-GAAP earnings per share was approximately 30 percent, representing a significant increase from approximately 12 percent in 2014.

Moreover, over two-thirds of registration statements related to IPOs that were declared effective in 2015 included disclosure of non-GAAP information.[11]

A recent report[12] of the earnings releases of over 800 companies that use non-GAAP measures further supported the disparity between GAAP and non-GAAP net income amounts. In addition, the report analyzed the types of adjustments made to GAAP net income, noting that the most common adjustments were restructuring charges, acquisition-related items, stock compensation costs, and, to a lesser extent, debt costs and legal costs.

Although these studies are based on different subsets of registrants, the message is clear — non-GAAP measures are prevalent, and they generally present a more positive financial picture than their GAAP counterparts.

1.2.2 Why Do Registrants Use Non-GAAP Measures?

Many registrants assert that non-GAAP measures are meaningful and provide valuable insight into the information management considers important in running the business. Registrants may believe that GAAP numbers do not provide a full picture of their business or their results of operations and liquidity unless they are supplemented with non-GAAP measures that they believe are useful. While the SEC staff allows registrants to use non-GAAP measures "to tell their story," registrants must apply the appropriate SEC guidance and provide disclosures.

[9] Audit Analytics, "Trends in Non-GAAP Disclosures" (December 2015).
[10] "Did DJIA Companies Report Higher Non-GAAP EPS in FY 2015?" FactSet *Insight* (March 11, 2016).
[11] Based on data from Intelligize. Research included all IPOs in excess of $5 million filed on Forms S-1, S-11, and F-1 with an offering of equity instruments that resulted in a capital increase to the registrant.
[12] "Measuring Non-GAAP Metrics: A Look at Adjusted Net Income," Calcbench and Radical Compliance (June 2016).

Reasons why registrants may use non-GAAP measures include the following:

- Management compensation and incentive plans may be based on non-GAAP measures.
- Debt covenants or other requirements may be based on non-GAAP measures.
- Investors, analysts, and others may find non-GAAP information useful for a variety of reasons; for example, the information may provide meaningful insight into items affecting a company's performance and comparability of results.
- Certain non-GAAP measures, such as EBITDA, may be used for assessing business valuations in analyses of either earnings multiples or comparable transactions.

1.3 Where Is Non-GAAP Information Generally Presented?

Registrants often provide non-GAAP financial information in an earnings press release in a Form 8-K. In these cases, the information is generally considered furnished, but a registrant may also elect to file such information. Non-GAAP measures may also be released orally, telephonically, by webcast or broadcast, or by similar means, including earnings calls or investor presentations. Further, non-GAAP disclosures may be included on a registrant's Web site or other electronic medium.

Non-GAAP measures may also be included in a periodic filing (e.g., Form 10-K, 10-Q, or 20-F), registration statement (e.g., Form S-1, S-4, F-1, or 10), proxy statement, or other SEC filing. The sections of a filing in which a registrant would generally include such information are the Business, Selected Financial Data, and MD&A sections. However, a registrant should not include such information in the financial statements or notes thereto.[13]

See Chapter 3 for information about required disclosures for non-GAAP measures.

1.4 To Whom Do the Rules Apply?

1.4.1 Domestic Issuers

The Rules apply to a registrant other than a registered investment company. Item 10(e) applies to domestic (U.S.) registrants that include non-GAAP financial measures "in a filing with the Commission." The Release states that Regulation G applies "whenever a company publicly discloses or releases material information that includes a non-GAAP financial measure."

[13] See Regulation S-K, Item 10(e)(1)(ii)(C), which notes that non-GAAP measures should not be presented "on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes."

1.4.2 Voluntary Filers

The SEC addressed the Rules' application to voluntary filers in C&DI Question 107.01.

C&DIs — Non-GAAP Financial Measures

Question 107.01

Question: Section 15(d) of the Exchange Act suspends automatically its application to any company that would be subject to the filing requirements of that section where, if other conditions are met, on the first day of the company's fiscal year it has fewer than 300 holders of record of the class of securities that created the Section 15(d) obligation. This suspension, which relates to the fiscal year in which the fewer than 300 record holders determination is made on the first day thereof, is automatic and does not require any filing with the Commission. The Commission adopted Rule 15d-6 under the Exchange Act to require the filing of a Form 15 as a notice of the suspension of a company's reporting obligation under Section 15(d). Such a filing, however, is not a condition to the suspension. A number of companies whose Section 15(d) reporting obligation is suspended automatically by the statute choose not to file the notice required by Rule 15d-6 and continue to file Exchange Act reports as though they continue to be required. Must a company whose reporting obligation is suspended automatically by Section 15(d) but continues to file periodic reports as though it were required to file periodic reports comply with Regulation G and the requirements of Item 10(e) of Regulation S-K?

Answer: Yes. Regulation S-K relates to filings with the Commission. Accordingly, a company that is making filings as described in this question must comply with Regulation S-K or Form 20-F, as applicable, in its filings.

As to other public communications, any company "that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934, or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934" must comply with Regulation G. The application of this standard to those companies that no longer are "required" to report under Section 15(d) but choose to continue to report presents a difficult dilemma, as those companies technically are not subject to Regulation G but their continued filing is intended to and does give the appearance that they are a public company whose disclosure is subject to the Commission's regulations. It is reasonable that this appearance would cause shareholders and other market participants to expect and rely on a company's required compliance with the requirements of the federal securities laws applicable to companies reporting under Section 15(d). Accordingly, while Regulation G technically does not apply to a company such as the one described in this question, the failure of such a company to comply with all requirements (including Regulation G) applicable to a Section 15(d)-reporting company can raise significant issues regarding that company's compliance with the anti-fraud provisions of the federal securities laws. [Jan. 11, 2010]

In short, Item 10(e) applies to a "voluntary filer" (i.e., a company that continues to file periodic reports even though its periodic reporting obligations under the Exchange Act are suspended). Regulation G's guidance on other public communications does not technically apply to a voluntary filer; however, the SEC staff noted that "the failure of such a company to comply with all requirements (including Regulation G) applicable to a Section 15(d)-reporting company can raise significant issues regarding that company's compliance with the anti-fraud provisions of the federal securities laws."

1.4.3 Foreign Private Issuers

While foreign private issuers (FPIs) are subject to Regulation G other than in the limited exceptions outlined below and to Item 10(e) if they file Form 20-F or registration statements under the Securities Act of 1933, the Rules do not apply to filers that use Form 40-F under the Multi-Jurisdictional Disclosure System (which applies to eligible Canadian issuers).

Regulation G states that its requirements do not apply to FPIs that include non-GAAP measures in publicly disclosed information when all three of the following three conditions are met:

- “[T]he securities of the [FPI] are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States” (e.g., the London Stock Exchange Group).
- “[T]he non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with [U.S. GAAP]” (e.g., IFRS information).
- “[T]he disclosure is made by or on behalf of the [FPI] outside the United States, or is included in a written communication that is released by or on behalf of the [FPI] outside the United States.”

In addition, the Release states that “[t]hese conditions focus on whether the financial measure relates to U.S. GAAP and whether the disclosure is made . . . outside of the United States.” In addition, the conditions “take into account the interests of [FPIs] . . . in communicating globally, including in their home markets.”

Regulation G further states that the exception for FPIs applies even under any of the following circumstances:

- “[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.”
- “[F]oreign, U.S. journalists or other third parties have access to the information.”
- “[T]he information appears on one or more web sites maintained by the [FPI], so long as the web sites, taken together, are not available exclusively to, or targeted at, persons located in the United States.”
- The information is included in a Form 6-K after the “disclosure or release of the information outside the United States.”

For more information about the applicability of the Rules to FPIs, see Section 8140 of the FRM and Section 106 of the C&DIs. See also Section 2.1.2.

Chapter 2 — What Is a Non-GAAP Measure?

This chapter provides some examples of common non-GAAP financial measures. In addition, it discusses measures that do **not** meet the definition of a non-GAAP measure and provides examples of measures that are outside the scope of the Rules.

2.1 Definition of a Non-GAAP Measure

2.1.1 General Requirements

Regulation G and Item 10(e) define a non-GAAP financial measure the same way. That is, as "a numerical measure of a registrant's *historical or future* financial performance, financial position or cash flows that:

(i) *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 GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or

(ii) *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" (emphasis added).

In addition, the Release states that the definition of a non-GAAP financial measure is intended to "capture all measures that have the effect of depicting either:

- [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."

If a registrant takes a commonly understood or defined GAAP amount and removes a component of that amount that is also presented in the financial statements, the resulting amount is generally considered a non-GAAP measure. As a simplified example, if a registrant discloses net income less restructuring charges and loss on debt extinguishment (having determined all amounts in accordance with GAAP), the resulting performance amount, which may be labeled "Adjusted Net Income," is a non-GAAP measure subject to the Rules. Adjusted Net Income "excludes amounts . . . that are included in the . . . measure calculated and presented in accordance with GAAP in the statement of income" and would be considered a "measure of performance that is different from that presented in the financial statements."

A registrant may present a table in MD&A that lists, in a balanced manner, the significant income and expense items that have affected comparability for the periods presented. The amounts in the table

would not be considered non-GAAP measures unless they were used to derive an adjusted income non-GAAP measure. For example, the registrant in the example above may want to separately disclose the impact that certain significant expense items, such as a $6 million restructuring charge and a $4 million loss on debt extinguishment, had on the current fiscal year's net income of $50 million compared with the prior year. If the registrant includes a table that lists the restructuring charge and loss on debt extinguishment amounts, and discusses narratively that net income excluding the impact of the restructuring charge and loss on debt extinguishment is $40 million, the resulting $40 million amount is a non-GAAP measure. If the registrant discloses that net income of $50 million includes a restructuring charge of $6 million and loss on debt extinguishment of $4 million and does not "do the math," these amounts are not considered non-GAAP measures.

2.1.2 Considerations for FPIs

The reference to "GAAP" in the above definition is to U.S. GAAP. However, for an FPI whose primary financial statements are prepared in accordance with non-U.S. GAAP (e.g., IFRSs or home-country GAAP), GAAP refers to the principles under which those primary financial statements are prepared. Nevertheless, when an FPI discloses a non-GAAP measure that is derived from or based on a measure calculated in accordance with U.S. GAAP, "GAAP" refers to U.S. GAAP.

Note that the Release states a non-GAAP measure that would otherwise be prohibited will be permitted in an FPI's filing "if the measure is (1) required or expressly permitted by the standard-setter that establishes the generally accepted accounting principles used in the [FPI's] primary financial statements and (2) included in the [FPI's] annual report or financial statements used in its home country jurisdiction or market."

This exception applies only to situations in which the foreign organization affirmatively acts to require or permit the measure; it is not intended to apply to circumstances in which the measure was merely not prohibited. Further, while such measures are not prohibited, footnote 41 of the Release confirms that Item 10's disclosure and other requirements apply to such measures.

See Section 1.4.3 for more considerations related to FPIs.

2.2 Common Non-GAAP Measures

The following are examples of common non-GAAP financial measures:

- Operating income that excludes one or more expense items.
- Adjusted revenues, adjusted earnings, and adjusted earnings per share.
- EBIT and EBITDA, and adjusted EBIT and EBITDA (see Sections 3.6 and 4.6).
- Core earnings.
- Free cash flow (see Section 4.11).
- FFO (see Section 4.12).
- Net debt, which could be calculated as borrowings less cash and cash equivalent or borrowings less derivative assets used to hedge the borrowings.
- Measures presented on a constant-currency basis, such as revenues and operating expenses (see Section 4.13).
- System-wide sales (see Section 4.15).

Certain measures not listed above may be common in specific industries, such as broadcast cash flows in the radio, television and cable industry and NOI used in the real estate industry.[1]

2.3 Financial and Other Measures That Are Not Subject to the Rules

This section discusses financial and other measures (e.g., metrics) that do **not** meet the definition of a non-GAAP measure under the Rules. As indicated in the Release, such measures include:

- Certain financial, operating, or statistical metrics (operating measures or other measures such as dollar revenue per square foot; same-store sales; revenues from slot machines for casinos provided that the sales figures were computed under GAAP; or unit sales, numbers of employees, numbers of subscribers, or numbers of advertisers).
- Financial measures required by GAAP, such as segment measures of profit or loss and total assets required by the guidance in ASC 280 on segment reporting.
- "[R]atios or statistical measures that are calculated using exclusively . . . financial measures calculated in accordance with GAAP."
- "[M]easures required to be disclosed by GAAP, Commission rules, or a system of regulation of a government or governmental authority or self-regulatory organization."
- Measures used in certain business combination transactions.
- "[D]isclosure of amounts of expected indebtedness, including contracted and anticipated amounts."
- "[D]isclosure of amounts of repayments that have been planned or decided upon but not yet made."
- "[D]isclosure 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" (e.g., projected revenue using GAAP principles).

Several of these items are discussed in the sections below.

2.4 Certain Financial or Operating Metrics

2.4.1 What Is a Metric?

A registrant may include certain ratios or statistical measures (i.e., metrics) in its SEC filings to illustrate the size and growth of its business, such as "same-store sales," "number of likes," "occupancy rates," and "average room rates." Such measures are not included in the financial statements or the notes, nor are they necessarily derived from any underlying financial statement amounts. While these customized metrics are generally not considered non-GAAP measures, the SEC staff has indicated that a registrant should provide certain disclosures about them, many of which are similar to those the registrant would provide for non-GAAP measures under the Rules.

[1] For more information about non-GAAP measures used in the real estate industry, see the Real Estate subsection in the Financial Services section of the Industry-Specific Topics discussion in Deloitte's *SEC Comment Letters —Including Industry Insights: What "Edgar" Told Us*.

2.4.2 How Is a Metric Different From a Non-GAAP Measure?

As discussed in Section 2.1 above, a registrant may calculate a non-GAAP measure by adding or subtracting items (that were also determined under GAAP) from the GAAP amount presented to arrive at an "adjusted GAAP" amount. A metric may be derived from data that is outside the GAAP financial statements, such as number of stores, quantity of customers, or Web site hits. Further, a metric may be derived from the division of a GAAP number by this data or from the presentation of a GAAP number as percentage of it. Given the amount of diversity inherent in the presentation of metrics, the SEC staff expects registrants to provide transparent disclosures about them, even if the metrics are not subject to the Rules.

2.4.3 Presentation and Disclosure Considerations for Metrics

The SEC staff noted at the "SEC Speaks in 2015" Conference that metrics should be discussed informatively since not all investors may be familiar with the registrant's use of them. Accordingly, a registrant should (1) clearly define the metrics used and how they are calculated, (2) describe any key assumptions and limitations (e.g., whether the metric is a "hard" amount or an estimate), (3) present a metric within a balanced discussion, and (4) clearly describe how a metric is related to current or future results of operations. A registrant should also consider disclosing how management uses the metrics and why they are important to investors. In addition, because metrics may evolve over time, registrants should disclose any changes and the reasons for the new metric (e.g., comparability with a measure used by peers).

Although metrics may help registrants "tell their story" in MD&A, management must use judgment when determining whether to include them in filings and should consider the following questions in making this determination:

- Is the metric integral to the registrant's story?
- Does the metric help investors understand changes quickly and effectively?
- Is the metric discussed outside of periodic filings (e.g., in earnings calls)?

The following table summarizes the SEC staff's observations from the "SEC Speaks in 2015" Conference related to certain industry metrics:

Industry	Metric	SEC Staff Observations
Technology and Internet	Online users	If subsets of online users are material to an investor's understanding of a registrant's results of operations and financial position, the registrant should consider disclosing the subsets and explaining any differences between them. For example, the monetization of (1) U.S. users often differs from that of international users and (2) mobile users often differs from that of desktop users.
Retail	Number of visitors to Web site	A registrant should disclose how metrics are clearly and directly related to its results of operations and financial position. For example, a registrant may disclose the number of individuals who visited its Web site but fail to note how this number differs from the number of visitors who actually purchase goods.
	Number of catalogs mailed	A registrant may disclose the number of catalogs mailed but fail to note sales made through mailed catalogs.
Retail and other industries	Same-store sales	The definition of this metric frequently varies by registrant or particular industry. The SEC staff has recommended clearly defining this metric and providing additional information about it, including how it is calculated, relevant assumptions, and limitations. For example, the staff has suggested that: • Retail companies with brick-and-mortar stores disclose how renovated stores are treated as part of this metric. • Brick-and-mortar retail companies that also offer online sales consider providing disclosures, when material, by either separately quantifying the change in the metric that is attributable to online sales or quantifying the change both "with and without" online sales.
Real estate	Occupancy and average rental rates	Registrants often do not explain the reasons for period-to-period changes.
E-commerce	Gross merchandise volume	E-commerce retailers sometimes disclose this metric when they do not own the merchandise sold on their Web sites and record revenue on a net basis. Such disclosures often fail to discuss why this metric is important or how it is linked to the registrant's results.

2.5 Financial Measures Required by GAAP — Segment Information

Financial measures that a registrant is required to disclose under GAAP are not considered non-GAAP measures under the Rules. The most common examples of such measures are related to segment financial information such as revenue, profit or loss, and total assets for each reportable segment.

2.5.1 Segment Information Presented in Conformity With ASC 280

Since ASC 280 requires disclosure of the segment information noted above, financial measures for each segment are not non-GAAP measures under the Rules even when presented outside the footnotes, such as in MD&A.[2]

C&DIs — Non-GAAP Financial Measures

Question 104.01

Question: Is segment information that is presented in conformity with Accounting Standards Codification 280, pursuant to which a company may determine segment profitability on a basis that differs from the amounts in the consolidated financial statements determined in accordance with GAAP, considered to be a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No. Non-GAAP financial measures do not include financial measures that are required to be disclosed by GAAP. Exchange Act Release No. 47226 lists "measures of profit or loss and total assets for each segment required to be disclosed in accordance with GAAP" as examples of such measures. The measure of segment profit or loss and segment total assets under Accounting Standards Codification 280 is the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance.

The list of examples in Exchange Act Release No. 47226 is not exclusive. As an additional example, because Accounting Standards Codification 280 requires or expressly permits the footnotes to the company's consolidated financial statements to include specific additional financial information for each segment, that information also would be excluded from the definition of non-GAAP financial measures. [Jan. 11, 2010]

Question 104.02

Question: Does Item 10(e)(1)(ii) of Regulation S-K prohibit the discussion in MD&A of segment information determined in conformity with Accounting Standards Codification 280?

Answer: No. Where a company includes in its MD&A a discussion of segment profitability determined consistent with Accounting Standards Codification 280, which also requires that a footnote to the company's consolidated financial statements provide a reconciliation, the company also should include in the segment discussion in the MD&A a complete discussion of the reconciling items that apply to the particular segment being discussed. In this regard, see Financial Reporting Codification Section 501.06.a, footnote 28. [Jan. 11, 2010]

[2] See also footnote 19 of the Release, which states that ASC 280 "requires that companies report a measure of profit or loss and total assets for each reportable segment. This tabular information is presented in a note to the audited financial statements and is required to be reconciled to the GAAP measures, with all significant reconciling items separately identified and described. A registrant is required to provide a Management's Discussion & Analysis of segment information if such a discussion is necessary to an understanding of the business. Such discussion would generally include the measures reported under [ASC 280]."

2.5.2 Segment Profit or Loss or Segment Liquidity *Not* in Conformity With ASC 280

A measure of segment profit or loss, or segment liquidity that is *not* consistent with the requirements of ASC 280 is a non-GAAP measure and subject to the requirements of the Rules.

C&DIs — Non-GAAP Financial Measures

Question 104.03

Question: Is a measure of segment profit/loss or liquidity that is not in conformity with Accounting Standards Codification 280 a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Segment measures that are adjusted to include amounts excluded from, or to exclude amounts included in, the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance do not comply with Accounting Standards Codification 280. Such measures are, therefore, non-GAAP financial measures and subject to all of the provisions of Regulation G and Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Example

Assume that Company X's segment earnings measure for resource allocation and performance assessment purposes is "adjusted EBITDA." Such amount is disclosed in the notes to the financial statements under ASC 280 and is therefore not subject to the Rules. If, however, X further adjusts each segment's adjusted EBITDA in its MD&A by excluding additional items such as restructuring costs, these amounts do not comply with ASC 280, and the "as further revised" adjusted EBITDA is subject to the Rules.

2.5.3 Total Segment Profit or Loss Measures Outside the Footnotes

The presentation of the *total* segment profit or loss measure, revenues, or assets on a consolidated basis outside the footnotes (e.g., MD&A) is considered a non-GAAP measure unless such total equals a measure presented under GAAP.

C&DIs — Non-GAAP Financial Measures

Question 104.04

Question: In the footnote that reconciles the segment measures to the consolidated financial statements, a company may total the profit or loss for the individual segments as part of the Accounting Standards Codification 280 required reconciliation. Would the presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote be the presentation of a non-GAAP financial measure?

Answer: Yes. The presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote would be the presentation of a non-GAAP financial measure because it has no authoritative meaning outside of the Accounting Standards Codification 280 required reconciliation in the footnotes to the company's consolidated financial statements. [Jan. 11, 2010]

Example

Assume that Company X has three reportable segments and includes the appropriate segment disclosures in its notes to the financial statements in accordance with ASC 280. Company X's measure of segment profitability is adjusted EBITDA. The following is an excerpt from X's segment footnote, which shows its segment measure of profitability (i.e., adjusted EBITDA) reconciled to income before income taxes:

Segment A	$	XX
Segment B		XX
Segment C	$	XX
Total segment-adjusted EBITDA	$	XX
Depreciation		XX
Interest		XX
Impairments		XX
Loss on sale of assets	$	XX
Income before income taxes	$	XX

Adjusted EBITDA at the segment level (i.e., separately for segments A, B, and C) is not considered a non-GAAP measure under the Rules when discussed in MD&A, whereas the total segment-adjusted EBITDA at the consolidated level is considered a non-GAAP measure and is subject to the Rules if presented in MD&A or elsewhere outside the financial statements. In this example, if total segment-adjusted EBITDA is presented in MD&A, it would be subject to the non-GAAP rules.

ASC 280 also requires registrants to disclose in the notes to the financial statements revenues for "each product and service or each group of similar products and services unless it is impracticable to do so." In MD&A, registrants often include similar disclosures about revenues on a disaggregated basis by products and services. These are not considered non-GAAP measures as further explained below.

2.6 Other Measures That Are Not Non-GAAP Measures

2.6.1 GAAP Operating and Other Statistical Measures

Financial measures (e.g., ratios or other measures) calculated exclusively from amounts presented in accordance with GAAP are not non-GAAP financial measures. Generally, a GAAP amount may be divided by another GAAP amount in the calculation of a specific ratio, and the resulting amount is not considered a non-GAAP measure. For example, disclosure of operating margin that is calculated by dividing GAAP operating income by GAAP revenues is not a non-GAAP measure.

2.6.2 Financial Measures Required by Commission Rules or a System of Regulation of a Government or Government Authority or Self-Regulatory Organization

Financial measures required by SEC rules (e.g., information required pursuant to an SEC industry guide) are not non-GAAP measures.

In addition, financial measures *required by* a regulatory organization that apply to the registrant (e.g., measures of capital or reserves calculated for such regulatory purpose) are not non-GAAP measures. The Release specifies that disclosure of such measures should be presented outside the financial statements "unless the financial measure is required or expressly permitted by the standard setter that is responsible for establishing the GAAP." However, if the above organizations do not *require* the information, but a registrant elects to present it, the information *is* considered a non-GAAP measure and thus subject to the appropriate non-GAAP disclosures required by the Rules.

C&DIs — Non-GAAP Financial Measures

Question 102.12

Question: A registrant discloses a financial measure or information that is not in accordance with GAAP or calculated exclusively from amounts presented in accordance with GAAP. In some circumstances, this financial information may have been prepared in accordance with guidance published by a government, governmental authority or self-regulatory organization that is applicable to the registrant, although the information is not required disclosure by the government, governmental authority or self-regulatory organization. Is this information considered to be a "non-GAAP financial measure" for purposes of Regulation G and Item 10 of Regulation S-K?

Answer: Yes. Unless this information is *required* to be disclosed by a system of regulation that is applicable to the registrant, it is considered to be a "non-GAAP financial measure" under Regulation G and Item 10 of Regulation S-K. Registrants that disclose such information must provide the disclosures required by Regulation G or Item 10 of Regulation S-K, if applicable, including the quantitative reconciliation from the non-GAAP financial measure to the most comparable measure calculated in accordance with GAAP. This reconciliation should be in sufficient detail to allow a reader to understand the nature of the reconciling items. [Apr. 24, 2009]

2.6.3 Business Combination Transactions

The Rules provide limited exceptions to the use and disclosure of non-GAAP financial measures related to business combination transactions. Accordingly, they do not apply to non-GAAP measures (e.g., projections or forecasts of results of operations based on the business combination) used in the communications described in C&DI Question 101.01.[3]

[3] See applicable rules under the Exchange Act; the Securities Act of 1933; and Regulation M-A, Item 1015, "Reports, Opinions, Appraisals and Negotiations."

C&DIs — Non-GAAP Financial Measures

Question 101.01

Question: Does the exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications relating to a business combination transaction extend to the same non-GAAP financial measures disclosed in registration statements, proxy statements and tender offer materials?

Answer: No. There is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications subject to Securities Act Rule 425 and Exchange Act Rules 14a-12 and 14d-2(b)(2); it is also intended to apply to communications subject to Exchange Act Rule 14d-9(a)(2). This exemption does not extend beyond such communications. Consequently, if the same non-GAAP financial measure that was included in a communication filed under one of those rules is also disclosed in a Securities Act registration statement or a proxy statement or tender offer statement, no exemption from Regulation G and Item 10(e) of Regulation S-K would be available for that non-GAAP financial measure.

In addition, there is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed pursuant to Item 1015 of Regulation M-A, which applies even if such non-GAAP financial measures are included in Securities Act registration statements, proxy statements and tender offer statements. [Jan. 11, 2010]

The exemption in C&DI Question 101.01 does not extend beyond communications that are subject to the rules specified in the C&DI.

2.6.4 Presentation of Revenue by Product Line

C&DI Question 104.05 describes a situation in which a registrant presents a table that breaks down revenues by certain products but does not sum these amounts to the revenue amount presented in its financial statements. If the product revenue amounts are calculated in accordance with GAAP and are not adjusted, the information presented in the table is not considered a non-GAAP financial measure.

C&DIs — Non-GAAP Financial Measures

Question 104.05

Question: Company X presents a table illustrating a breakdown of revenues by certain products, but does not sum this to the revenue amount presented on Company X's financial statements. Is the information in the table considered a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No, assuming the product revenue amounts are calculated in accordance with GAAP. The presentation would be considered a non-GAAP financial measure, however, if the revenue amounts are adjusted in any manner. [Jan. 11, 2010]

Example

Assume that in accordance with ASC 280-10-50-40, Company X includes in its notes to the financial statements product revenues from external customers for three different types of products as part of its segment disclosures. In addition, X discusses in MD&A its revenue by products in accordance with the presentation in its segment notes but also presents product revenue by type of customer served, as reflected in the following table:

	Wholesale Customers	Retail Customers
Product A	$ XX	$ XX
Product B	XX	XX
Product C	XX	XX
Total revenues	$ XXX	$ XXX

Company X uses GAAP to calculate revenues for products A, B, and C. When discussed in MD&A, these revenue amounts are not considered non-GAAP measures even if X does not sum the total of these products to the revenue amount presented in its financial statements. However, revenues from products A, B, and C that are adjusted from the amounts presented above are considered a non-GAAP measure if they are presented in MD&A or elsewhere outside the financial statements.

Chapter 3 — Disclosures About Non-GAAP Measures

This chapter discusses the disclosure requirements related to non-GAAP measures under Regulation G and SEC Regulation S-K, Item 10(e).

3.1 Overview and General Requirements of Regulation G and Item 10(e)

Regulation G applies to all public releases or disclosure of non-GAAP measures, even if such information is not part of a registrant's SEC filing (e.g., conference calls, investor presentations, and webcasts) and regardless of whether the information is furnished or filed with the SEC.

Regulation G states that:

- Non-GAAP financial measures must not be misleading.
- The most directly comparable GAAP measure must be presented.
- A quantitative reconciliation of the non-GAAP financial measure to the most comparable GAAP measure must be presented for (1) a historical non-GAAP measure and (2) forward-looking information (to the extent available without unreasonable effort).

Item 10(e) applies to all SEC filings, such as registration statements, proxy statements,[1] and Forms 10-K and 10-Q. Item 10(e) expands on Regulation G to require the following in addition to the three items above:

- That the prominence of the most directly comparable GAAP measure presented be **equal to or greater than** that of the non-GAAP measure.
- A statement indicating the reasons why the registrant believes that the non-GAAP measure provides useful information to investors about the registrant's financial condition and results of operations.
- To the extent material, a statement disclosing the additional purposes, if any, for which the registrant uses the non-GAAP measure.

The disclosure requirements for press releases furnished on Form 8-K are the same as those in Item 10(e).

The non-GAAP disclosure requirements are discussed in greater detail below. Factors for registrants to consider when determining what constitutes a misleading non-GAAP measure are outlined in Section 4.3.

[1] See C&DI Question 108.01, which discusses an exception for disclosures of target levels that are non-GAAP measures in Compensation Discussion & Analysis or other parts of the proxy statement.

The following table summarizes the disclosure requirements that apply to domestic[2] registrants under the Rules:

Disclosure Requirements Applicable to Domestic Registrants

Disclosure Requirements	All Disclosure of Non-GAAP Financial Measures (Regulation G[3, 4])	SEC Filings (Item 10(e) of Regulation S-K[5, 6])	Press Releases Furnished to the SEC (Item 2.02 of Form 8-K[7])
• Presentation of the most directly comparable GAAP financial measure	X		
• Presentation, **with equal or greater prominence**, of the most directly comparable GAAP financial measure		X	X
• Quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure	X	X	X
• Statement disclosing the reasons why management believes the non-GAAP financial measure provides useful information to investors		X	X
• To the extent material, a statement disclosing the additional purposes for which management uses the non-GAAP financial measure		X	X

3.1.1 Multiple Presentations of the Same Non-GAAP Measure

The SEC's rules regarding conditions for use of non-GAAP measures do not address situations in which a registrant presents the same non-GAAP measure in multiple sections of a filing (e.g., description of business, selected financial data, and MD&A) or multiple times within the same section of a filing. Although a registrant may repeat the disclosure each time the measure is used, repetitive disclosures may not be beneficial to users. One alternative is to provide the Item 10(e) disclosures for all non-GAAP measures in one section of the filing and a cross-reference to that section each time a non-GAAP measure is presented.

