

Tesla, Non-GAAP Financial Measures, and the Securities & Exchange Commission's Challenge: A Case Study Illustration

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Abstract

This teaching case is intended to help undergraduate and graduate accounting students deepen their understanding of non-GAAP financial measures and related Securities and Exchange Commission (SEC) regulations. Students will also increase their understanding of how companies announce quarterly earnings, learn how to navigate SEC data bases and deepen their research skills.

Using the SEC's recent challenge to Tesla on the company's disclosure of non-GAAP financial measures in earnings press releases the student will gain an understanding of: the nature of non-GAAP financial measures; how they are derived; why they are being used by companies in their communications to investors; and which SEC regulations govern their reporting and disclosures. This teaching case will also require students become familiar with accounting standards (ASCs) on revenue recognition, deferred revenue and operating leases.

Introduction

U.S. publicly traded companies have been reporting non-GAAP financial measures in unaudited earnings press releases and other investor communications since the 1980s. The reporting of these measures has grown significantly over the past several years getting the attention of the media, analysts, the FASB and the SEC. In 2003¹ 60% of S&P companies reported one or more non-GAAP financial measures in their quarterly earnings reports. That number increased to 88% in 2015 and 96% in 2016².

The impact of these non-GAAP financial measures is substantial and often favorable to the company. In 2015 Audit Analytics reported that quarterly non-GAAP net income (for companies reporting non-GAAP measures) was greater than GAAP net income 82% of the time and on average \$247m greater than reported quarterly GAAP net income³.

On May 17, 2016, in an effort to achieve greater clarity and consistency by companies reporting non-GAAP financial measures, the SEC published Compliance & Disclosure Interpretations (C&DI)s⁴. The C&DI)s set forth 39 questions and answers that provide further guidance on the use of non-GAAP financial measures.

The SEC followed up with aggressive actions. In 2015, prior to the C&DI, the SEC issued 288 staff comment letters relating to non-GAAP financial disclosures by registrant companies. This number went up to 429 in 2016 making non-GAAP financial measures the SEC's top concern. This trend continued in 2017 with 656 comment letters pertaining to non-GAAP issues.⁵ The SEC issued comment letters to such prominent companies as: GE, Colgate-Palmolive, Coca-Cola, Whirlpool and Tesla.

In 2016 the SEC challenged Tesla on how the company was reporting non-GAAP revenue and management's explanation as to why non-GAAP information is useful to investors.

The following case is based on that SEC challenge, Tesla's response and ultimate revision of their non-GAAP financial measure reporting practices.

Case Illustration

The following case places the student in the role of an employee at the fictional electric car company Edison Car, a rival of Tesla, Inc. The characters of the case and the case scenario are below:

Characters:

Manager at Edison Car: Charlotte F. O'Leary

Employee at Edison Car and role of the student: Taylor Prentice.

Mentor of the student: Madison Torres.

Scenario:

Your name is Taylor Prentice and you work for the electric car company *Edison Car*. Your manager, Charlotte F. O'Leary, is considering the disclosure of some non-GAAP financial measures in her communications with stakeholders. Charlotte is aware that Edison Car's competitor, Tesla, Inc., has recently come under scrutiny from the SEC for its voluntary non-GAAP disclosures. Charlotte does not want Edison Car to come under SEC scrutiny. She has tasked you with researching Tesla, what it did, and how Edison Car can learn from Tesla's situation.

Her memo to you on this assignment follows:

To: Taylor Prentice

From: Charlotte F. O'Leary

Subject: Non-GAAP Financial Measures

Taylor per our recent discussion Edison Car is considering disclosing non-GAAP financial measures in our quarterly earnings press releases. I understand Tesla has been doing this for a while but has recently received some comment letters from the SEC. We wish to avoid any negative press from the SEC.

I would like you to research the SEC regulations governing non-GAAP financial measures, what Tesla has been providing to its investors and the SEC's challenges to Tesla. Please provide me with the following in your report:

- Brief Background on Tesla including their various lines of business, when they began operations and when they went public.
- What types of non-GAAP financial measures has Tesla been reporting and how they differ from their related GAAP measures. Please describe these measures and if possible provide the financial differences between these measures and their most closely related GAAP measure. Perhaps you'll want to pick a recent quarterly report for this analysis.
- I would like to understand the impact that non-GAAP financial measures have on key financial ratios. Please provide an analysis of the impact on selected Tesla key ratios.
- What were the SEC's objections to Tesla's disclosure of non-GAAP financial measures?
- A brief summary of the applicable SEC regulations.
- I understand Tesla has a unique way of structuring its leasing deals and the way it recognizes revenue. Please give me a brief explanation of this including any relevant FASB standards.

Your report should be 5-10 pages (double spaced) including any charts or analysis you deem useful. Thanks for your help on this important matter.

You were very happy to receive such a high level and important task and you want to do an excellent job on this assignment. Your manager sets high standards, is detail oriented but extremely busy and likes to get reports that are thorough yet succinct. You have your own ideas on how to approach this problem, but you decide to check in with your mentor to make sure you can put together an excellent deliverable. You send your mentor, Madison Torres, the following note.

Hi Madison,

I am contacting you because I have received a very exciting assignment here at Edison Car and I know, given your expertise, that you are the perfect person to reach out to. My manager, Charlotte F. O'Leary, wants me to do a write up on Tesla and its non-GAAP financial disclosures. I think I understand what she wants but was hoping you could share your thoughts with me before I get started.

-Taylor Prentice

You receive the following reply from your mentor:

Hi Taylor,

Great to hear from you. This seems like a very interesting opportunity you have been given. It is a great chance to demonstrate your accounting skills to your manager.

