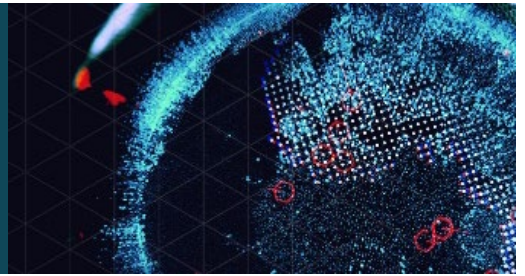


Managing Coronavirus/COVID-19 Non-GAAP Financial Measures and the Impact of COVID-19



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The COVID-19 pandemic continues to present public companies with new regulatory compliance and financial reporting challenges. Adjusting the presentation of GAAP financial measures to take into account COVID-19-related expenses is one such challenge and should be considered carefully in light of the SEC's heightened scrutiny in this area. The SEC's Division of Corporation Finance (the "Division") has provided [disclosure guidance](#) (the "Disclosure Guidance") for companies to consider with respect to the business disruptions caused by COVID-19. This guidance specifically highlights the Division's continued focus on companies' obligations under Item 10 of Regulation S-K and Regulation G with respect to the presentation of non-GAAP financial measures.

This alert discusses non-GAAP practices to be considered in advance of the presentation and disclosure of earnings and financial results for the second quarter of 2020.

1

Adjustments to Existing Non-GAAP Financial Measures

- Disclosure Roadmap. We recommend adding a clear "roadmap" or overview that identifies and describes non-GAAP financial measures that contain adjustments resulting from the impact of COVID-19.
- Introducing a New COVID-19 Expense Category. If a company includes a *new* COVID-19 line item in its non-GAAP reconciliation (e.g., "COVID-19 expenses" or "COVID-19 related costs") and that line item itself encompasses multiple expenses that are part of the non-GAAP adjustment, we recommend clearly defining the COVID-19 line item and outlining which specific material expenses are included within, or excluded from, that category. For instance, this could be done with a footnote that describes specific material costs included within, or excluded from, the COVID-19 expense umbrella.
- Redefining an Existing Expense Category to Include COVID-19 Costs. If a company decides to modify or redefine an *existing* line item in the non-GAAP reconciliation to include COVID-19 expenses (e.g., if "other non-recurring charges" now includes COVID-19 expenses), we recommend adding an explanatory footnote that discloses the inclusion of these expenses and, as noted above, identifies which specific material expenses are included within the COVID-19 umbrella. This enhanced explanation will be relevant in scenarios in which the line item represents expenses that now include COVID-19 expenses. In addition, a company may want to avoid "catch-all" line items, such as "special items" or "other costs," that include COVID-19 expenses along with other non-pandemic related expenses.
- Industry or Sector-Specific Terms. When using an industry- or sector-specific term in describing a non-GAAP financial measure, we recommend disclosing any deviations from

the commonly held understanding of that term (e.g., modifying “funds from operations,” as defined by the National Association of Real Estate Investment Trusts, to include COVID-19 expenses).

2

Consistent Presentation and Usage Across Disclosures

- Disclosure in Non-GAAP Reconciliation. When using a non-GAAP measure that includes a COVID-19 adjustment, consider repeating the definition in each section in which the measure is used. This will ensure a consistent understanding of this term throughout the disclosure package.
- Terminology Across Disclosures. We recommend a company evaluate whether its risk factors and MD&A disclosures are consistent with its specific non-GAAP COVID-19 adjustments and related reconciliation presentations. An inconsistency in the use of certain terms may present interpretive issues for investors and the Division (e.g., discussing general “costs” to the business as a result of the COVID-19 pandemic in MD&A while discussing specifically defined “COVID-19 costs” in the non-GAAP reconciliation). Further, we also recommend that a company that is making COVID-19 adjustments to its non-GAAP financial measures disclose such adjustments consistently in each of its earnings releases, periodic filings and other disclosures.
- Consistency When Discussing Drivers of Non-GAAP Results. When discussing results (whether GAAP or non-GAAP) in the context of COVID-19, we recommend, where possible, distinguishing between, and consistently describing, the income and expense drivers of those results. COVID-19 can impact non-GAAP results both directly as an expense item but also indirectly through reduced GAAP income or cash flow. Note, however, that while items such as unusual gains (e.g., due to a tax refund under the Coronavirus Aid, Relief and Economic Security Act or from an insurance recovery) would be permitted if properly disclosed, questions might be raised with non-GAAP adjustments that attempt to estimate lost revenue or income or that would otherwise result in an individually tailored revenue metric.
- When discussing trends in non-GAAP results, effective disclosures will clearly describe to what extent the changes in results are due to adjustments in the definition of that non-GAAP financial measure, as opposed to economic factors. If a non-GAAP financial measure has been redefined to account for COVID-19-related expenses, and the economic impact of COVID-19 has also led to material changes in that measure independent of the definitional adjustments (e.g., if Adjusted EBITDA has declined due to higher expenses associated with providing employees with personal protective equipment and lower revenues due to reduced demand for goods and services), the disclosure should describe these two distinct factors.
- Look Ahead to Future Presentations. Non-GAAP measures once modified to account for COVID-19 related expenses are almost certainly going to change as the pandemic continues. Ongoing modifications will therefore need to be tested for long-term consistency and comparability. With successive reports, COVID-19 related expenses may take on different aspects, and it will be important for companies to anticipate for investors how future expenses could play out.

3**Scale of COVID-19 Expenses**

- Consider Separating Costs By Magnitude. We have seen a wide variation in how COVID-19 expenses are defined and in the magnitude of those expenses. To address this variation, companies could present these expenses in separate categories based on size or scope, such as expenses resulting from market factors and those related to health and safety matters.

4**Management's Intended Purpose and Use of Non-GAAP Adjustments**

- Management's Rationale for Adjustment. The Division noted in the Disclosure Guidance that to "the extent a company presents a non-GAAP financial measure or performance metric to adjust for or explain the impact of COVID-19, it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations." To best adhere to the Disclosure Guidance, a company should provide clear disclosure if it introduces a new non-GAAP measure. A company will also want to consider the Disclosure Guidance when modifying an existing non-GAAP measure by fully describing the reasons why the measure was modified to take into account the impact of COVID-19 and why management finds that specific modification (and the modified non-GAAP financial measure itself) to be useful to investors.
- Disclosure of Rationale for Adjustment. Following the Disclosure Guidance, we would recommend that companies consider supplementing existing disclosures about the usefulness of their non-GAAP measures to investors with explanations of why their COVID-19 adjustments to those measures are also relevant. Although this may generally be self-evident, the decision as to why a company modified a non-GAAP financial measure may provide important context which may not otherwise be clear on its face.

We have seen a wide disparity in and varying levels of disclosure regarding adjustments to non-GAAP financial measures in the context of COVID-19. Given the novel and evolving nature of the pandemic's impact, we believe that the most effective COVID-19 related modifications to non-GAAP disclosures will be those that are described clearly and facilitate period-to-period comparability.

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