3.2 Reconciliation Requirement

A registrant must reconcile a non-GAAP measure to the most directly comparable GAAP measure. Such reconciliation should be quantitative and is generally presented as a table, although it may be disclosed in another clearly understandable format. Reconciling adjustments from the GAAP measure to the non-GAAP measure should be separately quantified and appropriately labeled.

[2] For guidance on FPIs, see Regulation G; Regulation S-K, Item 10(e); Section 106 of the C&DIs; and Section 8140 of the FRM.
[3] Regulation G applies whenever a registrant, or person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, whether that information is furnished to, or filed with, the SEC.
[4] In certain situations, Regulation G and Item 10(e) do not apply. For example, they do not apply to non-GAAP measures related to a proposed business combination or measures required to be disclosed by a governmental authority. See Section 2.3 for a discussion of measures that do not meet the definition of a non-GAAP measure under the Rules.
[5] Item 10(e) applies to all SEC filings that include non-GAAP financial measures.
[6] See footnote 4.
[7] Form 8-K, Item 2.02, requires registrants to furnish to the SEC all releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods, regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure.

3.2.1 Most Directly Comparable Measure

Whenever registrants disclose or release a non-GAAP measure, they must also disclose the most directly comparable financial measure calculated and presented in accordance with GAAP. In certain limited circumstances, the SEC staff has provided guidance on what is the most directly comparable GAAP measure. For example, C&DI Question 103.02 indicates that EBIT and EBITDA, if presented as a performance measure, should be reconciled to net income and not operating income (see Section 3.6). In other circumstances, registrants should use judgment in determining the most directly comparable GAAP measure.

3.2.2 Performance Versus Liquidity Measures

A registrant will need to determine whether a non-GAAP measure's purpose is to assess the registrant's performance or its liquidity or, in some cases, both. This determination will affect (1) which GAAP measure is most directly comparable to the non-GAAP measure and (2) any prohibitions against presentation, such as per-share amounts or adjustments (see Chapter 4 for a discussion of prohibitions).

For example, a performance measure should generally be reconciled to a line item from the statement of operations such as net income or income from continuing operations or, if a per-share performance measure is presented, to GAAP earnings per share. A liquidity measure should be reconciled to an amount from the statement of cash flows, such as cash provided by operating activities. The SEC's general view is that the presentation of non-GAAP liquidity measures "should be balanced with disclosure of amounts from the statement of cash flows (cash flows from operating, investing and financing activities)"; and the presentation of non-GAAP performance measures "should be balanced with net income, or income from continuing operations, taken from the [income] statement."[8]

Historically, the SEC staff has generally accepted management's determination of whether a measure is a performance measure or a liquidity measure. However, as indicated in C&DI Question 102.05 (see Section 4.4), the SEC staff may challenge a measure designated as a performance measure that appears to be more like a liquidity measure.

Registrants should consider whether the classification of a non-GAAP measure as a performance measure is appropriate if the non-GAAP measure is, in substance, a liquidity measure. The context of the non-GAAP disclosure may be an important consideration. For example, the SEC staff may comment if a non-GAAP measure is located in the registrant's discussion of financial condition and liquidity even though the registrant considers the measure to be a performance measure and reconciles it to net income. In addition, the SEC staff may question a non-GAAP measure that a registrant purports to be a performance measure if, for example, it includes several adjustments (many of which are noncash amounts) to reconcile it to the most comparable GAAP income measure and only one adjustment would be needed to reconcile it to a GAAP measure from the statement of cash flows, such as operating cash flow.

If the measure could be used as a liquidity measure and is ultimately determined to be a liquidity measure, a registrant would be prohibited from disclosing a per-share amount (e.g., free cash flow is a liquidity measure, and per-share presentation is expressly prohibited[9]). Given the prohibition against per-share liquidity measures, registrants that disclose a per-share measure should ensure that (1) they

[8] See footnote 26 of the Release.
[9] See C&DI Question 102.07.

have appropriately characterized the measure and (2) if they consider it a performance measure, they are able to articulate specifically why.

3.2.3 Additional Disclosures About Liquidity Measures

Specific disclosure requirements apply to the presentation of a non-GAAP liquidity measure. In addition to those in Item 10(e), the SEC has historically required the "prominent presentation of amounts for the three major categories of the statement of cash flows" (i.e., cash flows from operating, investing, and financing activities).

C&DIs — Non-GAAP Financial Measures

Question 102.06

Question: Is Item 10(e)(1)(i) of Regulation S-K, which requires the prominent presentation of, and reconciliation to, the most directly comparable GAAP financial measure or measures, intended to change the staff's practice of requiring the prominent presentation of amounts for the three major categories of the statement of cash flows when a non-GAAP liquidity measure is presented?

Answer: No. The requirements in Item 10(e)(1)(i) are consistent with the staff's practice. The three major categories of the statement of cash flows should be presented when a non-GAAP liquidity measure is presented. [Jan. 11, 2010]

3.2.4 Same Non-GAAP Measure Is Used as Both a Performance Measure and a Liquidity Measure

A registrant may use a specific non-GAAP financial measure to assess both performance and liquidity. In this situation, the registrant should disclose all the information required under Item 10(e), such as the reasons why management believes the measure is useful from a performance and a liquidity standpoint, as well as a reconciliation of the non-GAAP measure to the closest GAAP measures for both performance and liquidity. For example, if a registrant uses EBITDA as both a performance measure and a liquidity measure, it should present a reconciliation of EBITDA to (1) net income for the performance measure and (2) cash flows from operations for the liquidity measure.

3.2.5 Reconciliation of Non-GAAP "Per-Share" Measures

In some situations, a registrant may present a non-GAAP financial measure on a "per-share" basis (e.g., adjusted earnings per share).

As noted in C&DI Question 102.05 (see Section 4.4 and also discussion above), a registrant is prohibited from disclosing a non-GAAP per-share amount as a liquidity measure such as cash flow per-share data and other per-share measures of liquidity (since they are prohibited under GAAP (ASC 230) and SEC rules (ASR 142); however, a non-GAAP per-share measure may be disclosed if it is a performance measure (subject to the other requirements of the guidance). The C&DI indicates that, if presented, a non-GAAP per-share performance measure should be reconciled to GAAP earnings per share.

When disclosing a non-GAAP per-share performance measure, a registrant is required to reconcile both the numerator and the denominator of the non-GAAP per-share measure to the most directly comparable GAAP measure.[10] However, if the denominator represents diluted shares calculated in accordance with the guidance on earnings per share in ASC 260, a reconciliation of the denominator is

[10] See footnote 27 of the Release.

not necessary. As noted in footnote 49 of the Release, a registrant should carefully consider (1) whether it is appropriate to use any denominator other than diluted shares calculated in accordance with ASC 260 and (2) whether the resulting measure could potentially be misleading.

3.3 Presentation of Equal or Greater Prominence

Under Item 10(e), if a registrant presents a non-GAAP measure, it should present the most directly comparable GAAP measure with "equal or greater prominence." Before the SEC staff's May 2016 updates to the C&DIs, there was no formal guidance interpreting this requirement and, as a result, diversity developed in practice. C&DI Question 102.10 now provides examples illustrating when the presentation of a non-GAAP measure may fail to meet the requirement. As noted elsewhere in this Roadmap, the SEC staff has been focused on this topic and has commented when a registrant presents its non-GAAP measures more prominently than its GAAP measures.

C&DIs — Non-GAAP Financial Measures

Question 102.10

Question: Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence. This requirement applies to non-GAAP measures presented in documents filed with the Commission and also earnings releases furnished under Item 2.02 of Form 8-K. Are there examples of disclosures that would cause a non-GAAP measure to be more prominent?

Answer: Yes. Although whether a non-GAAP measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, the staff would consider the following examples of disclosure of non-GAAP measures as more prominent:

- Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures;
- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
- A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);
- Describing a non-GAAP measure as, for example, "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable GAAP measure;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B) 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. [May 17, 2016]

In assessing prominence, a registrant should consider, among other items, the order of presentation, degree of emphasis, style of presentation, and volume of disclosures in a filing. For example, in general, the registrant should present GAAP measures first followed by the non-GAAP measures. Further, to avoid creating an impression that the non-GAAP measure is more important than the GAAP measure, the registrant should not present the non-GAAP measure in more detail, or emphasize it more, than the comparable GAAP measure, or otherwise imply that it is superior to the comparable GAAP measure. Certain presentations that give undue prominence to non-GAAP information, such as a full non-GAAP income statement, are prohibited (see the separate discussion below).

Finally, as noted above, if a registrant presents forward-looking non-GAAP financial measures, it should provide a quantitative reconciliation unless it qualifies for the "unreasonable efforts" exception in Regulation G and Item 10(e). A registrant that qualifies for the exception should disclose that fact in a prominent location, identify the information that is not available, and indicate the probable significance of this information.

3.3.1 Full Non-GAAP Income Statement

As noted in C&DI Question 102.10 (see Section 3.3), the SEC generally prohibits the presentation of a full non-GAAP income statement in documents filed with or furnished to the SEC, including quarterly and annual earnings press releases furnished on Form 8-K.

In certain circumstances, a registrant may present a full non-GAAP income statement, which includes all of the GAAP line items and sub-total amounts in a columnar form that adjusts many (or all) of the line items from the GAAP comparable amounts. For example, such a presentation may occur in a reconciliation of non-GAAP measures or in a constant-currency income statement. A registrant should consider whether this presentation would give the appearance of a full non-GAAP income statement. The SEC staff believes that a full non-GAAP income statement creates multiple non-GAAP measures and may result in the inappropriate impression that the non-GAAP income statement is being presented on a comprehensive basis of accounting. A registrant may present and disclose various individual non-GAAP measures as an alternative to presenting a full non-GAAP income statement, but it should consider separately presenting and reconciling each individual measure. Further, a registrant should disclose, for each measure, the reasons why the measure is useful to an investor as well as any other appropriate non-GAAP information.

It is important for a registrant to balance (1) its need to provide a clear, understandable reconciliation of non-GAAP measures to the most directly comparable GAAP measures with (2) its consideration of whether its reconciliation appears to be a full non-GAAP income statement that is based on its GAAP financial statements.

Example

Company X presented a summary of its statement of operations in its first quarter 20X6 earnings release. To arrive at its "ongoing" operations, X presented its line items on a GAAP as-reported basis as well as adjustments to various expense items that it believes should be excluded. Although not all line items from the historical statement of operations in the "as-reported" column have been adjusted, such presentation may represent a full non-GAAP income statement and could be prohibited:

	As Reported	Adjustments	Ongoing
Sales	$ 300	$ —	$ 300
Cost of goods sold	100	(20)	80
Gross profit	200	(20)	220
Operating expenses	75	(25)	50
Operating income	125	45	170
Interest expense	10		10
Other nonoperating expense	10	(5)	5
Pretax income	105	50	155
Taxes	25	10	35
Net income	$ 80	$ 40	$ 120

3.4 Disclosure of the Use and Purpose of Non-GAAP Measures

A registrant's quantitative reconciliation should be accompanied by transparent disclosures that clearly demonstrate (1) the usefulness of the non-GAAP measure to investors and (2) the additional purposes for which management uses such measure (e.g., for incentive compensation arrangements, to manage its business, to allocate resources, or as a debt covenant). The registrant should avoid providing boilerplate disclosures related to the purpose of the measure. Rather, the disclosures should be specific to the measure used, to the registrant and the nature of its business and industry, and to the manner in which management assesses the non-GAAP measure. If the purpose of the non-GAAP measure is not disclosed, investors and analysts may not understand its relevance. Footnote 44 of the Release states, in part:

> [T]he fact that the non-GAAP financial measure is used by or useful to analysts cannot be the sole support for presenting the non-GAAP financial measure. Rather, the justification for the use of the measure must be substantive.

While the Rules require disclosure of additional purposes for which management uses a non-GAAP financial measure, a registrant is not prohibited from disclosing a measure that it believes would be useful to investors, even though the registrant does not use the measure for any other purpose.

C&DIs — Non-GAAP Financial Measures

Question 102.04

Question: Is the registrant required to use the non-GAAP measure in managing its business or for other purposes in order to be able to disclose it?

Answer: No. Item 10(e)(1)(i)(D) of Regulation S-K states only that, "[t]o the extent material," there should be a statement disclosing the additional purposes, "if any," for which the registrant's management uses the non-GAAP financial measure. There is no prohibition against disclosing a non-GAAP financial measure that is not used by management in managing its business. [Jan. 11, 2010]

Item 10(e)(1)(iii) indicates that for filings other than a Form 10-K or Form 20-F, a registrant need not disclose the reasons why a non-GAAP measure is useful to investors and the purpose for which management uses it if that information was included in its most recent annual report filed with the SEC (or a more recent filing) as long as the disclosure is updated to the extent necessary at the time of the current filing.

3.5 Labeling Non-GAAP Measures and Reconciling Items

The SEC staff has noted that it focuses on whether registrants have (1) clearly labeled and described non-GAAP measures and adjustments, (2) used appropriate conventional accounting terminology, and (3) provided context for their presentation of non-GAAP measures. Clear, transparent labeling is important for all items in the reconciliation. For example, a registrant should not use a reconciling item labeled "other" that includes numerous significant items without clear disclosure of the nature of the items used along with the related amounts for each adjustment. In addition, when labeling a non-GAAP financial measure, a registrant may not use titles or descriptions that are the same as, or are confusingly similar to, titles or descriptions used for GAAP financial measures. See Section 4.9 for more information about considerations related to labeling non-GAAP measures.

3.6 EBIT and EBITDA, and Adjusted EBIT and EBITDA

EBIT and EBITDA are two of the most commonly used non-GAAP measures. C&DI Question 103.02 provides guidance on the most directly comparable GAAP measure for EBIT and EBITDA if they are used as a performance measure and notes that they should not be reconciled to operating income.

C&DIs — Non-GAAP Financial Measures

Question 103.02

Question: If EBIT or EBITDA is presented as a performance measure, to which GAAP financial measure should it be reconciled?

Answer: If a company presents EBIT or EBITDA as a performance measure, such measures should be reconciled to net income as presented in the statement of operations under GAAP. 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. In addition, these measures must not be presented on a per share basis. See Question 102.05. [May 17, 2016]

Registrants often make additional adjustments to EBITDA for items such as restructuring activities or impairments, which they disclose as "adjusted EBITDA" or in a similar manner. Any adjustments to net income beyond those described in the traditional definition of EBIT or EBITDA create an "adjusted" non-GAAP measure. In a manner consistent with the concepts discussed in Section 3.5, a registrant

should not characterize or label the non-GAAP measure as EBIT or EBITDA if the measure does not meet these traditional definitions. Instead, the registrant should distinguish the measure from EBIT or EBITDA by using a title such as “adjusted EBITDA.”

C&DIs — Non-GAAP Financial Measures

Question 103.01

Question: Exchange Act Release No. 47226 describes EBIT as “earnings before interest and taxes” and EBITDA as “earnings before interest, taxes, depreciation and amortization.” What GAAP measure is intended by the term “earnings”? May measures other than those described in the release be characterized as “EBIT” or “EBITDA”? Does the exception for EBIT and EBITDA from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K apply to these other measures?

Answer: “Earnings” means net income as presented in the statement of operations under GAAP. Measures that are calculated differently than those described as EBIT and EBITDA in Exchange Act Release No. 47226 should not be characterized as “EBIT” or “EBITDA” and their titles should be distinguished from “EBIT” or “EBITDA,” such as “Adjusted EBITDA.” These measures are not exempt from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K, with the exception of measures addressed in Question 102.09. [Jan. 11, 2010]

Note that if EBIT or EBITDA are presented as liquidity measures, they are exempt from the liquidity measure prohibitions[11] under GAAP (see Section 4.5); however, they are still considered non-GAAP measures and are subject to all required disclosures. Further, for presentations of per-share amounts, the SEC staff considers EBIT and EBITDA to be liquidity measures; therefore, a registrant may not disclose them on a per-share basis regardless of whether the registrant considers them to be performance measures or liquidity measures.

The C&DIs do not expressly prohibit the presentation of earnings per share on adjusted EBIT and adjusted EBITDA. However, a registrant’s determination of whether it is acceptable to present these measures on a per-share basis may depend on the nature of the adjustments and on whether the measures are, in substance, performance or liquidity measures. If the measures are, in substance, liquidity measures, presentation on a per-share basis would be prohibited. See Section 4.4 for additional information.

3.7 Consistency of Non-GAAP Measures

3.7.1 Consistency in Communications

A registrant should consider whether its various forms of communications with investors, including both filed and furnished documents, include non-GAAP measures and, if so, whether those non-GAAP measures are consistently determined and presented in the various forms of communications. For example, a registrant should be aware of inconsistencies or contradictions in (1) the non-GAAP measures disclosed outside its SEC filings, such as on its Web site and in its press releases and earnings calls, and (2) the non-GAAP measures disclosed in its filings. Although the SEC staff does not require a registrant to include non-GAAP measures in its filings, it may comment if, for example, the non-GAAP disclosures in the registrant’s press release or other communications appear to be inconsistent with those in its periodic or other filings.

[11] As noted in Section 4.1, Item 10(e) prohibits a registrant from 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]” (emphasis added), referred to as the “liquidity measure prohibition.”

3.7.2 Consistent Use of Non-GAAP Measures

Registrants should consider establishing a formal policy for disclosing and calculating non-GAAP measures that defines and describes the adjustments (see Section 5.1.1). Non-GAAP financial measures should generally be calculated and presented consistently from period to period and, if there are any changes in the measures, such changes should be clearly disclosed (see Section 3.7.3). It may therefore be helpful for registrants to consider the following when they present non-GAAP measures:

- *Consistent presentation* — Generally registrants should consistently prepare and present non-GAAP measures from period to period in accordance with a defined policy, and they should use that policy to compute the measure for all periods presented.
- *Consistent types of adjustments* — A registrant should be cognizant of eliminating certain unfavorable charges in one year if it does not expect to eliminate them in a subsequent period if the charges happen to reverse, such as an accrual for a litigation contingency that it is ultimately settled in a later period for a favorable amount. Further, C&DI Question 100.03 (see Section 4.3) discusses a scenario in which a registrant excludes certain nonrecurring charges from a non-GAAP measure but fails to exclude nonrecurring gains (i.e., the registrant cherry-picks).
- *Consistent with non-GAAP measures used in the industry* — A registrant may want to consider whether its non-GAAP measures are consistent with standard measures used in its industry or by its peers and, if they are not, how the differences may affect comparability with other companies. A registrant's non-GAAP measures may differ from those used in its industry or of its peer companies. However, the registrant should consider whether any differences should be explained.

3.7.3 Changes in Non-GAAP Measures

As noted above, non-GAAP measures should generally be calculated and presented consistently for all periods presented. However, a registrant can change an existing non-GAAP measure for various reasons, such as changes that occur in the company's business. For example, a registrant may want to change a non-GAAP performance measure to add back significant restructuring costs in the current period related to a new streamlining initiative to be implemented over the next two years if it does not believe that such costs reflect its ongoing operations. In such a case, management, the audit committee, and others as appropriate should evaluate the appropriateness of the change, and the registrant should provide full and transparent disclosure about the change. As indicated in C&DI Question 100.02 (see Section 4.3), a non-GAAP measure may be considered misleading if a registrant adjusts an item in the current reporting period but does not adjust for a similar item in the prior period without appropriately disclosing the change and explaining the reasons for it.

In addition, as emphasized in 2015 at the AICPA Conference, if a non-GAAP measure used in the current period is calculated differently from one used in a prior period, the registrant should provide effective disclosures that permit comparability with the prior period. Further, footnote 23 of the Release states, in part:

> [R]egistrants should consider whether a change in the method of calculating or presenting a non-GAAP financial measure from one period to another, without a complete description of the change in that methodology, complies with the requirement of Regulation G 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.

Among other items, registrants should consider the following when changing an existing non-GAAP measure:

- *Transparent disclosure* — Registrants should clearly disclose (1) the nature of the change (e.g., specific details regarding the components that have changed), (2) the reason for the change, and (3) an updated discussion of how the new measure is used by management and why it is useful to investors. Registrants must also comply with all of the disclosure requirements in Regulation G and Item 10(e).
- *Recasting considerations* — C&DI Question 100.02 (see Section 4.3) indicates that a registrant may need to recast prior periods to conform to the current presentation if the change is significant.

Chapter 4 — Non-GAAP Measures That May Be Misleading or Prohibited and Other Considerations Related to Common Non-GAAP Measures

This chapter discusses potentially misleading and prohibited non-GAAP measures as well as other considerations related to common non-GAAP measures, including the treatment of tax adjustments and disclosures about free cash flow, funds from operations, constant currency, and system-wide sales.

4.1 Overview

Under Regulation G, Rule 100(b), a registrant is prohibited from presenting a non-GAAP measure that is misleading. Regulation G states that a registrant should not publicly disclose a non-GAAP financial measure "that . . . 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 measure . . . not misleading." Regulation G applies to all public statements that include or refer to non-GAAP measures. The guidance also applies to any SEC filing or furnished press releases under Form 8-K, Item 2.02 (see discussion in Chapter 6).

In May 2016, the SEC staff issued several new and updated C&DIs that provide guidance on misleading or prohibited non-GAAP measures. Section 100 of the C&DIs (see discussion below) illustrates various types of disclosures that could be potentially misleading.

Further, the requirements and prohibitions under Item 10(e) are more extensive and detailed than those under Regulation G. In addition to mandating certain disclosures, Item 10(e)(1)(ii) prohibits a registrant from:

- 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]" (the "liquidity measure prohibition"; emphasis added).
- Adjusting "a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when" (1) the nature of the charge or gain is such that it is reasonably likely to recur within two years or (2) there was a similar charge or gain within the prior two years (the "performance measure prohibition").
- Presenting "non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or *in the accompanying notes*" (emphasis added).

- 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."
- 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."

A registrant is also prohibited from presenting per-share measures of liquidity in documents filed with and furnished to the SEC. See Section 4.4 below.

The chart below summarizes the prohibitions against certain presentations of non-GAAP measures that apply to domestic[1] registrants under the Rules. Although Regulation G and Form 8-K, Item 2.02, do not refer to the prohibitions in Item 10(e)(1)(ii), registrants should consider the concepts in these and other prohibitions when using non-GAAP measures.

Prohibitions Applicable to Domestic Registrants

Prohibitions	All Disclosure of Non-GAAP Financial Measures (Regulation G[2,3])	SEC Filings (Item 10(e) of Regulation S-K[4,5])	Press Releases Furnished to the SEC (Item 2.02 of Form 8-K[6])
Prohibitions against certain presentations of non-GAAP financial measures:[7]			
• Material misstatements or omissions that would make the presentation of the non-GAAP financial measure misleading[8]	X	X	X
• Presenting per-share measures of liquidity[9]		X	X
• Excluding charges or liabilities that require, or will require, cash settlement, or would have required cash settlement in the absence of an ability to settle in another manner, from non-GAAP liquidity measures (other than EBIT and EBITDA)		X	

[1] For guidance on FPIs, see the following: Regulation G; Regulation S-K, Item 10(e); Section 106 of the C&DIs; and Section 8140 of the FRM.
[2] Regulation G applies whenever a registrant, or person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, whether that information is furnished to, or filed with, the SEC.
[3] In certain situations, Regulation G and Item 10(e) do not apply. For example, they do not apply to non-GAAP measures related to a proposed business combination or measures required to be disclosed by a governmental authority. See Section 2.3 for a discussion of measures that do not meet the definition of a non-GAAP measure under the Rules.
[4] Item 10(e) applies to all SEC filings that include non-GAAP financial measures.
[5] See footnote 3.
[6] Form 8-K, Item 2.02, requires registrants to furnish to the SEC all releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods, regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure. If a registrant elects to file the release or announcement with the SEC, such disclosure is subject to the requirements of Item 10(e).
[7] Although Regulation G and Form 8-K, Item 2.02, do not refer to the prohibitions in Item 10(e)(1)(ii), registrants should consider the concepts in these and other prohibitions when using non-GAAP measures.
[8] See Regulation G, Rule 100(b), and Section 100 of the C&DIs.
[9] Footnote 11 of the Release notes that certain non-GAAP per-share measures are prohibited under GAAP and SEC rules.

(Table continued)

Prohibitions	All Disclosure of Non-GAAP Financial Measures (Regulation G)	SEC Filings (Item 10(e) of Regulation S-K)	Press Releases Furnished to the SEC (Item 2.02 of Form 8-K)
• Adjusting a non-GAAP performance measure to eliminate or smooth items identified as nonrecurring, infrequent, or unusual when the nature of the charge or gain is such that is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years. The prohibition is based on the description of the charge or gain that is being adjusted		X	
• Presenting non-GAAP financial measures on the face of the GAAP financial statements or in the accompanying notes		X	
• Presenting non-GAAP financial measures on the face of any pro forma financial statements required to be disclosed by Article 11 of Regulation S-X		X	
• 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		X	

4.2 MD&A Considerations Related to Prohibited Disclosures

Regulation S-K, Item 303, provides guidance on the information a registrant should consider providing in its MD&A. A registrant is generally required to quantify, discuss, and analyze in its MD&A material items that affect the registrant's results of operations (e.g., material charges regardless of whether they are recurring or nonrecurring items).

As discussed in Section 2.1, depending on the way a registrant discloses material changes, the disclosure may or may not be a non-GAAP measure. For example, a registrant may want to disclose the effect of a large cash legal settlement on operating cash flows. Disclosure of an amount for "operating cash flows before legal settlement" would be a non-GAAP measure, and the registrant would need to consider the prohibition against excluding charges that required cash settlement from non-GAAP liquidity measures. If, however, the registrant disclosed GAAP operating cash flows and noted that the amount was significantly affected by the $XX payment of the legal settlement, those amounts individually are not considered non-GAAP measures, and the disclosure would therefore not be subject to the prohibition discussed above.

A registrant is also generally permitted to disclose in MD&A the individual effect of otherwise prohibited non-GAAP performance adjustments on GAAP earnings and earnings per share, such as by showing the per-share impact of a significant charge or gain. For example, the interpretative response to Question 3 of SAB Topic 5.P states the following:

> Discussions in MD&A and elsewhere which quantify the effects of unusual or infrequent items on net income and earnings per share are beneficial to a reader's understanding of the financial statements and are therefore acceptable.

Such discussions may be necessary and appropriate in MD&A for a registrant to be able to analyze the impact of unusual or infrequent items provided that the registrant maintains the proper context and balance. However, if the registrant "does the math" and presents a total profit measure or related per-share total excluding the unusual or infrequent item, it must consider all the applicable Rules.

4.3 What Is a Misleading Non-GAAP Measure?

An overriding theme of the SEC's guidance on the use of or references to non-GAAP measures in public statements or disclosures is that they should not be misleading, whether such measures are used in a filing (e.g., Form 10-K) or elsewhere (e.g., press release). As described in Section 100 of the C&DIs, non-GAAP measures that could mislead investors include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods, such as by adjusting an item in the current reporting period, but not a similar item in the prior period, without appropriate disclosure about the change and an explanation of the reasons for it (see Section 3.7.3).
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains (e.g., "cherry picking" non-GAAP adjustments to achieve the most positive measure; see Section 3.7.2).
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.

C&DIs — Non-GAAP Financial Measures

Question 100.01

Question: Can certain adjustments, although not explicitly prohibited, result in a non-GAAP measure that is misleading?

Answer: Yes. Certain adjustments may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP measure to be misleading. For example, presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business could be misleading. [May 17, 2016]

Question 100.02

Question: Can a non-GAAP measure be misleading if it is presented inconsistently between periods?

Answer: Yes. For example, a non-GAAP measure that adjusts a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods could violate Rule 100(b) of Regulation G unless the change between periods is disclosed and the reasons for it explained. In addition, depending on the significance of the change, it may be necessary to recast prior measures to conform to the current presentation and place the disclosure in the appropriate context. [May 17, 2016]

Question 100.03

Question: Can a non-GAAP measure be misleading if the measure excludes charges, but does not exclude any gains?

Answer: Yes. For example, a non-GAAP 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. [May 17, 2016]

C&DIs — Non-GAAP Financial Measures (continued)

Question 100.04

Question: 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. Can this measure be presented in documents filed or furnished with the Commission or provided elsewhere, such as on company websites?

Answer: No. Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. Other 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. [May 17, 2016]

As noted in C&DI Question 100.01, a registrant's non-GAAP performance measure should not eliminate costs necessary to generate revenues or normal, recurring cash charges. The SEC staff has, for example, commented when non-GAAP measures have:

- Excluded certain marketing expenses that were considered normal recurring operating cash expenditures.
- Used a "price normalized cash margin" that included higher oil and commodity prices from earlier periods. See Section 4.17.

In C&DI Question 100.04, the SEC staff provides an example of a prohibited non-GAAP performance measure that reflects revenue recognized over the service period under GAAP on an accelerated basis as if the registrant earned revenue when it billed its customers. The measure is prohibited because it is an individually tailored accounting principle and does not reflect the registrant's required GAAP measurement method. While the example is about revenue recognition, the C&DI indicates that individually tailored accounting principles may also be prohibited when they are applied to other financial statement line items to create a non-GAAP measure.

Further, under ASC 280, a registrant may present segment measures, including segment-adjusted revenues or segment profit, on a basis that is consistent with the manner in which the registrant is managed but different from the basis presented in its consolidated financial statements prepared in accordance with GAAP. While such segment measures are not non-GAAP financial measures under the Rules, as long as they are presented on a separate segment basis, the SEC staff may object to their presentation or discussion on a consolidated basis when they are based on individually tailored accounting principles (see additional discussion in Section 2.5).

In addition to the examples discussed in the C&DIs, various other presentations could also be considered misleading non-GAAP measures depending on the facts and circumstances.

Registrants should not use non-GAAP measures that could mislead an investor about their results of operations, financial condition, or liquidity. While the SEC staff has primarily used the comment-letter process of the SEC's Division of Corporation Finance (the "Division"), speeches, and the updated C&DIs to indicate its objection to misleading measures, there have also been some enforcement actions. In 2002, the SEC brought an enforcement action against a registrant for disclosure of non-GAAP information in its earnings release that removed a "one-time" charge but did not disclose that one-time gains had not been removed. In another enforcement action in 2009, the registrant used a non-GAAP measure that claimed it excluded certain nonrecurring items when the measure actually removed certain

operating expenses. In addition, SEC Chair Mary Jo White noted at the June 2016 International Corporate Governance Network Annual Conference that the staff would, if necessary, use its filing review process, enforcement, and further rulemaking to ensure that disclosures are optimal (see Appendix B for more information).

4.4 Non-GAAP Per-Share Measures

Item 10(e) does not specifically prohibit the presentation of non-GAAP per-share financial measures. However, footnote 11[10] of the Release notes that certain non-GAAP per-share measures are specifically prohibited under GAAP and SEC rules. This prohibition applies to disclosure in documents both filed with the SEC and furnished to the SEC (such as press releases).