I would be happy to provide you with a systematic and rigorous approach to investigate this problem. This approach will consist of (1) some general background in the form of popular press items, (2) an examination of Tesla's financials, (3) review of the accounting rules for the release of voluntary non-GAAP disclosures among other relevant issues, and finally (4) some closing advice. With this information I believe you will be able to craft a high-quality report for your manager.

Regards, Madison

General Background

Taylor,

This is a very timely project you have been given. Tesla and the way it communicates earnings has been a hot topic in the business press over the last couple of years. There are many articles to be found by searching Google with the terms "Tesla" and "non-GAAP."

Before I cite and quote popular press stories, let me refresh your memory on what it means for a financial measure to be non-GAAP. Below is the formal definition. You can find this definition on the SEC's website⁶.

"The SEC defines a non-GAAP financial measure as a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

- (i) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, or
- (ii) includes amounts or is subject to adjustments that have the effect of including amounts, that are included in or excluded from, as the case may be, the most directly comparable GAAP measure in the registrant's statement of income, balance sheet or statement of cash flows (or equivalent statements)."

That's a very precise way of saying a non-GAAP number is a GAAP number plus or minus something. You can see how this ties to the first popular press item below (I have bolded sections for emphasis):

SEC Criticizes Tesla over 'Tailored' Accounting⁷

Electric car maker has dropped non-GAAP metrics flagged by the regulator.

"The SEC said Tesla, in its August (2016) earnings release, used **"individually tailored" measurements** when the electric-vehicle maker **added back** certain costs to revenue calculated under generally accepted accounting principles. **While the SEC allows the use of some non-GAAP metrics, certain figures that adjust revenue are prohibited** as detailed in the regulator's guidelines from May 17, 2016".

Here is another story, this one from Accounting Today:

Tesla Backs Away from Non-GAAP Metrics after SEC Letters⁸

"The SEC has been prodding companies to highlight the GAAP numbers in their earnings releases and not to feature non-GAAP measures as prominently. Since the SEC released guidance on the use of non-GAAP measures in May 2016, over 25 percent of S&P 500 companies have begun to put the GAAP figures at the head of their earnings releases. **The SEC has also doubled the percentage of comment letters criticizing companies for using non-GAAP measures** since last year from 14 to 28 percent, according to the research firm Audit Analytics."

Your friend,

Madison

You are happy to hear back so quickly from your mentor but you still have some questions. You write back:
Madison,

Thanks for directing me to these relevant articles but how do I get familiar with Tesla's business and financials and will you provide an outline how I might structure a deliverable for my boss?

Taylor,

The following items should guide you through how you can analyze Tesla's GAAP and non-GAAP disclosures. Please note that you will be able to find much of this information on Google, but your boss will be much more impressed if you are able to cite primary source documents.

You can get these primary source documents in at least two places.

- i. The official investor relations page for Tesla <http://ir.tesla.com/>
- ii. The SEC's website Edgar (search by ticker TSLA)
<https://www.sec.gov/edgar/searchedgar/legacy/companysearch.html>

First you will need to outline some basic characteristics of Tesla, Inc. I suggest you look at information pertaining to their 2016 fiscal year.

- 1) What is Tesla's line of business?

- a) Look at the 10-K: Since you work for Edison Car, I think the car side of Tesla's business is what you should be most interested in. The overview section of Tesla's 2016 10-K will give you the information you need.
- 2) When did Tesla begin Operations?
 - a) You can find this on the "About" section of Tesla's website: <https://www.tesla.com/about>
- 3) When did Tesla go public?
 - a) You can find this information in the Market Equity section of the 10-K

Next, I suggest you gain a thorough understanding of the applicable SEC regulations and the specific non-GAAP disclosures made by Tesla in their earnings press releases and communications to investors.

SEC RULES FOR THE RELEASE OF VOLUNTARY NON-GAAP DISCLOSURES

It is important to reiterate that the SEC does permit companies to provide non-GAAP financial measures in their public disclosures and these measures are subject to compliance under SEC regulation G⁹ and regulation S-K¹⁰ amended in 2003.

Moreover, in an effort to achieve greater clarity and consistency by companies reporting non-GAAP financial measures on May 17, 2016 the SEC published Compliance & Disclosure Interpretations (C&DIs). The C&DIs set forth 39 questions and answers that provide further guidance on the use of non-GAAP financial measures.

The SEC was generally concerned about four issues that prompted their May 17 C&DIs:

- i. The number of non-GAAP financial measures being provided by companies.
- ii. Prominence given to non-GAAP measures over GAAP measures.
- iii. Justification for the use of non-GAAP financial measures and the benefit to investors.
- iv. The use of individually tailored non-GAAP financial measures.

I urge you to review these SEC regulations and C&DIs, which can be found on the SEC web-site, and consider incorporating key features into the report to you manager.

Keep me apprised of your progress,
Madison

Tesla's Non-GAAP Disclosures and GAAP Accounting

Taylor,

It also occurred to me that in order to provide appropriate advice to your manager an analysis of Tesla's reporting and disclosure of non-GAAP financial measures is needed. Although non-GAAP financial measures are not subject to FASB standards your analysis would be incomplete without contrasting relevant GAAP accounting and non-GAAP financial measures used by Tesla. You'll need to research and answer the following questions:

- 4) What types of non-GAAP financial measures did Tesla disclose to investors in their quarterly earnings press releases?
 - a) The best place to find this information is in the quarterly update letters issued directly from Tesla. <http://ir.tesla.com/releases.cfm>. You can also find them as 8-Ks on the SEC Edgar website. You should take a look at Tesla's 2016 second quarter press release pages 4 and 7-9 for Non-GAAP information.

