

2011 US GAAP & SEC Developments

*Non-GAAP measures in an SEC filing -
Easier than ever?*

Assaf Shemer, partner, Assurance Leader
PwC Israel

January 3rd, 2012

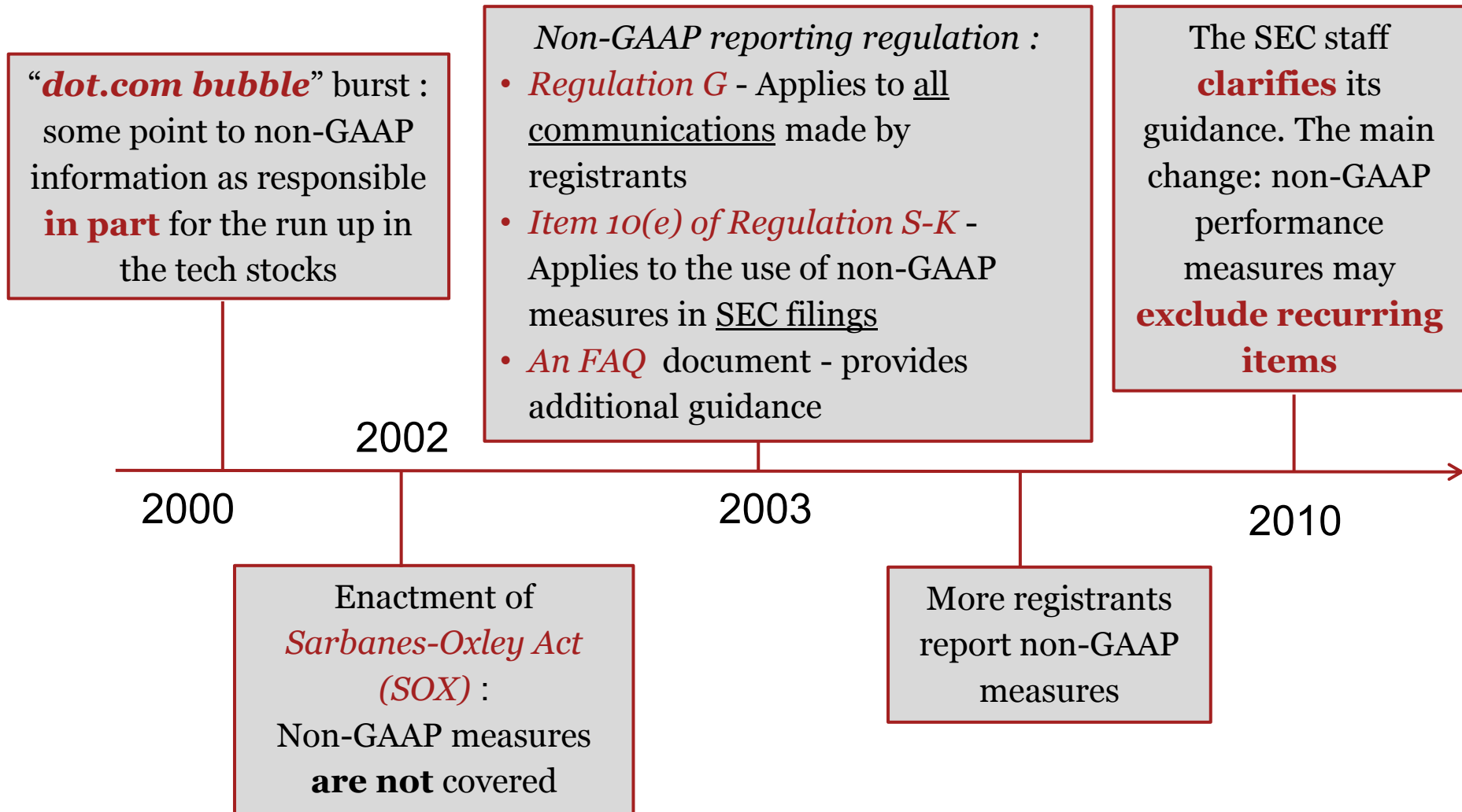
Non-GAAP measures in an SEC filing - Easier than ever?

Definition of non-GAAP measures under Regulation G and Item 10(e) of Regulation S-K

“a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.”

Non-GAAP measures in an SEC filing - Easier than ever?



Non-GAAP measures in an SEC filing - Easier than ever?