C&DIs — Non-GAAP Financial Measures

Question 102.05

Question: While Item 10(e)(1)(ii) of Regulation S-K does not prohibit the use of per share non-GAAP financial measures, the adopting release for Item 10(e), Exchange Act Release No. 47226, states that "per share measures that are prohibited specifically under GAAP or Commission rules continue to be prohibited in materials filed with or furnished to the Commission." In light of Commission guidance, specifically Accounting Series Release No. 142, *Reporting Cash Flow and Other Related Data*, and Accounting Standards Codification 230, are non-GAAP earnings per share numbers prohibited in documents filed or furnished with the Commission?

Answer: No. Item 10(e) recognizes that certain non-GAAP per share performance measures may be meaningful from an operating standpoint. 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 Commission, 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. [May 17, 2016]

Prohibited per-share measures include:

- *Cash flow per share and other per-share measures of* ***liquidity*** — ASC 230 states that "[f]inancial statements shall not report an amount of cash flow per share. Neither cash flow nor any component of it is an alternative to net income as an indicator of an entity's performance, as reporting per-share amounts might imply." The SEC's guidance in ASR 142 contains a similar prohibition. Free cash flow is a liquidity measure and, therefore, per-share presentation is expressly prohibited. In addition, C&DI Question 103.02 notes that EBIT or EBITDA should not be presented on a per-share basis. The C&DI does not discuss the presentation of earnings per share on adjusted EBIT or adjusted EBITDA. The determination of whether they are acceptable may depend on the nature of the adjustment and whether the measure is clearly, in substance, a liquidity measure. See Section 4.11 for a discussion of free cash flow, and see Sections 3.6 and 4.6 for a discussion of EBIT, EBITDA, and adjusted EBIT and EBITDA.
- *Per-share measures derived from prohibited non-GAAP measures* — While there is no explicit restriction on the presentation of non-GAAP per-share measures, other than the restriction described above, registrants are not allowed to disclose a non-GAAP per-share measure that is derived from a prohibited non-GAAP financial measure. That is, the numerator in the non-GAAP per-share measure must be a non-GAAP measure permitted by Item 10(e). See discussion below regarding the denominator.

[10] Footnote 11 states, "While we have not included a prohibition on per share non-GAAP financial measures in Item 10 of Regulation S-K or Item 10 of Regulation S-B, per share measures that are prohibited specifically under GAAP or Commission rules continue to be prohibited in materials filed with or furnished to the Commission. See, for example, the prohibition on cash flow per share in paragraph 33 of FASB Statement No. 95, *Statement of Cash Flows*."

Registrants may generally disclose other non-GAAP per-share *performance* measures as long as they comply with other SEC requirements for such measures (including the reconciliation to GAAP earnings per share; see Section 3.2.2). C&DI Question 102.05 (see Section 4.4) indicates that in a registrant's discussion of its operations, certain non-GAAP per-share performance measures "may be meaningful." However, the C&DI also specifies that the SEC staff may challenge measures designated as performance measures that appear to be more like liquidity measures (i.e., the staff will look at the substance of the disclosure, not necessarily its form of characterization). See Section 3.2.2 for more information.

Registrants are reminded to comply with all disclosure requirements in Item 10(e), including the requirement to reconcile both the numerator and denominator. A reconciliation of the denominator is not necessary, however, if the denominator represents diluted shares in accordance with ASC 260. If the denominator does not represent diluted shares, registrants should use caution in presenting the measure and consider whether the resulting measure could potentially be misleading (see footnote 49 of the Release).[11]

4.5 Liquidity Measure Prohibitions

Implicit in the reconciliation requirement of Item 10 is that a registrant must characterize any non-GAAP financial measure in a filing as either a liquidity measure or a performance measure. See Section 3.2.2 for a discussion of liquidity and performance measures.

The characterization of a non-GAAP measure is important since it dictates the disclosures required and the nature of the adjustments to the non-GAAP measure that are permitted under Item 10. For example, a registrant is prohibited from excluding cash charges (or charges that will in the future require cash settlement) from a liquidity measure. However, the Rules provide an exception to the liquidity prohibitions specifically for EBIT and EBITDA, which, by definition, would exclude cash charges such as interest and taxes. If the measure is a performance measure, a registrant may be able to exclude cash or noncash charges, but it should appropriately describe the charges excluded. The ability to eliminate recurring items from a non-GAAP performance measure is further discussed in Section 4.7 (see also Section 4.14, which discusses certain exceptions for material credit agreement covenants).

For additional guidance on non-GAAP per-share liquidity measures, see the discussion above.

4.6 EBIT and EBITDA, and Adjusted EBIT and EBITDA

As discussed in Chapter 3, EBIT, EBITDA, and adjusted EBIT and EBITDA may be presented as a performance measure or a liquidity measure. If presented as a liquidity measure, EBIT and EBITDA are, as noted above, specifically exempt from the liquidity measure prohibition; however, they are still considered non-GAAP financial measures and therefore must include all of the required non-GAAP disclosures.

As discussed in Section 3.6, any adjustments to net income beyond those described in the traditional definition of EBIT or EBITDA create an "adjusted" measure, which is also considered a non-GAAP measure. Therefore, to avoid investor confusion, a registrant should not characterize or label the non-GAAP measure as EBIT or EBITDA if the measure does not meet these traditional definitions. Instead, the registrant should distinguish the measure from EBIT or EBITDA by using a title such as "adjusted EBITDA." Any additional adjustments to derive adjusted EBITDA are subject to the non-GAAP

[11] Regulation G indicates that a non-GAAP measure should not contain "an untrue statement of a material fact" or omit material facts that would make its presentation misleading.

liquidity and performance measure prohibitions in Item 10 (with the exception of measures regarding material covenants to debt agreements; see Section 4.14 for a discussion of credit agreement covenant disclosures).

Also, C&DI Question 103.02 notes that EBIT or EBITDA should not be presented on a per-share basis. The C&DI does not discuss the presentation of earnings per share on adjusted EBIT or adjusted EBITDA. The determination of whether they are acceptable may depend on the nature of the adjustments and whether the measure is, in substance, a liquidity measure.

See Section 3.6 for additional discussion of EBIT, EBITDA, and adjusted EBIT and EBITDA.

4.7 Performance Measure Prohibitions

A registrant may decide to disclose a non-GAAP performance measure that adjusts for recurring charges that would appear to be necessary to run its business operations. A registrant should be able to support why it believes that this type of measure would be useful to an investor, particularly when the measure removes “normal” types of expenses. See Section 4.3.

Further, many registrants adjust GAAP earnings for items they consider to be one-time, nonrecurring, infrequent, or unusual, such as restructuring charges, asset impairments, and gains and losses on asset sales. Depending on the description of the item, these same items may be a prohibited adjustment for a non-GAAP performance measure. Item 10(e) prohibits registrants 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.” C&DI Question 102.03 clarifies that a charge or gain may be presented as an adjustment as long as it is not inappropriately labeled or described as nonrecurring, infrequent, or unusual.

C&DIs — Non-GAAP Financial Measures

Question 102.03

Question: Item 10(e) of Regulation S-K prohibits adjusting a non-GAAP financial 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. Is this prohibition based on the description of the charge or gain, or is it based on the nature of the charge or gain?

Answer: The prohibition is based on the description of the charge or gain that is being adjusted. It would not be appropriate to state that a charge or gain is non-recurring, infrequent or unusual unless it meets the specified criteria. The fact that a registrant cannot describe a charge or gain as non-recurring, infrequent or unusual, however, does not mean that the registrant cannot adjust for that charge or gain. Registrants can make adjustments they believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K. See Question 100.01. [May 17, 2016]

Thus, if management concludes that an adjustment to a non-GAAP performance measure is appropriate, but that the adjustment is reasonably likely to recur within two years or there was a similar charge in the last two years, it may adjust the non-GAAP performance measure (subject to Regulation G and the other requirements in Item 10(e)) but may not describe the adjustment as nonrecurring, infrequent, or unusual because it does not meet the specified criteria.

Example

A registrant reflects an impairment charge in its 20X6 statement of operations that it believes is an appropriate adjustment to its non-GAAP performance measure. Management believes that it is reasonably likely that an impairment will recur within one of the next two years. Management may adjust the non-GAAP performance measure for the impairment charge but may not label it or describe it in a note as nonrecurring, infrequent, or unusual since it does not meet the criteria in Item 10.

4.8 Non-GAAP Measures on the Face of Financial Statements and Notes

Item 10(e)(1)(ii)(C) expressly prohibits a registrant from presenting non-GAAP measures in financial statements prepared in accordance with GAAP. Accordingly, a registrant may not present non-GAAP measures in either of the following places:

- The face of the financial statements.
- The footnotes accompanying the financial statements.

In some circumstances, a registrant may be required by GAAP to present a measure that might otherwise be considered a non-GAAP measure (e.g., adjusted EBITDA) in the notes to the financial statements, such as segment disclosures presented in accordance with ASC 230. A measure presented in this context is not considered a non-GAAP measure under the Rules and therefore would not be prohibited. For additional discussion, see Section 2.5.

Item 10(e)(1)(ii)(D) also prohibits a registrant from presenting non-GAAP measures on the face of any pro forma financial statements required to be disclosed by Article 11.

4.9 Considerations Related to Labeling Non-GAAP Measures

When labeling a non-GAAP financial measure, a registrant may not use titles or descriptions that are the same as, or are confusingly similar to, titles or descriptions used for GAAP financial measures.

For example:

- A non-GAAP measure identified as “operating earnings” may be considered confusingly similar to the “operating income” GAAP measure.
- A non-GAAP measure should not be identified as “EBITDA” if it excludes any amounts other than interest, taxes, depreciation, and amortization (e.g., impairment charges).

A registrant should also be cautious when using terms that are defined in SEC literature to label non-GAAP items. For instance, a non-GAAP measure with a label that includes the term “pro forma” would generally be expected to be consistent with the concepts in Article 11 and GAAP, as appropriate.

Further, the SEC staff has indicated that in adjusting non-GAAP measures, registrants sometimes use conventional accounting terms differently from the way they are commonly understood by investors. Citing an example of such use in the oil and gas industry, the staff noted that derivative gains and losses may be labeled in a way that suggests that the adjustments are calculated under GAAP even when they exclude net unrealized gains and losses. The SEC staff has reminded registrants to stay true to the meaning of accounting terminology as defined in GAAP.

Note that clear, transparent labeling is important for all items in the reconciliation, including the non-GAAP measure and reconciling items. For a discussion of labeling the reconciling items from the GAAP to the non-GAAP measure, see Section 3.2.

4.10 Treatment of Tax Adjustments

In certain circumstances, a registrant may reflect a non-GAAP measure after taxes and therefore show the tax adjustments when reconciling a non-GAAP measure to the appropriate GAAP measure. C&DI Question 102.11 indicates that the tax expense impact for a performance measure should be consistent with the amount of non-GAAP income since adjusting revenue or income before income tax could affect the tax expense or benefits assumed in the calculation of the tax provision. For example, suppose that a registrant has a $200 million GAAP loss for the most recent fiscal year, which resulted in a 3 percent tax rate. After making various reconciling adjustments, if the registrant presents a non-GAAP adjusted income measure of $400 million, the SEC staff may comment if the registrant uses the same 3 percent effective tax rate to compute the tax provision.

If a non-GAAP measure is a liquidity measure, adjusting the GAAP tax amount to present taxes paid in cash may be acceptable.

Registrants should present adjustments gross of tax and should disclose how the tax adjustments were determined.

C&DIs — Non-GAAP Financial Measures

Question 102.11

Question: How should income tax effects related to adjustments to arrive at a non-GAAP measure be calculated and presented?

Answer: 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. [May 17, 2016]

Example

To illustrate the discrete effect of taxes on individual adjustments in the reconciliation, the registrant may present the tax effect of all adjustments as a single line in the reconciliation as follows:

Net income	$ XYZ
Add: Stock-based compensation	XX
Restructuring charges	YY
Less: Tax effect of adjustments	ZZ
Adjusted net income	$ UVW

The registrant should clearly disclose how it determined the tax effect. Other alternative presentations may be appropriate as long as the gross amount of adjustments are disclosed. For example, a registrant could disclose the relevant information about the gross amount of the adjustment and the tax amount in parentheses (e.g., stock-based compensation $10 million less the amount of taxes $3 million) to arrive at the net amount (e.g., $7 million) and could provide similar disclosure for the restructuring charges.

When calculating a non-GAAP measure, a registrant should be mindful of how the adjustments made to a GAAP measure affect income tax expense. As indicated above, a registrant's adjustment of revenue or income before tax expense could affect the tax expense or benefits assumed in the calculation of the tax provision and therefore could have an impact on the tax computation in the reconciliation.

4.11 Presentation of Free Cash Flow

Free cash flow is a non-GAAP measure, commonly defined as cash flows from operating activities as presented in the statement of cash flows less capital expenditures. According to C&DI Question 102.07, the measure does not violate the liquidity measure prohibition of Item 10(e) even though some of the capital expenditures may have been or will be paid in cash. In addition to capital expenditures, other adjustments may also be used to derive free cash flow. C&DI Question 102.07 notes that the measure is not uniformly defined, and its title does not describe how it is calculated. Therefore, registrants must clearly describe how free cash flow is calculated and disclose the other information required by Item 10(e), including a reconciliation.

C&DIs — Non-GAAP Financial Measures

Question 102.07

Question: Some companies present a measure of "free cash flow," which is typically calculated as cash flows from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures. Does Item 10(e)(1)(ii) of Regulation S-K prohibit this measure in documents filed with the Commission?

Answer: No. The deduction of capital expenditures from the GAAP financial measure of cash flows from operating activities would not violate the prohibitions in Item 10(e)(1)(ii). However, companies should be aware that this measure does not have a uniform definition and its title does not describe how it is calculated. Accordingly, a clear description of how this measure is calculated, as well as the necessary reconciliation, should accompany the measure where it is used. Companies should also avoid inappropriate or potentially misleading inferences about its usefulness. For example, "free cash flow" should not be used in a manner that inappropriately implies that the measure represents the residual cash flow available for discretionary expenditures, since many companies have mandatory debt service requirements or other non-discretionary expenditures that are not deducted from the measure. Also, free cash flow is a liquidity measure that must not be presented on a per share basis. See Question 102.05. [May 17, 2016]

Since free cash flow is presumed to be a liquidity measure, registrants would be prohibited from disclosing free cash flow per share. See the discussion of non-GAAP per-share measures in Section 4.4.

4.12 Presentation of Funds From Operations

Funds from operations (FFO) is a non-GAAP measure commonly used in the real estate industry. C&DI Questions 102.01 and 102.02 indicate that FFO, as defined by the NAREIT and in effect as of May 17, 2016, as well as FFO per share will continue to be accepted as a performance measure.

The presentation of any FFO measure in a manner that departs from NARIET's definition (e.g., adjusted FFO, core FFO), or as a per-share amount based on such a modified measure, is subject to the prohibitions in Item 10(e). Accordingly, that measure must comply with the requirements in Item 10(e) for a performance measure or a liquidity measure. If modified FFO is considered a performance measure, it may be presented on a per-share basis; if a modified FFO per share is, in substance, a liquidity measure, presentation on a per-share basis is prohibited. Acceptability of FFO per-share measures, or modified FFO per share, does not override the prohibition against the presentation of cash flow per-share data and other per-share measures of liquidity.

C&DIs — Non-GAAP Financial Measures

Question 102.01

Question: What measure was contemplated by "funds from operations" in footnote 50 to Exchange Act Release No. 47226, Conditions for Use of Non-GAAP Financial Measures, which indicates that companies may use "funds from operations per share" in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K?

Answer: The reference to "funds from operations" in footnote 50, or "FFO," refers to the measure as defined as of January 1, 2000, by the National Association of Real Estate Investment Trusts (NAREIT). NARIET has revised and clarified the definition since 2000. The staff accepts NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis. [May 17, 2016]

Question 102.02

Question: May a registrant present FFO on a basis other than as defined by NAREIT as of May 17, 2016?

Answer: Yes, provided that any adjustments made to FFO comply with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. 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, some of which may trigger the prohibition on presenting this measure on a per share basis. See Section 100 and Question 102.05. [May 17, 2016]

FFO may be reported gross or net of noncontrolling interest adjustments. In situations in which the FFO calculation appears to take into account noncontrolling interest adjustments and is simply labeled "FFO," the registrant should clearly label the measure to reflect "FFO attributable to common stockholders" or "FFO attributable to the company."

4.13 Constant Currency Presentations

Constant currency is a method used to eliminate the effects of exchange rate fluctuations of international operations in a registrant's determination of financial performance. For example, when presenting its MD&A, a registrant with material operations in various countries should disclose the impact of material exchange rates. To do so, the registrant may use a constant exchange rate between periods for translation, which would remove the effect of fluctuations in foreign exchange rates.

The presentation of financial results in a constant currency is considered a non-GAAP measure.

C&DIs — Non-GAAP Financial Measures

Question 104.06

Question: Company X has operations in various foreign countries where the local currency is used to prepare the financial statements which are translated into the reporting currency under the applicable accounting standards. In preparing its MD&A, Company X will explain the reasons for changes in various financial statement captions. A portion of these changes will be attributable to changes in exchange rates between periods used for translation. Company X wants to isolate the effect of exchange rate differences and will present financial information in a constant currency — e.g., assume a constant exchange rate between periods for translation. Would such a presentation be considered a non-GAAP measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Company X may comply with the reconciliation requirements of Regulation G and Item 10(e) by presenting the historical amounts and the amounts in constant currency and describing the process for calculating the constant currency amounts and the basis of presentation. [Jan. 11, 2010]

Since constant-currency amounts are non-GAAP measures, the registrant should include the appropriate non-GAAP disclosures to isolate the effects of the exchange rate differences for (1) the historical amounts and (2) the amounts in constant currency. The disclosure of the non-GAAP measure should describe both the basis of presentation and how the constant-currency amounts were computed. Note that if a registrant only discloses the impact of exchange rates as part of its explanation of the period-to-period fluctuation between two GAAP amounts, such disclosure would not constitute a non-GAAP measure (e.g., foreign currency fluctuations resulted in $XX of the change in net revenue).

4.14 Credit Agreement Covenants

Credit agreements often require registrants to comply with certain financial or non-financial covenants. The financial covenants, which may be based on GAAP or on non-GAAP measures such as EBITDA or adjusted EBITDA, are often material to an investor's understanding of the registrant's financial condition and liquidity. Accordingly, disclosure of information about covenants may be required in the MD&A section of a filing.

C&DIs — Non-GAAP Financial Measures

Question 102.09

Question: Item 10(e)(1)(ii)(A) of Regulation S-K prohibits "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 the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA)." A company's credit agreement contains a material covenant regarding the non-GAAP financial measure "Adjusted EBITDA." If disclosed in a filing, the non-GAAP financial measure "Adjusted EBITDA" would violate Item 10(e), as it excludes charges that are required to be cash settled. May a company nonetheless disclose this non-GAAP financial measure?

Answer: Yes. The prohibition in Item 10(e) notwithstanding, because MD&A requires disclosure of material items affecting liquidity, if management believes that the credit agreement is a material agreement, that the covenant is a material term of the credit agreement and that information about the covenant is material to an investor's understanding of the company's financial condition and/or liquidity, then the company may be required to disclose the measure as calculated by the debt covenant as part of its MD&A. In disclosing the non-GAAP financial measure in this situation, a company should consider also disclosing the following:

- the material terms of the credit agreement including the covenant;
- the amount or limit required for compliance with the covenant; and
- the actual or reasonably likely effects of compliance or non-compliance with the covenant on the company's financial condition and liquidity. [Jan. 11, 2010]

As indicated in C&DI Question 102.09, a registrant must disclose in its MD&A material items affecting its financial condition or liquidity. The C&DI emphasizes that a registrant should disclose a measure that is calculated in accordance with a credit agreement when (1) the credit agreement is a material agreement, (2) the covenant is a material term of the credit agreement, and (3) information about the covenant is "material to an investor's understanding of [its] financial condition and/or liquidity" (e.g., when the registrant is at risk of violating the covenant). Disclosure of the measure may be required even if the measure would otherwise be prohibited under Item 10(e) (see Section 4.1).

In addition to providing the non-GAAP disclosures required by Item 10(e), a registrant should consider the other disclosures described in C&DI Question 102.09.

4.15 Presentation of a System-Wide Sales Measure

System-wide sales is a non-GAAP financial measure commonly used by registrants in certain industries (e.g., retail and restaurant). It is generally defined as the combination of sales generated by corporate-owned and franchised locations.

The SEC staff had noted at the April 6, 2010, CAQ SEC Regulations Committee joint meeting with the SEC staff that it objected to the presentation of system-wide sales. However, at the 2015 AICPA Conference, the staff indicated that it did not object to the use of this non-GAAP measure in certain situations (when the registrant has complied with all of the other non-GAAP requirements and disclosures) since the measure is generally understood in the marketplace and used by investors (e.g., to assess the overall strength of a brand).

Example

The following table illustrates how a registrant might disclose system-wide sales in a filing (the accompanying table omits the required disclosures about non-GAAP measures, including the purpose and use of the measure):

Form 10-K MD&A Non-GAAP Sales Table

	20X6	20X5
Company-owned	$ XX	$ XX
Franchise	YY	YY
System-wide	$ ZZ	$ ZZ

4.16 Treatment of Pension and Other Postemployment Benefits Expense in Non-GAAP Measures

Some registrants present non-GAAP measures that adjust for defined-benefit pension-related items. For example, a registrant may adjust to remove (1) all nonservice-related pension expense, (2) all pension expense in excess of cash contributions, or (3) the amortization of actuarial gains and losses. Some registrants that immediately recognize all actuarial gains and losses in earnings present non-GAAP measures that remove the actual gain or loss attributable to the change in the fair value of plan assets from a performance measure and include an expected return.

The SEC staff has observed that these pension-related adjustments can be confusing without the appropriate context about the nature of the adjustment. For example, the staff has noted that pension adjustment disclosures often:

- Do not clearly describe what the adjustment represents (e.g., the adjustment removes the amount of actuarial gain/loss immediately recognized in earnings or removes all nonservice-related pension costs).
- Refer to “noncash” pension expense even though the pension liability is expected ultimately to be settled in cash.
- Do not provide context about adjustments related to actuarial gains and losses.
- Inconsistently reflect adjustments related to actuarial gains and losses.

At the 2013 AICPA Conference, the SEC staff provided an example of a registrant that immediately recognized its actuarial gains and losses. The adjustment in the non-GAAP measure included the impact of changes in pension plan assumptions (e.g., changes in discount rate) as well as the difference between the actual return on plan assets and the expected return on plan assets. The staff indicated that this presentation might be confusing because the adjusted non-GAAP measure reflected only the expected return, which is always positive no matter how the market actually performs. The staff noted that a registrant should disclose that the non-GAAP measure reflects:

- An expected return on plan assets of X percent or $XX.
- An actual return of Y percent or $YY.
- Pension expense of $ZZ.

Registrants that amortize actuarial gains and losses (rather than immediately recognize their actuarial gains and losses) should disclose similar information. That is, they should (1) quantify the expected return on plan assets reflected in the non-GAAP measure and (2) disclose the amount of pension expense reflected in the non-GAAP measure.

At the 2015 AICPA Conference, the SEC staff expressed some observations regarding a registrant's change in approach when measuring its service cost and interest cost. The SEC staff has also highlighted that it expects registrants to disclose any significant impact of a change in the approach used to measure net periodic benefit cost on any non-GAAP measures. Specifically, registrants should explain how the change in approach affected components of net periodic benefit cost and actuarial gains and losses in the current period and on a prospective basis to the extent that those items are reflected in non-GAAP measures.

4.17 Normalized Market Prices

Because of significant volatility in commodity prices, a registrant may believe that investors would benefit from disclosure of a non-GAAP financial measure that adjusts its results of operations by eliminating the effect of significant changes in commodity prices. At the 2015 AICPA Conference, the SEC staff stated that it objects to the presentation of such a non-GAAP measure because ever-changing market conditions and volatility in commodity prices present a challenge for registrants to ascertain a "normal" market price.

Chapter 5 — Disclosure Controls and Procedures Related to Non-GAAP Measures and Other Considerations

5.1 Disclosure Controls and Procedures Versus Internal Control Over Financial Reporting

It is important to understand whether controls over non-GAAP measures are related to disclosure controls and procedures (DCPs), to internal control over financial reporting (ICFR), or to both.

As defined in both SEC and PCAOB rules, ICFR focuses on controls related to the "reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles." DCPs, on the other hand, are more broadly defined and pertain to all information required to be disclosed by the company.

Because the starting point for a non-GAAP measure is a GAAP measure, ICFR would be relevant to consider up to the point at which the GAAP measure that forms the basis of the non-GAAP measure has been determined. However, regarding controls over the adjustments to the GAAP measure and the related calculation of the non-GAAP measure — including the oversight and monitoring of the non-GAAP measure — it is appropriate to consider such controls within the realm of DCPs.

5.1.1 Non-GAAP Measures, Earnings Releases, and DCPs

The SEC's final rule on certifications states that Section 302 of the Sarbanes-Oxley Act of 2002 requires management to certify on a quarterly basis that DCPs are effective "to ensure that information required to be disclosed by the issuer in the reports filed or submitted by it under the Exchange Act [footnote omitted] is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms." Earnings releases containing non-GAAP measures are often furnished on Form 8-K, which does not require certifications of the effectiveness of DCPs. However, the final rule also indicates that "[d]isclosure controls and procedures . . . are required to be designed, maintained and evaluated to ensure full and timely disclosure in current reports."

Therefore, registrants that use non-GAAP measures in earnings releases furnished on Form 8-K — or those that use them in Forms 10-Q and 10-K (outside the financial statements), which would be explicitly covered by Section 302 certifications — should consider the appropriateness of their DCPs in the context of their non-GAAP information. Registrants should, at a minimum, consider designing DCPs to ensure that procedures are in place regarding:

- *Compliance* — Non-GAAP measures are presented in compliance with SEC rules, regulations, and guidance.
- *Consistency of preparation* — Non-GAAP measures are presented consistently each period, and potential non-GAAP adjustments are evaluated on an appropriate, consistent basis each period.
- *Data quality* — Non-GAAP measures are calculated on the basis of reliable inputs that are subject to appropriate controls.
- *Accuracy of calculation* — Non-GAAP measures are calculated with arithmetic accuracy, and the non-GAAP measures in the disclosure agree with the measures calculated.
- *Transparency of disclosure* — Descriptions of the non-GAAP measures, adjustments, and any other required disclosures are clear and not confusing.
- *Review* — Non-GAAP disclosures are reviewed by appropriate levels of management to confirm the appropriateness and completeness of the non-GAAP measures and related disclosures.
- *Monitoring* — The registrant's monitoring function (e.g., internal audit, disclosure committee, or audit committee) appropriately reviews the DCPs related to non-GAAP disclosures. The audit committee is involved in the oversight of the preparation and use of non-GAAP measures.

A critical aspect of such DCPs is the involvement of the appropriate levels of management and those charged with governance. Depending on the registrant, this may include reviewing the selection and determination of non-GAAP measures with a disclosure committee, the audit committee, or both. Establishing a written policy that (1) clearly describes the nature of allowable adjustments to GAAP measures, (2) defines the non-GAAP measure(s) to be used under the policy, and (3) explains how potential changes in the inputs, calculation, or adjustments will be evaluated and approved may help management identify its DCPs. For example, a policy might describe qualitatively the types of adjustments that are nonrecurring and abnormal and thus within the defined policy. It may also outline specific quantitative thresholds for which income or expense items might be evaluated in the determination of whether they should be included in non-GAAP adjustments. This could help ensure that appropriate non-GAAP measures are used as well as eliminate the need for numerous immaterial adjustments in the reconciliation that may confuse investors.

5.1.2 Disclosure Committee Considerations

Some companies may find it helpful to use a disclosure committee to assist the CEO, CFO, and audit committee in preparing and overseeing disclosures, including those related to non-GAAP measures. Disclosure committees are typically management committees, although some companies prefer that the disclosure committee function as a subcommittee of the board and audit committee.

Disclosure committees can set parameters for and determine the appropriateness of disclosures related to non-GAAP measures. In particular, the disclosure committee could review draft earnings releases to provide input and oversight by using the seven considerations outlined above. As part of its review, the disclosure committee can provide effective governance and play an integral role in the accuracy, completeness, timeliness, and fairness of a company's disclosures.

5.1.3 Sample Approach — Controls Associated With the Disclosure of Non-GAAP Measures

A global manufacturing company uses certain non-GAAP measures in its quarterly earnings releases that are furnished to the SEC on Form 8-K. The manager of external reporting (1) prepares the non-GAAP measures that the entity plans to include in the quarterly earnings release and (2) provides to the controller for review the computed non-GAAP measures and related support (e.g., reconciliation between the most directly comparable GAAP financial measure and the non-GAAP measure) for the calculations.

The controller recomputes each non-GAAP measure and agrees the underlying GAAP measure to the general ledger. The controller then reviews each reconciliation of the GAAP measure to the non-GAAP measure, which includes agreeing the adjustments to the trial balance or other support and considering whether the reconciliation clearly labels and describes the nature of each adjustment. The controller also considers whether each adjustment is appropriate under company policy and is consistent with adjustments made in prior periods, and the controller excludes immaterial adjustments that are not the focus of management. Further, the controller reviews a list of prohibited presentations of non-GAAP financial measures to ensure that the measures are consistent with SEC guidance. The list of prohibited presentations includes the following, which can be evaluated before the draft earnings release is prepared:

- The inclusion of material misstatements or omissions that would make the presentation of the non-GAAP financial measure misleading.
- The presentation of per-share measures of liquidity.
- The exclusion of charges or liabilities that require, or will require, cash settlement, or would have required cash settlement in the absence of an ability to settle in another matter, from non-GAAP liquidity measures.
- Adjustments to a non-GAAP performance measure to 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 controller considers whether the non-GAAP measures contain misleading adjustments, including those that:

- Exclude normal, recurring cash operating expenses necessary for business operation.
- Adjust an item in the current reporting period but do not adjust for a similar item in the prior period.
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains.
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.

The controller considers the income tax effects of the adjustments made to the GAAP measure (mindful that adjusting revenue or income before tax could affect the tax expense or benefits assumed in the calculation of the tax provision and that if the measure is a performance measure, a current and deferred income tax expense commensurate with the non-GAAP measure of profitability should be calculated and included in the disclosure). In addition, the controller verifies that adjustments for

income taxes are presented separately and there is disclosure of how the adjustment for income taxes was determined. Finally, the controller reviews the non-GAAP measures used by the company's peers and considers whether the company's non-GAAP measures are comparable to them. The controller will follow up, if necessary, with the manager of external reporting regarding these review steps and, when any outstanding issues are resolved, will submit the reviewed non-GAAP measures to the director of investor relations. The director of investor relations drafts the earnings release and includes the non-GAAP measures reviewed by the controller.