- b) Also review Tesla's 2016 second quarter earnings press release (same link noted above) and determine how the company developed or derived its non-GAAP financial measures. I believe you'll find the company disclosed eight key non-GAAP measures. You might consider preparing a table that describes how each measure is derived and include this in your report.
- 5) How does Tesla structure its vehicle lease arrangements and leased vehicle buy-back guarantees? In addition, how did Tesla describe its revenue model and how did the company report revenue on a non-GAAP vs. GAAP basis. Pay particular attention to *Tesla's resale value guarantee* program (see figure 1). Again reference Tesla's 2016 Q2 earnings release and page 35 of their 2016 10-K section Critical Accounting Policies and Estimates. I believe you'll find several accounting standards that apply to how the company recognized and accounted for revenue and resale guarantees on a GAAP basis. I encourage you to review FASB's Accounting Standards Codification (ASCs) 430,460,605,606,840 for guidance and include a summary of the relevant key features in your report to Charlotte.
- 6) What was the difference between Tesla's reported GAAP net income and revenue and non-GAAP net income and revenue and what impact did non-GAAP measures have on Tesla's key financial ratios?
- a) Again, look at the quarterly earnings update letters directly from Tesla, particularly the company's 2016 second quarter earnings release. <http://ir.tesla.com/releases.cfm>. I suggest you develop a chart, to be included in your report, comparing Tesla's non-GAAP financial measures to their most closely related GAAP including net income and revenue measures. You should also provide an analysis of the impact on key financial ratios e.g. Operating Expense ratio, R&D as a Percentage of Sales ratio, and Net Income (Loss) as a percentage of sales.
- b) What was management's explanation as to why they believe non-GAAP measures are useful to investors?
- 7) What was the SEC's reaction to Tesla's difference in the GAAP and non-GAAP measures? Here you will want to look for *comment letters* from the SEC to Tesla and Tesla's response. To understand these comment letters, it is important to have a deeper understanding of just what a non-GAAP disclosure is and the guidance surrounding these disclosures. *I have attached relevant excerpts of these letters and a tutorial on how to find these letters at the end of this document in the Appendix.*
- 8) Finally, how did Tesla revise its reporting of non-GAAP financial measures and management's explanation as to investor usefulness between its 2016 second and third quarter earnings releases? You may want to create a chart contrasting Tesla's original Q2 2016 non-GAAP measures with their revised measures reported in Q3 2016.

Closing Advice

Taylor,

I believe the process I outlined for you will provide you with ample information to write an effective report to you manager.

In summarizing the lessons learned from your research you might also want to pose the following questions or a check list for your boss:

- Why is the company providing the non-GAAP measure or measures?
- Does the measure (s) actually provide investors with meaningful and useful information?
- Are the disclosures and reasons for the non-GAAP financial measure substantive and clear and not simply boiler plate?
- Do the non-GAAP financial measures have prominence over the GAAP measure?

- Is a detail reconciliation to the most closely related GAAP measure provided for each non-GAAP financial measure?
- Is the company making any misleading statement or statements? Are the non-GAAP financial measures being provided on a consistent basis, calculated accurately and derived from reliable sources?
- Is the company in compliance with SEC regulations G, S-K and recent CD&Is?

Good luck with your report,

Madison Torres.

Teaching Note

This case requires students to take on the role of an employee at the fictional electric car company Edison Car. Edison Car is thinking of disclosing non-GAAP financial measures but wants to avoid scrutiny from the SEC on these non-GAAP financial measures. Edison Car's rival, Tesla, Inc., has come under SEC scrutiny for its non-GAAP disclosures and the student's job in the role of Edison Car employee is to research Tesla, Inc. in order to guide management about what Tesla did to draw the SEC's attention and how best to avoid doing the same. The student will complete the requirements listed below in the form of a report for his/her manager. The report should contain references to applicable SEC regulations and guidance on the use and reporting of non-GAAP measures.

It is unlikely that a student will write a report as thorough as the sample provided below. The sample is meant to be an exemplar to be shared with the student to further the student's learning after the submission his/her work.

This case is appropriate for any class that discusses financial statements. Tesla was chosen because students are aware of and interested in it. With proper guidance, the issues in the case are understandable to novice accounting students while the depth of the issues allow for this case to be used in upper level or graduate level accounting classes.

Here are the requirements of the case and a sample report:

The requirements of the case are as follows (instructions for the student are within the case):

1. What is Tesla's line of Business?
2. When did Tesla begin Operations?
3. When did Tesla go public?
4. What types of non-GAAP financial measures did Tesla disclose to investors in their quarterly earnings press releases?
5. What is Tesla's accounting policy for recognizing revenue on a GAAP basis and in particular which accounting standards guide their accounting for revenue and operating leases? Look to ASCs 430,460,605,606,840.
6. What was the difference between Tesla's reported GAAP net income and revenue and non-GAAP net income and revenue?
 - a) What impact did Tesla's non-GAAP financial measures in Q2 2016 have on their key financial ratios?
7. What were the SEC's objections to Tesla's disclosure of non-GAAP financial measures?
8. How did Tesla revise its reporting of non-GAAP financial measures and management's explanation as to investor usefulness between its 2016 second quarter and third quarter earnings releases?

Please find below a sample report that follows the guidance of the mentor in the case study.

Suggested Response

To: Charlotte F. O'Leary
From: Taylor Prentice
RE: Edison Car & non-GAAP Disclosures

Hello Charlotte,

Recently you gave me an assignment to research Tesla, its voluntary non-GAAP disclosures, subsequent issues with the Securities and Exchange Commission (SEC) and lessons learned. I have completed this assignment and am ready to report my findings.

Company Background

Tesla Inc. was founded in 2003 “by a group of engineers who wanted to prove that people didn’t need to compromise to drive electric – that electric vehicles can be better, quicker and more fun to drive than gasoline cars¹¹.” Tesla went public on June 29, 2010. In the overview section of its 10-K, Tesla states:

“We currently produce and sell two fully electric vehicles, the Model S sedan and the Model X sport utility vehicle (SUV). Both vehicles offer exceptional performance, functionality and attractive styling. We commenced deliveries of Model S in June 2012 and as of December 31, 2015 we have delivered over 107,000 new Model S vehicles worldwide. We have continued to improve Model S by introducing performance, all-wheel drive dual motor, and autopilot options, as well as free over-the-air software updates.”

