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## SEC Provides Additional Guidance Regarding Non-GAAP Financial Measures

The Securities and Exchange Commission recently provided additional guidance regarding the kinds of non-GAAP (Generally Accepted Accounting Principles) financial measures that may be used by SEC registrants in financial reporting. SEC officials have said recently that examiners will begin to review closely companies' use of non-GAAP measures.

A non-GAAP financial measure is a performance or liquidity measure derived from a GAAP line item by excluding amounts used or including amounts not used in determining the GAAP item. For example, EBITDA (earnings before interest, taxes, depreciation and amortization) is a common non-GAAP financial measure derived by deducting those amounts (interest, taxes, depreciation and amortization) from net income. Generally, if a non-GAAP measure is reported (whether in an SEC report or informally, such as in an earnings release), the SEC requires an explanation of its use and a reconciliation to the GAAP amount. In general, the GAAP measure must be given prominence equal to or greater than that of the related non-GAAP measure. Presentations violating this rule include omitting the comparable GAAP measure from an earnings release headline that includes a non-GAAP measure, using more prominent typeface for a non-GAAP measure than for the comparable GAAP measure, and describing a non-

GAAP measure as a "record" or "exceptional," without an equally prominent description of the comparable GAAP measure.

In no case may a company present any non-GAAP measure that is misleading, and in the new guidance, the SEC gave examples of misleading non-GAAP measures, including:

- A performance measure that excludes normal, recurring cash operating expenses.
- A measure calculated differently between periods, unless the differences are disclosed and explained; in some cases the SEC would require a reconciliation of the amounts from the different periods.
- An individualized method of recognizing or measuring revenue.
- Any per-share liquidity measure, even if management uses the item as a performance measure; for example, EBITDA per share cannot be presented.

Non-GAAP earnings per share amounts are permitted, as are non-GAAP cash flow measures, such as free cash flow (i.e., cash flow from operating activities minus

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capital expenditures). Companies should not present non-GAAP measures “net of tax.” Instead, income taxes should be shown as a separate adjustment. Any non-GAAP measure a company does use must be clearly explained and reconciled to the GAAP measure from which it is derived.

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