The draft earnings release is then subject to review by the disclosure committee, which consists of the chief financial officer, the general counsel, the income tax director, and the director of internal audit. The disclosure committee reviews the non-GAAP measures disclosed in the draft earnings release for compliance with Regulation G and other SEC guidance and ensures the following:

- The non-GAAP measure is neither misleading nor prohibited.
- The non-GAAP measure is presented with and reconciled to the most directly comparable GAAP measure and with no greater prominence than the GAAP measure.
- The non-GAAP measure is appropriately defined and described and is clearly labeled as non-GAAP.
- The non-GAAP measure is balanced (i.e., it adjusts not only for nonrecurring expenses but also for nonrecurring gains).
- There is transparent and company-specific disclosure of the substantive reason(s) why management believes that the measure is useful for investors and, if material, the purpose for which management uses the measure.
- The non-GAAP measure is not presented on the face of the GAAP financial statements or in the accompanying notes or on the face of any pro forma financial statements required to be disclosed by Regulation S-X, Article 11.
- The titles or descriptions of non-GAAP financial measures are not the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.
- The measure is consistently prepared from period to period in accordance with the defined policy and is comparable to that of the company's peers.

If there are any inconsistencies between the above compliance issues and the non-GAAP measures and their disclosure in the draft earnings release, the disclosure committee will follow up with the director of investor relations, the controller, or both and request that conforming changes be made to the draft earnings release. Once any outstanding matters have been resolved, the disclosure committee approves the draft earnings release and forwards it to the audit committee for its review.

The audit committee exercises its oversight with respect to external financial reporting in performing its review of the earnings release, including confirming that the non-GAAP measures are appropriately disclosed in accordance with policy and are consistent with SEC rules, regulations, and guidance.

5.2 Auditor Responsibility for Non-GAAP Measures

Because non-GAAP financial information is not permitted in a registrant's financial statements or in the notes thereto, the external auditor's opinion does not cover it. Therefore, since such information is not subject to audit, the auditor's responsibility with respect to it is limited. In general, when registrants include other information, such as a non-GAAP measure, in a document containing financial statements covered by the auditor's report, professional auditing standards require the auditor to read the other

information and consider whether it is materially inconsistent with the information in the audited financial statements. Auditors may also be asked by underwriters to provide "comfort" regarding the reconciliation between a non-GAAP measure and the closest GAAP measure that was presented in an offering document.

Note, however, that although the external auditor's report does not currently cover non-GAAP measures, the PCAOB's Standing Advisory Group discussed the auditor's role with respect to non-GAAP measures at its May 18–19, 2016, meeting. See Deloitte's June 22, 2016, *Audit & Assurance Update* for more information.

5.3 Use of Non-GAAP Measures to Assess Materiality of Errors

A registrant performs a materiality analysis to determine the impact of identified misstatements on its (1) financial statements and (2) conclusions about ICFR and DCPs. SAB Topics 1.M (SAB 99) and 1.N (SAB 108) contain the SEC staff's guidance on assessing the materiality of misstatements.

The SEC staff has observed that certain registrants have argued that a quantitatively large error in the GAAP financial statements is immaterial when the error has a quantitatively small impact on non-GAAP metrics. While it may be appropriate for a registrant to look at metrics other than those that are GAAP-based in determining whether the financial statements taken as a whole are materially misstated, the SEC staff will most likely focus primarily on the GAAP metrics. Also, while the SEC staff acknowledged that it is possible for quantitatively small errors to be material and for quantitatively large errors to be immaterial, a quantitatively material GAAP error does not become immaterial simply because of the presentation of non-GAAP measures. Further, there may be circumstances in which an error that is otherwise quantitatively immaterial to the GAAP financial statements — when taken as a whole and depending on the focus that management, investors, and financial statement users have historically placed on non-GAAP information — is qualitatively material in the context of non-GAAP information.

Chapter 6 — Press Releases

Form 8-K, Item 2.02, requires registrants to furnish to the SEC a Form 8-K within four business days of any public release or announcement (often a press release) disclosing material non-public information regarding a registrant's results of operations or financial condition for an annual or quarterly fiscal period that has ended. In such circumstances, a Form 8-K is required whether or not the press release includes disclosure of a non-GAAP financial measure. Question 106.07 in the C&DIs on Exchange Act Form 8-K indicates that a registrant must comply with all the requirements of Item 2.02 when it reports "preliminary" earnings and results of operations for a completed quarterly period. Note that a separate Form 8-K may also be required for nonpublic information that is disclosed orally, telephonically, or by webcast, broadcast, or similar means, unless certain conditions are met.[1]

The information a registrant provides under Item 2.02 is considered furnished to the SEC, not filed, and therefore is not subject to the requirements in Exchange Act Section 18 on liability for misleading statements. If a registrant specifically states in Form 8-K that the information is to be considered "filed," or incorporates it by reference into a registration statement, proxy statement, or other report, it will be considered filed and therefore subject to Section 18. The concept of furnishing, rather than filing, information is also common in Regulation FD disclosures made under Form 8-K, Item 7.01.

When a press release that is furnished to the SEC ("furnished press release") includes a non-GAAP liquidity or performance measure, registrants are required to comply with the presentation and disclosure requirements of Regulation G and Item 10(e)(1)(i). Although Regulation G and Form 8-K, Item 2.02, do not refer to the specific prohibitions in Item 10(e)(1)(ii), registrants should consider the concepts in these and other prohibitions when using non-GAAP measures. For example, the title used for a non-GAAP financial measure in a Form 8-K should not be the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

Registrants may satisfy the disclosure requirements by including the information directly in the Form 8-K containing the furnished press release or as an exhibit to the Form 8-K. Alternatively, registrants may include the disclosures in their most recent annual report filed with the SEC (or a more recent filing) and should update the disclosures, as necessary, before the date the Form 8-K is furnished to the SEC. If a registrant elects to "file" the press release with the SEC, all the provisions in Item 10(e) apply.

[1] See Form 8-K, Item 2.02(b).

Footnote 11 of the Release indicates that regardless of whether the press release is furnished to or filed with the SEC, the prohibition against the presentation of cash flow per-share data and other per-share measures of liquidity applies. The guidance in the footnote prohibits the disclosure of cash flow data on a per-share basis in both materials filed with or furnished to the SEC, including press releases, since such disclosures are prohibited by GAAP and SEC rules. See Section 4.4 for more information about non-GAAP per-share measures.

See Section 3.1 for a summary of the disclosures required by Regulation G; Item 10; and Form 8-K, Item 2.02, about non-GAAP information “furnished” or “filed” by a registrant.

Appendix A — Non-GAAP Measures: What to Ask

Management should consider the following questions related to its use of non-GAAP measures:

- Is the measure neither misleading nor prohibited?
- Is the measure presented with the most directly comparable GAAP measure and with no greater prominence than the GAAP measure?
- Is the measure appropriately defined and described, and is it clearly labeled as non-GAAP?
- Does the reconciliation between the GAAP and non-GAAP measure clearly label and describe the nature of each adjustment, and is each adjustment appropriate?
- Is there transparent and company-specific disclosure of the substantive reason(s) why management believes that the measure is useful for investors and the purpose for which management uses the measure?
- Does the registrant have a policy regarding appropriate non-GAAP measures and, if so, how is it determined? Is the measure consistently prepared from period to period in accordance with that policy, and is it comparable to that of its peers?
- If the registrant makes changes to its non-GAAP measures, are the changes clearly described, and are the reasons for the changes clear?
- Is the measure balanced (i.e., does it adjust not only for nonrecurring expenses but also for nonrecurring gains)?
- Does the measure appropriately focus on material adjustments and not include immaterial adjustments that would not seem to be a focus of management?
- Do the disclosure controls and procedures address non-GAAP measures?
- Is the audit committee involved in the oversight of the preparation and use of non-GAAP measures?

Appendix B — SEC Remarks

Speeches by the chairman, commissioners, and SEC staff generally cover a wide range of topics including the state of the markets and the Commission's current agenda and focus. Non-GAAP measures have been the subject of several speeches in 2015 and 2016 by SEC officials, including Chair Mary Jo White and Chief Accountant James Schnurr. A consistent message conveyed in the speeches has been the SEC's increasing level of concern about how non-GAAP measures are used and interpreted by investors and analysts. Several of these speeches are summarized below, and links to the full text of the presenter's remarks, if available publicly, are provided.

Remarks at the 2015 AICPA Conference

Keynote Address

In her keynote address at the 2015 AICPA Conference, Chair White expressed concern that the prevalent use of non-GAAP measures in financial reporting may be a source of potential confusion for investors. She emphasized that registrants should pay close attention to this topic to ensure that they are applying the current rules. She also encouraged registrants, as well as their audit committees, finance teams, and legal departments, to ask questions such as the following:

- "Why are you using the non-GAAP measure, and how does it provide investors with useful information? "
- "Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules?"
- "Are your explanations of how you are using the non-GAAP measures — and why they are useful for your investors — accurate and complete, drafted without boilerplate [language]?"
- "Are there appropriate controls over the calculation of non-GAAP measures?"

The full text of Chair White's speech is available on the SEC's Web site.

Division Staff Discussion

The Division staff reinforced Chair White's comments at the 2015 AICPA Conference and also reminded registrants to (1) clearly label and describe non-GAAP measures and adjustments, (2) use appropriate conventional accounting terminology, and (3) disclose any changes in their method of calculating a non-GAAP measure that may affect comparability with the prior years.

In addition, the staff discussed some examples of disclosures related to non-GAAP measures for system-wide sales (see Section 4.15), pension adjustments (see Section 4.16), and normalized market prices (see Section 4.17).

Finally, the staff reminded registrants that it would continue to object to any non-GAAP measures that are misleading, noting that it is critical to evaluate non-GAAP measures in the context of a registrant's specific facts and circumstances (i.e., notwithstanding the use of non-GAAP measures and disclosures by other registrants).

Remarks at the 2016 Capital Markets Summit

At the U.S. Chamber of Commerce 2016 Capital Markets Summit in March 2016, Chair White expanded on the remarks she made at the 2015 AICPA Conference, indicating that the SEC staff is concerned that the use of non-GAAP measures in financial reporting may be confusing for investors and analysts. She stated that such use is "something that we are really looking at — whether we need to rein that in a bit even by regulation." Her remarks reiterated that non-GAAP financial measures should be used to help registrants communicate with financial statement users more meaningfully about results of operations and financial condition. She also urged registrants to carefully consider how non-GAAP measures are being employed. This includes questioning whether (1) registrants are giving equal prominence to GAAP measures and (2) the non-GAAP measures always "result in a much rosier picture" than the GAAP measures.

Remarks Before the 12th Annual Life Sciences Accounting and Reporting Congress

In a speech at the 12th Annual Life Sciences Accounting and Reporting Congress in March 2016, Mr. Schnurr indicated that the SEC staff has observed "a significant and, in some respects, troubling increase over the past few years in the use of, and nature of adjustments within, non-GAAP measures" as well as their prominence. He commented that the non-GAAP measures "are intended to supplement . . . and not supplant the information in the financial statements." He also discussed the prominence that analysts and the media have placed on such measures when they report on the results of registrants, as well as the increase in the difference between the amounts reported for GAAP and non-GAAP measures, noting that these concerns have led to an increased focus by the SEC staff. Mr. Schnurr indicated that the staff will continue "to monitor non-GAAP disclosures as part of its selective review process" and will be "vigilant in [its] review of the use of these measures for compliance with the rules."

Mr. Schnurr further remarked that the "proliferation of non-GAAP reporting measures" should cause increased focus by management and the audit committee. He noted that registrants should not only comply with the rules but also question why they have concluded that a non-GAAP measure is the appropriate way to measure performance and convey useful information to investors. He also emphasized that there should be appropriate controls and oversight procedures associated with the use these measures.

The full text of Mr. Schnurr's speech is available on the SEC's Web site.

Remarks at the 2016 Baruch College Financial Reporting Conference

In a speech at the 2016 Baruch College Financial Reporting Conference in May 2016, then SEC Deputy Chief Accountant Wesley Bricker and SEC Division Chief Accountant Mark Kronforst expressed concerns about the use of specific non-GAAP presentations. Their comments primarily focused on the use of individually tailored accounting principles (see Section 4.3 regarding potentially misleading measures), the appropriate identification of a non-GAAP measure as either a performance measure or a liquidity measure (see Section 3.2.2), and the tax impact of non-GAAP adjustments (see Section 4.10).

The full text of Mr. Bricker's speech is available on the SEC's Web site.

Remarks at the May 18, 2016, Meeting of the PCAOB's Standing Advisory Group

At the May 2016 meeting of the PCAOB's Standing Advisory Group, Mark Kronforst discussed the SEC's concerns about non-GAAP measures, noting that "this next quarter will be a great opportunity for companies to self-correct." Mr. Kronforst also referred to the SEC's issuance that month of new and updated C&DIs on non-GAAP measures, noting that the tone in the C&DIs was intended to "send a message" to registrants to take a fresh look at their use of non-GAAP measures in earnings releases and periodic reports. See Deloitte's May 23, 2016, *Heads Up* for more information.

Remarks at the June 27, 2016, International Corporate Governance Network Annual Conference

In a speech at the June 2016 International Corporate Governance Network Annual Conference, Chair White noted that while registrants have flexibility to explain their business "through the eyes of management," non-GAAP measures often become the "key message to investors." In reference to the C&DIs issued by the staff in May, Chair White highlighted that registrants should consider the guidance while revisiting their non-GAAP disclosures. She further noted that the staff is ready to "act through the filing review process, enforcement and further rulemaking if necessary to achieve the optimal disclosures for investors and the markets."

The full text of Chair White's speech is available on the SEC's Web site.

Appendix C — Examples of SEC Comments on Non-GAAP Measures

Non-GAAP measures continue to be on the top-10 list of topics frequently commented on by the SEC staff. The table below summarizes comment-letter trends in the 12-month period ended June 30, 2016.[1] As noted in the table, comments about non-GAAP measures rose from fourth place for the 12 months ended June 30, 2015, to third place for the 12-month period ended June 30, 2016. Also, for the three months ended June 30, 2016, non-GAAP measures rose to second place, after all sections of MD&A (i.e., results of operations, critical accounting policies, and liquidity combined).

Twelve Months Ended June 30, 2016				
Topic	**Reviews[2]**	**Percentage of Total[3]**	**Rank**	**Change in Rank From Prior Year**
MD&A			1	—
Results of operations	308	23		—
Critical accounting policies and estimates	148	11		—
Liquidity	116	9		—
Fair value	286	21	2	—
Non-GAAP measures (includes EBIT, EBITDA)	240	18	3	↑ 1
Revenue recognition	171	13	4	↓ 1
Segment reporting	166	12	5	↑ 3
Income tax	155	12	6	—
Intangible assets and goodwill	147	11	7	↑ 2
Signatures, exhibits, or agreements	119	9	8	↓ 3
Business overview	104	8	9	↑ 1
Acquisitions, mergers, and business combinations	103	8	10	↓ 3

The table above reflects completed reviews for comment letters that have been posted to EDGAR through June 30, 2016. Note that comment letters and registrants' responses are made public and posted to the SEC EDGAR system no earlier than 20 business days after completion of the Division's review of a periodic or current report. Therefore, the above table does not include any comments that have been issued after the issuance of the C&DIs in May unless the staff's review of the comment letter was completed.

[1] Comment letter trend information in the table was derived from data provided by Audit Analytics.
[2] Represents the number of Form 10-K and 10-Q reviews with comment letters that include a comment on topic.
[3] Represents the percentage of all comment-letter-yielding Form 10-K and 10-Q reviews that include a comment on topic.

For additional information about SEC staff comment trends, see Deloitte's *SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us*.

Examples of SEC Comments

Below are extracts from SEC staff comments published on the SEC's Web site. Dollar amounts and information identifying registrants or their businesses have been redacted.

Undue Prominence

The SEC staff has commented when a registrant presents its non-GAAP financial measures more prominently than its GAAP measures (e.g., the registrant presents them before, or places greater emphasis on them than, its GAAP measures or if it uses a full non-GAAP income statement format). C&DI Question 102.10 provides several examples illustrating when the presentation of a non-GAAP measure may be unduly prominent. See Section 3.3 for additional information.

Undue Prominence of a Non-GAAP Financial Measure

Examples of SEC Comments

- With respect to the disclosures of the non-GAAP measures of adjusted net loss and adjusted diluted loss per share in the highlights and in the consolidated results . . . , tell us how you have presented the most directly comparable measures calculated according to GAAP with equal or greater prominence. Refer to the guidance from Item 10(e)(1)(i)(A) of Regulation S-K.
- 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 the guidance disclosed in the press release for the fiscal year . . . includes a range of expected adjusted EBITDA, adjusted net income and adjusted net income per share. Please note that Regulation G requires a schedule or other presentation detailing the differences between the forward-looking non-GAAP financial measures and the appropriate forward-looking GAAP financial measures. Also, if the GAAP financial measure is not accessible on a forward-looking basis, that fact and reconciling information that is unavailable without an unreasonable effort must be disclosed, and the information that is unavailable must be identified together with its probable significance. In addition, pursuant to Item 10(e)(1)(i) you should disclose why management believes the measures are useful to investors. Please tell us your consideration of providing the required disclosures.

Full Non-GAAP Income Statement

Examples of SEC Comments

- We note you presented full non-GAAP income statements for purposes of reconciling non-GAAP financial measures of adjusted sales and adjusted EPS to the most directly comparable GAAP measures. Please tell us why you believe the presentation of full non-GAAP income statements do not attach undue prominence to the non-GAAP information. Please also revise future filings to comply with the disclosure requirements of Regulation G and Item 10(e) of Regulation S-K.
- We note you present full GAAP to Non-GAAP Adjusted Statements of Earnings . . . . Please note that the presentation of a full non-GAAP income statement may place undue prominence to the non-GAAP information and may give the impression that the non-GAAP income statement represents a comprehensive basis of accounting. Please confirm to us that you will not present non-GAAP consolidated income statements in future filings. Please refer to Question 102.10 of the Non-GAAP Financial Measures Codification and Disclosure Interpretation . . . . As an alternative, you may present a non-GAAP performance measure reconciled to the most comparable measure calculated in accordance with GAAP.
- We note your reconciliation of non-GAAP Financial Measures in Exhibit 99.1. We believe this presentation [of a full non-GAAP income statement] conveys undue prominence to a statement based on non-GAAP information. Please tell us how you considered Question 102.10 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations . . . . As a substitute for this presentation format, you may consider presenting only individual non-GAAP measures (i.e., line items, subtotals, etc.) provided each one complies with Item 10(e)(1)(i) of Regulation S-K or Regulation G.

Reconciliation

The SEC staff has continued to comment when a non-GAAP measure is not appropriately reconciled. See Section 3.2.

Examples of SEC Comments

- Given your disclosure stating that management utilizes Adjusted EBITDA for evaluating your capacity to fund capital expenditures as well as a measure of your operating performance, please explain why you have not reconciled this non-GAAP liquidity measure to operating cash flow as the most directly comparable GAAP measure, in addition to net income, to comply with Item 10(e)(1)(i)(B) of Regulation S-K.
- You present a summary table of non-GAAP results that includes revenues and operating expenses but we note that you did not reconcile these items to the most directly comparable GAAP financial measures as required by Item 10(e)(1)(i)(B) of Regulation S-K. In future filings when you present non-GAAP measures, please include all of the disclosures required by Item 10(e) of Regulation S-K, including the required reconciliations.
- Please revise your reconciliation of EBITDA and Adjusted EBITDA to begin with net income rather than operating income. Please refer to Question 103.01 of the Non-GAAP Financial Measures Compliance & Disclosure Interpretations for guidance.

Disclosures About the Purpose and Use of Non-GAAP Measures and Clear Labeling

The SEC staff has commented on the extent of a registrant's disclosures and whether the disclosures demonstrate the purpose of the measures (i.e., their usefulness to investors and how management uses them). If a registrant cannot justify why a non-GAAP measure is an appropriate indicator of its performance and how it is useful to investors, the SEC may object to the measure (see Section 3.4). The SEC staff also issues comments when non-GAAP measures are not clearly labeled. See Sections 3.5 and 4.9.

Purpose and Use

Examples of SEC Comments

- Please revise to disclose the reasons why you believe your presentation of each of the non-GAAP financial measures provides useful information to investors regarding your financial condition and results of operations. The justification for the use of the non-GAAP financial measure must be substantive. Merely indicating that you provide such non-GAAP financial measures to give investors additional data to evaluate your operations is not sufficient support for disclosure of the non-GAAP financial measures. Please also revise to expand your disclosure of the additional purposes for which management uses each of the non-GAAP financial measures. Please refer to Item 10(e) of Regulation S-K.
- We note your use of Core Earnings, a non-GAAP measure, in this filing. In future Exchange Act periodic reports, please include all of the disclosures required by Item 10(e) of Regulation S-K, including a discussion of why management believes Core Earning provides useful information to investors regarding your financial condition and results of operations.

Clear Labeling

Examples of SEC Comments

- [In] your summary table of non-GAAP results, you label the items using the same name as your GAAP measures while in your discussion of the non-GAAP measures you refer to the non-GAAP measures with different titles, such as non-GAAP gross profit. In future filings when disclosing non-GAAP financial measures, please revise your presentation to use titles consistently and to use titles or descriptions for your non-GAAP financial measures that are not the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures. Refer to Item 10(e)(1)(ii)(E) of Regulation S-K.
- Please confirm that in future filings and press releases [you] will eliminate all references to "pro forma." The information you have presented should be referred to as "non-GAAP" and not "pro forma." Pro forma has a different meaning as defined by generally accepted accounting principles and SEC rules that is different than your presentation.
- Within your discussion of modified net operating income, we note you have indicated that some of your adjustments are non-recurring. Given the nature of these adjustments, it is not clear why they are non-recurring. Please clarify and/or revise to remove the reference to non-recurring from your disclosure. Reference is made to Question 102.03 of the Division's Compliance and Disclosure Interpretations for Non-GAAP Financial Measures.

Liquidity Versus Performance Measures

The SEC staff has commented when a non-GAAP measure is not reconciled to the appropriate GAAP measure as determined on the basis of whether the purpose of the non-GAAP measure is to assess the registrant's performance or its liquidity or both. Further, the staff may comment on how a registrant characterizes a non-GAAP measure. See Section 3.2.2.

Examples of SEC Comments

- We note you believe Adjusted EBITDA is presented, in part, as a performance measure. As previously requested, please tell us the appropriateness of this measure as a performance measure.
- Please ensure your disclosures appropriately characterize your non-GAAP measures as operating performance measures and/or liquidity measures or cash flow measures. For example, you appear to have characterized free cash flow as an operating performance measure. . . . However, you reconciled free cash flow from net cash used for operating activities . . . which indicates that free cash flow is a liquidity measure.

Nature of Adjustments

The SEC staff has commented on the nature of the reconciling adjustments and the related disclosures.

Examples of SEC Comments

- Please expand your disclosures to explain how you calculated the tax effect for the adjustments to net (loss) income attributable to . . . and per diluted share in accordance with the guidance in Question 102.11 of the Non-GAAP Financial Measures Compliance & Disclosure Interpretations.
- Please significantly expand your disclosures in footnotes . . . of the net income to adjusted net income before income taxes reconciliation to include discussions of the nature of the purchase accounting adjustments and purchase accounting amortization including the various components making up these adjustments as described in detail in your response.

Appendix D — Summary of Disclosure Requirements and Prohibitions

The following chart summarizes the disclosure requirements and prohibitions under Regulation G, Item 10(e), and for furnished press releases, that apply to domestic[1] registrants:

Non-GAAP Measures: Summary of Disclosure Requirements and Prohibitions Applicable to Domestic Registrants

Disclosure Requirements/Prohibitions	All Disclosure of Non-GAAP Financial Measures (Regulation G[2,3])	SEC Filings (Regulation S-K, Item 10(e)[4,5])	Press Releases Furnished to the SEC (Form 8-K, Item 2.02[6])
Presentation requirements:			
• Presentation of the most directly comparable GAAP financial measure	X		
• Presentation, **with equal or greater prominence**, of the most directly comparable GAAP financial measure		X	X
• Quantitative reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure	X	X	X
• Statement disclosing the reasons why management believes the non-GAAP financial measure provides useful information to investors		X	X
• To the extent material, a statement disclosing the additional purposes for which management uses the non-GAAP financial measure		X	X

1 For guidance applicable to FPIs, see Regulation G; Regulation S-K, Item 10(e); Section 106 of the C&DIs; and Section 8140 of the FRM.

2 Regulation G applies whenever a registrant, or person acting on its behalf, publicly discloses or releases material information that includes a non-GAAP financial measure, whether that information is furnished to, or filed with, the SEC.

3 In certain situations, the requirements of Regulation G and Regulation S-K, Item 10(e), do not apply. For example, these rules do not apply to non-GAAP measures related to a proposed business combination or measures required to be disclosed by a governmental authority. See Section 2.3 for a discussion of measures that do not meet the definition of a non-GAAP measure under the Rules.

4 Regulation S-K, Item 10(e), applies to all SEC filings that include non-GAAP financial measures.

5 See footnote 3.

6 Form 8-K, Item 2.02, requires registrants to furnish to the SEC all releases or announcements disclosing material nonpublic financial information about completed annual or quarterly fiscal periods, regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure. If a registrant elects to file the release or announcement with the SEC, such disclosure is subject to the requirements of Regulation S-K, Item 10.

Disclosure Requirements/Prohibitions (continued)	All Disclosure of Non-GAAP Financial Measures (Regulation G)	SEC Filings (Regulation S-K, Item 10(e))	Press Releases Furnished to the SEC (Form 8-K, Item 2.02)
Prohibitions on certain presentations of non-GAAP financial measures:[7]			
• Material misstatements or omissions that would make the presentation of the non-GAAP financial measure misleading[8]	X	X	X
• Presenting per-share measures of liquidity[9]		X	X
• Excluding charges or liabilities that require, or will require, cash settlement, or would have required cash settlement in the absence of an ability to settle in another manner, from non-GAAP liquidity measures (other than EBIT and EBITDA)		X	
• Adjusting a non-GAAP performance measure to 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 (prohibition is based on the description of the charge or gain that is being adjusted)		X	
• Presenting non-GAAP financial measures on the face of the GAAP financial statements or in the accompanying notes		X	
• Presenting non-GAAP financial measures on the face of any pro forma financial statements required to be disclosed by Regulation S-X, Article 11		X	
• 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		X	

[7] Although Form 8-K, Item 2.02, and Regulation G do not refer to the prohibitions in Regulation S-K, Item 10(e)(1)(ii), registrants should consider the concepts in these and other prohibitions when using non-GAAP measures.

[8] See Regulation G, Rule 100(b), and Section 100 of the C&DIs.

[9] Footnote 11 of SEC Rule Release 33-8176, *Conditions for the Use of Non-GAAP Measures*, notes that certain non-GAAP per-share measures are prohibited under GAAP and SEC rules.

Appendix E — Regulation G

The text of SEC Regulation G is reproduced below.

Part 244 — Regulation G

244.100 — General rules regarding disclosure of non-GAAP financial measures.

(a) Whenever a registrant, or person acting on its behalf, publicly discloses material information that includes a non-GAAP financial measure, the registrant must accompany that non-GAAP financial measure with:

(1) A presentation of the most directly comparable financial measure calculated and presented in accordance with Generally Accepted Accounting Principles (GAAP); and

(2) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most comparable financial measure or measures calculated and presented in accordance with GAAP identified in paragraph (a)(1) of this section.

(b) 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 and any other accompanying discussion of 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.

(c) This section 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:

(1) The securities of the registrant are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States;

(2) The non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with generally accepted accounting principles in the United States; and

(3) 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.

(d) This section shall not apply to a non-GAAP financial measure included in 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 § 230.425 of this chapter, § 240.14a-12 or § 240.14d-2(b)(2) of this chapter or § 229.1015 of this chapter.

Part 244 — Regulation G (continued)

Notes to § 244.100:

1. If a non-GAAP financial measure is made public orally, telephonically, by Web cast, by broadcast, or by similar means, the requirements of paragraphs (a)(1)(i) and (a)(1)(ii) of this section will be satisfied if:

(i) The required information in those paragraphs is provided on the registrant's Web site at the time the non-GAAP financial measure is made public; and

(ii) The location of the web site is made public in the same presentation in which the non-GAAP financial measure is made public.

2. The provisions of paragraph (c) of this section shall apply notwithstanding the existence of one or more of the following circumstances:

(i) 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;

(ii) Foreign journalists, U.S. journalists or other third parties have access to the information;

(iii) The information appears on one or more web sites maintained by the registrant, so long as the web sites, taken together, are not available exclusively to, or targeted at, persons located in the United States; or

(iv) Following the disclosure or release of the information outside the United States, the information is included in a submission by the registrant to the Commission made under cover of a Form 6-K.

244.101 — Definitions.

This section defines certain terms as used in Regulation G (§§ 244.100 through 244.102).

(a) (1) *Non-GAAP financial measure*. A non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

(i) 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 GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or

(ii) 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.

(2) A non-GAAP financial measure does not include operating and other financial measures and ratios or statistical measures calculated using exclusively one or both of:

(i) Financial measures calculated in accordance with GAAP; and

(ii) Operating measures or other measures that are not non-GAAP financial measures.

(3) A non-GAAP financial measure does not include financial measures required to be disclosed by GAAP, Commission rules, or a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant.

Part 244 — Regulation G (continued)

(b) *GAAP*. GAAP refers to generally accepted accounting principles in the United States, except that:

(1) In the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. generally accepted accounting principles, GAAP refers to the principles under which those primary financial statements are prepared; and

(2) In the case of foreign private issuers that include a non-GAAP financial measure derived from a measure calculated in accordance with U.S. generally accepted accounting principles, GAAP refers to U.S. generally accepted accounting principles for purposes of the application of the requirements of Regulation G to the disclosure of that measure.

(c) *Registrant*. A registrant subject to this regulation is one that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), excluding any investment company registered under Section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

(d) *United States*. United States means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

244.102 — No effect on antifraud liability.

Neither the requirements of this Regulation G (17 CFR 244.100 through 244.102) nor a person's compliance or non-compliance with the requirements of this Regulation shall in itself affect any person's liability under Section 10(b) (15 U.S.C. 78j(b)) of the Securities Exchange Act of 1934 or § 240.10b-5 of this chapter.

Appendix F — Regulation S-K, Item 10(e)

The text of SEC Regulation S-K, Item 10(e), is reproduced below.