Tesla's Non-GAAP Financial Measures Disclosures

In the second quarter (Q2) of 2016, Tesla reported eight non-GAAP financial measures:

1. Revenue
2. Automotive Gross Margin
3. R&D Expenses
4. SG&A Expenses
5. Total Operating Expenses
6. Net Loss
7. Loss Per Share
8. Cash Flow from Operations

Table one in the appendix shows the differences between the non-GAAP measures and the company's related GAAP measures. Table two reflects how the non-GAAP measures were derived while table three in the appendix shows effect of Tesla's revised Q2 non-GAAP financial measures. Table four is an analysis that non-GAAP financial measures have on certain key ratios.

SEC Challenge

The SEC challenged Tesla in two areas:

1. Tesla's non-GAAP revenue claiming this to be an individually tailored measurement method; and
2. Management's explanation of the usefulness of non-GAAP financial measures to investors. The SEC claimed the explanation appear to be boiler plate and requested a more substantive discussion of how Tesla's non-GAAP financial measures are useful to investors.

I included the following two excerpts from some of the SEC's comment letters to Tesla which I believe you will find informative. We clearly want to avoid these types of comments from the SEC. I've also included the applicable specific disclosures from Tesla's earnings press release.

- 1) **SEC:** We note that you adjust your non-GAAP measures to add back the deferred revenue and related costs for cars sold with resale value guarantees and where you collected the purchase price in cash, **which substitutes an individually tailored measurement method for those of GAAP.** Please describe the changes you expect to make to your presentation in light of the new guidance issued on May 17, 2016.

A review of Tesla's 2016 Q2 earnings press release revealed the company's explanation on non-GAAP revenue follows:

“Our non-GAAP measures align the recognition of revenues and cost related to a vehicle sale with the time when the customer takes delivery of the car and cash is received or owed us. This contrasts with the approach of other automotive manufacturers who under GAAP accounting recognize revenue when the vehicle is sold into dealership inventory rather than to end customers, even though in the case of a captive finance lease they may not collect cash for several years on a consolidated basis.” Tesla further stated: “Our non-GAAP revenue and gross profit is determined by adding back deferred revenue and related costs for cars sold with resale value guarantee and where we have collected or will collect from a bank intermediary in a matter of days, the purchase price of the car in cash”.

Tesla added back deferred revenue of \$292 million to its 2016 Q2 GAAP automotive revenues and approximately \$241 million to its automotive cost of revenues.

- 2) **SEC:** We note that your current disclosure about the usefulness of your non-GAAP measures appears to be boilerplate. In your next earnings release, please provide a substantive discussion of how your non-GAAP measures are useful to investors.

Tesla’s explanation in its 2016 Q2 earnings press release as to the reasons why the company believes the presentation of non-GAAP financial measures provides useful information to investors follows:

“Management believes that it is useful to supplement its GAAP financial statements with this non-GAAP information because management uses such information internally for its operating, budgeting and financial planning purposes. These measures also facilitate management’s internal comparisons to Tesla’s historical performance as well as comparisons to the operating results of other companies.”

Tesla Revises Non-GAAP Disclosures & Practices

It is important to note that based upon the SEC’s comment letters Tesla revised its reporting practices of non-GAAP financial measures with its 2016 third quarter earnings press release and stated it would no longer include non-GAAP revenue disclosures in future press releases. I’ve included an analysis (appendix table three) showing the impact of Tesla’s revised 2016 Q2 non-GAAP financial measures.

Tesla also revised their explanation as to why it believes non-GAAP financial measures are useful to investors. I believe this is a good example for us to follow.

“Management believes that presentation of the non-GAAP financial measures provides useful information to our investors regarding our financial condition and results of operations because it allows investors greater transparency to the information used by Tesla management in its financial and operational decision-making so that investors can see through the eyes of Tesla management regarding important financial metrics that Tesla management uses to run the business as well as allows investors to better understand Tesla’s performance. Non-GAAP information is not prepared under a comprehensive set of accounting rules and therefore, should only be read in conjunction with financial information reported under U.S. GAAP when understanding Tesla’s operating performance.”

Applicable SEC Regulations

I’ve also summarized for you the SEC regulations governing the use of non-GAAP financial measures to ensure we don’t run afoul of the requirements.

There are two key SEC rules to be aware of:

Regulation G applies to public company non-SEC filing communications such as earnings press releases, investor presentations, web sites. This regulation prohibits registrants from making an untrue statement of material fact or

omission of a material fact that is necessary to make information not misleading. When non-GAAP measures are provided the company must:

- Provide the most directly comparable GAAP measure;
- Provide a reconciliation of the differences between the GAAP and non-GAAP measure.

Regulation S-K applies to the use of non-GAAP measures in SEC filings such as annual reports (10-K), quarterly reports (10-Q) and non-SEC filing communications related to non-GAAP communications. Key features of this regulation include:

- The reasons management believes the use of non-GAAP measures are useful to investors;
- The purposes for which management uses non-GAAP measures;
- Presenting the most comparable GAAP measure with equal or greater prominence to the non-GAAP measure; and
- Prohibiting of using terms such as non-recurring, infrequent and unusual.

If we comply with the key features of these two regulations our non-GAAP disclosures should pass SEC scrutiny.

Related GAAP

I also reviewed Tesla's 2016 10-K audited financial statements and summary of significant accounting policies section in order to better understand the required GAAP treatment of revenues. The company recognizes revenue for products and services on a GAAP basis when: (1) a persuasive evidence of an arrangement exists; (2) delivery has occurred and there are no uncertainties regarding customer acceptance; (3) pricing or fees are fixed and determinable; (4) collection is reasonably assured.