In 2003 the SEC staff regulated non-GAAP reporting at two levels:

- **Regulation G** - applies to **all communications** made by registrants and, inter alia, requires that non-GAAP measures be reconciled to the corresponding GAAP measures
- **Item 10(e)** of **Regulation S-K** - applies to the use of non-GAAP measures in SEC filings:
 - a company may not adjust, eliminate or smooth items identified as non-recurring, infrequent or unusual, where the nature of the charge or gain is such that it is reasonably **likely to recur within two years** or there was a similar charge or gain within **the prior two years**
- **An FAQ document** - provides interpretations regarding the Regulation G and Item 10(e) of Regulation S-K



Non-GAAP measures in an SEC filing - Easier than ever?

What happened to non-GAAP reporting pursuant to the 2003 regulations?

- The non-GAAP regulation raised a fundamental problem - it is very difficult to have a rule that **prohibits** disclosure of information!
- As a consequence, in the following years, there was a large volume of non-GAAP financial information that was only disclosed **outside** the SEC filing system (such as press releases and other communications)
- Companies seemed to be concerned that the SEC staff would ask them to remove non-GAAP information from the filing and therefore provided such information elsewhere
- This fact raised the SEC staff concern that the 10-K/20-F filing would become merely a compliance exercise and not a communications document



Non-GAAP measures in an SEC filing - Easier than ever?

The new interpretation provided by the SEC staff in 2010

- In January 2010, the SEC staff **clarified** its interpretive guidance by publishing series of 32 Compliance and Disclosure Interpretations , which **superseded** the 2003 FAQ document
- In the new guidance the staff clarified that there is no “blanket prohibition” on disclosing non-GAAP performance measures that exclude recurring items, as long as the company discloses the **reason for the measure to be useful to investors**, does not label them as “recurring” and otherwise complies with the requirements of Item 10(e)
- The staff retained the definition of a recurring item when there was a similar item during the **prior two years** or when it is reasonably likely that a similar item will arise during the **next two years**

Non-GAAP measures in an SEC filing - Easier than ever?

Is it really THAT simple?

- The SEC staff seems to have come full circle: registrants are now **encouraged** (through comment letters) to include consistent and transparent Non-GAAP measures in their filings
- **However**, though the SEC staff may seem to have “soften” their interpretation to the rules, it should not be viewed as an invitation to **include any and all non-GAAP measures in SEC filings**
- Companies are of course **prohibited** from disclosing a non-GAAP measure that is **misleading** and they must continue to present the most directly comparable GAAP measure with equal or greater prominence, along with a reconciliation between the two
- Companies are still required to disclose **the reason** why the non-GAAP measure provides useful information to investors and any other material ways management uses the measure (if any)
- There is still a need to use a **“boiler-plate”** regarding the limitation of non-GAAP measures as far as comprehensiveness and comparability

Non-GAAP measures in an SEC filing - Easier than ever?

August 2011 - The story of “Groupon” (or: what is ACSOI?)

- **Groupon** filed an IPO registration statement which included a non-GAAP measure referred to as **ACSOI** (Adjusted Consolidated Segments Operating Income).
- ACSOI represents **operating income before online marketing expenses** and Subscribers Acquisition Costs (SAC) which are usually **significant operating expenses** among companies providing Internet marketing services

(Dollars in million)		
Operating income(loss) (GAAP)	ACSOI (non-GAAP)	
(420.3)	60.6	2010
(117.1)	81.6	Q1 2011

Reconciliation between ACSOI and Operating Income (loss):

Operating loss- (420.3)

Marketing Expenses 241.5

SAC 203.2

Share based payment 36.2

ACSOI 60.6

- Management failed to disclose the reason it believes ACSOI provides useful information to investors (as required under Item 10(e) of Regulation S-K)
- The SEC comment read: “We note your use of the non-GAAP measure Adjusted Consolidated Segment Operating Income, which excludes, among other items, online marketing expense. It appears that online marketing expense is a normal, recurring operating cash expenditure of the company. Your removal of this item from your results of operations creates a non-GAAP measure that is potentially misleading to readers. Please revise your non-GAAP measure accordingly. Refer to Rule 100(b) of Regulation G”

Non-GAAP measures in an SEC filing - Easier than ever?

