



## What CFOs should know when using Non-GAAP measures

### Benefits and challenges of non-GAAP reporting

Non-GAAP measures can be a powerful tool for communicating with investors and analysts. In a business climate marked by digital transformation, business innovation, and disruption—most recently COVID-19 and an uncertain economic environment—non-GAAP measures can play an important role in delivering a view of the company's financial or operational results to supplement what is captured in the financial statements.

While non-GAAP measures can help management provide further perspective on business performance, they have also been a focus area of the Securities and Exchange Commission (SEC) in recent years, and were one of the top areas of [SEC comment during 2020](#). Therefore, CFOs need to be aware of the SEC's rules and interpretations regarding non-GAAP information.

With CFOs increasingly expected to develop and execute on business strategy, the ability to communicate with stakeholders has become a more central measure of CFO success. The ability to provide stakeholders with the key information that management uses to run and evaluate the business may result in CFOs deciding the use of non-GAAP measures presents an effective means of

achieving this objective. Given the uncertain economic environment, and ongoing technology and business innovation, management may also determine that existing non-GAAP measures need adjustment, or no longer capture the current focus of management.

Across all industries and sectors, it's become clear that effective use of non-GAAP measures requires careful upfront and thoughtful planning. However, that investment, and evaluation of the applicable rules and regulations, can allow CFOs to effectively communicate management's perspective on your organization's financial position and/or performance.

"As the impacts of COVID-19 continue to reverberate, non-GAAP reporting may help CFOs provide investors with better insights into the unique, uncertain circumstances COVID-19 has created."

## Continued SEC scrutiny and guidance on non-GAAP reporting

While the SEC has issued rules and interpretive guidance on non-GAAP measures since 2001, several factors heightened SEC scrutiny in 2015:

- Increased use and prominence of non-GAAP reporting
- Potential for non-GAAP measures to be misleading
- Progressively larger differences between the amounts reported for non-GAAP and GAAP measures

In 2016, the SEC released updated Compliance and Disclosure Interpretations (C&DIs) that clarify SEC guidance on non-GAAP reporting. The C&DIs, along with additional public statements from SEC staff have helped establish a more clear understanding of the SEC's views: The SEC permits the use of non-GAAP measures to help management "tell their story," as long as the appropriate SEC guidance is applied and disclosures are provided.

In response, many companies have modified their approach to disclosures, particularly to address SEC guidance on the prominence of non-GAAP measures in press releases and filings. However, companies should be prepared for the SEC to remain focused on the following five key areas.

- Undue prominence of non-GAAP measures
- Enhancement of disclosures related to the purpose and use of non-GAAP measures
- Clear labeling of non-GAAP measures
- The potential for adjustments to be misleading or represent tailored accounting
- Presentation of tax impact of non-GAAP adjustments

Integrity and consistency are essential in making use of non-GAAP reporting. The SEC has also emphasized that companies should have controls and processes in place to provide timely information to management to allow for timely decisions regarding required disclosures.

## Non-GAAP reporting in the current economic environment, and COVID-19 impacts

Following the emergence of COVID-19, one of the key areas of focus for the SEC was the impact the pandemic might have on non-GAAP reporting for public companies. As the impacts of COVID-19 continue to reverberate, recent non-GAAP reporting of companies has indicated that COVID-19 has not resulted in significant changes in terms of the types of adjustments used by management in developing non-GAAP measures. For instance, impairments,

### Common non-GAAP financial measures

- Operating income that excludes one or more expense items
- Adjusted revenues, adjusted earnings, and adjusted earnings per share
- EBIT and EBITDA, and adjusted EBIT and EBITDA
- Core earnings
- Free cash flow
- Funds from operations
- Net debt, which could be calculated as borrowings less cash and cash equivalent or borrowings less derivative assets used to hedge the borrowings
- Measures presented on a constant-currency basis, such as revenues and operating expenses

restructuring changes, and other unusual or non-cash gains and losses have historically been commonplace within non-GAAP reconciliations.

However, the impact that COVID-19 has had on the overall economy has resulted in some companies adjusting non-GAAP measures to reflect new circumstances that have become focus areas of management and stakeholders. For example, companies may have redefined non-GAAP measures to include or exclude certain adjustments related to cash flows that were not previously included such as dividends or certain classifications of capital expenditures. Companies may also determine that new non-GAAP measures are more relevant than non-GAAP measures used in the past due to the evolving focus of the users of financial statements, such as a heightened attention to liquidity. Accordingly, a company may begin to report a liquidity based non-GAAP measure that was not a focus in previous years.

"Analysts and investors often look at non-GAAP measures to compare to peer companies."



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Although the total number of instances remains small, as outlined in our recent [Financial Reporting Alert 20-5](#), in the quarter ended June 30, 2020, an increased number of companies provided non-GAAP measures that included COVID-19-related adjustments. Notwithstanding that increase, some companies chose not to provide such non-GAAP measures because of concerns regarding (1) judgments related to which COVID-19-related costs were in fact “unusual or incremental” and objectively quantifying those costs and (2) creating potential negative comparisons in future periods to the extent that certain COVID-19-related costs (or a portion thereof) become recurring costs.

Of the companies that did incorporate COVID-19-related non-GAAP adjustments, many were associated with activities that are often included in non-GAAP adjustments but were described as being caused by or related to the impact of COVID-19. To a lesser degree, companies reported COVID-19-related adjustments that were described as incremental employee compensation or benefits, and incremental expenses associated with personal protective equipment, incremental cleaning, and sanitation efforts.

### Why and when could you use non-GAAP measures?

Non-GAAP measures can be a meaningful way to supplement GAAP numbers for a complete picture of business operations and liquidity. Analysts and investors often look at non-GAAP measures

for information utilized in their modeling, that is not easily or clearly captured from the financial statements. For instance, certain non-GAAP measures, such as EBITDA, may be used for assessing business valuations based on earnings multiples or comparable transactions. The added information can also show investors how management views the performance of the business and may facilitate peer comparisons.

Additionally, non-GAAP reporting might help companies convey helpful information for stakeholders when non-GAAP measures are the basis for management compensation and incentive plans, debt covenants or other requirements, or used by management in evaluating segment performance and resource allocation, and in the development of forecasts and budgets.

### How can Deloitte help?

In addition to deep experience with SEC reporting, we offer CFOs a worldwide network of accounting advisors who can help guide you through the technical aspects of non-GAAP reporting. Through our understanding of business and financial statements, and how to communicate effectively with investors, and simultaneously comply with SEC guidelines, we can help you report measures you utilize to present the current state and future prospects of your company in a way that meets your objectives, while remaining in compliance with the SEC’s rules and regulations.

## Let’s talk



### Matthew Burley

Audit & Assurance Partner  
Deloitte & Touche LLP  
+1 720 264 4866  
mburley@deloitte.com



### Isabelle Bordas

Risk and Financial Advisory Partner  
Deloitte & Touche LLP  
+1 212 436 5653  
isbordas@deloitte.com



### Sean Torr

Risk and Financial Advisory  
Managing Director  
Deloitte & Touche LLP  
+1 615 259 1888  
storr@deloitte.com

### Additional resources

- A roadmap to non-GAAP financial measures
- A roadmap to SEC comment letter considerations, including industry insights (2019)
- SEC Reporting and Disclosures Involving COVID-19

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