As of December 31, 2016, the company deferred \$291.2 million related to the purchase of vehicle maintenance and service plans, access to the company's Supercharge network and other software plans.

Regarding Tesla's resale value guarantees and other financing programs the company provides resale value guarantees or similar buy-back terms to customers who purchase vehicles and who financed their vehicle through one of the company's specified commercial banking partners. Although the company receives full payment for the vehicle sales price at the time of delivery they are required to account for these transaction as operating leases. The amount of the sale proceeds equal to the resale value guarantee is deferred until the guarantee expires or is exercised.

In order to better understand the company's GAAP treatment, I reviewed the following FASB accounting standards: ASCs 430,460, 605, 606 revenue recognition and ASC 840 leases.

ASC 606 set forth the following criteria for recognizing revenue:

- a. The parties to the contract have approved the contract and are committed to perform their respective obligations.
- b. The entity can identify each party's rights regarding the goods and services to be transferred.
- c. The entity can identify the payment terms for the goods or services to be transferred
- d. The contract has commercial substance
- e. It is possible that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Based upon my reading of ASC 606 Tesla meets criteria a-d for recognizing revenue but its resale value guarantees do not meet criteria e resulting a deferral of revenue.

ASC 605 which was in effect in 2016 stipulates that the entity should recognize revenue when (or as) it satisfies a performance obligation. As Tesla's resale value guarantees associated with lease vehicles is a continuing obligation and the standard would require the company to defer recognition of revenue until the performance obligation expires or is exercised. ASC 430 deferred revenue and ASC 460 provides the standards for establishing Tesla's deferred revenue on these transactions.

ASC 840-Operating Leases establishes the criteria for recording operating leases. As Tesla guarantees the value of leased vehicles this standard requires the company to account for these transactions as interest bearing collateralized borrowings and operating leases. The associated deferred revenue is accreted to automotive lease revenue on a straight-line basis over the guarantee period.

In closing I thought it useful to provide you with some key questions that you should address when deciding to disclose various non-GAAP financial measures in the company's next quarterly earnings release as follows:

- Why is the company providing the non-GAAP measure or measures?
- Does the measure (s) actually provide investors with meaningful and useful information?
- Are the disclosures and reasons for the non-GAAP financial measure substantive and clear and not simply boiler plate?
- Do the non-GAAP financial measures have prominence over the GAAP measure?
- Is a detail reconciliation to the most closely related GAAP measure provided for each non-GAAP financial measure?
- Is the company making any misleading statement or statements?
- Are the non-GAAP financial measures being provided on a consistent basis, calculated accurately and derived from reliable sources?
- Is the company in compliance with SEC regulations G, S-K and recent C&DIs?

Charlotte, I hope you find my research and analysis helpful as you make your decision regarding providing non-GAAP financial measures to the company's investors. I am available to discuss further at your earliest convenience.

References

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- ⁴ United States Securities and Exchange Commission. Available at: <https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>
- ⁵ McKeon, J. and Usvyatsky, O. A Look at Top SEC Comment Letter Issues in 2017 (December 4, 2017). Available at: <http://www.auditanalytics.com/blog/a-look-at-top-sec-comment-letter-issues-in-2017/>
- ⁶ United States Securities and Exchange Commission. <https://www.sec.gov/rules/final/33-8176.htm>
- ⁷ Shumsky, T. SEC Criticizes Tesla Over 'Tailored' Accounting (November 29, 2016). Available at: <https://www.wsj.com/articles/sec-criticizes-telsa-over-tailored-accounting-1480373158>
- ⁸ Cohn, M. Tesla Backs Away from Non-GAAP Metrics after SEC Letters (November 29, 2016). Available at: <https://www.accountingtoday.com/news/tesla-backs-away-from-non-gaap-metrics-after-sec-letters>
- ⁹ Electronic Code of Federal Regulations. Available at: <https://www.ecfr.gov/cgi-bin/text-idx?node=17:4.0.1.1.5&rgn=div5>
- ¹⁰ Legal Information Institute at Cornell Law School. Available at: <https://www.law.cornell.edu/cfr/text/17/229.10>
- ¹¹ Tesla, Inc. Available at: <https://www.tesla.com/about>

APPENDIX FOR CASE STUDY (for student use): EXCERPTED COMMENT LETTERS WITH RESPONSES AND A TUTORIAL ON RETRIEVING SEC AND TESLA CORRESPONDENCE

What follows is an excerpt of the actual correspondence between the SEC and Tesla. Excerpted here you will find two requests from the SEC and Tesla's response.

SEC: We note that you adjust your non-GAAP measures to add back the deferred revenue and related costs for cars sold with resale value guarantees and where you collected the purchase price in cash, **which substitutes an individually tailored measurement method for those of GAAP.** Please describe the changes you expect to make to your presentation in light of the new guidance issued on May 17, 2016.

Tesla: The Company is currently in the process of evaluating the updated Compliance and Disclosure Interpretations relating to non-GAAP financial measures used in public disclosures issued by the Staff on May 17, 2016, with respect to its use and presentation of non-GAAP financial measures. The Company respectfully submits that it has already taken certain steps to modify its prior disclosure practices in this area.

SEC: We note that your current disclosure about the usefulness of your non-GAAP measures appears to be boilerplate. In your next earnings release, please provide a substantive discussion of how your non-GAAP measures are useful to investors.

Tesla: The Company respectfully directs the Staff's attention to its disclosure which states that the Company's management believes that it is useful to supplement its GAAP financial statements with certain non-GAAP information because "management uses such information internally for its operating, budgeting and financial planning purposes" However, in the Company's next earnings release, the Company will provide a more substantive discussion of how its non-GAAP financial measures are useful to investors.