Regulation S-K, Item 10(e)

(e) *Use of non-GAAP financial measures in Commission filings*. (1) Whenever one or more non-GAAP financial measures are included in a filing with the Commission:

(i) The registrant must include the following in the filing:

(A) A presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with Generally Accepted Accounting Principles (GAAP);

(B) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP identified in paragraph (e)(1)(i)(A) of this section;

(C) A statement disclosing the reasons 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

(D) To the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not disclosed pursuant to paragraph (e)(1)(i)(C) of this section; and

(ii) A registrant must not:

(A) Exclude 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 the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation, and amortization (EBITDA);

(B) Adjust 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;

(C) Present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes;

(D) Present non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X (17 CFR 210.11-01 through 210.11-03); or

(E) Use 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; and

(iii) If the filing is not an annual report on Form 10-K or Form 20-F (17 CFR 249.220f), a registrant need not include the information required by paragraphs (e)(1)(i)(C) and (e)(1)(i)(D) of this section if that information was included in its most recent annual report on Form 10-K or Form 20-F or a more recent filing, provided that the required information is updated to the extent necessary to meet the requirements of paragraphs (e)(1)(i)(C) and (e)(1)(i)(D) of this section at the time of the registrant's current filing.

Regulation S-K, Item 10(e) (continued)

(2) For purposes of this paragraph (e), a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

(i) 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 GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or

(ii) 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.

(3) For purposes of this paragraph (e), GAAP refers to generally accepted accounting principles in the United States, except that:

(i) In the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. generally accepted accounting principles, GAAP refers to the principles under which those primary financial statements are prepared; and

(ii) In the case of foreign private issuers that include a non-GAAP financial measure derived from or based on a measure calculated in accordance with U.S. generally accepted accounting principles, GAAP refers to U.S. generally accepted accounting principles for purposes of the application of the requirements of this paragraph (e) to the disclosure of that measure.

(4) For purposes of this paragraph (e), non-GAAP financial measures exclude:

(i) Operating and other statistical measures; and

(ii) Ratios or statistical measures calculated using exclusively one or both of:

(A) Financial measures calculated in accordance with GAAP; and

(B) Operating measures or other measures that are not non-GAAP financial measures.

(5) For purposes of this paragraph (e), non-GAAP financial measures exclude financial measures required to be disclosed by GAAP, Commission rules, or a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant. However, the financial measure should be presented outside of the financial statements unless the financial measure is required or expressly permitted by the standard-setter that is responsible for establishing the GAAP used in such financial statements.

(6) The requirements of paragraph (e) of this section shall not apply to a non-GAAP financial measure included in 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 § 230.425 of this chapter, § 240.14a-12 or § 240.14d-2(b)(2) of this chapter or § 229.1015 of this chapter.

(7) The requirements of paragraph (e) of this section shall not apply to investment companies registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8).

Notes to paragraph (e):

A non-GAAP financial measure that would otherwise be prohibited by paragraph (e)(1)(ii) of this section is permitted in a filing of a foreign private issuer if:

1. The non-GAAP financial measure relates to the GAAP used in the registrant's primary financial statements included in its filing with the Commission;

2. 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

3. 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.

Appendix G — Compliance and Disclosure Interpretations — Non-GAAP Financial Measures

The C&DIs below are reprinted from the SEC's Web site as updated on May 17, 2016.

Section 100. General

Question 100.01

Question: Can certain adjustments, although not explicitly prohibited, result in a non-GAAP measure that is misleading?

Answer: Yes. Certain adjustments may violate Rule 100(b) of Regulation G because they cause the presentation of the non-GAAP measure to be misleading. For example, presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business could be misleading. [May 17, 2016]

Question 100.02

Question: Can a non-GAAP measure be misleading if the measure excludes charges, but does not exclude any gains?

Answer: Yes. For example, a non-GAAP measure that adjusts a particular charge or gain in the current period and for which other, similar charges or gains were not also adjusted in prior periods could violate Rule 100(b) of Regulation G unless the change between periods is disclosed and the reasons for it explained. In addition, depending on the significance of the change, it may be necessary to recast prior measures to conform to the current presentation and place the disclosure in the appropriate context. [May 17, 2016]

Question 100.03

Question: Can a non-GAAP measure be misleading if it is presented inconsistently between periods?

Answer: Yes. For example, a non-GAAP 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. [May 17, 2016]

Question 100.04

Question: 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. Can this measure be presented in documents filed or furnished with the Commission or provided elsewhere, such as on company websites?

Answer: No. Non-GAAP measures that substitute individually tailored revenue recognition and measurement methods for those of GAAP could violate Rule 100(b) of Regulation G. Other 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. [May 17, 2016]

Section 101. Business Combination Transactions

Question 101.01

Question: Does the exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications relating to a business combination transaction extend to the same non-GAAP financial measures disclosed in registration statements, proxy statements and tender offer materials?

Answer: No. There is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed in communications subject to Securities Act Rule 425 and Exchange Act Rules 14a-12 and 14d-2(b)(2); it is also intended to apply to communications subject to Exchange Act Rule 14d-9(a)(2). This exemption does not extend beyond such communications. Consequently, if the same non-GAAP financial measure that was included in a communication filed under one of those rules is also disclosed in a Securities Act registration statement or a proxy statement or tender offer statement, no exemption from Regulation G and Item 10(e) of Regulation S-K would be available for that non-GAAP financial measure.

In addition, there is an exemption from Regulation G and Item 10(e) of Regulation S-K for non-GAAP financial measures disclosed pursuant to Item 1015 of Regulation M-A, which applies even if such non-GAAP financial measures are included in Securities Act registration statements, proxy statements and tender offer statements. [Jan. 11, 2010]

Question 101.02

Question: If reconciliation of a non-GAAP financial measure is required and the most directly comparable measure is a "pro forma" measure prepared and presented in accordance with Article 11 of Regulation S-X, may companies use that measure for reconciliation purposes, in lieu of a GAAP financial measure?

Answer: Yes. [Jan. 11, 2010]

Section 102. Item 10(e) of Regulation S-K

Question 102.01

Question: What measure was contemplated by "funds from operations" in footnote 50 to Exchange Act Release No. 47226, Conditions for Use of Non-GAAP Financial Measures, which indicates that companies may use "funds from operations per share" in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K?

Answer: The reference to "funds from operations" in footnote 50, or "FFO," refers to the measure defined as of January 1, 2000, by the National Association of Real Estate Investment Trusts (NAREIT). NAREIT has revised and clarified the definition since 2000. The staff accepts NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis. [May 17, 2016]

Question 102.02

Question: May a registrant present FFO on a basis other than as defined by NAREIT as of May 17, 2016?

Answer: Yes, provided that any adjustments made to FFO comply with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. 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, some of which may trigger the prohibition on presenting this measure on a per share basis. See Section 100 and Question 102.05. [May 17, 2016]

Section 102. Item 10(e) of Regulation S-K (continued)

Question 102.03

Question: Item 10(e) of Regulation S-K prohibits adjusting a non-GAAP financial 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. Is this prohibition based on the description of the charge or gain, or is it based on the nature of the charge or gain?

Answer: The prohibition is based on the description of the charge or gain that is being adjusted. It would not be appropriate to state that a charge or gain is non-recurring, infrequent or unusual unless it meets the specified criteria. The fact that a registrant cannot describe a charge or gain as non-recurring, infrequent or unusual, however, does not mean that the registrant cannot adjust for that charge or gain. Registrants can make adjustments they believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K. See Question 100.01. [May 17, 2016]

Question 102.04

Question: Is the registrant required to use the non-GAAP measure in managing its business or for other purposes in order to be able to disclose it?

Answer: No. Item 10(e)(1)(i)(D) of Regulation S-K states only that, "[t]o the extent material," there should be a statement disclosing the additional purposes, "if any," for which the registrant's management uses the non-GAAP financial measure. There is no prohibition against disclosing a non-GAAP financial measure that is not used by management in managing its business. [Jan. 11, 2010]

Question 102.05

Question: While Item 10(e)(1)(ii) of Regulation S-K does not prohibit the use of per share non-GAAP financial measures, the adopting release for Item 10(e), Exchange Act Release No. 47226, states that "per share measures that are prohibited specifically under GAAP or Commission rules continue to be prohibited in materials filed with or furnished to the Commission." In light of Commission guidance, specifically Accounting Series Release No. 142, *Reporting Cash Flow and Other Related Data*, and Accounting Standards Codification 230, are non-GAAP earnings per share numbers prohibited in documents filed or furnished with the Commission?

Answer: No. Item 10(e) recognizes that certain non-GAAP per share performance measures may be meaningful from an operating standpoint. 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 Commission, 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. [May 17, 2016]

Question 102.06

Question: Is Item 10(e)(1)(i) of Regulation S-K, which requires the prominent presentation of, and reconciliation to, the most directly comparable GAAP financial measure or measures, intended to change the staff's practice of requiring the prominent presentation of amounts for the three major categories of the statement of cash flows when a non-GAAP liquidity measure is presented?

Answer: No. The requirements in Item 10(e)(1)(i) are consistent with the staff's practice. The three major categories of the statement of cash flows should be presented when a non-GAAP liquidity measure is presented. [Jan. 11, 2010]

Section 102. Item 10(e) of Regulation S-K (continued)

Question 102.07

Question: Some companies present a measure of "free cash flow," which is typically calculated as cash flows from operating activities as presented in the statement of cash flows under GAAP, less capital expenditures. Does Item 10(e)(1)(ii) of Regulation S-K prohibit this measure in documents filed with the Commission?

Answer: No. The deduction of capital expenditures from the GAAP financial measure of cash flows from operating activities would not violate the prohibitions in Item 10(e)(1)(ii). However, companies should be aware that this measure does not have a uniform definition and its title does not describe how it is calculated. Accordingly, a clear description of how this measure is calculated, as well as the necessary reconciliation, should accompany the measure where it is used. Companies should also avoid inappropriate or potentially misleading inferences about its usefulness. For example, "free cash flow" should not be used in a manner that inappropriately implies that the measure represents the residual cash flow available for discretionary expenditures, since many companies have mandatory debt service requirements or other non-discretionary expenditures that are not deducted from the measure. Also, free cash flow is a liquidity measure that must not be presented on a per share basis. See Question 102.05. [May 17, 2016]

Question 102.08

Question: Does Item 10(e) of Regulation S-K apply to filed free writing prospectuses?

Answer: Regulation S-K applies to registration statements filed under the Securities Act, as well as registration statements, periodic and current reports and other documents filed under the Exchange Act. A free writing prospectus is not filed as part of the issuer's registration statement, unless the issuer files it on Form 8-K or otherwise includes it or incorporates it by reference into the registration statement. Therefore, Item 10(e) of Regulation S-K does not apply to a filed free writing prospectus unless the free writing prospectus is included in or incorporated by reference into the issuer's registration statement or included in an Exchange Act filing. [Jan. 11, 2010]

Question 102.09

Question: Item 10(e)(1)(ii)(A) of Regulation S-K prohibits "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 the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA)." A company's credit agreement contains a material covenant regarding the non-GAAP financial measure "Adjusted EBITDA." If disclosed in a filing, the non-GAAP financial measure "Adjusted EBITDA" would violate Item 10(e), as it excludes charges that are required to be cash settled. May a company nonetheless disclose this non-GAAP financial measure?

Answer: Yes. The prohibition in Item 10(e) notwithstanding, because MD&A requires disclosure of material items affecting liquidity, if management believes that the credit agreement is a material agreement, that the covenant is a material term of the credit agreement and that information about the covenant is material to an investor's understanding of the company's financial condition and/or liquidity, then the company may be required to disclose the measure as calculated by the debt covenant as part of its MD&A. In disclosing the non-GAAP financial measure in this situation, a company should consider also disclosing the following:

- the material terms of the credit agreement including the covenant;
- the amount or limit required for compliance with the covenant; and
- the actual or reasonably likely effects of compliance or non-compliance with the covenant on the company's financial condition and liquidity. [Jan. 11, 2010]

Section 102. Item 10(e) of Regulation S-K (continued)

Question 102.10

Question: Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure with equal or greater prominence. This requirement applies to non-GAAP measures presented in documents filed with the Commission and also earnings releases furnished under Item 2.02 of Form 8-K. Are there examples of disclosures that would cause a non-GAAP measure to be more prominent?

Answer: Yes. Although whether a non-GAAP measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, the staff would consider the following examples of disclosure of non-GAAP measures as more prominent:

- Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures;
- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
- A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);
- Describing a non-GAAP measure as, for example, "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable GAAP measure;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B) 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. [May 17, 2016]

Question 102.11

Question: How should income tax effects related to adjustments to arrive at a non-GAAP measure be calculated and presented?

Answer: 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. [May 17, 2016]

Section 102. Item 10(e) of Regulation S-K (continued)

Question 102.12

Question: A registrant discloses a financial measure or information that is not in accordance with GAAP or calculated exclusively from amounts presented in accordance with GAAP. In some circumstances, this financial information may have been prepared in accordance with guidance published by a government, governmental authority or self-regulatory organization that is applicable to the registrant, although the information is not required disclosure by the government, governmental authority or self-regulatory organization. Is this information considered to be a "non-GAAP financial measure" for purposes of Regulation G and Item 10 of Regulation S-K?

Answer: Yes. Unless this information is *required* to be disclosed by a system of regulation that is applicable to the registrant, it is considered to be a "non-GAAP financial measure" under Regulation G and Item 10 of Regulation S-K. Registrants that disclose such information must provide the disclosures required by Regulation G or Item 10 of Regulation S-K, if applicable, including the quantitative reconciliation from the non-GAAP financial measure to the most comparable measure calculated in accordance with GAAP. This reconciliation should be in sufficient detail to allow a reader to understand the nature of the reconciling items. [Apr. 24, 2009]

Section 103. EBIT and EBITDA

Question 103.01

Question: Exchange Act Release No. 47226 describes EBIT as "earnings before interest and taxes" and EBITDA as "earnings before interest, taxes, depreciation and amortization." What GAAP measure is intended by the term "earnings"? May measures other than those described in the release be characterized as "EBIT" or "EBITDA"? Does the exception for EBIT and EBITDA from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K apply to these other measures?

Answer: "Earnings" means net income as presented in the statement of operations under GAAP. Measures that are calculated differently than those described as EBIT and EBITDA in Exchange Act Release No. 47226 should not be characterized as "EBIT" or "EBITDA" and their titles should be distinguished from "EBIT" or "EBITDA," such as "Adjusted EBITDA." These measures are not exempt from the prohibition in Item 10(e)(1)(ii)(A) of Regulation S-K, with the exception of measures addressed in Question 102.09. [Jan. 11, 2010]

Question 103.02

Question: If EBIT or EBITDA is presented as a performance measure, to which GAAP financial measure should it be reconciled?

Answer: If a company presents EBIT or EBITDA as a performance measure, such measures should be reconciled to net income as presented in the statement of operations under GAAP. 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. In addition, these measures must not be presented on a per share basis. See Question 102.05. [May 17, 2016]

Section 104. Segment Information

Question 104.01

Question: Is segment information that is presented in conformity with Accounting Standards Codification 280, pursuant to which a company may determine segment profitability on a basis that differs from the amounts in the consolidated financial statements determined in accordance with GAAP, considered to be a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No. Non-GAAP financial measures do not include financial measures that are required to be disclosed by GAAP. Exchange Act Release No. 47226 lists "measures of profit or loss and total assets for each segment required to be disclosed in accordance with GAAP" as examples of such measures. The measure of segment profit or loss and segment total assets under Accounting Standards Codification 280 is the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance.

The list of examples in Exchange Act Release No. 47226 is not exclusive. As an additional example, because Accounting Standards Codification 280 requires or expressly permits the footnotes to the company's consolidated financial statements to include specific additional financial information for each segment, that information also would be excluded from the definition of non-GAAP financial measures. [Jan. 11, 2010]

Question 104.02

Question: Does Item 10(e)(1)(ii) of Regulation S-K prohibit the discussion in MD&A of segment information determined in conformity with Accounting Standards Codification 280?

Answer: No. Where a company includes in its MD&A a discussion of segment profitability determined consistent with Accounting Standards Codification 280, which also requires that a footnote to the company's consolidated financial statements provide a reconciliation, the company also should include in the segment discussion in the MD&A a complete discussion of the reconciling items that apply to the particular segment being discussed. In this regard, see Financial Reporting Codification Section 501.06.a, footnote 28. [Jan. 11, 2010]

Question 104.03

Question: Is a measure of segment profit/loss or liquidity that is not in conformity with Accounting Standards Codification 280 a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Segment measures that are adjusted to include amounts excluded from, or to exclude amounts included in, the measure reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance do not comply with Accounting Standards Codification 280. Such measures are, therefore, non-GAAP financial measures and subject to all of the provisions of Regulation G and Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Question 104.04

Question: In the footnote that reconciles the segment measures to the consolidated financial statements, a company may total the profit or loss for the individual segments as part of the Accounting Standards Codification 280 required reconciliation. Would the presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote be the presentation of a non-GAAP financial measure?

Answer: Yes. The presentation of the total segment profit or loss measure in any context other than the Accounting Standards Codification 280 required reconciliation in the footnote would be the presentation of a non-GAAP financial measure because it has no authoritative meaning outside of the Accounting Standards Codification 280 required reconciliation in the footnotes to the company's consolidated financial statements. [Jan. 11, 2010]

Section 104. Segment Information (continued)

Question 104.05

Question: Company X presents a table illustrating a breakdown of revenues by certain products, but does not sum this to the revenue amount presented on Company X's financial statements. Is the information in the table considered a non-GAAP financial measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: No, assuming the product revenue amounts are calculated in accordance with GAAP. The presentation would be considered a non-GAAP financial measure, however, if the revenue amounts are adjusted in any manner. [Jan. 11, 2010]

Question 104.06

Question: Company X has operations in various foreign countries where the local currency is used to prepare the financial statements which are translated into the reporting currency under the applicable accounting standards. In preparing its MD&A, Company X will explain the reasons for changes in various financial statement captions. A portion of these changes will be attributable to changes in exchange rates between periods used for translation. Company X wants to isolate the effect of exchange rate differences and will present financial information in a constant currency — e.g., assume a constant exchange rate between periods for translation. Would such a presentation be considered a non-GAAP measure under Regulation G and Item 10(e) of Regulation S-K?

Answer: Yes. Company X may comply with the reconciliation requirements of Regulation G and Item 10(e) by presenting the historical amounts and the amounts in constant currency and describing the process for calculating the constant currency amounts and the basis of presentation. [Jan. 11, 2010]

Section 105. Item 2.02 of Form 8-K

Question 105.01

Question: 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 web site any financial and other statistical information contained in the presentation, together with any information that would be required by Regulation G. Would an audio file of the initial webcast satisfy this condition to the exemption?

Answer: Yes, 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 web site. Alternatively, slides or a similar presentation posted on the web site at the time of the presentation containing the required, previously undisclosed, material financial and other statistical information would satisfy the condition. In each case, the company must provide all previously undisclosed material financial and other statistical information, including information provided in connection with any questions and answers. Regulation FD also may impose disclosure requirements in these circumstances. [Jan. 11, 2010]

Question 105.02

Question: 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 web site 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. When must all of this information appear on the company's web site?

Answer: The required information must appear on the company's web site at the time the oral presentation is made. In the case of information that is not provided in a presentation itself but, rather, is disclosed unexpectedly in connection with the question and answer session that was part of that oral presentation, the information must be posted on the company's web site promptly after it is disclosed. Any requirements of Regulation FD also must be satisfied. A webcast of the oral presentation would be sufficient to meet this requirement. [Jan. 11, 2010]

Section 105. Item 2.02 of Form 8-K (continued)

Question 105.03

Question: Does a company's failure to furnish to the Commission the Form 8-K required by Item 2.02 in a timely manner affect the company's eligibility to use Form S-3?

Answer: No. Form S-3 requires the company to have filed in "a timely manner all reports required to be filed in twelve calendar months and any portion of a month immediately preceding the filing of the registration statement." Because an Item 2.02 Form 8-K is furnished to the Commission, rather than filed with the Commission, failure to furnish such a Form 8-K in a timely manner would not affect a company's eligibility to use Form S-3. While not affecting a company's Form S-3 eligibility, failure to comply with Item 2.02 of Form 8-K would, of course, be a violation of Section 13(a) of the Exchange Act and the rules thereunder. [Jan. 11, 2010]

Question 105.04 [withdrawn]

Question 105.05

Question: Company X files its quarterly earnings release as an exhibit to its Form 10-Q on Wednesday morning, prior to holding its earnings conference call Wednesday afternoon. Assuming that all of the other conditions of Item 2.02(b) are met, may the company rely on the exemption for its conference call even if it does not also furnish the earnings release in an Item 2.02 Form 8-K?

Answer: Yes. Company X's filing of the earnings release as an exhibit to its Form 10-Q, rather than in an Item 2.02 Form 8-K, before the conference call takes place, would not preclude reliance on the exemption for the conference call. [Jan. 11, 2010]

Question 105.06

Question: Company A issues a press release announcing its results of operations for a just-completed fiscal quarter, including its expected adjusted earnings (a non-GAAP financial measure) for the fiscal period. Would this press release be subject to Item 2.02 of Form 8-K?

Answer: Yes, because it contains material, non-public information regarding its results of operations for a completed fiscal period. The adjusted earnings range presented would be subject to the requirements of Item 2.02 applicable to non-GAAP financial measures. [Jan. 11, 2010]

Question 105.07

Question: A company issues its earnings release after the close of the market and holds a properly noticed conference call to discuss its earnings two hours later. That conference call contains material, previously undisclosed, information of the type described under Item 2.02 of Form 8-K. Because of this timing, the company is unable to furnish its earnings release on a Form 8-K before its conference call. Accordingly, the company cannot rely on the exemption from the requirement to furnish the information in the conference call on a Form 8-K. What must the company file with regard to its conference call?

Answer: The company must furnish the material, previously non-public, financial and other statistical information required to be furnished on Item 2.02 of Form 8-K as an exhibit to a Form 8-K and satisfy the other requirements of Item 2.02 of Form 8-K. A transcript of the portion of the conference call or slides or a similar presentation including such information will satisfy this requirement. In each case, all material, previously undisclosed, financial and other statistical information, including that provided in connection with any questions and answers, must be provided. [Jan. 15, 2010]

Section 106. Foreign Private Issuers

Question 106.01

Question: The Note to Item 10(e) of Regulation S-K permits a foreign private issuer to include in its filings a non-GAAP financial measure that otherwise would be prohibited by Item 10(e)(1)(ii) if, among other things, the non-GAAP financial measure is required or expressly permitted by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission. What does "expressly permitted" mean?

Answer: A measure is "expressly permitted" if the particular measure is clearly and specifically identified as an acceptable measure by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission.

The concept of "expressly permitted" can be also be demonstrated with explicit acceptance of a presentation by the primary securities regulator in the foreign private issuer's home country jurisdiction or market. Explicit acceptance by the regulator would include (1) published views of the regulator or members of the regulator's staff or (2) a letter from the regulator or its staff to the foreign private issuer indicating the acceptance of the presentation — which would be provided to the Commission's staff upon request. [Jan. 11, 2010]

Question 106.02

Question: A foreign private issuer furnishes a press release on Form 6-K that includes a section with non-GAAP financial measures. Can a foreign private issuer incorporate by reference into a Securities Act registration statement only those portions of the furnished press release that do not include the non-GAAP financial measures?

Answer: Yes. Reports on Form 6-K are not incorporated by reference automatically into Securities Act registration statements. In order to incorporate a Form 6-K into a Securities Act registration statement, a foreign private issuer must specifically provide for such incorporation by reference in the registration statement and in any subsequently submitted Form 6-K. See Item 6(c) of Form F-3. Where a foreign private issuer wishes to incorporate by reference a portion or portions of the press release provided on a Form 6-K, the foreign private issuer should either: (1) specify in the Form 6-K those portions of the press release to be incorporated by reference, or (2) furnish two Form 6-K reports, one that contains the full press release and another that contains the portions that would be incorporated by reference (and specifies that the second Form 6-K is so incorporated). Using a separate report on Form 6-K containing the portions that would be incorporated by reference may provide more clarity for investors in most circumstances. A company must also consider whether its disclosure is rendered misleading if it incorporates only a portion (or portions) of a press release. [Jan. 11, 2010]

Question 106.03

Question: A foreign private issuer publishes a non-GAAP financial measure that does not comply with Regulation G, in reliance on Rule 100(c), and then furnishes the information in a report on Form 6-K. Must the foreign private issuer comply with Item 10(e) of Regulation S-K with respect to that information if the company chooses to incorporate that Form 6-K report into a filed Securities Act registration statement (other than an MJDS registration statement)?

Answer: Yes, the company must comply with all of the provisions of Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Question 106.04

Question: If a Canadian company includes a non-GAAP financial measure in an annual report on Form 40-F, does the company need to comply with Regulation G or Item 10(e) of Regulation S-K with respect to that information if the company files a non-MJDS Securities Act registration statement that incorporates by reference the Form 40-F?

Answer: No. Information included in a Form 40-F is not subject to Regulation G or Item 10(e) of Regulation S-K. [Jan. 11, 2010]

Section 107. Voluntary Filers

Question 107.01

Question: Section 15(d) of the Exchange Act suspends automatically its application to any company that would be subject to the filing requirements of that section where, if other conditions are met, on the first day of the company's fiscal year it has fewer than 300 holders of record of the class of securities that created the Section 15(d) obligation. This suspension, which relates to the fiscal year in which the fewer than 300 record holders determination is made on the first day thereof, is automatic and does not require any filing with the Commission. The Commission adopted Rule 15d-6 under the Exchange Act to require the filing of a Form 15 as a notice of the suspension of a company's reporting obligation under Section 15(d). Such a filing, however, is not a condition to the suspension. A number of companies whose Section 15(d) reporting obligation is suspended automatically by the statute choose not to file the notice required by Rule 15d-6 and continue to file Exchange Act reports as though they continue to be required. Must a company whose reporting obligation is suspended automatically by Section 15(d) but continues to file periodic reports as though it were required to file periodic reports comply with Regulation G and the requirements of Item 10(e) of Regulation S-K?

Answer: Yes. Regulation S-K relates to filings with the Commission. Accordingly, a company that is making filings as described in this question must comply with Regulation S-K or Form 20-F, as applicable, in its filings.

As to other public communications, any company "that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934, or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934" must comply with Regulation G. The application of this standard to those companies that no longer are "required" to report under Section 15(d) but choose to continue to report presents a difficult dilemma, as those companies technically are not subject to Regulation G but their continued filing is intended to and does give the appearance that they are a public company whose disclosure is subject to the Commission's regulations. It is reasonable that this appearance would cause shareholders and other market participants to expect and rely on a company's required compliance with the requirements of the federal securities laws applicable to companies reporting under Section 15(d). Accordingly, while Regulation G technically does not apply to a company such as the one described in this question, the failure of such a company to comply with all requirements (including Regulation G) applicable to a Section 15(d)-reporting company can raise significant issues regarding that company's compliance with the anti-fraud provisions of the federal securities laws. [Jan. 11, 2010]

Section 108. Compensation Discussion and Analysis/Proxy Statement

Question 108.01

Question: Instruction 5 to Item 402(b) provides that "[d]isclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G and Item 10(e); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements." Does this instruction extend to non-GAAP financial information that does not relate to the disclosure of target levels, but is nevertheless included in Compensation Discussion & Analysis ("CD&A") or other parts of the proxy statement - for example, to explain the relationship between pay and performance?

Answer: No. Instruction 5 to Item 402(b) is limited to CD&A disclosure of target levels that are non-GAAP financial measures. If non-GAAP financial measures are presented in CD&A or in any other part of the proxy statement for any other purpose, such as to explain the relationship between pay and performance or to justify certain levels or amounts of pay, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K.

In these pay-related circumstances only, the staff will not object if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement, provided the registrant includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information. [July 8, 2011]

Appendix H — Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

FASB Accounting Standards Codification (ASC) Topics

ASC 230, *Statement of Cash Flows*

ASC 260, *Earnings per Share*

ASC 280, *Segment Reporting*

SEC Division of Corporation Finance FRM

Topic 8, "Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth"

SEC Final Rules

33-8039, *Cautionary Advice Regarding the Use of "Pro Forma" Financial Information in Earnings Releases*

33-8124, *Certification of Disclosure in Companies' Quarterly and Annual Reports*

33-8176, *Conditions for Use of Non-GAAP Financial Measures*

SEC Regulation S-K

Item 10, "General"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

SEC Regulation S-X

Article 11, "Pro Forma Financial Information"

SEC Regulation M-A

Item 1015, "Reports, Opinions, Appraisals and Negotiations"

SEC Accounting Series Release

ASR 142 (FRR Section 202), *Reporting Cash Flow and Other Related Data* (Rule 5-02.28 of SEC Regulation S-X)

SEC SAB Topics

SAB Topic 1.M, “Materiality” (SAB 99)

SAB Topic 1.N, “Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements” (SAB 108)

SAB Topic 5.P, “Restructuring Charges”

Securities Act of 1933 Rules

Rule 425 “Filing of Certain Prospectuses and Communications Under § 230.135 in Connection With Business Combination Transactions”

Securities Exchange Act of 1934 Rules

Rule 14a-12, “Solicitation Before Furnishing a Proxy Statement”

Rule 14d-9, “Recommendation or Solicitation by the Subject Company and Others”

SEC Compliance and Disclosure Interpretation (C&DI) Topics

Non-GAAP Financial Measures

Exchange Act Form 8-K

Appendix I — Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASR	SEC Accounting Series Release
C&DI	SEC Compliance and Disclosure Interpretation
CAQ	Center for Audit Quality
CD&A	Compensation Discussion and Analysis
CEO	chief executive officer
CFO	chief financial officer
DCPs	disclosure controls and procedures
EBIT	earnings before interest and taxes
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
FASB	Financial Accounting Standards Board
FAQs	frequently asked questions

Abbreviation	Description
FFO	funds from operations
FPI	foreign private issuer
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IPO	initial public offering
MD&A	Management's Discussion and Analysis
NAREIT	National Association of Real Estate Investment Trusts
NOI	net operating income
PCAOB	Public Company Accounting Oversight Board
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
S&P	Standard and Poor's

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Technical Line

A closer look at the SEC staff's scrutiny of non-GAAP financial measures

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What you need to know

- The SEC staff is continuing to focus on whether companies' use of non-GAAP financial measures in earnings releases complies with the more explicit guidance the staff issued in May 2016.
- The SEC staff is currently reviewing and commenting on companies' use of non-GAAP measures in second-quarter earnings releases, which should provide more information about how the staff will apply the interpretations.
- Companies should challenge their disclosures of non-GAAP measures and monitor developments in SEC staff views and comments.
- Companies should involve the audit committee in discussions about their non-GAAP measures and strengthening disclosure controls and procedures related to those disclosures.