Non-GAAP reporting by the larger Israeli and Israeli-related registrants

	Domestic	Foreign Private Issuers	Total
Total registrant population (TASE 100 index and large non-dual listed co's)	6	16	22
Of which registrants which provided non-GAAP measures	3	14	17

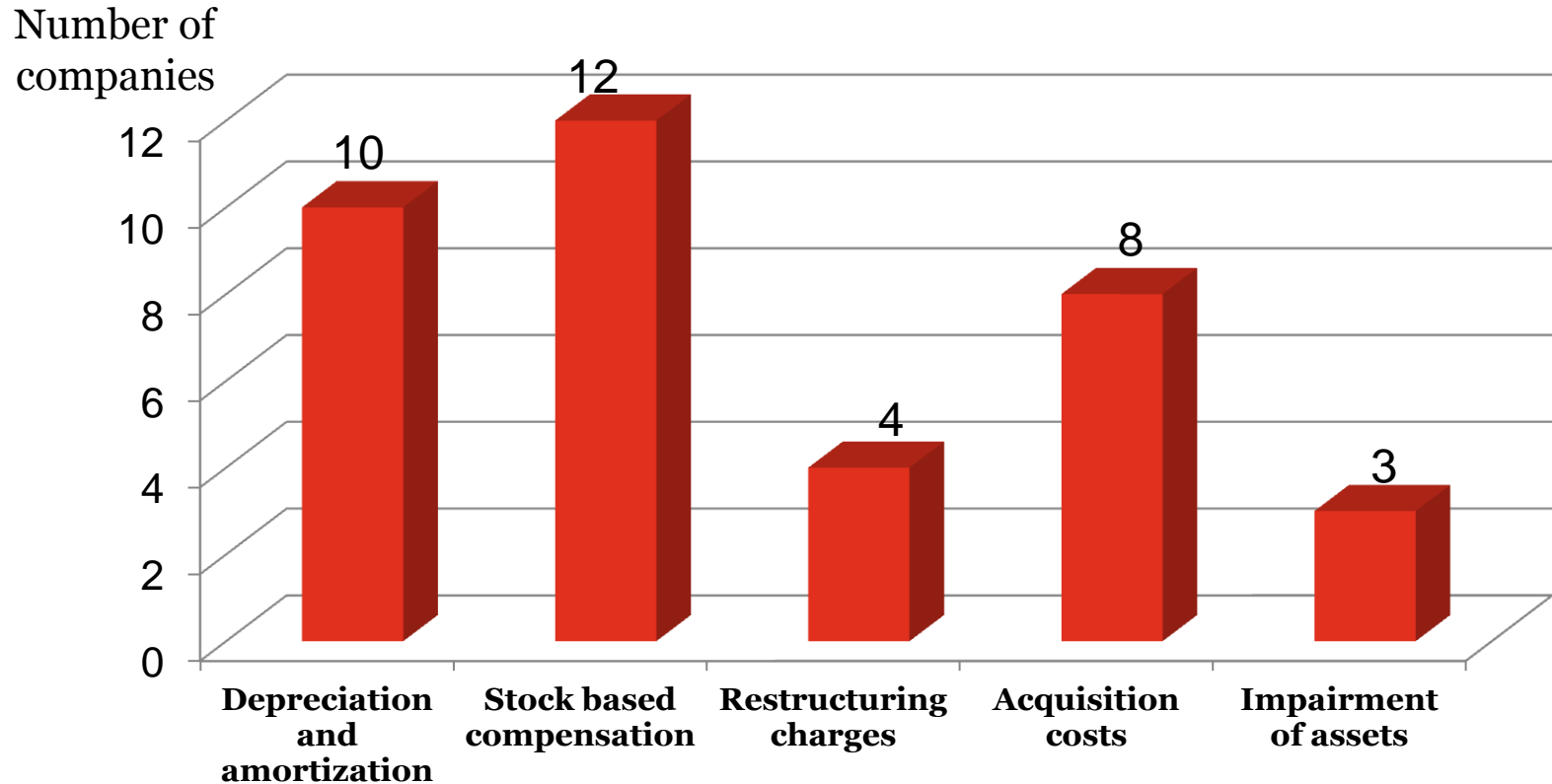
Non-GAAP measure	EBITDA	Non-GAAP operating income (*)	Non-GAAP net income(*)	More than one non-GAAP measure	Total
Number of Companies	3	1	4	9	17

(*) In 2010 both non-GAAP measures reflect an average increase of 60% compared to the respective comparable GAAP measure

Non-GAAP measures in an SEC filing - Easier than ever?

Non-GAAP reporting by the larger Israeli and Israeli-related registrants

Below is a chart of the most common adjustments that were observed





PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 162,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See www.pwc.com for more information.

PwC[®] is the brand under which member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide services. Together, these firms form the PwC network. “ Each firm in the network is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way.

and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information responsibility or ,contained in this publication, and, to the extent permitted by law, Kesselman & Kesselman, its members, employees and agents do not accept or assume any liability .duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it



In this document, “PwC” refers to Kesselman & Kesselman, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

©2010 Kesselman & Kesselman. All rights reserved.