



## On the Radar

# Non-GAAP Financial Measures and Metrics

Non-GAAP financial measures and metrics are used commonly by both existing registrants and companies seeking to gain access to the U.S. capital markets through an initial public offering. Many registrants assert that non-GAAP measures are meaningful and provide valuable insight into the information that management considers important in running the business.

The SEC monitors non-GAAP measures and metrics vigilantly. Non-GAAP reporting, particularly related to misleading measures and prominence, is consistently among the top areas of SEC comment, and this trend is expected to continue. Registrants should therefore remain mindful of key topics of focus, including whether:

Undue prominence is placed on non-GAAP measures	Enhanced disclosure of the purpose and use of such measures has been provided	Non-GAAP measures are clearly labeled	The nature of certain adjustments may be misleading or could represent tailored accounting	When metrics are used, they have been clearly defined and state why they are useful to investors and how management uses them
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In December 2022, in response to numerous comments and questions from issuers, the SEC staff published new and updated [C&Dis](#) on how it evaluates non-GAAP measures. This updated guidance provides greater insight into, and examples of, (1) misleading measures and adjustments and (2) non-GAAP measures that may be more prominent than GAAP measures. The topics addressed in the updated guidance continue to be among the non-GAAP matters that the SEC staff comments on most frequently.

In addition, given the ongoing uncertainty associated with macroeconomic events (e.g., the Russia-Ukraine war, geopolitical unrest in the Middle East, and supply-chain disruptions) and related economic conditions, companies may be faced with a number of financial reporting and disclosure challenges that result in the recognition of infrequent or unusual gains, charges, or losses and may consider non-GAAP adjustments for these items. In [disclosure guidance](#) issued at the onset of the global pandemic, the SEC staff reminded registrants that the SEC's non-GAAP rules also apply to adjustments made for the impact of COVID-19. Further, the SEC issued a [sample letter](#) to companies regarding disclosures about the financial impact of the Russia-Ukraine war and related supply-chain disruptions. The letter included examples of SEC comments that issuers can consider when evaluating potential non-GAAP adjustments. While the SEC interpretive guidance and sample comments address specific macroeconomic events, registrants should remain mindful that the underlying principles may apply to other circumstances.

## Prominence

A registrant that presents a non-GAAP measure is required to present the most directly comparable GAAP measure with "equal or greater prominence." For example:

- If GAAP and non-GAAP measures are presented in a particular section of a document, the GAAP measures should be presented before the non-GAAP measures.
- When a registrant reconciles a non-GAAP measure to the most comparable GAAP measure, it should start with the GAAP measure.
- When a registrant presents a ratio that includes a non-GAAP measure in the numerator, denominator, or both, the ratio calculated by using the most directly comparable GAAP measure(s) should be presented before the ratio that includes the non-GAAP measure(s).
- A registrant should not present a non-GAAP measure in more detail, or emphasize it more, than the comparable GAAP measure.
- The disclosures related to the purpose and use of non-GAAP measures should not state or imply that such measures are superior to, provide better information about, or more accurately represent the results of operations than GAAP measures.
- Certain presentations that give undue prominence to non-GAAP information, such as a non-GAAP income statement, are prohibited.
- A registrant should not include charts or graphics presenting trends in a non-GAAP measure without presenting the same charts or graphics for the comparable GAAP measure first.

## Purpose and Use

A registrant should provide transparent disclosure that clearly demonstrates (1) the usefulness of the non-GAAP measure to investors and (2) the additional purposes, if any, for which management uses such measure (e.g., for incentive and compensation arrangements, to manage its business, to allocate resources, or as a debt covenant).

**The disclosures should be specific to the measure used, to the registrant and the nature of its business and industry, and to the manner in which management assesses the non-GAAP measure, rather than boilerplate disclosures.**

The registrant should also ensure that its disclosure of the usefulness and purpose of the measure is consistent with the categorization of the measure as a liquidity or a performance measure.

## Clear Labeling

Non-GAAP measures and related adjustments should be clearly and transparently labeled as such. The appropriate conventional accounting terminology should be used, the context of the presentation of such measures should be clear, and the label should reflect the nature of the measure or adjustment. For example, when labeling a non-GAAP financial measure, a registrant must not use titles or descriptions that are the same as, or are confusingly similar to, titles or descriptions used for GAAP financial measures or amounts presented under Regulation S-X, which could be misleading. Further, a registrant should not use a reconciling item labeled “other” that includes numerous significant items without clearly disclosing the nature of the items being used, along with the related amounts for each adjustment.

