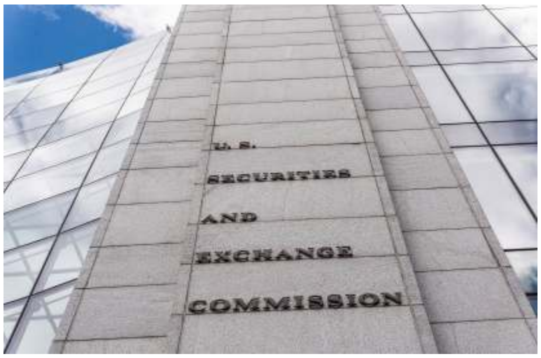
THE WALL STREET JOURNAL.

http://www.wsj.com/articles/sec-probes-whether-companies-are-misusing-adjusted-earnings-metrics-1477577108

MARKETS | FINANCIAL REGULATION

SEC Probes Whether Companies Are Misusing Adjusted Earnings Metrics

SEC's inquiries focusing on if companies use adjusted earnings too prominently



A primary focus of the SEC's latest inquiries is whether companies have featured customized measures too prominently in earnings releases and other disclosures. *PHOTO: STEPHEN VOSS FOR THE WALL STREET JOURNAL*

By **MICHAEL RAPOPORT**
Updated Oct. 27, 2016 10:23 a.m. ET

The Securities and Exchange Commission's enforcement division has informed some companies in recent weeks that it is examining their use of adjusted earnings measures, according to people familiar with the matter.

The inquiries are the latest in a series of steps by the agency this year to discourage use of these metrics, which critics contend allow companies to flatter their financial performance. The SEC's focus on this issue has occurred as the difference between these adjusted measures and results under generally accepted accounting principles showed their widest difference last year since 2008.

RELATED

- SEC Cracks Down on 'Adjusted' Accounting Measures (May 18)
- What Exactly are Non-GAAP Numbers? (July 5)
- Mind the GAAP Gap, Even for Blue Chip Stocks (March 15)
- U.S. Companies Increasingly Adjust to Mind the GAAP (Dec. 14)

A primary focus of the SEC's latest inquiries is whether companies have featured customized measures too prominently in earnings releases and other disclosures, the people familiar with the matter said. It isn't known how many companies the SEC is targeting, or when or whether it might take any action.

"The SEC has made it clear it is serious about trying to put at least some of the non-GAAP genie back in the bottle," said David Trainer, chief executives of New Constructs, an investment-research firm. "Non-GAAP" refers to results provided by companies that don't conform to generally accepted accounting principles.

The SEC declined to comment on the latest inquiries.

Companies that use non-GAAP metrics contend they provide a truer picture of performance, often by stripping out noncash and nonrecurring items. But their growing prominence has stoked memories of similar usage during the dot-com bubble.

In May, the commission issued new guidelines on non-GAAP use, and there have been a series of sometimes-pointed comment letters from the agency to companies about the practice.

In the May guidance, the SEC detailed some ways it might find use of non-GAAP numbers objectionable—tailoring numbers to remove costs that are important to measuring the company's performance, for instance, or spotlighting non-GAAP measures so much they obscure the official GAAP numbers.

The commission suggested companies should use their next earnings reports to "self-correct" any problems, and many did so: More than a quarter of S&P 500 companies reporting earnings in July and August shifted to giving GAAP numbers the greatest prominence in their earnings releases instead of non-GAAP numbers, according to an analysis from consulting firm Audit Analytics conducted for The Wall Street Journal.

That hasn't completely alleviated the SEC's concerns, however. Since the May guidance, the SEC's corporation-finance division has sent more than 100 comment letters to companies questioning whether their non-GAAP disclosures comply with it.

The latest SEC enforcement inquiries appear to be separate from the May guidance because they pertain to companies' disclosures from before it was issued, one of the people with knowledge of the situation said. "I think the enforcement people think (the companies) have violated longstanding rules," this person said.

Even after the May guidance, some companies kept using non-GAAP metrics in ways the SEC had cautioned against, though some have since said they plan to change. "There are some judgment calls that need to be made," said Matthew E. Kaplan, a securities attorney at law firm Debevoise & Plimpton.

Electric-car maker Tesla Motors Inc., for instance, reported adjusted non-GAAP revenue of $1.6 billion when it announced second-quarter earnings in August. In doing so, it added back nearly $300 million in deferred revenue the company collects up front but doesn't book until future quarters. The SEC said specifically in its May guidance that companies shouldn't report non-GAAP revenue that way.

Tesla has since said it would stop reporting non-GAAP revenue in that fashion; it didn't include non-GAAP revenues in its third-quarter earnings announcement Wednesday. A Tesla spokeswoman said the company had no further comment.

Another example: Medical-device maker Syneron Medical Ltd. touted its second-quarter non-GAAP earnings of 9 cents a share in the headline of its August press release, and didn't disclose until much further down in the release that its GAAP net income was only 3 cents a share.

The SEC had said in its guidance that if companies use non-GAAP measures in earnings-release headlines, they must include the comparable GAAP measure as well. Hugo Goldman, Syneron's chief financial officer, said the company wasn't under SEC investigation and was "changing the format of our non-GAAP reporting to comply with SEC rules and the recent guidance."

Write to Michael Rapoport at Michael.Rapoport@wsj.com