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SEC Brings Enforcement Proceedings on Non-GAAP Financial Disclosure

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The SEC recently instituted cease and desist proceedings relating to a company's use of non-GAAP financial measures, signaling the agency's continued focus on these disclosures, particularly in public company earnings releases. The case centered on a company's presentation of non-GAAP financial measures in two earnings releases without giving equal or greater prominence to the comparable GAAP financial measure, as required by Item 10(e) of Regulation S-K. The company settled the action, agreeing to pay a civil money penalty of $100,000.

Headlines in the company's earnings releases included Adjusted EBITDA but did not reference net income or loss, which is the most directly comparable GAAP measure. One of the earnings releases also presented "First Quarter 2018 Highlights," listing Adjusted EBITDA (up 7%), Adjusted Net Income (up 26%), and Adjusted Net Income Per Share (up 10%) without mentioning net income or loss. Later in the earnings release, the company reported an increase in its GAAP net loss, from $141 million to $157 million.

When a company presents a non-GAAP financial measure in an SEC filing, Item 10(e) requires the company to include a presentation with equal or greater prominence of the most directly comparable GAAP measure. This requirement applies to earnings releases that are furnished to the SEC on Form 8-K. In 2016, the SEC staff provided clear guidance that omission of comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures would be considered a violation of the prominence requirements in Item 10(e) of Regulation S-K. In practice, any non-GAAP measure that precedes a presentation of the most directly-comparable GAAP measure should be carefully considered for prominence concerns.

It is worth noting that the company's earnings releases at issue in this case presented revenue in the headline along with Adjusted EBITDA. Although revenue is a GAAP measure, it did not satisfy the prominence requirement because it is not the most directly comparable GAAP measure. Unlike the headlines, the GAAP to non-GAAP reconciliations included in the same earnings releases correctly reconciled Adjusted EBITDA to net income or loss.

Take Away

Although staff comments on non-GAAP financial measures generally have declined since 2016, this case serves as a reminder that the SEC remains serious about enforcing its non-GAAP disclosure rules. Companies should avoid the temptation to relax their oversight of non-GAAP disclosure simply because staff comments have been less frequent and have shifted to some of the more challenging aspects of non-GAAP compliance, such as individually tailored accounting measures. Instead, companies should continue to carefully monitor all non-GAAP disclosures – including earnings release headlines and bullet points – to ensure full compliance. SEC staff has been clear that prominence means the comparable GAAP measure must be presented in close proximity to the non-GAAP measure, e.g., within the same headline or adjacent bullet points. It is not sufficient for the comparable GAAP measure to appear elsewhere in the disclosure.

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