The SEC was not satisfied with the above answers from TESLA. Here is an excerpt from the second correspondence that demonstrates this dissatisfaction and Tesla's response.

SEC: Based on your response to our prior comment, it is not clear what changes you expect to make to your presentation of non-GAAP measures that add back the deferred revenue and related costs for cars sold with resale value guarantees and where you collected the purchase price in cash, which substitutes an individually tailored measurement method for those of GAAP. As previously requested, please describe the changes you expect to make to your presentation.

Tesla: The Company respectfully advises the Staff that it will remove any presentation of non-GAAP measures that adds back the deferred revenue and related costs for cars sold with resale value guarantees and where the Company collected the purchase price in cash.

SEC: We note your response to our prior comment in which you direct our attention to your disclosure which indicates how "management uses such information internally." Item 10(e)(1)(i)(C) of Regulation S-K requires a statement disclosing the reasons why you believe that the presentation of a non-GAAP financial measure provides useful information to investors regarding your financial condition and results of operations not how your management uses the information. In your next earnings release, please provide a substantive discussion of how your non-GAAP measures are useful to investors. **Provide us with your intended revised disclosure.**

Tesla: The Company respectfully advises the Staff that it will revise its Non-GAAP Financial Information legend in future earnings releases. The Company's intended disclosure is set forth below, with the new disclosure underlined for ease of the Staff's review.

Non-GAAP Financial Information

Consolidated financial information has been presented in accordance with GAAP as well as on a non-GAAP basis. On a non-GAAP basis, financial measures exclude non-cash items such as stock-based compensation, the change in fair value related to Tesla's warrant liability, non-cash interest expense related to Tesla's convertible senior notes. Management believes that it is useful to supplement its GAAP financial statements with this non-

GAAP information because management uses such information internally for its operating, budgeting and financial planning purposes. These non-GAAP financial measures also facilitate management's internal comparisons to Tesla's historical performance as well as comparisons to the operating results of other companies. Management believes that presentation of the non-GAAP financial measures provides useful information to our investors regarding our financial condition and results of operations because it allows investors greater transparency to the information used by Tesla management in its financial and operational decision-making so that investors can see through the eyes of Tesla management regarding important financial metrics that Tesla management uses to run the business as well as allows investors to better understand Tesla's performance. Non-GAAP information is not prepared under a comprehensive set of accounting rules and therefore, should only be read in conjunction with financial information reported under U.S. GAAP when understanding Tesla's operating performance. A reconciliation between GAAP and non-GAAP financial information is provided below.

To retrieve the SEC and Tesla correspondence, go to:

<https://www.sec.gov/edgar/searchedgar/companysearch.html>

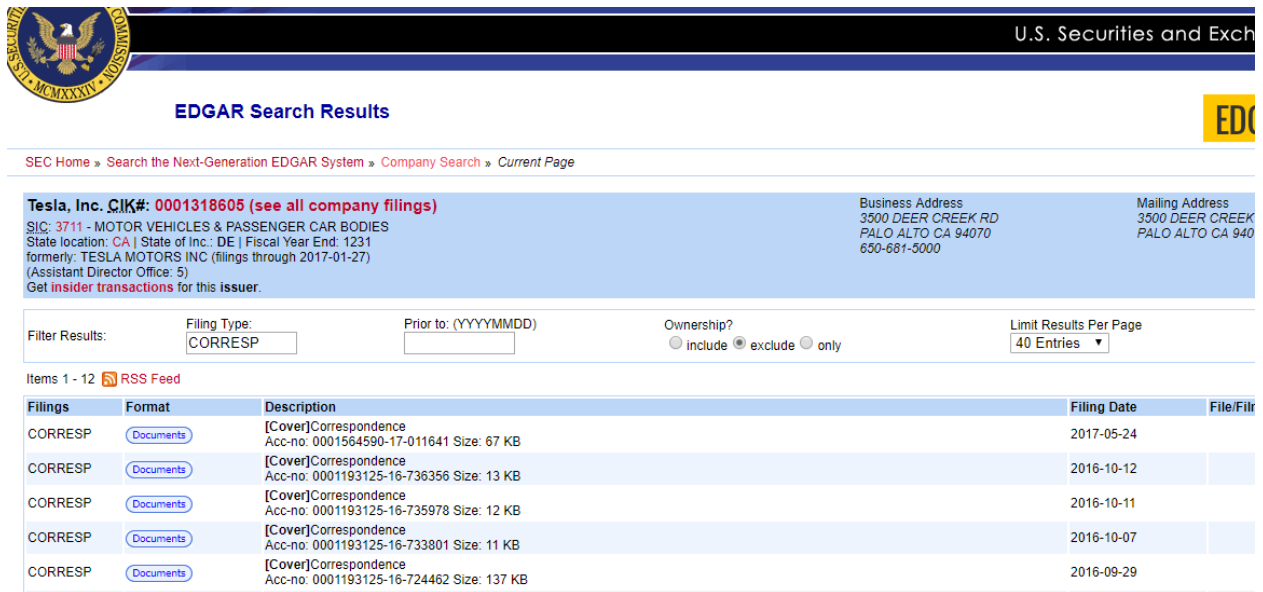
Enter "TSLA" (Tesla's stock ticker) into the fast search box. Figure 2 presents a screen shot of what you should see.

The screenshot shows the U.S. Securities and Exchange Commission's Edgar Company Filings search interface. At the top, there is a search bar for SEC.gov and a navigation menu with links for ABOUT, DIVISIONS, ENFORCEMENT, REGULATION, EDUCATION, FILINGS, and NEWS. The main content area is titled 'EDGAR Company Filings' and includes a 'Fast Search' box where 'TSLA' has been entered. Below the search bar, there are sections for 'Guides' and 'Search Tools'. A sidebar on the left provides additional search options like 'Latest Filings', 'Mutual Funds', and 'Daily Filings by Type'.

