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SEC brings enforcement action for violation of “equal or greater prominence” requirement in presentation of non-GAAP financial measures

The SEC’s Division of Enforcement recently instituted cease-and-desist proceedings against a company for violating Section 13(a) of the Exchange Act and Rule 13a-11 by including non-GAAP financial measures in two of its earnings releases without presenting the most directly comparable GAAP financial measures “with equal or greater prominence.” The non-GAAP financial measures, which included adjusted EBITDA and adjusted net income, appeared in the headlines and a highlights section of the earnings releases. The company agreed to pay a US\$100,000 civil money penalty in settlement of the enforcement action.

The SEC’s order in this action is available [here](#).

Presentation of GAAP measures with “equal or greater prominence”

Paragraph (e)(1)(i)(A) of Item 10 of Regulation S-K requires companies disclosing non-GAAP financial measures in SEC filings to present the most directly comparable GAAP financial measure “with equal or greater prominence.” Instruction 2 to Item 2.02 of Form 8-K applies the “equal or greater prominence” requirement to earnings releases and other public announcements furnished to the SEC under Item 2.02.

Before the staff’s issuance in May 2016 of updated interpretive guidance on the use of non-GAAP financial measures, market practice concerning prominence issues had evolved to encompass a wide variety of approaches, particularly in the context of the placement of non-GAAP results in the headlines or captions of earnings releases. In a Compliance and Disclosure Interpretation (CDI) issued as part of the 2016 guidance, the staff included a list of presentations that it considered non-compliant with the “equal or greater prominence” requirement.

Many companies have modified their non-GAAP disclosure practices in response to the guidance.

The staff indicated in the 2016 CDI that 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 then cautioned that, in any circumstance, it “would consider the following examples of disclosure of non-GAAP measures as more prominent” than the comparable GAAP measures and therefore as failing to comply with the “equal or greater prominence” requirement:

- 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 text or a 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 that disclosure with an equally prominent tabular disclosure of the



comparable GAAP measures or including the comparable GAAP measures in the same table; and

- providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location of equal or greater prominence. (Question 102.10)

Enforcement action

In its recent enforcement action, the SEC found that ADT Inc., an NYSE-listed company, had violated the “equal or greater prominence” requirement in two routine earnings releases, each of which the company had furnished under Item 2.02 of Form 8-K.

In an earnings release reporting full year financial results, the company disclosed in the headline its adjusted EBITDA for the recently completed year. The company stated in the headline that this non-GAAP financial measure was up 8 percent year-over-year, without referring to the company’s net income or loss, which is the GAAP financial measure most directly comparable to adjusted EBITDA when used as a performance measure.

In its next quarterly earnings release, the company included a similar headline with the same shortcoming. In addition, the company presented at the top of the first page of the release quarterly “highlights” that included bullet points disclosing quarter-over-quarter changes to non-GAAP financial measures that included adjusted EBITDA, adjusted net income, and adjusted net income per share without providing the most comparable GAAP results. The SEC noted that the company disclosed in the second and sixth full paragraphs of the release – after the highlights section – that its GAAP net loss had increased quarter-over-quarter.

Conclusion

This is the SEC’s first enforcement action regarding non-compliance with the “equal or greater prominence” requirement in Item 10(e). The action might signal SEC concern that companies have become less attentive to this aspect of the 2016 guidance with the passage of time. Some surveys of earnings releases in the quarters immediately following publication of the guidance found a sharp increase in compliance with the “equal or greater prominence” requirement.

The enforcement action indicates more generally that the SEC staff will not be content in all cases to address deficiencies in non-GAAP financial presentations by

directing the company to comply with the SEC’s rules in future filings and public announcements. The action also suggests that non-compliant disclosures could attract enforcement interest even if the presentation of the company’s financial results, taken as a whole, does not appear to the company to provide a materially misleading picture of performance.

In light of this enforcement action, reporting companies should consider whether they may need to modify their non-GAAP presentation practices to ensure compliance with the “equal or greater prominence” requirement and other provisions of Item 10(e).

This SEC Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed on the following page of this update.

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