Overview

In the nearly six months since the Securities and Exchange Commission (SEC) staff updated its Compliance and Disclosure Interpretations (C&DIs) on non-GAAP financial measures, the staff has focused on compliance with that guidance in its reviews of earnings releases and SEC filings. The staff is currently performing reviews of second-quarter earnings releases, and the related SEC staff comment letters should provide more information about how the staff will apply the updated C&DIs.

In some cases, the staff is looking at earnings releases of companies that it had already reviewed this year and is challenging measures and presentations that it didn't previously question.

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As we previously reported,[1] the updated C&DIs describe in detail non-GAAP financial measures that the staff believes would be misleading and would therefore violate applicable SEC rules. The clear message is that companies need to reevaluate their use and presentation of non-GAAP financial measures. In response to the updated C&DIs and comments from SEC officials, many companies changed the format of their earnings releases and filings in the second quarter to present GAAP figures more prominently than non-GAAP measures, and a number of them began developing and implementing more robust disclosure controls and procedures.

The Financial Accounting Standards Advisory Council, which advises the Financial Accounting Standards Board, and the Standing Advisory Group, which advises the Public Company Accounting Oversight Board, have also been discussing whether additional standard setting and auditor involvement is needed with respect to non-GAAP measures.

This publication discusses the SEC staff's main areas of focus in comment letters seeking compliance with the updated C&DIs, changes companies have made to their disclosures and challenges companies are encountering with their non-GAAP disclosures.

Staff focus areas and changes companies are making

Prominence of non-GAAP measures

The SEC staff's views on prominence were clarified in the C&DIs. As a result, many companies revised their non-GAAP disclosures in recent earnings releases and SEC filings to comply with the C&DIs. Based on our review, the most common request from the staff has been that companies reorganize their disclosures so that non-GAAP measures are not shown with greater prominence than the corresponding GAAP measures.

Example comment: Prominence
We note that you present non-GAAP measures in the headline of your press release without also presenting GAAP with equal or greater prominence, as required by Item 10(e)(1)(i)(A) of Regulation S-K. 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. Please review this guidance when preparing your next earnings release.

While this may seem like a straightforward rule to follow, some companies with extensive non-GAAP disclosures have struggled to comply. For example, in addition to presenting non-GAAP measures in bulleted highlights in earnings releases, those companies often disclosed non-GAAP measures before GAAP measures, used a bold font for non-GAAP measures and put more emphasis on non-GAAP measures throughout the release. These practices have required some companies to substantially overhaul their earnings releases to comply with the updated C&DIs. In some cases, companies have chosen to discontinue disclosure of some non-GAAP measures.

Some companies also struggled with the requirement to reconcile any forward-looking non-GAAP disclosures with GAAP measures. While the reconciliation of forecasted guidance is clearly required by Item 10(e) of Regulation S-K, the rule provides an exception that allows companies to omit a reconciliation if it would require "unreasonable efforts" to prepare. The C&DIs challenge how frequently companies can rely on that exception, which applies in limited cases such as when a significant reconciling item is difficult to predict. One example might be the change in the fair value of a derivative that is not a designated hedge. If a company does not provide the reconciliation in reliance on the exception, it must disclose that fact and explain what information is unavailable and how it might affect the GAAP measure.

Example comment: Non-GAAP forecasts
In future filings, when presenting a forecasted non-GAAP financial measure, please provide a reconciliation of that measure to the most directly comparable GAAP financial measure. If you omit the information due to unreasonable efforts, please provide the required disclosures.

Appropriateness of adjustments and disclosures

The updated C&DIs also provide guidance on measures the staff would consider misleading or inappropriate under Regulation G. These include applying "individually tailored" accounting principles or adjusting performance measures to remove normal cash operating expenses.

Example comments: Tailored accounting principles
It appears you adjust a GAAP measure to accelerate the recognition of revenue in your presentation of gross operating margin, which may be inconsistent with the updated non-GAAP Compliance and Disclosure Interpretations. Please review this guidance and explain to us whether and how it will impact your disclosures in future filings.

The updated C&DIs clearly state that non-GAAP performance measures that accelerate revenue recognition are unacceptable, and many companies changed their measures to comply. However, the C&DIs don't explain what other types of adjustments the staff would consider to be "tailored" accounting principles.

The reconciliation of forecasted guidance is clearly required by Item 10(e) of Regulation S-K.

The SEC staff recently said that it will object to non-GAAP measures calculated based on proportionate consolidation when those measures don't follow the applicable GAAP consolidation principles. The staff has objected to non-GAAP measures that combine unconsolidated and consolidated interests (or removing the non-controlling interest holders' share of consolidated amounts) on the basis that such presentations can be misleading. Such measures are common in the real estate industry, among others.

The SEC staff has said it will not object to companies disclosing the various components of measures that otherwise are prohibited because they use tailored accounting principles. That is, a company could disclose the components of such measures as key performance indicators (i.e., operating statistics) or GAAP financial measures. For example, to help investors calculate a revenue metric that removes the effect of deferred revenue and rebates, a company could provide information about bookings and disclose components of GAAP revenue such as rebates, discounts and the change in deferred revenue, among others.

The SEC staff has said that it would not object if companies that have been presenting non-GAAP measures calculated using proportionate consolidation separately present financial statement line item information applicable to each type of interest (i.e., controlling and non-controlling). Analysts could then calculate alternative measures that are relevant to them (e.g., deduct the non-controlling interest share from the consolidated balances and add the proportionate share of any unconsolidated interests).

Excluding normal recurring cash operating expenses

The staff is issuing more comments on non-GAAP performance measures that exclude recurring cash operating expenses (e.g., those that add back restructuring charges, acquisition costs, litigation expenses, store opening expenses and elements of pension costs). The updated C&DIs state that excluding recurring expenses could be considered misleading because these items are routine and related to activities that drive profitability. Companies should consider why they are making such adjustments to their non-GAAP performance measures and whether those measures reflect the company's operating performance. To date, we have not seen the SEC staff challenge adjustments to non-GAAP performance measures that eliminate stock-based compensation, because such amounts are noncash.

Example comment: Excluding recurring cash operating expenses
You disclosed a non-GAAP financial measure, Adjusted Operating Income, which excludes various compensation, restructuring and acquisition charges from net income. Please explain, in greater detail, the nature of the excluded charges in the calculation of the non-GAAP financial measure and tell us whether these charges are recurring and/or cash expenses and how they are in line with the updated Compliance and Disclosure Interpretations.

Other considerations

Strengthening disclosure controls and procedures

SEC Chair Mary Jo White has said that companies should implement controls over their preparation and disclosure of non-GAAP measures. When disclosed in SEC filings, non-GAAP measures and the related reconciliations and disclosures fall under a company's disclosure controls and procedures that require certification by the Chief Executive Officer and Chief Financial Officer. Common types of disclosure controls implemented by companies include establishing policies that clearly describe the adjustments made to calculate a non-GAAP measure, establishing a process for changing how a non-GAAP financial measure is calculated (including reviewing non-GAAP adjustments for compliance with the SEC rules and staff interpretations) and enhancing audit committee oversight of the company's disclosure of non-GAAP financial measures.

Applying the non-GAAP rules and regulations

One of the common challenges companies encounter involves which rules apply to which forms of communication (i.e., earnings releases, filings required by the Securities Act or the Securities Exchange Act, earnings calls, investor presentations and other forms of communication with investors).

For example, the rules on the prominence of non-GAAP measures appear in Item 10(e) of Regulation S-K, which applies to all documents filed with the SEC and earnings releases furnished under Item 2.02 of Form 8-K (including supplemental information included or incorporated into such filings). The prominence rules do not apply to other communications such as investor presentations or information a company posts on its website or presents in an earnings call. Therefore, the prominence rules technically do not apply to these other forms of communication. Nevertheless, companies should still consider whether the nature of non-GAAP measures, or the manner of their presentation, is misleading. We encourage companies to consult with their securities counsel on such questions.

Regulation G prohibits misleading uses of non-GAAP measures in all communications by registrants. Regulation G also requires a reconciliation to the most comparable GAAP measure for non-GAAP measures used in all communications.

Presenting changes to non-GAAP disclosures

The SEC staff has said that changing a non-GAAP measure from period to period could be misleading. Companies that are changing their measures to comply with the updated staff interpretations should provide clear and transparent communication to explain the change, why it was made and how the new measure provides useful information. For example, a company might reconcile a revised measure to the one it previously presented in addition to recasting the previously presented measure to reflect the new calculation.

If a company changes how it calculates a non-GAAP measure to comply with the staff guidance, the staff has said it won't object if the company presents the inappropriate measure for one additional period to explain the change to investors.

What's next?

In the coming months, we expect the SEC staff to continue its focus on non-GAAP disclosures through its comment letter process. We also expect senior officials to continue to discuss the topic. Chair White said in a recent speech that enforcement actions and rulemaking were also possible.[2]

Endnotes:

[1] Our publication To the Point, *SEC staff updates guidance on non-GAAP financial measures* discusses the staff's updated interpretations issued in May 2016. For additional information on non-GAAP rules also refer to our Technical Line, *Spotlight on non-GAAP financial measures*.

[2] Keynote Address, International Corporate Governance Network Annual Conference: Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability https://www.sec.gov/news/speech/chair-white-icgn-speech.html.

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Issue 1, 12 January 2017

SEC in Focus

Quarterly summary of current SEC activities

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SEC reporting implications of new accounting standards

Securities and Exchange Commission (SEC or the Commission) Chief Accountant Wesley Bricker and other SEC staff members shared their views on the SEC reporting implications of the new accounting standards on revenue, leases and financial instruments, among other issues, during the annual AICPA National Conference on Current SEC and PCAOB Developments (AICPA Conference) in December 2016. They discussed the accounting transition disclosures required by Staff Accounting Bulletin (SAB) Topic 11.M, the effects of the adoption of new accounting standards on registration statements and the status of existing staff revenue guidance in SAB Topic 13.

Transition disclosures

SEC staff members emphasized the importance of providing accounting transition disclosures required under SAB Topic 11.M and discussed the SEC staff's expectations about the extent of these disclosures. Mr. Bricker said that investors and his staff will be looking for increased disclosures in 2016 filings and during 2017 about the significance of the effect (quantitative or qualitative) that the adoption of the new revenue and other major new standards will have on registrants' financial statements.

Sylvia Alicea, a professional accounting fellow in the Office of Chief Accountant (OCA), said that if a registrant does not know or cannot reasonably estimate how the adoption of a new standard will affect its financial statements, it should make a statement to that effect and consider providing qualitative disclosures to help the reader assess the potential significance of the effect on the registrant's financial statements.

EY resources

- Compendium of significant accounting and reporting issues, *2016 AICPA National Conference on Current SEC and PCAOB Developments* (SCORE No. 04331-161US)

Separately, Assistant Deputy Chief Accountant Jenifer Minke-Girard said that companies should consider including as part of their qualitative disclosures a description of their processes to assess the effect of a new accounting standard on their financial statements, where they stand in the implementation process, what matters still need to be addressed and what additional steps they plan to take.

How we see it

As the adoption date of the new revenue standard approaches, registrants should assess the adequacy of their accounting transition disclosures under SAB Topic 11.M in their upcoming annual reports. We expect the SEC staff to closely monitor through its comment letter process whether registrants have appropriately provided quantitative or qualitative information to explain the effect of the new revenue standard. Accordingly, companies should also consider the strength of their internal controls in complying with this disclosure requirement.

Effect of new accounting standards on registration statements

Nili Shah, a Deputy Chief Accountant in the SEC's Division of Corporation Finance (DCF), said that in new or amended registration statements filed after the first interim period report reflecting the adoption of the new standard, companies that use the full retrospective transition method to adopt Accounting Standards Codification (ASC) 606 must provide retrospectively recasted financial statements for the most recent annual periods required to be included (or incorporated by reference). For example, a calendar-year registrant filing a Form S-3 registration statement in 2018 after it adopts ASC 606 using the full retrospective method in a Form 10-Q filing, but before it files the annual financial statements for the year of adoption, would be required to recast its prior-period annual financial statements (i.e., for 2015, 2016 and 2017) prior to the Form S-3 going effective. The SEC staff also noted that the guidance in ASC 250-10-45-5 on accounting changes provides an exception if retrospective revision is impracticable. While preclearance would not be required to rely on the exception, the SEC staff is available to discuss fact patterns with companies.

The SEC staff would not object if companies conclude that the adoption of the new revenue and leases standards is not considered a "fundamental change."

Keith Higgins, Director of DCF, noted that the SEC staff would not object if companies and their securities counsel conclude that the adoption of new accounting standards such as those on revenue recognition and leases is not a "fundamental change" for purposes of drawing on an effective shelf registration statement. A fundamental change would require a post-effective amendment to the shelf registration statement, which would trigger the need to recast as discussed above.

How we see it

Companies should closely monitor the planned timing of any registration statements if they plan to use the full retrospective method of adoption and consider accelerating the timing of those registration statements, if possible, to avoid needing to recast an earlier period than would otherwise be required.

Application of SAB Topic 13

Ms. Alicea said SAB Topic 13, *Revenue Recognition*, will continue to apply to registrants until the adoption of the new revenue standard. However, registrants should apply ASC 606 instead of SAB Topic 13 when evaluating the post-adoption accounting for their revenue arrangements.

Recent updates to SEC staff guidance

Financial Reporting Manual

The SEC staff updated its *Financial Reporting Manual* to incorporate its views on certain SEC reporting issues related to the adoption of new accounting standards, including the following:

- Registrants filing pro forma financial information in the year they adopt the new revenue standard are not required to reflect the effect of the standard in the pro forma income statement for the previous year.
- The date of initial application for purposes of the new leases standard would not change if a registrant is required to provide financial statements for earlier periods when issuing retrospectively revised financial statements for a registration statement filed in the year of adoption.
- Registrants do not need to disclose a consolidated 10-year loss reserve development table as specified in Industry Guide 6 once they begin disclosing the claims development tables required by Accounting Standards Update 2015-09, *Disclosures about Short-Duration Contracts*, after adoption.

Compliance and Disclosure Interpretations

The SEC staff issued *Compliance and Disclosure Interpretations* (C&DIs) on the following topics:

- Pay ratio disclosures — New guidance on the disclosure of the ratio of the median employee's annual total compensation to that of the principal executive officer addresses how a registrant should select a "consistently applied compensation measure" to identify the median employee if annual total compensation is not calculated in accordance with Item 402(c)(2)(x) of Regulation S-K. It also addresses how furloughed employees and workers whose compensation is determined by an unaffiliated third party should be considered in the employee population used to determine the median employee. The rule is effective for fiscal years beginning on or after 1 January 2017.
- Annual report delivery obligation — In lieu of submitting the annual report to shareholders on EDGAR or mailing paper copies, registrants may satisfy their obligation to furnish the report to the SEC by posting it on their corporate website. If a registrant chooses this option, it must keep the annual report accessible for one year after it is posted.
- Foreign private issuers — Certain provisions of Securities Act Rule 405 and Exchange Act Rule 3b-4 were clarified, including the following:
    - When a registrant has two boards of directors, it must assess whether the majority of the board that performs the functions closest to those undertaken by a US-style board is made up of US citizens or residents. If those functions are divided between both boards, the registrant may aggregate the members of both boards to calculate the majority.
    - A registrant must assess on a consolidated basis the location from which its officers, partners or managers primarily direct, control and coordinate its operations to determine whether its business is administered principally in the US.
    - A registrant may use geographic segment information to determine whether more than 50% of the assets are located in the US or may apply another reasonable methodology on a consistent basis.

SEC rulemaking and implementation

Final rules on registered investment company reporting

EY resources

- To the Point, *SEC adopts rules to enhance investment company reporting* (SCORE No. 03582-161US)

The SEC adopted new rules and forms and amended other rules to modernize and enhance the reporting and disclosure of information by registered investment companies (RICs). The SEC said these changes, which require RICs to report certain information in a structured XML format, will allow it to more effectively analyze data reported by funds. The SEC also amended Regulation S-X to standardize and enhance disclosures about derivatives and other items in investment company financial statements. Certain RICs will be required to report information about their monthly portfolio holdings on new Form N-PORT within 30 days of the end of each month. In addition, RICs, except face-amount certificate companies, will be required to file census-type information annually on new Form N-CEN within 75 days of the end of their fiscal year (or calendar year for unit investment trusts).

The compliance date for Form N-PORT is 1 June 2018, for fund complexes with $1 billion or more in net assets, or 1 June 2019 for smaller fund complexes. The compliance date for Form N-CEN is 1 June 2018, and the amendments to Regulation S-X are effective 1 August 2017.

Final rules on fund liquidity risk management and swing pricing

EY resources

- To the Point, *Rules on fund liquidity risk management and swing pricing* (SCORE No. 03482-161US)

The SEC adopted final rules designed to reduce the risk that investors in exchange-traded funds (ETFs) and open-end mutual funds (except money market funds) will be unable to redeem their shares and receive their assets in a timely manner during periods of financial stress. The rules require these funds to establish a liquidity risk management program and expand their disclosures about fund liquidity and redemption practices.

The SEC also adopted final rules permitting open-end funds (except for money market funds and ETFs) to use swing pricing, which is designed to protect existing shareholders from dilution associated with shareholder purchases and redemptions. When the level of net purchases or net redemptions exceeds a specified percentage of net asset value (i.e., the swing threshold), the fund would reflect in its net asset value the costs associated with satisfying requests for shareholder purchases or redemptions. The use of swing pricing would be an additional tool to help funds manage liquidity risks.

Fund complexes with net assets of $1 billion or more will be required to comply with the liquidity risk management program requirements starting 1 December 2018, while those with less than $1 billion in net assets will have to do so starting 1 June 2019. The effective date for the swing pricing rule is 19 November 2018.

New rules on exemptions for intrastate and regional securities offerings

The SEC adopted a new Rule 147A to overcome the limitations of current rules governing intrastate offerings. The SEC decided to retain and amend current Rule 147 as a safe harbor under Section 3(a)(11) to preserve the continued availability of existing state law exemptions for in-state offers, including crowdfunding.

Unlike the current or amended Rule 147 for intrastate offering, under the new Rule 147A:

- An issuer in an intrastate offering will be able to engage in general solicitation and advertising of its offering, using any form of mass media, including publicly available internet websites, even if the offering materials are accessible to out-of-state residents, as long as all of the offering materials prominently disclose that sales will be made only to the residents of the same state as the issuer.
- An issuer will be able make an intrastate offering within the state of its principal place of business even if its business is incorporated or organized in a different state.

The amended Rule 147 and new Rule 147A will be effective 20 April 2017.

For regional securities offerings, the SEC also raised the offering limit under Rule 504 of Regulation D to $5 million from $1 million in any 12-month period and disqualified certain "bad actors" from participating in Rule 504 offerings. Rule 504 continues to impose no limits on the number of purchasers or their qualifications (i.e., all may be unaccredited and not necessarily sophisticated), but it does prohibit general solicitation and advertising. The amendments are effective 20 January 2017. The SEC also repealed Rule 505 effective 22 May 2017.

Proposal would require universal proxy ballot

The SEC proposed requiring the use of a universal proxy ballot that lists the names of all board nominees, regardless of whether they are nominated by the company or a dissident shareholder. The proposed rule would allow shareholders voting by proxy to use a single ballot to vote for any combination of candidates nominated by either the company or dissident shareholders.

EY resources

- To the Point, *SEC explores possible changes to Regulation S-K requirements for business and financial disclosures* (SCORE No. 00544-161US)
- EY Comment Letter – *Regulation S-K concept release requirements for business and financial disclosures* (SCORE No. 02125-161US)
- EY Comment Letter – *Amendments to Smaller Reporting Company Definition* (SCORE No. CL02785-161US)
- EY Comment Letter – *Disclosure Update and Simplification* (SCORE No. CL03620-161US)
- EY Comment Letter – *Exhibit Hyperlinks and HTML Format* (SCORE No. CL03612-161US)
- EY Comment Letter – *Subpart 400 of Regulation S-K Disclosure Requirements* (SCORE No. CL04154-161US)

Update on disclosure effectiveness initiative

Report on Modernization and Simplification of Regulation S-K

The SEC staff issued its *Report on Modernization and Simplification of Regulation S-K* in November 2016 to Congress, as required by the Fixing America's Surface Transportation Act (FAST Act). The report highlighted recent changes proposed by the Commission in its disclosure effectiveness initiative. The SEC staff also made certain recommendations for the Commission to consider for future rulemaking, including:

- Revise Item 303 for management's discussion and analysis to require only a period-to-period comparison for the two most recent fiscal years presented in the financial statements and permit registrants to include a hyperlink to the prior year's annual report for the additional period-to-period comparison
- Eliminate the requirement to provide a table of contractual obligations and instead require registrants to include a hyperlink to the relevant financial statement notes, along with a discussion of liquidity that describes material changes to contractual obligations and the ability to pay such obligations over time
- Allow registrants to omit attachments and schedules filed with exhibits, unless they contain information that has not been disclosed and would be material to an investment decision
- Revise Item 102 to clarify that physical properties should be disclosed only to the extent they are material to the registrant's business

The FAST Act requires the Commission to issue proposed rules to implement the recommendations in the report within 360 days.

Other SEC activities

CAQ SEC Regulations committee meeting

The Center for Audit Quality (CAQ) SEC Regulations Committee issued highlights from its 27 September 2016 meeting with the SEC staff that included:

- A discussion of the SEC staff's views on non-GAAP financial measures and the implementation of the C&DIs issued in May 2016

- A confirmation that, absent relief based on its specific rules and a registrant's circumstances, the registrant must provide condensed consolidating information to comply with Regulation S-X Rule 3-10 if the guaranteed securities were outstanding at period end even if the securities were subsequently extinguished before the filing date
- The SEC staff's view that it would not take exception to periods used to prepare pro forma financial information differing by slightly more than 93 days when that difference is solely a result of one of the companies having a 52-53 week year when combined with a calendar-year company

IAC discusses 2017 priorities

The Investor Advisory Committee (IAC) discussed investor protection priorities for 2017, including suggestions from members to continue working on its initiatives from 2016, such as the universal proxy proposal. At the December 2016 meeting, SEC Chair Mary Jo White emphasized the importance of rulemaking done to protect investors following the 2008 financial crisis and urged both the Commission and the IAC to continue working together to address the issues facing investors in areas under the Commission's jurisdiction.

SEC Advisory Committee defers recommendation for board diversity disclosures

The SEC's Advisory Committee on Small & Emerging Companies (ACSEC) deferred making a recommendation on board diversity disclosures until it considers certain concerns. ACSEC plans to discuss the recommendation in its upcoming meeting.

In most cases, the SEC staff is unlikely to object to non-GAAP measures that remove restructuring charges.

Current practice matters

Recent updates on non-GAAP financial measures

The SEC staff acknowledged at the AICPA Conference that companies have been changing their disclosures of non-GAAP financial measures in response to the updated C&DIs issued in May 2016. However, Mr. Bricker said companies can make more progress in evaluating the appropriateness of a non-GAAP measure and its prominence, as well as the effectiveness of disclosure controls and procedures, among other things.

Mark Kronforst, Chief Accountant of DCF, also expressed the following staff views on some specific non-GAAP measures and adjustments:

- *Prominence* — The SEC staff is now issuing comments requesting that companies present the GAAP measure first in the required non-GAAP reconciliation (i.e., reconciling from GAAP to the non-GAAP measure) because it believes presenting the non-GAAP measure first would give it undue prominence.
- *Stock compensation* — The SEC staff would not object to non-GAAP performance measures that include adjustments adding back stock compensation.
- *Restructuring charges* — In most cases, the SEC staff is unlikely to object to non-GAAP measures that remove restructuring charges unless a company's fact pattern suggests that it has restructuring initiatives on a recurring basis.
- *Business combinations* — Following a business combination, the staff will not object to non-GAAP adjustments that eliminate the effects of recording inventory or deferred revenue at fair value.
- *Individually tailored accounting principles* — The staff has objected to a few types of non-GAAP measures that use individually tailored accounting principles. For example, the SEC staff has objected to non-GAAP measures that accelerate revenue recognition, change the number of shares used in calculating earnings per share or alter consolidation principles by presenting financial statement measures using proportionate consolidation.

Mr. Kronforst also cautioned companies that, as it relates to non-GAAP measures and ASC 280 segment disclosures, companies cannot circumvent the non-GAAP rules by presenting multiple segment measures of profit in their financial statements.

MD&A disclosure considerations for income taxes

During the AICPA Conference, Ms. Shah observed that the SEC staff continues to issue comments on income tax disclosures included in management's discussion and analysis (MD&A). She further expressed concerns that registrants' income tax disclosures in MD&A often aren't cohesive and don't tell a complete story about the company's tax positions and related trends and uncertainties.

Ms. Shah said that when the staff reviews a registrant's income tax disclosures in MD&A, it primarily looks for robust MD&A disclosures related to:

- Reasons for historical changes in the effective tax rate
- Discussion about changes in reconciling items between the effective and statutory tax rates
- Insight into the extent to which past income tax rates are indicative of future tax rates
- Trends and uncertainties related to changes in unrecognized tax benefits
- Differences between trends in income tax expenses and cash taxes paid

How we see it

While both the Financial Accounting Standards Board (FASB) and the SEC consider ways to enhance income tax disclosures as part of specific projects, it's no surprise that the SEC staff is seeking expanded disclosures from registrants based on the existing principles-based MD&A requirements. In preparing MD&A this year, registrants should revisit whether they adequately discuss trends and uncertainties related to their income tax provision, including the effect of uncertain tax positions and the underlying drivers of changes in effective tax rates.

Auditor's involvement in interpretive and waiver process

During the AICPA Conference, the SEC staff recommended that registrants seek the input and feedback of their auditors on interpretive and waiver letters prior to their submission to DCF to make the SEC staff's review more efficient.

SEC staff no longer requires 'Tandy' language

The SEC staff said it no longer requires registrants to acknowledge in their responses to comment letters that their disclosures are their responsibility and that they will not raise the SEC review process as a defense in any legal proceeding. These representations are known as "Tandy" language, after the first company to receive such a request.

2017 US GAAP Taxonomy released

The 2017 US GAAP Financial Reporting Taxonomy is available on the FASB website, along with materials that describe changes from the 2016 version. The 2017 Taxonomy may be used for SEC XBRL submissions only after it is adopted by the SEC, which is expected in early 2017.

Personnel changes

SEC Chair White to step down in January 2017

Mary Jo White said she will step down as SEC chair at the end of the current administration in January 2017. She has led the agency since April 2013, and her term was set to expire in 2019. Chair White's departure will leave three of the five commissioner seats vacant, assuming there are no confirmations prior to the end of her tenure.

Mary Jo White

In a recent letter to the US Senate Committee on Banking, Housing, and Urban Affairs and Subcommittee on Securities, Insurance, and Investment, Ms. White listed a number of rulemaking initiatives that are on her agenda before her departure, including:

- Proposal for requiring the use of the inline XBRL format in the submission of certain Commission filings
- Request for comment on statistical and other disclosures by bank holding companies and other financial institutions

Jay Clayton

President-elect Donald Trump plans to nominate Jay Clayton, a partner at Sullivan & Cromwell LLP, to head the SEC. Mr. Clayton has dealt with legal matters involving merger and acquisition transactions, capital market offerings, regulatory and enforcement proceedings, among others. His appointment requires approval from the Senate Banking Committee and confirmation by the Senate.

Chair White's departure will leave three of the five commissioner seats vacant.

DCF Director Higgins to leave in early January 2017

Keith Higgins, Director of the SEC's Division of Corporation Finance, plans to leave the Commission in early January 2017. He has been with the SEC since 2013. Shelley Parratt, the current Deputy Director for the Division of Corporation Finance, will become the Acting Director.

SEC names Bricker Chief Accountant, Panucci Deputy Chief Accountant

Wesley Bricker was named Chief Accountant in the SEC's Office of the Chief Accountant (OCA), succeeding James Schnurr, who is retiring. Mr. Bricker has served as Interim Chief Accountant since July 2016 and was previously Deputy Chief Accountant in OCA's Accounting group.

Wesley Bricker

Additionally, Marc Panucci was named Deputy Chief Accountant in OCA. He will oversee OCA's Professional Practice group, which is responsible for matters related to internal control over financial reporting, auditor independence and auditing standards. He succeeds Brian Croteau.

Other changes

The following members of the SEC staff also announced they will leave the SEC by early January or before:

- Andrew Ceresney, Director of SEC's Division of Enforcement
- Mark Flannery, Director of SEC's Division of Economic and Risk Analysis
- Stephen Luparello, Director of SEC's Division of Trading and Markets

Enforcement activities

The SEC charged an energy services provider and four former executives for prematurely recognizing revenue on service contracts to meet internal targets. The company restated its financial statements in 2013 for annual periods 2008 through 2011 and the first quarter of 2012 to correct its accounting. The SEC found that company's controller recklessly participated in the improper revenue recognition because the company's internal controls did not require adequate documents from one of its divisions to support journal entries recorded at the corporate level. The company agreed to pay $1 million to settle the charges, and the four executives also agreed to settlements.

Separately, a technology company and two former executives agreed to settle the SEC's charges that they understated the company's paid-time-off liability by $800,000 to meet a performance target in the first quarter of 2013, among other things. The technology company agreed to pay $2.5 million to settle the charges, and the two executives agreed to pay fines and penalties.

The SEC charged a chemical company and its general counsel for failing to make timely material loss contingency disclosures. The SEC alleged that the company's general counsel did not inform the company's chief executive officer, chief financial officer, audit committee and external auditors about material facts related to a Department of Justice (DOJ) investigation of the company. This resulted in, among other things, the company's failure to timely disclose or accrue in several SEC filings the loss contingencies related to the DOJ investigation. The company restated its results for the three quarters during which the DOJ investigation occurred. However, the company is contesting the SEC's allegations.

Separately, the SEC charged the top executives and the founder of a hedge fund for allegedly inflating asset values and improperly using investor funds to cover losses.

The SEC, along with other US and foreign regulatory authorities, continued to pursue enforcement actions involving violations under the Foreign Corrupt Practices Act (FCPA). In the recent quarter ended 31 December 2016, five companies agreed to pay more than $2 billion in fines to settle FCPA charges with the SEC and other regulatory authorities.

The SEC recently awarded $20 million to a whistleblower, the third largest award it has made since its whistleblower program began in 2011. The program has paid more than $136 million to 37 whistleblowers since its inception.

What's next at the SEC?

After Chair White leaves the Commission in January 2017, a deadlock between the two remaining commissioners could stall rulemaking and other actions until the Chair or other vacancies are filled and confirmed by the Senate.

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Executive View

ASC 842, Leases – Transition disclosures

February 2017

Companies should expect scrutiny of their SAB 74 disclosures related to their forthcoming adoption of the new leases standard.