Click enter and you will get to Tesla's SEC Edgar page:

<https://www.sec.gov/cgi-bin/browse-edgar?CIK=tsla&owner=exclude&action=getcompany>

In the “Filing Type” box, type “CORRESP”. Hit enter , or click search, you will arrive on this page..



EDGAR Search Results

SEC Home » Search the Next-Generation EDGAR System » Company Search » Current Page

Tesla, Inc. CIK#: 0001318605 (see all company filings)

SIC: 3711 - MOTOR VEHICLES & PASSENGER CAR BODIES
 State location: CA | State of Inc.: DE | Fiscal Year End: 1231
 formerly: TESLA MOTORS INC (filings through 2017-01-27)
 (Assistant Director Office: 5)
 Get **insider transactions** for this issuer.

Business Address: 3500 DEER CREEK RD, PALO ALTO CA 94070, 650-681-5000
 Mailing Address: 3500 DEER CREEK, PALO ALTO CA 940

Filter Results: Filing Type: Prior to: (YYYYMMDD) Ownership? include exclude only Limit Results Per Page: 40 Entries

Items 1 - 12 [RSS Feed](#)

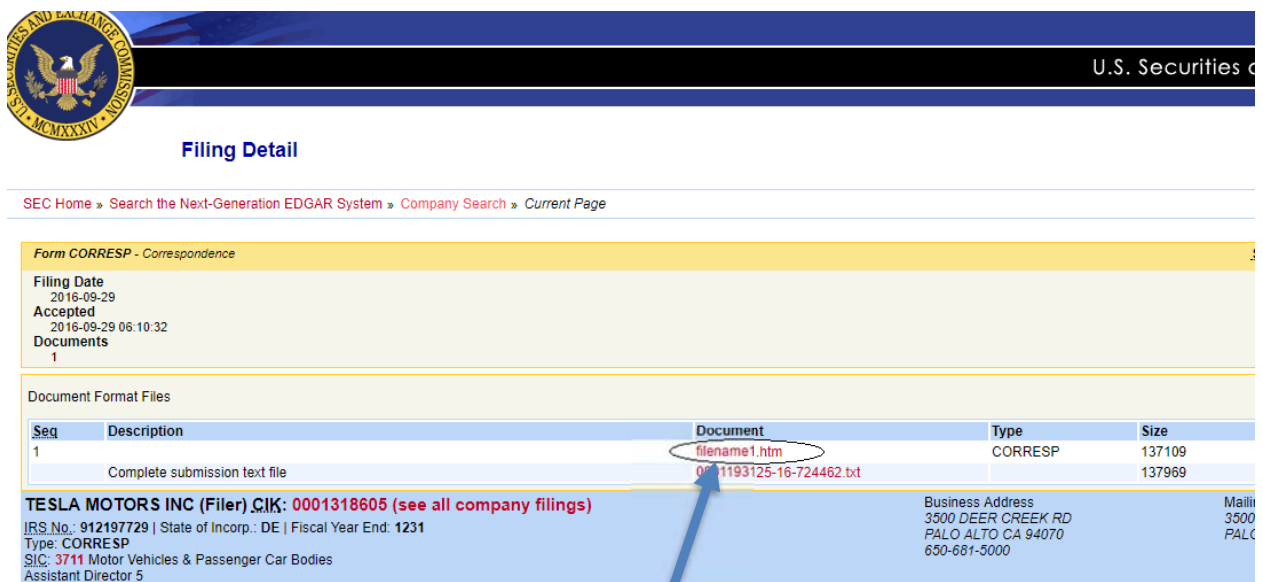
Filings	Format	Description	Filing Date	File/Fil
CORRESP	Documents	[Cover]Correspondence Acc-no: 0001564590-17-011641 Size: 67 KB	2017-05-24	
CORRESP	Documents	[Cover]Correspondence Acc-no: 0001193125-16-736356 Size: 13 KB	2016-10-12	
CORRESP	Documents	[Cover]Correspondence Acc-no: 0001193125-16-735978 Size: 12 KB	2016-10-11	
CORRESP	Documents	[Cover]Correspondence Acc-no: 0001193125-16-733801 Size: 11 KB	2016-10-07	
CORRESP	Documents	[Cover]Correspondence Acc-no: 0001193125-16-724462 Size: 137 KB	2016-09-29	

Now, on the correspondence filings page:

<https://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0001318605&type=corresp&dateb=&owner=exclude&count=40>

You will see multiple correspondence documents. The most relevant to this case are the “2016-09-29” and the “2016-09-19” correspondence. If you click the document button associated with the “2016-09-29” file you will arrive at the page.

<https://www.sec.gov/Archives/edgar/data/1318605/000119312516724462/0001193125-16-724462-index.htm>



Filing Detail

SEC Home » Search the Next-Generation EDGAR System » Company Search » Current Page

Form CORRESP - Correspondence

Filing Date: 2016-09-29
 Accepted: 2016-09-29 06:10:32
 Documents: 1

Document Format Files

Seq	Description	Document	Type	Size
1	Complete submission text file	filename1.htm	CORRESP	137109
		0001193125-16-724462.txt		137969

TESLA MOTORS INC (Filer) CIK: 0001318605 (see all company filings)

IRS No.: 912197729 | State of Incorp.: DE | Fiscal Year End: 1231
 Type: CORRESP
 SIC: 3711 Motor Vehicles & Passenger Car Bodies
 Assistant Director 5

Business Address: 3500 DEER CREEK RD, PALO ALTO CA 94070, 650-681-5000
 Mailing Address: 3500 DEER CREEK, PALO ALTO CA 940

Once on this page, click on “filename1.htm”, this is circled above. Finally, you will arrive at the correspondence from Tesla to the SEC. The document states the SEC’s inquiry and provides Tesla’s response. A screenshot of an excerpt of this document appears below.

