

SEC STAFF ISSUES REVISED GUIDANCE ON NON-GAAP FINANCIAL MEASURES

On January 11, 2010, the staff of the Securities and Exchange Commission (SEC) updated its Compliance and Disclosure Interpretations (C&DIs) regarding the disclosure of non-GAAP financial measures.¹ The C&DIs supersede the SEC's Frequently Asked Questions (FAQ) regarding the use of such measures published in 2003 but incorporate much of the SEC's prior guidance.

Use of Non-GAAP Financial Measures

The SEC's rules on the use of non-GAAP financial measures were adopted in January 2003 pursuant to the Sarbanes Oxley Act. The rules are contained in Regulation G and Item 10(e) of Regulation S-K. In recent public speeches, SEC staff indicated that they believe the prior guidance in the 2003 FAQ was more restrictive than what Regulations G and S-K intended, prompting issuance of the new C&DI guidance. The new C&DIs interpret, but do not modify, Regulations G and S-K. Accordingly, disclosures relating to non-GAAP financial measures are still required to be clear and understandable and specific to the registrant, its industry, and the financial measure presented. The key revisions and additions to the guidance are detailed below.

Adjusting for Recurring Items

S-K Item 10(e) 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 means 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 102.03 clarifies that this prohibition is based on the description of the item being adjusted, rather than its nature. In other words, the rule does not prohibit adjustment for recurring items. It prohibits characterizing an item as non-recurring, infrequent or unusual unless it, in fact, meets the specified criteria.





Reconciling Non-GAAP Measures

Two C&DIs were added to clarify that it is not generally appropriate to present a full non-GAAP income statement for purposes of reconciling non-GAAP measurements (C&DI 102.10) and that a registrant may present an adjustment “net of tax” when reconciling a non-GAAP performance measurement (C&DI 102.11). C&DI 102.11 further explains that, when providing “net of tax” information, a registrant should either disclose the tax effect of each reconciling item parenthetically or in a footnote to the reconciliation or present the tax effect in one line in the reconciliation, and that regardless of the format of the presentation, a registrant should disclose how the tax effect was calculated.

Revenue by Product

C&DI 104.05 clarifies that when a registrant discloses revenue by product based on GAAP, it is not necessary for the registrant to sum the revenues to a total that equals the revenue amount presented in the registrant’s financial statements, in order to avoid characterization as a non-GAAP financial measure.

Constant Currency

C&DI 104.06 addresses the situation in which a registrant that has operations in various foreign countries (where the local currency is used to prepare the financial statements which are then translated into the reporting currency under the applicable accounting standards) wants to isolate the effect of exchange rate differences between the periods presented by reporting information in a constant currency—e.g., assuming a constant exchange rate between periods for translation. The CD&I confirms that presenting the constant currency amounts is a non-GAAP measure under Regulation G and S-K Item 10(e). The CD&I further provides that a registrant may comply with the reconciliation requirements of those rules by presenting the historical amounts and the amounts in a constant currency, and describing the process for calculating the constant currency amounts and the basis of presentation.

Foreign Private Issuers

S-K item 10(e)(1)(ii) allows foreign private issuers to include non-GAAP financial measures in filings if it is required or “expressly permitted” by the home country regulatory standard setter. Previously, a specific measure was “expressly permitted” if it was clearly and specifically identified by the home country accounting standards. However, in many cases, home country accounting standard-setters require or

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permit certain measures that are not specified in standards. To address this discrepancy, C&DI 106.01 provides that the concept of “expressly permitted” can also be demonstrated with “explicit acceptance” of the presentation of a non-GAAP measure by the primary securities regulator in the issuer’s home country jurisdiction or market if there is (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.

Continuing Guidance

The SEC staff confirmed prior guidance regarding the prohibition on use of per share non-GAAP liquidity measures, such as cash flow, in documents filed or furnished with the SEC. The new guidance also continues to allow use of a “free cash flow” measure so long as the registrant presents a clear description of how the measure is calculated and reconciled to the GAAP financial measure of cash flows from operating activities.

¹<http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>

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