## Misleading Adjustments

An overriding theme of the SEC’s guidance on the use of or references to non-GAAP measures in public statements or disclosures is that they should not be misleading. The staff has indicated that non-GAAP measures that could mislead investors include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods, such as by adjusting an item in the current reporting period, but not a similar item in the prior period, without appropriate disclosure about the change and an explanation of the reasons for it.
- Exclude certain nonrecurring charges but do not exclude nonrecurring gains (e.g., “cherry picking” non-GAAP adjustments to achieve the most positive measure).
- Are based on individually tailored accounting principles, including certain adjusted revenue measures.

In comments on misleading adjustments, the SEC staff often focuses on individually tailored accounting principles and the exclusion of normal, recurring cash operating expenses. The staff has indicated that adjustments that change the accounting policy or the method of recognition of an accounting measure may be misleading and therefore may not be permitted. In particular, the staff continues to challenge any adjustments to GAAP revenue, emphasizing that revenue is “special.” For example, the staff has issued [interpretive guidance](#) on a prohibited non-GAAP performance measure that reflects revenue recognized ratably over time under GAAP on an accelerated basis as if the registrant earned revenue when it billed its customers. The measure is prohibited because it is an individually tailored accounting principle and does not reflect the registrant’s required GAAP measurement method. Similarly, the SEC would object to the presentation of gross or adjusted revenue that adds back sales discounts, return allowances, or other concessions to revenue as an adjusted gross sales measure because this presentation would be a substitute for a GAAP accounting recognition and measurement method.

**While the SEC often comments on individually tailored revenue recognition principles in non-GAAP measures, the interpretive guidance indicates that individual tailoring may also be prohibited when applied to expenses or other financial statement line items to create a non-GAAP measure.**

A registrant should also consider whether its non-GAAP performance measure removes costs necessary to generate revenues or normal, recurring cash charges. The SEC staff has, for example, commented when non-GAAP measures have excluded expenses that a registrant has incurred over several successive quarters or years that appear to be necessary for operating its business, such as rent, preopening costs, or up-front and milestone payments in a collaboration arrangement.

In interactions with the SEC staff regarding non-GAAP measures viewed as misleading, some registrants have proposed supporting continued presentation of such measures by adding transparent disclosures related to the calculation of the measures or about the measures' purpose and use. However, even detailed disclosures about a misleading measure may not prevent it from being misleading.

The SEC staff has also indicated that once a non-GAAP measure or adjustment is concluded to be misleading or otherwise inconsistent with non-GAAP rules, the staff expects the registrant to correct the presentation in the next filing or publicly available SEC document by removing the measure or adjustment. If comparable periods are presented, the non-GAAP measure or adjustment should be removed from all periods presented.

## Metrics

Many registrants also disclose the metrics and key performance indicators (KPIs) used to manage their business. While such customized metrics are generally not considered non-GAAP measures (although they may be derived from such measures), a registrant should provide certain disclosures about them, many of which are similar to those the registrant would provide for non-GAAP measures.

The SEC has issued an [interpretive release](#) that highlights disclosure considerations related to metrics and KPIs and addresses the application of the existing MD&A rules to them. Accordingly, a registrant should (1) clearly define the metrics used and how they are calculated, (2) describe the reasons why each metric provides useful information to investors, and (3) describe how management uses each metric in managing or monitoring the performance of its business. A registrant should also disclose any key estimates, assumptions, and limitations specific to a metric (e.g., whether the metric is a "hard" amount or an estimate).

## Disclosure Controls and Procedures

The SEC has spoken publicly about the implementation of appropriate disclosure controls and procedures (DCPs) related to the disclosure of non-GAAP measures and metrics. DCPs pertain to controls over all information that a public company must disclose. Companies and audit committees should consider designing DCPs to ensure that procedures are in place regarding (1) compliance, (2) consistency of preparation, (3) data quality, (4) accuracy of calculation, (5) transparency of disclosure, (6) review, and (7) monitoring. A critical aspect of such DCPs is the involvement of the appropriate levels of management and those charged with governance. Depending on the registrant, this may include reviewing the selection and determination of non-GAAP measures with a disclosure committee, the audit committee, or both. When identifying its DCPs, management may find it helpful to establish a written policy that (1) clearly describes the nature of allowable adjustments to GAAP measures, (2) defines the non-GAAP measure(s) to be used under the policy, and (3) explains how potential changes in the inputs, calculation, or adjustments will be evaluated and approved.

Staff members in the SEC's Division of Enforcement have recently highlighted actions taken against registrants in connection with their non-GAAP measures and other disclosures. They have emphasized the importance of having appropriate DCPs in place to ensure that any adjustments and non-GAAP measures, as a whole, are appropriately prepared and reviewed in accordance with the non-GAAP rules.

Deloitte's Roadmap [Non-GAAP Financial Measures and Metrics](#) combines the SEC's guidance on non-GAAP measures with Deloitte's interpretations and examples in a comprehensive, reader-friendly format.

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