NAREIT Alert (May 19, 2016)

NAREIT Alert Important Industry Updates from NAREIT

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SEC Issues Compliance and Disclosure Interpretations on the Use of Non-GAAP Financial Measures

On May 17, the Securities and Exchange Commission issued a Compliance and Disclosure Interpretations (the Interpretations) of the rules and regulations on the use of non-GAAP financial measures. Among many topics discussed, the Interpretations focused a number of comments on reporting "funds from operations" (FFO). Of note, the Interpretations include a definitive statement that "The staff accepts NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis." Given recent criticisms and public statements by regulators surrounding non-GAAP measures, NAREIT views this statement as a positive development for REITs. Additionally, the Interpretations provide a reminder that when a registrant presents a non-GAAP measure, it must present the most directly comparable GAAP measure *with equal or greater prominence*.

Questions and Answers referencing FFO

Question 102.01: "What measure was contemplated by 'funds from operations' in footnote 50 to Exchange Act Release 47226, *Conditions for the Use of Non-GAAP Measures,* which indicates that 'companies may use 'funds from operations per share' in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K?"'

Answer: "The reference to 'funds from operations' in footnote 50, or 'FFO', refers to the measure defined as of January 1, 2000, by the National Association of Real Estate Investment Trusts (NAREIT). NAREIT has revised and clarified the definition since 2000. The staff accepts NAREIT's definition of FFO in effect as of May 17, 2016 as a performance measure and does not object to its presentation on a per share basis."

Question 102.02: "May a registrant present FFO on a basis other than as defined by NAREIT as of May 17, 2016?"

Answer: "Yes, provided that any adjustments made to FFO comply with Item 10(e) of Regulation S-K and the measure does not violate Rule 100(b) of Regulation G. Any adjustment made to FFO must comply with the requirements of Item 10(e) of Regulation S-K for a performance measure or liquidity measure, depending on the nature of the adjustments, some of which may trigger the prohibition on presenting this measure on a per share basis."

Question 102.03: "Item 10(e) of Regulation S-K prohibits adjusting a non-GAAP financial performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual when 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. Is this prohibition based on the description of the charge or gain, or is it based on the nature of the charge or gain?"

Answer: "The prohibition is based on the description of the charge or gain that is being adjusted. It would not be appropriate to state that a charge or gain is non-recurring, infrequent or unusual unless it meets the specified criteria. The fact that a registrant cannot describe a charge or gain as non-recurring, infrequent or unusual, however, does not mean that the registrant cannot adjust for that charge or gain. Registrants can make adjustments they believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K. See Question 100.01."

Question and Answer referencing Prominence of Non-GAAP Measures

Question 102.10: "Item 10(e)(1)(i)(A) of Regulation S-K requires that when a registrant presents a non-GAAP measure it must present the most directly comparable GAAP measure *with equal or greater prominence*. This requirement applies to non-GAAP measures presented in documents filed with the Commission and also earnings releases furnished under Item 2.02 of Form 8-K. Are there examples of disclosures that would cause a non-GAAP measure to be more prominent?"

Answer: "Yes. Although whether a non-GAAP measure is more prominent than the comparable GAAP measure generally depends on the facts and circumstances in which the disclosure is made, the staff would consider the following examples of disclosure of non-GAAP measures as more prominent:

- Presenting a full income statement of non-GAAP measures or presenting a full non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures;
- Omitting comparable GAAP measures from an earnings release headline or caption that includes non-GAAP measures;
- Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font) that emphasizes the non-GAAP measure over the comparable GAAP measure;
- A non-GAAP measure that precedes the most directly comparable GAAP measure (including in an earnings release headline or caption);
- Describing a non-GAAP measure as, for example, "record performance" or "exceptional" without at least an equally prominent descriptive characterization of the comparable GAAP measure;
- Providing tabular disclosure of non-GAAP financial measures without preceding it with an equally prominent tabular disclosure of the comparable GAAP measures or including the comparable GAAP measures in the same table;
- Excluding a quantitative reconciliation with respect to a forward-looking non-GAAP measure in reliance on the "unreasonable efforts" exception in Item 10(e)(1)(i)(B) without disclosing that fact and identifying the information that is unavailable and its probable significance in a location of equal or greater prominence; and
- Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence."

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