CORRESP 1 filename1.htm

[Letterhead of Wachtell, Lipton, Rosen & Katz]
September 29, 2016

VIA FEDEX AND EDGAR

J. Nolan McWilliams
Division of Corporation Finance
Office of Transportation and Leisure
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: **Tesla Motors, Inc.**
Amendment No. 1 to Registration Statement on Form S-4
Amendment No. 2 to Registration Statement on Form S-4
Filed September 19, 2016
File No. 333-213390
Form 10-K for the Fiscal Year Ended December 31, 2015
Form 8-K Furnished August 3, 2016
Response Dated September 19, 2016
File No. 001-34756

Dear Mr. McWilliams:

On behalf of Tesla Motors, Inc. (“Tesla” or the “Company”), and in response to the comments of the staff (the “Staff”) of the Securities and Exchange Commission (the “Commission”) to (1) the Company’s Registration Statement on Form S-4 filed with the Commission on August 31, 2016, as amended twice on September 19, 2016 (the “Registration Statement”), (2) the Company’s Annual Report on Form 10-K filed with the Commission on February 24, 2016 (the “Form 10-K”) and (3) the Company’s Current Report on Form 8-K furnished to the Commission on August 3, 2016 (the “Form 8-K”), contained in your letter dated September 23, 2016 (the “Comment Letter”), we submit this letter containing the Company’s responses to the Comment Letter.

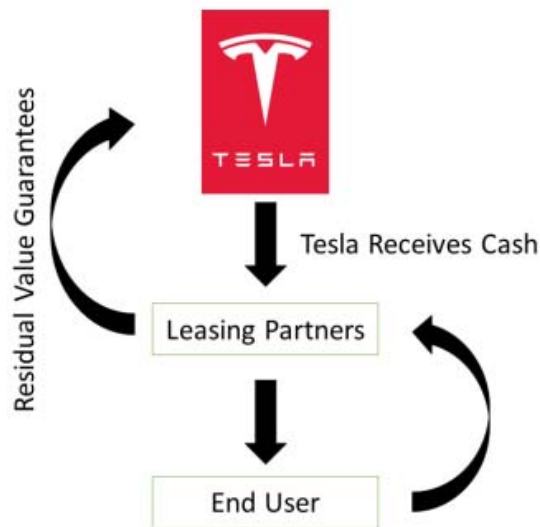


Figure 1: Tesla’s Leasing Arrangement

As you can see in figure 1, Tesla provides guarantees on leased vehicles, through third party banks, where the bank has an option to sell the vehicle back to Tesla at a predetermined price at the end of the lease term. In addition, should the bank sell the vehicle elsewhere at a price that is less than the guarantee buy back price, Tesla will cover the difference.

APPENDIX (TEACHING NOTE)**Table One Analysis of Tesla's 2016 Q2 GAAP vs. Non-GAAP financial measures**

	GAAP	Non-GAAP	Difference	% Difference
1 Revenue	\$1,270	1,562	\$292	23%
2 Automotive Gross Margin	23.10%	21.90%	1.20%	5%
3 R&D Expenses	\$192	\$158	\$34	18%
4 SG&A Expenses	\$321	\$294	\$27	8%
5 Total Operating Expenses	\$513	\$452	\$61	12%
6 Net Loss	(\$293)	(\$150)	\$143	49%
7 Loss per Share	(\$2.09)	(\$1.06)	\$1.03	49%
8 Cash Flow from Operations	\$150	\$293	\$143	95%

Table 1: Analysis of Tesla's 2016 Q2 GAAP vs. Non GAAP Measurements
 All numbers are in millions except per share numbers.

Table Two Calculation of non-GAAP financial measures

Non-GAAP financial measure	Calculation
1 Revenue	GAAP revenue plus deferred revenue
2 Gross Margin	GAAP gross margin plus stock based compensation
3 R&D Expenses	GAAP R&D less stock based compensation
4 SG&A Expenses	GAAP SG&A less stock based compensation
5 Operating Expenses	GAAP Operating Expenses less stock based compensation
6 Net Loss	GAAP Net Loss: Plus stock based compensation Plus non-cash interest expense Plus deferred gross profit
7 Loss Per Share	GAAP Loss Per Share: Plus stock based compensation Plus non-Cash interest expense Plus deferred profit
8 Cash Flow for Operations	GAAP Operating Cash Flow: Plus change in collateralized lease borrowing

Table 2: Analysis of non-GAAP Financial Measure Calculations

Table Three Impact Analysis of Tesla's revised non-GAAP financial measures

	Original Q2 2016	Revised
1 Revenue	\$1562.00	Not Reported
2 Automotive Gross Margin	21.90%	23.60%
3 R&D Expenses	\$158.00	\$158.00
4 SG&A Expenses	\$294.00	\$294.00
5 Total Operating Expenses	\$452.00	\$452.00
6 Net Loss	(\$150.00)	(\$225.00)
7 Loss Per Share	\$1.06	(\$1.61)
8 Cash Flow from Operations	\$293.00	\$293.00
9 Free Cash Flow	Not Reported	\$144.00

Table 3: Tesla's Revised Q2 2016 Non GAAP Measures

All numbers are in millions except per share numbers.

Table Four Analysis of Tesla's non-GAAP financial measures on key ratios

	GAAP	Non GAAP
1 Operating Expense Ratio	$513/1270 = 40\%$	$452/1562 = 29\%$
2 R&D as a % of Sales	$192/1270 = 15\%$	$158/1562 = 10\%$
3 Net Income/(Loss) Ratio as a % of Sales	$(293)/1270 = -23\%$	$(150)/1562 = -9\%$

Table 4: Teaching Note Suggested Answer
All numbers are in millions.