Regulatory background

SEC Staff Accounting Bulletin Topic 11.M (SAB Topic 11.M or SAB 74) requires SEC registrants to evaluate new Accounting Standards Updates (ASUs) that they have not yet adopted when determining what financial statement disclosures to make about the potential material effects of adopting those ASUs.

These disclosures generally should include a discussion about the effect that adoption is expected to have on the financial statements, unless this is not known or reasonably estimable. In that case, a registrant should state that the effect of adoption is unknown.

At the September 22, 2016 EITF meeting, the SEC staff announced that, consistent with SAB Topic 11.M, when the effect is not known or reasonably estimable, a registrant should consider making additional qualitative financial statement disclosures to assist financial statement users in understanding the significance of the effect that a new standard will have on the financial statements when adopted.[1]

The SEC staff expects disclosures to include a description of the effect of the accounting policies that the registrant expects to apply, if determined, and a comparison with the current accounting policies.

Also, the SEC staff indicated that a registrant should describe its progress in implementing the new standards and the significant implementation matters that it still needs to address.

At the December 2016 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff stressed the importance of transition disclosures to investors. The SEC staff expects to issue comments on materially deficient disclosures in its review of 2016 Form 10-K filings. Accordingly, registrants should avoid boilerplate transition disclosures and provide investors with useful information about adoption and implementation efforts for new ASUs, including ASU 2016-02, *Leases*.

Example disclosures

The following examples, including combinations of these examples, can be a starting point for SAB Topic 11.M disclosures about the effect of adopting ASU 2016-02. Management should amend these examples to fit their circumstances and comply with SAB Topic 11.M and recent SEC staff guidance outlined above.

[1] The SEC staff announcement is codified in the FASB's Accounting Standards Codification at paragraph 250-10-S99-6.

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Lessee

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases, which requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The new standard is effective for us on [January 1, 2019], with early adoption permitted. We expect to adopt the new standard [on its effective date (or earlier date; or we have not yet decided whether we will early adopt the new standard)]. A modified retrospective transition approach is required for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

We expect that this standard will have a material effect on our financial statements. While we are continuing to assess the effect of adoption, we currently believe the most significant changes relate to (1) the recognition of new ROU assets and lease liabilities on our balance sheet for [office and equipment] [retail store] [real estate] operating leases; (2) the derecognition of existing assets and liabilities for certain sale-leaseback transactions (including those arising from build-to-suit lease arrangements for which construction is complete and we are leasing the constructed asset) that currently do not qualify for sale accounting; and (3) the derecognition of existing assets and liabilities for certain assets under construction in build-to-suit lease arrangements that we will lease when construction is complete. We do not expect a significant change in our leasing activity between now and adoption.[2] We expect to elect all of the standard's available practical expedients on adoption[3]. Consequently, on adoption, we expect to:

- Recognize additional operating liabilities ranging from $X,XXX to $X,XXX, with corresponding ROU assets of the same amount based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases.
- Derecognize existing debt obligations ranging from $X,XXX to $X,XXX and existing fixed assets ranging from $X,XXX to $X,XXX for sale-leaseback transactions that currently do not qualify for sale accounting. Any gains or losses associated with this change in accounting will be recognized through opening retained earnings[4] on adoption, and we will recognize new ROU assets and lease liabilities ranging from $X,XXX to $X,XXX on our balance sheet for the associated leases.
- Derecognize existing debt obligations ranging from $X,XXX to $X,XXX, with corresponding construction in process of the same amount for assets under construction in build-to-suit lease arrangements for which we expect construction to be complete before the effective date. On completion of construction, we expect to recognize new ROU assets and lease liabilities ranging from $X,XXX to $X,XXX on our balance sheet for the associated leases. Debt obligations and construction-in-process arising from build-to-suit lease arrangements for which construction is not yet complete as of the effective date will be evaluated under the new standard, which may or may not result in those amounts being derecognized. If those amounts are not derecognized on adoption, they will be derecognized only when (and if) the sale-leaseback requirements in the new standard are met.

[2] Alternatively, we plan to explore alternative financing solutions for the leased [equipment] between now and adoption.

[3] Alternatively, we expect not to elect all of the standard's practical expedients on adoption. (The use of the hindsight practical expedient may be elected on its own or with the other package of practical expedients. The other practical expedients must be elected together as a package.)

[4] For sale-leaseback transactions that qualify for sale accounting under the new standard during the comparative periods preceding the effective date (2017 and 2018 for public companies that adopt on January 1, 2019), companies will recognize transition period gain or loss on the sale and lease expense in the income statements for the comparative periods.

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Lessor

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, *Leases*, which requires lessors to classify leases as a sales-type, direct financing, or operating lease. A lease is a sales-type lease if any one of five criteria are met, each of which indicate that the lease, in effect, transfers control of the underlying asset to the lessee. If none of those five criteria are met, but two additional criteria are both met, indicating that the lessor has transferred substantially all the risks and benefits of the underlying asset to the lessee and a third party, the lease is a direct financing lease. All leases that are not sales-type or direct financing leases are operating leases.

The new standard is effective for us on [January 1, 2019], with early adoption permitted. A modified retrospective transition approach is required for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

[We currently expect to early adopt the new standard effective January 1, 2018 in conjunction with our adoption of the new revenue standard. Our ability to early adopt is dependent on [system readiness and] the completion of our analysis of information necessary to restate prior period financial statements.] We are currently evaluating the effect of adoption of the new standard on our financial statements and do not expect a significant change in our leasing activity between now and adoption.

[We believe substantially all of our leases will continue to be classified as operating leases under the new standard.] [While a substantial number of our leases will now be classified as sales-type leases, rather than direct financing leases, we do not expect that change in classification to have a significant effect on the accounting for our leases.]

[On adoption of the new standard, maintenance services will no longer be considered part of the lease element of our equipment leasing contracts. Instead, they will be accounted for as a non-lease component within the scope of the new revenue standard. As a result, we will be required to recognize revenues associated with our equipment leases separately from revenues associated with maintaining the equipment. Our preliminary assessment is that approximately X-XX% of customer lease payments will be attributed to the maintenance services. At this time, we do not believe application of the recognition provisions in the new revenue standard to our maintenance services will affect the timing of recognition of our maintenance services revenue. In addition, due to the new standard's narrowed definition of *initial direct costs*, we expect to expense as incurred significant lease origination costs currently capitalized as initial direct costs and amortized to expense over the lease term.]

[Subsequent to our adoption of the new standard, common area maintenance provided in our real estate contracts will be accounted for as a non-lease component within the scope of the new revenue standard. As a result, we will be required to recognize revenues associated with our real estate leases separately from revenues associated with common area maintenance. We are continuing to evaluate whether the variable payment provisions in the new lease standard, or the allocation and recognition provisions of the new revenue standard, will affect the timing of recognition for our lease and non-lease revenue. In addition, due to the new standard's narrowed definition of *initial direct costs*, we expect to expense as incurred significant lease origination costs currently capitalized as initial direct costs and amortized to expense over the lease term.]

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A reminder: effective dates and transition

	Public business and certain other entities[5]	All other entities
Annual periods – Fiscal years beginning after	December 15, 2018	December 15, 2019
Interim periods – In fiscal years beginning after	December 15, 2018	December 15, 2020
Early adoption allowed?	Yes, immediately.	

For further reading

Defining Issues: EITF Reaches Final Consensus: SEC Staff Discusses Recent Accounting Standards

Issues and Trends: AICPA National Conference on Current SEC and PCAOB Developments

Issues In-Depth: Leases

[5] (1) public business entities; (2) not-for-profits that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market; and (3) employee benefit plans that file financial statements with the SEC.

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KPMG's Financial Reporting View

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NAREIT Alert (September 30, 2016)

NAREIT Alert Important Industry Updates from NAREIT

September 30, 2016

Reporting Pro-Rata Information

On September 27 at NAREIT's Senior Financial Officer Workshop, a representative of the Securities and Exchange Commission's (SEC) Division of Corporation Finance indicated that certain pro-rata financial information, which is provided by most REITs that invest in joint ventures, does not comply with the SEC's May 17, 2016 Compliance and Disclosure Interpretations (the C&DI) of the rules and regulations on the use of non-GAAP financial measures.

Subsequently, NAREIT discussed this matter with SEC staff. NAREIT understands that SEC staff would not object to the following presentation of elements of pro-rata financial statements:

Elements of Pro-Rata Statement of Operations	Noncontrolling Interest Share of Consolidated Ventures	Company Share of Unconsolidated Ventures
Minimum rent	-	-
Overage rent	-	-
Tenant reimbursements	-	-
Other income	-	-
Property operating expenses	-	-
Depreciation and amortization	-	-
Real estate taxes	-	-
Repairs and maintenance	-	-
Advertising and promotion	-	-
Provision for credit losses	-	-
Other	-	-
Interest Expense	-	-

Elements of Pro-Rata Balance Sheet	Noncontrolling Interest Share of Consolidated Ventures	Company Share of Unconsolidated Ventures
Investment properties, at cost	-	-
Less - accumulated depreciation	-	-
Cash and cash equivalents	-	-
Tenant receivables and accrued revenue, net	-	-
Investment in unconsolidated entities, at equity	-	-
Deferred costs and other assets	-	-
Mortgage and unsecured indebtedness	-	-
Accounts payable and accrued expenses	-	-
Other liabilities	-	-
Commitments and contingencies	-	-
Limited partners' preferred interest in the Operating Partnership	-	-

Important notes:

- *The consolidated GAAP financial statements may not be reported on the same table with the pro-rata information.*
- *The elements shown in this illustration of reporting pro-rata information may be different for each company's facts and circumstances.*
- *No totals or subtotals should be presented.*
- *Analysts could deduct the non-controlling interest share of consolidated ventures from the consolidated amounts.*
- *Analysts could add the company share of unconsolidated ventures to the consolidated amounts.*

Contact: George Yungmann at gyumgmann@nareit.com or Christopher Drula at cdrula@nareit.com.

NAREIT Alert (October 18, 2016)

NAREIT Alert Important Industry Updates from NAREIT

October 18, 2016

Further Guidance on Pro-Rata Reporting of Non-GAAP Financial Measures and Metrics

On Oct. 17, NAREIT held further discussions on pro-rata reporting with the Securities and Exchange Commission (SEC or Commission) staff in the Division of Corporation Finance.

NAREIT understands that the SEC staff will object to the use of the full presentation of non-GAAP pro-rata financial statements. The staff believes that this presentation is inconsistent with the Commission's rules for reporting non-GAAP financial measures and recent staff guidance for prominence and tailored accounting principles.

NAREIT understands that the SEC staff will not object to a presentation of proportional investee amounts, which may include a column of adjustments that would have been made to arrive at the full pro-rata financial statements. For further information, refer to the NAREIT Alert: Reporting Pro-Rata Information dated Sept. 30. Further, NAREIT understands that the SEC staff will not object to including subtotals and totals in the table of adjustments originally included in the Alert.

Currently, NAREIT understands that the SEC staff will also not object to the limited use of other measures and metrics that incorporate pro-rata financial information. Any disclosure of pro-rata financial information should be transparent. Registrants should include disclosure clearly explaining the nature and limits of the pro-rata results, such as:

- Registrants should provide clear disclosure of the relationship to the consolidated and unconsolidated investees and explain how the pro-rata information was derived.
- Registrants should explicitly disclose that they do not control the unconsolidated investees.
- Registrants should clearly explain any limitations of the proportional data. For example, registrants should caution investors that multiplying each of the investees' financial statement line items by the registrant's percentage ownership and adding those amounts to the registrant's totals may not accurately depict the legal and economic implications of holding a non-controlling interest in the investee.

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July 21, 2016

Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Delivered Electronically

Re: Concept Release on Business and Financial Disclosure Required by Regulation S-K; 17 CFR Parts 210, 229, 230, 232, 239, 240 and 249; Release Nos. 33-10064, 34-77599; File No. S7-06-16; RIN 3235-AL78

Dear Mr. Fields:

The National Association of Real Estate Investment Trusts (NAREIT) is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. We represent a large and diverse industry including equity REITs, which own commercial properties, mortgage REITs, which invest in mortgage securities, REITs traded on major stock exchanges, public non-listed REITs and private REITs. Public U.S. REITs collectively own nearly $2 trillion of real estate assets and, by making investment in commercial real estate available in the form of stock, our REIT members enable all investors – importantly, small investors – to achieve what once only large institutions and the wealthy could.

NAREIT supports the goals of the Securities and Exchange Commission's (SEC, or the Commission) Disclosure Effectiveness Initiative and appreciate this opportunity to submit comments responding to the *Concept Release on Business and Financial Disclosure Required by Regulation S-K* (*Concept Release*)[1].

REITs as publicly traded real estate companies are a growing asset class, both domestically and abroad. Last year S&P and MSCI announced that for the first time since the Global Industry Classification Standard (GICS®) was created in 1999, it will create a new headline sector named *Real Estate*, which will be predominately populated by equity REITs and will become effective August 31, 2016.[2] Promoting *Real Estate* to a GICS® headline sector from its current

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[1] All page references here in refer to the ***Federal Register*** version of *Business and Financial Disclosure Required by Regulation S-K* , 81 FR 23915 (April 22, 2016).
[2] S&P Dow Jones Indices, *S&P DOW JONES INDICES AND MSCI ANNOUNCE AUGUST 2016 CREATION OF A REAL ESTATE SECTOR IN THE GLOBAL INDUSTRY CLASSIFICATION STANDARD* (GICS®) STRUCTURE [Press Release, (March 13, 2015)], available at https://www.msci.com/documents/10199/6aac98e5-a0f6-485c-ad7c-20394024e07f.

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industry classification under *Financials* recognizes the growing position of REITs in the global investment landscape. Worldwide, 36 countries currently have enacted laws supporting equity REITs, which own and operate real estate assets.[3]

REITs as publicly traded real estate companies share many commonalities with other SEC-registered companies, but also exhibit important differences. Most relevant to disclosure, the "real estate-centric" nature of REITs presents some challenges for meaningful financial reporting. Historical cost accounting for real estate assets implicitly assumes that the value of real estate assets diminishes predictably over time, although this has not been accurate over the long periods of time in which real estate investments have historically been valued. To address this anomaly, in 1991, NAREIT, working with its corporate members and the REIT investment community, developed a non-GAAP measure of REIT performance, NAREIT Funds from Operations (FFO), which is calculated by adding depreciation and amortization related to real estate to GAAP net income and subtracting gains and losses from real estate sales.

NAREIT FFO is now widely used as a supplemental metric to measure operating performance and has been recognized by the SEC since 2002 as a standard non-GAAP performance measure for the real estate industry.[4] REIT disclosure practices, incorporating NAREIT FFO metrics, are consistently praised by the financial and investor communities for their transparency and comparability.[5] NAREIT continues to engage in efforts to refine the understandability and uniformity of FFO estimates.

NAREIT and its members have long understood the critical importance of communicating accurate and material business and financial information to REIT investors and appreciate this historic opportunity to participate in the SEC's Disclosure Effectiveness Initiative. NAREIT convened groups of NAREIT members of its committees on government relations, accounting and sustainability in a series of conference calls to discuss the disclosure topics most relevant to REITs that are raised in the *Concept Release*. Although the views of NAREIT members on some

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[3] Available at https://www.reit.com/investing/reit-basics/global-real-estate-investment.
[4] *See* SEC, *The Use of Non-GAAP Financial Measures* (May 17, 2016), available at https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm; *See also*, SEC, *Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures* (June 13, 2003), available at https://www.sec.gov/divisions/corpfin/faqs/nongaapfaq.htm ("Question 7:What measure was contemplated by 'funds from operations' in footnote 50 to the adopting release, which indicates that companies may use 'funds from operations per share' in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K? Answer 7: Footnote 50 contemplated only the measure 'funds from operations' defined and clarified, as of January 1, 2000, by the National Association of Real Estate Investment Trusts.").
[5] *See, e.g.*, Chilton Capital Management investment team, as reported in *Seeking Alpha* (May 3, 2016) ("In fact, we would argue that REIT disclosures rank near the top of all sectors, making them extremely transparent to investors. Upon spending the time to understand some of these new metrics, we believe that market participants will determine that REITs are *less* complex than the average company and FFO estimates, dividend forecasts, and valuations are *more* accurate."), available at http://seekingalpha.com/article/3970520-gics-change-validates-investment-merits-reits.

topics varied, there was overwhelming agreement on key foundational points, which are summarized below:

- NAREIT strongly believes that materiality, as evaluated through the eyes of a "reasonable investor" under the prevailing Supreme Court[6] standard, should continue to be the guidepost of the SEC's disclosure regime and that reform efforts should focus on best ways to ensure the disclosure of *company-specific* material information to investors;[7]
- NAREIT strongly favors a "Principles-based" approach to SEC disclosure and believes it is best suited to the constantly evolving business environment in which REITs and other businesses operate. We agree that the disclosure requirements should be streamlined and suggest that limiting prescriptive "line-item" disclosure requirements would reduce "over-disclosure" of irrelevant, outdated or immaterial information;
- NAREIT appreciates the SEC's recognition of the value of NAREIT FFO, an industry-wide Non-GAAP metric, to REIT investors;
- NAREIT believes that greater coordination between the SEC and FASB would reduce overlapping and redundant disclosure requirements and lead to better disclosure;
- NAREIT believes that Principles-based disclosure based on materiality remains the best approach to environmental, sustainability and similar disclosures and does not believe that the SEC should prescribe specific standards or reporting frameworks in this area; and,
- NAREIT suggests that SEC disclosure reform should incentivize long-term business value creation rather than short-term results. Reforms should prioritize reporting rules and metrics that highlight long-term results.

I. Core Company Business Information (Item 101)

The *Concept Release* seeks general comments on the usefulness of disclosure required by Item 101 of Regulation S-K and whether it duplicates information provided elsewhere in the reports.

NAREIT supports efforts to streamline the reporting of core company business information generally, through the elimination of redundant, outdated and excessive reporting requirements. We believe that streamlining efforts should adopt a Principles-based approach and that additional line-item reporting should be resisted.

NAREIT also generally supports the idea, raised in Question 28 of the *Concept Release,* of a rule change that would "require a more detailed discussion of a registrant's business in the initial filing, and in subsequent filings only require a summary of the registrant's business along with a discussion of material changes in the business as previously disclosed in the registrant's Form

[6] ***TSC Industries, Inc. v. Northway, Inc***., 426 U.S. 438 (1976) at 449.
[7] NAREIT's comments herein primarily address proposed disclosure reforms related to the requirements of SEC Forms 10-K, 10-Q and 8-K (collectively referred to herein as'34 Act reports).

10-K…" There are many forms that this suggestion could assume, including permitting registrants to lodge a "date and time stamped" basic company profile in the EDGAR system, which could be updated as necessary (again, date and time stamped). This would not eliminate the need for periodic reports, but would likely streamline reporting and reduce compliance burdens.

However, we do not favor core business reporting requirements that would effectively impose "continuous reporting" obligations, because we believe that the existing '34 Act reporting, including Form 8-K filings, are sufficient to provide investors with timely updates. Moreover, as noted in section VI below (Frequency of Interim Reporting) some NAREIT members also question whether current quarterly reporting obligations lead to excessive managerial and investor focus on short-term results at the expense of long-term sustainable value.

Item 102 of Regulation S-K

The *Concept Release* poses a series of questions about Item 102 of *Regulation S-K*, relating to the disclosure of the location and general character of important physical properties of the registrant and its subsidiaries, noting that some registrants have questioned the continuing relevance of this requirement.[8] Item 102 clearly has more relevance for REITs than some other registrants.

NAREIT generally believes that reforms here should also be Principles-based and caution against the adoption of new prescriptive rules mandating specific forms or terms for disclosing physical property, or attempts to redefine materiality in this context. There is tremendous variation in the types and forms of real property and real property ownership among subcategories of REITs and even within REIT subcategories. Principles-based rules will continue to provide the flexibility to management to fashion meaningful communication about real properties to investors.

Most REITs are also required to submit Schedule III (as defined by Regulation S-X rule 210.5-04(c))[9], which requires even more extensive disclosure about the individual properties held by REITs than Item 102, overlapping some Item 102 requirements and conflicting with others. The burdens of Schedule III preparation for REITs have become substantial. Many REITs devote considerable time and resources to Schedule III preparation, which requires copious details about individual properties, such as original purchase price, cumulative capital improvements, the year acquired or developed and accumulated depreciation and amortization. Moreover, some NAREIT members report that their investor feedback does not support the value to investors of the incremental detail currently required by Schedule III. They tell us that their investors are typically more interested in information about particular geographies or categories of properties, which can provide the basis of comparisons between companies.

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[8] *Concept Release* at 23937.
[9] 17 CFR 210.12-28 - Real estate and accumulated depreciation.

Further, the SEC's rules related to interactive data[10] now require extensive XBRL tagging of much of the information included in Schedule III. As noted above, there is significant variation in the types and forms of real property held by REITs. Many large REITs have complex real estate portfolios requiring customized tagging of literally thousands of discrete items that are *sui generis*, producing Schedule III disclosures that are overly complex, difficult to compare and often of little incremental value to investors.

NAREIT recommends that disclosure compliance burdens and confusing duplication be eased by incorporating those requirements of Schedule III that do provide additional useful information into Item 102. Alternatively, Schedule III could be amended to allow for aggregation of properties in a geographic region and/or by similar property types.

Industry Guides

The *Concept Release* seeks input on "whether the Industry Guides elicit disclosure that is important to investment and voting decisions."[11] NAREIT generally endorses the periodic reevaluation and updates of all SEC guidance, including Securities Act Industry Guide 5 – Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships (Industry Guide 5),[12] which has particular relevance to REITs. With regard to Industry Guide 5, we note that it currently prescribes multiple quantitative disclosures in tabular format, making preparation onerous. We suggest that these requirements be reevaluated and streamlined so that material quantitative information may be disclosed into a single table.

Further, we are generally concerned that additional static, line-item requirements would not benefit investors, and we therefore urge the SEC against attempting to broadly codify guidance contained in Industry Guide 5 into Regulation S-K, as some have suggested.[13]

Similarly, the *Concept Release* alludes to past SEC efforts to integrate the disclosure requirements for the registration of an initial offering and subsequent periodic reporting. Question 203 specifically asks if the SEC should "move to consolidate industry-specific

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[10] *Interactive Data to Improve Financial Reporting, Release No. 33-9002* (Jan. 20, 2009), available at https://www.sec.gov/rules/final/finalarchive/finalarchive2009.shtml.
[11] *Concept Release* at 23967**.**
[7] Securities Act Industry Guide 5 by its terms, applies only to real estate limited partnerships, however, in 1991 the SEC stated that "the requirements contained in the Guide should be considered, as appropriate, in the preparation of registration statements for real estate investment trusts and for all other limited partnership offerings." *See*, *Securities Act Release No. 33-6900* (June 25, 1991), available at https://www.sec.gov/rules/interp/1991/33-6900.pdf
[13] *See*, *e.g*., Division of Corporation Finance, U.S. Securities and Exchange Commission, *Report on Review of Disclosure Requirements in Regulation S-K* (Dec. 2013) (the "*SEC 2013 Staff Report*") at16 and 103 ("In addition, review could be made as to whether any of the Industry Guide provisions should be codified in Regulation S-K…). *See also, Release No. 33-10098, Modernization of Property Disclosures for Mining Registrants* (June 16, 2016) (codifying the Industry Guide 7 into new subpart 1300 of Regulation S-K), available at http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf.

disclosure requirements," such as those set forth in Form S-11, into Regulation S-K. NAREIT strongly believes that disclosure reform should streamline the disclosure process, not simply aggregate existing rules, or worse, increase prescriptive line-item requirements. We urge that any such consolidation efforts be guided by a Principles-based approach focused on company-specific materiality.

II. Company Performance, Financial Information and Future Prospects

Selected Financial Data (Item 301) including Instruction 2

NAREIT recommends that disclosure of Selected Financial Data only be required for three years rather than the current five years, except where the inclusion of the two fiscal years preceding those three fiscal years is required to illustrate material trends in the registrant's business. NAREIT also believes that Instruction 2 currently provides "a reasonable balance between specified content and a flexible approach" and urges the SEC not to adopt "a more prescriptive approach"(Q. 76). Registrants should continue to have the flexibility to present selected data that best illustrates trends in their financial condition and the results of operations. For REITs, this additional information may include NAREIT FFO and other non-GAAP metrics, which may be significant to an understanding of the trends in financial condition and results of operations. Retaining the current Instruction 2 requirements would permit registrants to continue to provide additional information that is material to their business.

The *Concept Release* also seeks comment on whether the SEC should require auditor involvement (*e.g.*, audit, review or specified procedures) for Item 301 disclosure (Q. 77). NAREIT does not believe that additional auditor involvement should be required with regard to disclosures made under Items 301, 302 or 303. Currently, the registrant's auditor is required to review the table of selected financial data to ensure that there is no inconsistency between this data and the financial statements on which the auditor has rendered an audit opinion. In addition, if any non-GAAP metric is included in the table, such metric must be reconciled to the nearest GAAP metric, which is subject to audit.

Supplementary Financial Information (Item 302)

NAREIT believes that interim results can be misleading and that including this quarterly data in annual financial statements may obscure important trends. The *Concept Release* requests comment on whether Item 302(a)(1), which requires disclosure of quarterly financial data of selected operating results, "remains useful and relevant," noting that much of the required data has already been reported in prior quarterly reports. (Qs. 67-75). As noted in section V below, in addition to concerns about such data being misleading, many NAREIT members are concerned that quarterly reporting generally may incentivize excessive focus on short-term results at the expense of long-term performance. Based on these concerns, NAREIT suggests that the SEC should consider eliminating Item 302 (a)(1).

Finally, as noted above, we do not believe that it would provide additional benefit to investors to "require auditor involvement on the reliability of the disclosure under Item 302" (Q. 82).

Content and Focus of MD&A (Item 303 - Generally)

MD&A is a critical part of a registrant's financial reporting to investors and other financial statement users. However, NAREIT agrees that MD&A disclosure could be streamlined and recommends that Item 303 revisions follow a Principles-based approach. NAREIT believes that management is best positioned to determine whether an operating trend or change in financial condition is material to its business and should be discussed in MD&A and does not believe that it would be useful to impose quantitative thresholds to determine the materiality of trends or to adopt other prescriptive requirements (Q. 89). Rather, Item 303 should continue to provide management the flexibility to present its own perspective of the registrant's financial condition and results of operations.

NAREIT also agrees that it would improve the quality of MD&A disclosure if the SEC would consolidate its disparate sources of guidance on MD&A into a single place (Q. 90).

Finally, as noted above, each registrant's auditors currently must ensure that MD&A includes no information that is materially misleading and/or inconsistent with audited financial statements. NAREIT believes that expanding auditor involvement in MD&A disclosures would be costly and is unlikely to benefit investors. (Q. 96).

Key Indicators of Financial Condition and Results from Operations

While noting that both financial and non-financial key indicators and performance measures vary considerably across industries and even among industry segments,[14] the *Concept Release* requests comment on whether the SEC should mandate the disclosure of key indicators (Qs. 103-6). NAREIT believes that registrants should retain the flexibility to disclose key indicators and performance measures that they deem material or that illustrate material trends. However, NAREIT is concerned that prescriptive requirements mandating the disclosure of designated key indicators could lead to confusing disclosure overload without corresponding benefit to investors.

Disclosure rules applicable to such measures should be Principles-based and afford management the flexibility to disclose key indicators specific to its business when appropriate (and omit these when not material). Specifically, the SEC should not require registrants to disclose all

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[14] *Concept Release* at 23944 ("For example, electronic gaming or social media companies typically discuss their numbers of monthly active users; numbers of unique users; numbers of unique payers; and other metrics relating to usage. Software service companies typically discuss their numbers of subscribers; customer renewal rates; and customer retention rates. Hospitals typically discuss their numbers of admissions; numbers of beds; the average length of inpatient stays; and occupancy rates.")

performance metrics and other key variables, or even a defined set of metrics. Requiring registrants to disclose *all* relevant key indicators and business drivers would be so expansive as to provide information that could easily confuse investors, rather than provide information to evaluate the investment quality of a registrant. This is especially true for key performance indicators similar to those referenced in the *Concept Release*[15] that have no uniform definition.

For example, the *Concept Release* noted that "[r]etailers typically discuss comparable store sales, sales per square foot or gross merchandise value."[16] Many retail shopping centers are owned by REITs and "tenant sales per square foot" *may, in some instances,* be a useful metric to illustrate REIT operating results. However, not all retailers, retail centers, nor shopping center REITs, compile this data and/or calculate this metric, and among those who do, there is considerable variation, because it does not have a standardized definition. As a result, comparisons among retailers and /or among shopping center REITs could prove misleading to investors.

Similarly, real estate companies that operate as REITs generally report NAREIT FFO which, as noted above, is widely accepted as a standardized industry-wide performance measure and facilitates transparency and comparability. On the other hand, requirements specifying the disclosure of some, or all, business drivers that impact the calculation FFO, many of which are not uniformly defined, would be similarly confusing and possibly misleading.

Critical Accounting Estimates

Needless to say, critical accounting estimates and the disclosures related to them may represent important information to investors. However, disclosure of critical accounting estimates should be guided by materiality and should be Principles-based. In undertaking reform, NAREIT urges the SEC to coordinate with the FASB to integrate current SEC and FASB requirements, which are now often duplicative.

NAREIT agrees that the SEC should also clarify the disclosure objectives related to critical accounting estimates in MD&A and should also refine the definition of "critical accounting policies" to ensure that only significant accounting policies in financial statements that provide distinct and useful information to investors are disclosed (Q. 138).

NAREIT agrees that there is often duplication in the disclosure of accounting estimates and policies and suggests that the SEC consider rule changes to permit or require cross referencing, which would reduce repetition between MD&A and the notes to the financial statements. Alternatively, the SEC could permit registrants to post a comprehensive listing of accounting policies on a company's website, with cross referencing through hyperlinks. Companies could update accounting policies as new standards are issued (Q. 139).

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[15] *Id*.
[16] *Id*.

