It’s Time Again for Audit Committees to Mind the Non-GAAP

MARCH 28, 2016

Judging by the frequency of recent news reports and SEC staff speeches focused on non-GAAP financial measures, audit committees may be well served to take a fresh look at the non-GAAP measures reported by their companies and the prominence which those non-GAAP measures are given over GAAP measures.

The most recent SEC staff remarks came from SEC Chief Accountant James Schnurr in a March 22 speech at a life sciences accounting conference. Mr. Schnurr ended his speech, which largely touched on items relating to the transition to the new accounting standard for revenue recognition and on internal controls, by turning to non-GAAP measures, commenting on the SEC staff’s:

- observation of a “troubling increase over the past few years in the use of, and nature of adjustments within, non-GAAP measures by companies”
- concern about the prominence analysts and media give to those non-GAAP measures, noting that “when the financial news networks report quarterly earnings, they very frequently report the non-GAAP measure of earnings with no reference to the actual GAAP earnings, often not even identifying it as having been adjusted”
- concern about the extent and nature of adjustments companies make to their non-GAAP measures that go beyond customary measures such as EBITDA or certain understandable non-recurring items

Mr. Schnurr warned that companies can expect the SEC staff to continue to be “vigilant” during the normal comment letter review process to ensuring full compliance with existing rules regarding use of non-GAAP measures. Perhaps more importantly, however, he encouraged companies to look beyond mere technical compliance:

> The proliferation of non-GAAP reporting measures among registrants, and reliance and reporting by analysts, should warrant increased focus by management and the audit committee. I believe the focus should go beyond determinations that the measures comply with the Commission’s rules and include probing questions on why, in contrast to the GAAP measure, the non-GAAP measure is an appropriate way to measure the company’s performance and is useful to investors. In addition, companies should ensure that the measure is prepared in a manner that includes appropriate controls and oversight procedures.

Mr. Schnurr's speech builds on recent comments in several forums by SEC Chair Mary Jo White, including in December 2015 at the annual AICPA national conference and earlier this month to the US Chamber of Commerce. Press reports of Chair White's comments to the Chamber of Commerce suggest that one item under consideration might be to expand the scope of communications that are subject to the current requirement that GAAP measures be given equal or greater prominence compared to non-GAAP measures. At present, the equal or greater prominence requirement only applies to SEC filings and earnings announcements that must be furnished to the SEC on Form 8-K, not to other public communications.

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