SQUIRE PATTON BOGGS

Failure to Provide "Equal Prominence" When Using Non-GAAP Measures Results in Fine

SEC Imposes Civil Penalty for Improper Use of Non-GAAP Financial Measures

The Securities and Exchange Commission (SEC) recently demonstrated that it is willing to use its regulatory power against registrants that improperly use Generally Accepted Accounting Principles (GAAP) and non-GAAP financial measures in public disclosures. When a registrant uses a non-GAAP financial measure in a filing with the SEC, the registrant must also include the most directly comparable financial measure calculated in accordance with GAAP presented *with equal or greater prominence* than the non-GAAP figure.

On December 26, 2018, the SEC issued an order requiring a registrant to pay a US$100,000 fine and cease-and-desist with further violations of Section 13(a) of the Securities Exchange Act and Rule 13a-11. The registrant was in violation of Section 13(a) and Rule 13a-11 for failing to comply with Regulation S-K Item 10(e) in two quarterly Earnings Releases.

Registrant Did Not List GAAP Financial Measures with Equal or Greater Prominence

Item 10(e) requires registrants using non-GAAP financial measures in a filing to include "with equal or greater prominence" the "most directly comparable financial measure or measures calculated and presented in accordance with GAAP." In this recent case, the registrant's specific violations included:

- Providing the adjusted EBITDA, adjusted net income and free cash flow items before special items in its FY 2017 Earnings Release and Q1 2018 Earnings Release without providing comparable GAAP financial measures
- The headline of the FY 2017 Earnings Release stating that its adjusted EBITDA was up 8% year-over-year without providing the comparable GAAP financial measure (net income or loss) in the headline
- Listing bullet points in its Q1 2018 Earnings Release including adjusted EBITDA of US$620 million being up 7%, adjusted net income of US$249 million being up 26% and adjusted net income per share of US$0.34 being up 10% under the heading "FIRST QUARTER 2018 HIGHLIGHTS" without including any comparable GAAP financial measures for net income or loss in the section

Interestingly, the registrant was not in violation because it omitted the comparable GAAP financial measures entirely. As the SEC points out, the registrant did list the GAAP net loss in the two different paragraphs of the Q1 2018 Earnings Release. This, however, was not considered "with equal or greater prominence."

SEC Is Focused on Registrants' Use of Non-GAAP Financial Measures

The SEC's strong enforcement action against this registrant is consistent with its recent focus on the use of non-GAAP financial measures. On April 4, 2018, the SEC updated its Compliance & Disclosure Interpretations regarding non-GAAP financial measures. In these interpretations, the SEC provided examples of what would be considered a "more prominent" non-GAAP measure. These examples include:

- A non-GAAP measure preceding the most directly comparable GAAP measure in an earnings release headline or caption
- Presenting a non-GAAP measure in a bold or larger font than the comparable GAAP measure
- Describing a non-GAAP measure as "exceptional" or "record performance" without an equal characterization of the comparable GAAP measure

The SEC's December 26 order evidences the SEC's seriousness in cracking down on the improper use of non-GAAP financial measures.

Our Team is Here to Help You Comply With SEC Regulations

Registrants using non-GAAP financial measures in earnings releases or other SEC filings should take warning from this order and work to comply fully with SEC regulations when drafting filings. For further information relating to the impact of the SEC's December 26, 2018 order, and help with SEC filings, please contact your principal lawyer or any of the lawyers listed in this publication.

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