III. Risk and Risk Management

Risk Factor Disclosure

The *Concept Release* requests comment on Items 305 and 503(c) of Regulation S-K, relating to risk factor disclosure and disclosures about market risk, as well as the overall approach to risk management and risk management processes. NAREIT agrees with many of the comments from other registrants, as reported in the *Concept Release,* that risk factor disclosure has become so voluminous that material information is often obscured. NAREIT also agrees with observations by SEC Chair White, among others, suggesting that "disclosure overload" can be motivated by liability concerns, possibly exacerbated by the *Private Securities Litigation Reform Act of 1995* (*PSLRA*).[17]

NAREIT recommends that reform of risk factor disclosure should follow a Principles-based approach, focused exclusively on risks that are material to an understanding a *specific registrant's business,* rather than risks "common to an industry or to registrants in general" (Q. 149). Specifically,

- NAREIT largely supports the recommendation set forth in the *SEC 2013 Staff Report,* suggesting that the consolidation of "requirements relating to risk factors, legal proceedings and other quantitative and qualitative information about risk and risk management into a single requirement."[18]
- NAREIT agrees with the suggestion included in the *Concept Release* that it could be helpful if the SEC, from time to time, issued guidance specifying risks it considers to be generic to all registrants that are *not* required to be disclosed (Q. 150).
- NAREIT disagrees with several other suggestions mentioned in the *Concept Release*. Specifically, we disagree that "each risk factor be accompanied by a specific discussion of how the registrant is addressing the risk" (Q. 145). Similarly, NAREIT does not agree that the SEC should require registrants to discuss the probability of occurrence and the effect on performance for each risk factor (Q. 146), or that it should require registrants to "identify and disclose in order their ten most significant risk factors without limiting the total number of risk factors disclosed"(Q. 147). NAREIT tends to believe that this kind of reporting would be speculative, pose liability risk and provide little value to investors.

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[17] SEC Chairman Mary Jo White, *The Path Forward on Disclosure remarks at the National Association of Corporate Directors - Leadership Conference (Oct. 15, 2013)* available at https://www.sec.gov/News/Speech/Detail/Speech/1370539878806 .
[18] *SEC 2013 Staff Report* at 99.

Forward Looking Statements--Safe Harbor Provisions

NAREIT strongly believes that the safe harbor provisions of the *PSLRA* [19] have been beneficial to REITs and their investors and have succeeded in promoting the provision of material forward-looking information to investors. We urge the SEC to ensure that any recommendations for streamlining risk factor disclosure requirements do not result in unnecessarily increasing liability exposure for registrants.

IV. Disclosure of Information Relating to Public Policy and Sustainability Matters

REITs, as a group, are highly focused on operating their properties sustainably and committed to conserving energy and other scarce resources. Moreover, many REITs have long records of leadership roles on sustainability matters.[20] Several listed REITs are among *Fortune* 100 pioneers in releasing comprehensive sustainability data and information to the public in the form of annual sustainability reports, or by periodic website updates.[21] However, NAREIT believes that the existing standard of materiality coupled with the current disclosure framework is adequate and sufficiently flexible to enable REITs to disclose material sustainability information to their investors. Most importantly, NAREIT opposes any attempt by the SEC to adopt additional detailed, prescriptive sustainability disclosure requirements.

Just as real estate assets vary considerably across the REIT sector, across geographies and business models, so, too, do appropriate and successful REIT sustainability efforts. The same energy conservation strategies and measurement tools are unlikely to work for a New York City medical center and a shopping center in Duluth. The age, location, utility infrastructure and configuration of local government services will often influence, or limit, viable REIT sustainable strategies. Correspondingly, our members have told us that their investors do not uniformly seek detailed information regarding environmental matters and that those who do appropriately seek distinct information from say, a lodging REIT, than from a higher energy-use data center REIT, or from a multifamily REIT. In other words, "one size does not fit all," even within the REIT sector.

Nevertheless, most NAREIT members readily endorse the value of developing some voluntary standard metrics of comparability regarding energy use and sustainable performance for real

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[19] 15 U.S. Code 77z–2 - Application of safe harbor for forward-looking statement.
[20] Several U.S. REITs have been named ENERGY STAR®. "Partner of the Year**"** by the U.S. Environmental Protection Agency (EPA) since the program's inception, including (but not limited to) Simon Properties, Macerich, AvalonBay Communities, Inc., Boston Properties, Inc., Kilroy Realty Corporation, Prologis, HCP., Inc., Vornado Realty Trust, Hersha Hospitality Trust, and SL Green Realty Corp. The CDP (formerly the "Carbon Disclosure Project") has also recognized several U.S. REITs for efforts toward addressing climate change, including Host Hotels & Resorts, Inc., Macerich and **S**imon Property Group in 2015.
[21] Vosilla, Behrendt and Hanson**,** *State of the Industry: Sustainability Reporting in the REIT Sector – 2016 Update* (2016) available at http://www.usgbc.org/resources/state-industry-sustainability-reporting-reit-sector-%E2%80%93-2016-update.

property assets and believe such metrics increasingly contribute to a vibrant global property market for tenants and investors alike. For this reason, some NAREIT members have, for many years, voluntarily participated in the *Global Real Estate Sustainability Benchmark* (*GRESB*) assessment.[22] *GRESB,* a unit of *The Green Building Certification Institute (GBCI),*[23] is an industry-driven organization, based in the Netherlands, committed to assessing the environmental, social, and governance (ESG) performance of real assets globally, including the performance of real estate portfolios and infrastructure assets. In 2015, 707 property companies and funds participated in the *GRESB* annual survey. The *GRESB* database covers 49,000 assets in 46 countries.[24] Organizations, such as the Global Reporting Initiative (GRI)[25] and the Sustainability Accounting Standards Board (SASB) have drawn heavily on GRESB research and in some cases have adopted its metrics.[26]

Today, many REITs already determine that certain information about their sustainability practices and/or related status of their real property assets is useful to investors and accordingly provide this information in their '34 Act reports. Also, as noted above, many REITs publish comprehensive corporate sustainability reports and/ or post this information on their websites, or on social media. Some do both and much more. In any event, NAREIT believes that a "one size fits all approach" to sustainability reporting is not appropriate. Some NAREIT members have voiced skepticism that placing detailed prescriptive reporting requirements into the '34 Act would lead to incremental conservation gains for the REIT sector.

NAREIT is generally comfortable that the existing standard of materiality coupled with the current SEC public company disclosure framework provides the flexibility to disclose material sustainability information to investors. We believe that REITs are in the best position to determine whether particular sustainability information is material to investors and whether it should be disclosed. In this regard, it is noteworthy that REITs as a group report high levels of engagement with investors. Several of our members recounted instances when shareholders have

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[22] *See, e.g.,2015 GRESB Report* (September 2, 2015), available at https://www.gresb.com/results2015/downloads.
[23] GBCI is a third-party organization that provides independent oversight of professional credentialing and project certification programs related to green building. GBCI is committed to ensuring precision in the design, development and implementation of measurement processes for green building performance (through project certification) and green building practice (through professional credentials and certificates). *See*, http://www.gbci.org .
[24] *Id*.
[25] GRI reports that it is currently partnering with GRESB in developing construction and real estate reporting tools, *See*, *e.g*., https://www.globalreporting.org/standards/sector-guidance/sector-guidance/construction-and-real-estate/Pages/Reporting-Tools.aspx.
[26] SASB's *Research Brief, Real Estate Owners Developers and Investment Trus*ts (March 2016), draws heavily on GRESB data, available at http://www.sasb.org/approach/our-process/industry-briefs/infrastructure-sector-industry-briefs/. According to its press release, SASB's recently-issued provisional Sustainability Standards for the Real Estate Sector "leverage[s] the industry-specific and widely used GRESB Real Estate Assessment. Over 75% of the quantitative metrics contained in the SASB standard are aligned with GRESB or require no additional data collection," available at http://www.prnewswire.com/news-releases/sasb-issues-provisional-sustainability-accounting-standards-for-infrastructure-sector-300243040.html.

requested and have been readily provided with additional sustainability information. We also note that all investors have the option of submitting shareholder proposals to promote particular sustainability practices by particular firms if they have unmet needs.

Voluntary Sustainability Reporting Frameworks

The *Concept Release* notes that "several organizations have published or are working on sustainability reporting frameworks" (Q. 219). Not all NAREIT members are familiar with these frameworks, many of which are in early stages, although about a dozen NAREIT members participated in recent outreach sponsored by SASB's Industry Working Group for the Infrastructure Sector.[27] Those who are familiar with them report a range of opinions, although relatively few have detailed knowledge of the relative merits of the alternative approaches. NAREIT does not believe that it would be helpful for the SEC to preempt these private efforts or to adopt and codify any one of them, or even to codify more than one of them into Regulation S-K at this time. We believe that voluntary standards are inherently more flexible and easier to update and adapt to new facts and investor demands than federal agency rules promulgated under the *Administrative Procedures Act*.

Costs and Burdens

Moreover, there are significant costs associated with the collection, analysis, validation and management of the data that would be required by some of the sustainability frameworks referenced in the *Concept Release*, which may impose a burden on many businesses, including REITs. In recent outreach to our members, 78% of the respondents indicated that that they would likely need to implement costly new procedures and/or systems to compile and report the type of information required by these frameworks. Many companies would be required to upgrade equipment and/or acquire additional technology to capture and track data and also add additional staff to monitor performance and analyze results. Some of these frameworks would require firms to arrange costly third-party data verification. Additionally, the capture of additional reportable tenant information, as proposed by some reporting frameworks, may not be feasible for all property categories and when it is possible could add substantially to these costs estimates.[28]

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[27] The roster of participants in the activities of SASB's Infrastructure Sector Task Force is available at http://www.sasb.org/sectors/infrastructure/. NAREIT also submitted comments to SASB's Infrastructure Sector Task Force. *See*, https://www.reit.com/advocacy/policy/other-federal-legislation/sustainability-green-initiatives.
[28] RealFoundations, a professional services firm focused on the real estate industry that was retained by NAREIT estimated that the costs for an average property portfolio (containing 200 commercial assets) to implement a system capable of managing and reporting the type of data required by many of these types of sustainability frameworks would exceed $1 million and that operational expenses associated with system data collection, normalization, monitoring and reporting may add an additional 20-40% of system purchase and installation costs on an annual basis. *See*, www.realfoundations.net.

V. Company Websites and Social Media for Non-Financial Information

As the *Concept Release* acknowledges, "some registrants already provide information about ESG matters in sustainability corporate social responsibility reports or on their websites" and NAREIT members are a category of registrants that make excellent use of their corporate websites for information about sustainability, corporate responsibility and other ESG-related information.

Questions 307-317 of the *Concept Release* pose a series of questions about the use of company websites in the SEC disclosure regime, including whether there are categories of business or financial information that the SEC should permit registrants to disclose by posting on their websites in lieu of including in their periodic reports (Q. 312)." NAREIT members increasingly seek avenues outside '34 Act reports, including websites and social media, to communicate a variety of kinds of non-financial information to investors—updates about sustainability efforts being only one example. Much of this information is not "material" in the '34 Act sense, but may be of interest or value to investors and others. Some REIT members have suggested that if there were a mechanism outside'34 Act reporting that permitted the dissemination of a range of non-financial information without increasing liability concerns,[29] the value of'34 Act reports (likely streamlined) would be enhanced. In undertaking disclosure reform, NAREIT urges the SEC to consider ways in which REITs and other businesses may more readily furnish such non-financial information, whether ESG or otherwise, outside of '34 Act filings.

VI. Frequency of Interim Reporting

The *Concept Release* poses a series of questions regarding the frequency of '34 Act periodic reports and asks if the SEC should allow certain categories of registrants to file periodic reports on a less frequent basis, such as semi-annually, and if so, what these categories of registrants should be and what disclosure should be provided.

Some NAREIT members believe that "short-termism," incentivized by quarterly reporting, is a problem for U.S. businesses and capital markets generally, including for the REIT sector. Accordingly, these members have suggested that it would be beneficial if SEC disclosure reform efforts include a thorough analysis of the relative merits of a semi-annual reporting regime, such as has been adopted in other jurisdictions, as well as of other options, such as the suggestion put forth the *Concept Release* that the SEC permit abbreviated reporting for the first and third quarters of each year (Q. 282).

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[29] In this regard, we acknowledge that corporate website content is appropriately subject to the anti-fraud provisions of the '34 Act. Less clear is the application of the safe harbor provisions of the *PSLRA* to such non-financial disclosures. Some have suggested that the safe harbor provisions currently apply to certain sustainability disclosures and others have suggested that it would be beneficial if the SEC clarified the extent of coverage.

VII. Conclusion

NAREIT and its members have a long-time commitment to investing in efforts to serve the needs of REIT investors and appreciate this opportunity to participate in the SEC's Disclosure Effectiveness Initiative by submitting these comments. NAREIT believes that a Principles-based disclosure framework that provides REITs as publicly traded real estate companies and other registrants with the flexibility to communicate company-specific, material information to investors in an accessible form best serves investors. In reworking its disclosure framework to serve the needs of the 21st century investor community, NAREIT urges the SEC to propose Principles-based rule changes to Regulation S-K and to resist pressures to develop prescriptive rules mandating specific disclosures of either financial or non-financial information.

We would be happy to discuss these comments at any time. Please feel free to contact me at (202) 739-9431, or vrostow@nareit.com; or any of the following NAREIT professionals: Tony M. Edwards, EVP & General Counsel (tedwards@nareit.com); Sheldon M. Groner, EVP, Finance & Operations, (sgroner@nareit.com); George Yungmann, SVP, Financial Standards (gyungmann@nareit.com); or Christopher Drula, VP, Financial Standards (cdrula@nareit.com).

Respectfully submitted,

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NAREIT

NATIONAL

ASSOCIATION

OF

REAL ESTATE

INVESTMENT

TRUSTS®

October 28, 2016

Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Delivered Electronically

Re: Proposed Rule on Disclosure Update and Simplification; 17 CFR Parts 210, 229, 230, 239, 240, 249, and 274; Release No. 33-10110, 34-78310; IC-32175; File No. S7-15-16; RIN 3235-AL82

Dear Mr. Fields:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) in response to the Securities and Exchange Commission's (SEC) Proposed Rule on *Disclosure Update and Simplification (17 CFR Parts 210, 229, 230, 239, 240, 249, and 274; Release No. 33-10110, 34-78310; IC-32175; File No. S7-15-16; RIN 3235-AL82)* (the Proposed Rule or Proposal).

NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other businesses throughout the world that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service those businesses.

REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs acquire, develop, lease and operate income-producing real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT All REITs Index, which covers both Equity REITs and Mortgage REITs. This Index contains 221 companies representing an equity market capitalization of $1.052 trillion as of September 30, 2016. Of these companies, 181 were Equity REITs representing 94.5% of total U.S. listed REIT equity market capitalization (amounting to $994

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billion)[1]. The remainder, as of September 30, 2016, was 40 publicly traded Mortgage REITs with a combined equity market capitalization of $58 billion.

NAREIT and its members have long understood the critical importance of communicating accurate and material business and financial information to REIT investors and appreciate the opportunity to participate in this phase of the SEC's Disclosure Effectiveness Initiative. NAREIT fundamentally believes that eliminating redundant and outdated disclosure requirements improves the effectiveness and usefulness of the information presented to investors and analysts while also decreasing the costs of preparing that information, which ultimately benefits shareholders.

To that end on July 21, 2016, NAREIT submitted a comment letter responding to the SEC's *Concept Release on Business and Financial Disclosure Required by Regulation S-K.* In NAREIT's July 21, 2016 comment letter we emphasized that NAREIT strongly believes that materiality, as evaluated through the eyes of a "reasonable investor" under the prevailing Supreme Court[2] standard, should continue to be the guidepost of the SEC's disclosure regime and that we believe that a "Principles-based" approach to disclosure is best suited to the constantly evolving business environment in which REITs and other businesses operate.

NAREIT's comment letter on the Proposed Rule was developed by a task force of NAREIT members, including members of NAREIT's Best Financial Practices Council. Members of the task force include financial executives of both Equity and Mortgage REITs, representatives of major accounting firms, institutional investors and industry analysts.

In analyzing the Proposed Rule, NAREIT considered the following guiding principles that we suggest should guide the SEC's efforts to update and simplify SEC disclosures:

- Simplification efforts should rigorously maintain the long-standing distinction between historical information and forward-looking disclosures. Forward-looking information (subject to safe-harbor protections) should continue to be set forth in Management's Discussion and Analysis (MD&A) and historical data and related disclosures should be reported in the footnotes to the annual or interim financial statements;

- The SEC should maintain the existing division of oversight duties between the FASB and the SEC by maintaining the FASB's role in developing accounting standards and related disclosure guidance for financial statements and the SEC's charge of developing and reviewing MD&A disclosure requirements;

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[1] https://www.reit.com/sites/default/files/returns/FNUSIC2016.pdf.
[2] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) at 449.

- We endorse efforts to reduce repetitive disclosures in annual and quarterly reports and urge the SEC and FASB to coordinate efforts to ensure that interim disclosures - both in MD&A and in the notes to the financial statements - do not simply repeat annual disclosures, absent a material change; and,

- We urge the SEC to develop and implement an ongoing systematic process (such as FASB's current process) to comprehensively identify and eliminate outdated or redundant disclosure requirements, at regular intervals or upon the issuance of new requirements.

The following is a discussion of NAREIT's recommendations on the Proposed Rule that are relevant to REITs. Our comments below are keyed to the relevant sections of the Proposal, which are referenced by citations in parentheticals

1. Overlapping Requirements - Proposed Deletions (Proposal, Section III, C)

a. REIT Disclosures (Proposal, Section III, C, 1)

i. Undistributed Gains or Losses on the Sale of Properties

NAREIT supports the Proposed Rule's suggestion to delete Rule 3-15(a)(2) of Regulation S-X. NAREIT agrees that Regulation S-X's current requirement that REITs present undistributed gains or losses on the sale of properties on a book basis does not provide meaningful information to investors. Based on discussions with REIT analysts and investors, the disclosures required by Rule 3-15(c) of Regulation S-X of the tax status of distributions provide users of financial statements with the information they need.

ii. Status as a REIT

NAREIT concurs with the Proposed Rule's conclusion that Regulation S-K and Regulation S-X currently contain overlapping disclosure requirements about an issuer's status as a REIT. NAREIT observes that issuers typically repeat the disclosures of REIT status. We further note that U.S. GAAP, in ASC Topic 740, also requires disclosure when an entity is not subject to entity level income taxes because its income is taxed directly to its owners. Therefore, NAREIT supports the SEC's proposal to eliminate Rule 3-15(b) of Regulation S-X. In our view, deletion of the requirement to disclose the entity's REIT status and the principal assumptions that underlie the decisions regarding the applicability of federal income taxes in the financial statements would not result in a material change in the disclosures provided by REITs, as this information is presented elsewhere in a Form 10-K or registration statement.

b. Ratio of Earnings to Fixed Charges (Proposal, Section III, C, 18)

NAREIT concurs with the suggestion set forth in the Proposed Rule to delete the requirement to disclose the historical and pro forma ratios of Earnings to Fixed Charges. Given the often large depreciation charges for REITs and real estate companies, the ratio does not provide meaningful information to investors. In the event that investors are interested in the ratio, NAREIT understands that the financial statements currently disclose many of the components of this ratio, allowing investors to compute this metric. In addition, NAREIT notes that this specific metric predates many of the other ratios, analytical tools and sophisticated financial models that currently are at the financial statement users' disposal and readily calculated based on information in the financial statements. Therefore, NAREIT does not see a continued need for the SEC to require this narrowly focused metric.

2. Overlapping Requirements – Potential Modifications, Eliminations, or FASB Referrals (Proposal, Section III, E)

a. REIT Disclosures – Tax Status of Distributions (Proposal, Section III, E, 1)

NAREIT suggests that the SEC eliminate the requirement in Rule 3-15(c) of Regulation S-K for REITs to disclose the tax status of distributions as ordinary income, capital gain, or return of capital. This information is provided to shareholders in Form 1099 much earlier than when the Form 10-Ks are filed with the SEC. Additionally, this information is communicated to the general public on NAREIT's website. Therefore, NAREIT does not believe that duplicative disclosure is necessary.

b. Legal Proceedings (Proposal, Section III, E, 15)

As noted in the Proposed Rule, issuers frequently repeat or reference the disclosures required by Regulation S-K Item 103 ("Item 103") in their historical financial statements. However, the Proposed Rule also acknowledges that there are several differences in the criteria set forth in Regulation S-K and U.S. GAAP for disclosing legal proceedings. Although NAREIT generally favors streamlining overlapping reporting requirements, we do not believe it would be appropriate to incorporate the requirements of Item 103 into the footnotes to the U.S. GAAP financial statements. In this circumstance, we believe there are different objectives for the respective disclosures, objectives that are best achieved by the existing rules. Further, while it is appropriate for the financial statement disclosures to be covered by the audit opinion of an issuer's independent auditor, NAREIT believes it would be unnecessarily burdensome and costly to expand that audit requirement to address the incremental information required by Item 103 if it was relocated to the financial statements.

As noted in the Proposed Rule, there are many differences between the two disclosure regimes in this regard. For example, Regulation S-K, which focuses on the factual information investors may reasonably require to make an informed investment decision, logically may require an array

of fact-specific material qualitative information regarding legal proceedings, including factual bases and timing of legal actions, and information regarding courts, agencies, parties and allegations. Regulation S-K also exempts some ordinary routine litigation from disclosure, which may not be material. U.S. GAAP, which is concerned with material financial statement consequences of legal proceedings, necessarily applies a different framework to requiring disclosure. As catalogued in the Proposed Rule, Regulation S-K and U.S. GAAP also have different standards of materiality, with Regulation S-K having quantitative disclosure thresholds for certain matters. Relocating Item 103 disclosures into the historical financial statements would subject factual information that may not have direct financial consequences to audit or review, internal controls and XBRL requirements, as well as place it outside the safe harbor protections of the Private Securities Litigation Reform Act of 1995

For these reasons, NAREIT does not believe that wholesale relocation of Item 103 disclosures into the historical financial statements would improve the effectiveness of disclosures, or provide meaningful incremental benefit to investors. However, we would encourage the SEC to reconsider the quantitative disclosure thresholds in Item 103 to determine if those bright lines (either in absolute dollars or percentage terms) remain relevant to investors.

3. Superseded Requirements (Proposal, Section V)

Gain or Loss on Sale of Properties by REITs (Proposal, Section V, B 3)

Rule 3-15(a)(1) of Regulation S-X has presented a potential conflict between SEC and U.S. GAAP requirements for some time: the SEC's rule requires all gains and losses on the sale of properties to be presented outside of continuing operations, whereas U.S. GAAP does not permit that presentation unless the properties sold meet the definition of a discontinued operation. That conflict was manageable when most sales of properties met the U.S. GAAP definition of a discontinued operation. However, in 2014 the FASB issued new financial reporting guidance narrowing the definition of a discontinued operation[3]. As a result of the FASB's new definition, NAREIT believes that very few sales of properties by REITs are permitted to be presented outside of continuing operations under U.S. GAAP. This creates a clear and frequently occurring conflict between U.S. GAAP and Rule 3-15(a)(1). Therefore, NAREIT welcomes and fully supports the SEC's proposal to eliminate Rule 3-15(a)(1).

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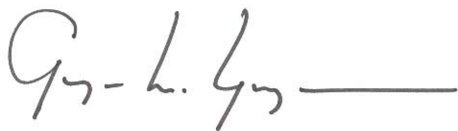
[3]UPDATE NO. 2014-08—PRESENTATION OF FINANCIAL STATEMENTS (TOPIC 205) AND PROPERTY, PLANT, AND EQUIPMENT (TOPIC 360): REPORTING DISCONTINUED OPERATIONS AND DISCLOSURES OF DISPOSALS OF COMPONENTS OF AN ENTITY (April 2014).

We thank the SEC for the opportunity to comment on the Proposed Rule. If you would like to discuss our views in greater detail, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at gyungmann@nareit.com or 1-202-739-9432, Victoria Rostow, NAREIT's Senior Vice President, Policy & Regulatory Affairs, at vrostow@nareit.com or 1-202-739-9431, or Christopher T. Drula, NAREIT's Vice President, Financial Standards, at cdrula@nareit.comor 1-202-739- 9442.

Respectfully submitted,



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Real Estate Alert

Non-GAAP financial measures – a focus on publically registered real estate companies

Why are we talking about non-GAAP financial measures?

There has been a great deal of focus recently on non-GAAP financial measures, primarily through speeches and other public comments made by the SEC staff at conferences and through other forms of media. These comments have not been limited to the typical sources of accounting and reporting commentary (e.g., Division of Corporate Finance or the Office of the Chief Accountant) as even Mary Jo White, Chair of the SEC, has made comments on non-GAAP financial measures over the past year, including at the 2015 AICPA National Conference on Current SEC and PCAOB Developments.

Given their importance among publically-registered real estate companies, non-GAAP financial measures were also one of the featured topics at NAREIT's 2016 REITWise conference, most notably during the Future of Financial Reporting session, which featured Wes Bricker, Deputy Chief Accountant of the SEC, and Russ Golden, Chair of the FASB.

Registrants across the real estate industry continue to receive comments from the SEC's Division of Corporate Finance related to the presentation of non-GAAP financial measures, including inquiries on the adequacy of disclosures around the comparability of non-GAAP financial measures to those used by peers, the prominence with which non-GAAP financial measures presented, and the usefulness of the non-GAAP financial measures presented. On May 17, 2016, the SEC staff issued new Compliance and Disclosure Interpretations (CDI) on non-GAAP financial measures, which provide clarifying guidance and examples in areas of frequent SEC staff comment, including non-GAAP presentations that are misleading or presented with greater prominence than the comparable GAAP measures. As such, the comments received from the SEC's Division of Corporate Finance are not expected to become less frequent in the near future.

What is a non-GAAP financial measure?

To level set, non-GAAP financial measures are numerical measures derived by adjusting the most directly comparable GAAP measure. Publically-listed real estate companies often present non-GAAP financial measures in their MD&A, earnings releases, and other public communications to provide investors and other constituents with insight into its business and performance not otherwise attainable by GAAP measures. From a regulatory perspective, non-GAAP financial measures are governed by SEC regulations, specifically:

- Regulation G governs all public disclosures and communications that contain non-GAAP financial measures by any registrant, including press releases, investor presentations, and conference calls;
- Item 2.02 of Form 8-K governs earnings releases; and
- Item 10(e) of Regulation S-K governs all filings with the SEC under the Securities Act or Exchange Act.

While publically-registered real estate companies use a variety of non-GAAP financial measures, there are a few that are tailored to real estate investments trusts (REITs), most notably:

- Funds from Operations (FFO), as defined by the National Association of Real Estate Investments Trusts (NAREIT) and applicable to all publically registered REITs. FFO is defined by NAREIT as net income (computed in accordance with GAAP), adjusted to exclude gains or losses from sales of real estate properties, impairment charges and depreciation and amortization from real estate assets, and similar adjustments for unconsolidated investees.

- Adjusted FFO (AFFO). AFFO is not a standardized non-GAAP financial measure, but it is commonly presented by publically registered REITs. AFFO is generally comprised of company-specific adjustments to FFO (as defined by NAREIT) to exclude certain non-recurring or non-cash items, such as share-based compensation charges and straight-line rent adjustments. Similar adjustments are typically made for non-recurring or non-cash items of unconsolidated investees.

- Modified FFO (MFFO), as defined by the Investment Program Association (IPA) and applicable to publicly registered, non-listed REITs. MFFO is defined by the IPA as FFO (as defined by NAREIT), adjusted for a number of non-recurring or non-cash items, such as acquisition fees, straight-line rent adjustments, amortization of above or below intangible lease assets and liabilities, and similar adjustments for unconsolidated investees.

In addition to these REIT-specific non-GAAP financial measures, there are other non-GAAP financial measures commonly used by publically-registered real estate companies, including:

- Net Operating Income (NOI)

- Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)

- Adjusted EBITDA

What's changed with the issuance of the CDI on non-GAAP financial measures?

The CDI does not change the SEC's rules and regulations around non-GAAP financial measures. However, it is important for publically-registered real estate companies to consider the SEC's interpretive guidance.

In the CDI, the SEC staff cautions preparers against certain adjustments in deriving non-GAAP financial measures that could violate Regulation G, including:

- Presenting a performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business;

- Presenting non-GAAP financial measures inconsistently between periods without disclosing the change and the reasons for it;

- Presenting non-GAAP financial measures that exclude non-recurring charges but do not exclude non-recurring gains; and

- Presenting non-GAAP measures that substitute tailored revenue policies for those that comply with GAAP.

The SEC staff also cautions preparers against certain non-GAAP financial measure presentations that could lead to the non-GAAP financial measure being disclosed more prominently than the comparative GAAP measure, which could violate Item 10(e) of Regulation S-K, including:

- Providing a discussion and analysis of a non-GAAP financial measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence;

- 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;

- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP financial measures;

- Presenting a non-GAAP financial measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP financial measure over the comparable GAAP measure; and

- Presenting a non-GAAP financial measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption).

Finally, the SEC staff provided the following interpretive guidance related to FFO specifically:

- The SEC staff confirmed that FFO, as discussed in Footnote 50 to its *Final Rule on Conditions for Use of Non-GAAP Financial Measures*, is meant to be FFO as defined by NAREIT. Footnote 50 states that companies may use FFO per share in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G, Item 2.02 of Form 8-K, and Item 10(e) of Regulation S-K. Further, the SEC staff confirmed that they continue to accept NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis.

- The SEC staff confirmed that a registrant may present FFO on a basis other than as defined by NAREIT, provided that any adjustments comply with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. The SEC staff highlighted that certain adjustments might preclude a registrant from presenting the performance measure on a per share basis.

What does this mean for publically registered real estate companies?

The impact of the recent focus on non-GAAP financial measures, including the issuance of the CDI, on publically registered real estate companies depends on the non-GAAP financial measures they choose to present.

What types of adjustments are appropriate when presenting non-GAAP financial measures?

The SEC staff continues to support the presentation of FFO both when it is presented in accordance with NAREIT's definition and when adjustments are in compliance with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. When presenting MFFO or AFFO, or any other non-GAAP financial measure, such as NOI or EBITDA, companies should continue to consider whether the non-GAAP financial measure could be misleading or is provided with undue prominence. Further, companies should carefully evaluate the nature of the adjustments to ensure:

- Charges that represent normal, recurring costs of running their business are not excluded;

- The items being excluded are consistent from period-to-period;

- Non-recurring charges are not excluded without excluding non-recurring income when both existed during the period or in comparable periods; and

- Excluded items are not labelled as "non-recurring" when they have occurred in recent prior periods or are expected to recur in near-term future periods.

Can non-GAAP financial measures be presented on a per share basis?

Non-GAAP financial measures that are used as liquidity measures are prohibited from being presented on a per share basis. The SEC staff continues to support FFO calculated based on NAREIT's definition as a performance measure, in which case the presentation of FFO is permitted. When presenting other non-GAAP financial measures, including MFFO and AFFO, companies should carefully assess the nature of the adjustments to determine if the resulting non-GAAP measure represents a liquidity measure rather than a performance measure. For example, the SEC staff prohibits the presentation of EBITDA on a per share basis as they view it to represent a liquidity measure.

Should companies maintain internal controls over non-GAAP financial measures?

All publically registered real estate companies that present non-GAAP financial measures should ensure they have appropriately designed internal controls over the creation and reporting of non-GAAP financial measures. Existing internal controls should be reassessed to ensure they adequately address the risks of presenting non-GAAP financial measures as highlighted in the CDI.

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