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Technology Industry Accounting Guide

Other Accounting and Financial Reporting Topics: Non-GAAP Financial Measures and Metrics

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Preface

We are pleased to present the inaugural edition of Deloitte's *Technology Industry Accounting Guide* (the "Guide").

The technology industry ecosystem encompasses a wide array of entities, from enterprise software and software-as-a-service (SaaS) providers to hardware and semiconductor manufacturers. The technology industry has also experienced convergence with other types of businesses, creating subsectors such as fintech, health tech, energy tech, education tech, and auto tech, to name a few. Many entities have fueled the significant growth of the technology industry by embracing emerging technologies such as artificial intelligence (AI) and machine learning, everything as a service (XaaS) powered by the cloud, robotics, the Internet of Things (IoT), blockchain, and edge computing. Continuous innovation by technology entities produces novel business models while introducing potentially complex accounting and financial reporting matters.

Finance and accounting professionals in the technology industry face complex issues and must exercise significant judgment in applying existing rules to matters such as revenue recognition, software-related costs, acquisitions and divestitures, consolidation, stock-based compensation, leases, financial instruments, income taxes, digital assets, initial public offerings (IPOs), and disclosures of non-GAAP measures and metrics. To help technology entities work through some of the more difficult accounting and financial reporting issues related to these and other relevant topics, this Guide includes interpretive guidance, illustrative examples, and discussion of recent standard-setting developments (through February 28, 2023).

Appendix A lists the titles of standards and other literature we cited, and Appendix B defines the abbreviations we used.

We hope this Guide is helpful in navigating the various accounting and reporting challenges that technology entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

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Chapter 5 — Other Accounting and Financial Reporting Topics

5.10 Non-GAAP Financial Measures and Metrics

5.10.1 Non-GAAP Financial Measures

While an entity's financial statements must be prepared in accordance with GAAP, many entities also elect to disclose non-GAAP financial measures[1] — that is, numerical measures of an entity's financial performance, financial position, or cash flows for which the GAAP counterparts are adjusted in some fashion. Examples of common non-GAAP financial measures include EBITDA, adjusted EBITDA, adjusted earnings or adjusted EPS, and free cash flow.

When using non-GAAP financial measures, an SEC registrant must be aware of certain SEC requirements, including the rules in SEC Regulation G and SEC Regulation S-K, Item 10(e). In addition, the SEC staff has published a number of Compliance and Disclosure Interpretations (C&DIs) (which are updated periodically) to clarify its views on many non-GAAP presentation issues. SEC officials have indicated in public forums that the SEC is looking for full compliance with the C&DIs in SEC filings.

The key requirements for disclosure of non-GAAP information in SEC filings, including press releases, are related to the following:

- *Prominence* — The most directly comparable GAAP measure should be presented with equal or greater prominence.
- *Not misleading* — A non-GAAP measure should not be presented in a misleading manner.
- *Reconciliation* — Registrants should present a quantitative reconciliation of the non-GAAP measure to the most directly comparable GAAP measure and should transparently describe all adjustments.
- *Clear labeling* — Registrants should clearly label and describe non-GAAP measures and adjustments but should not, for example, use titles or descriptions that are confusingly similar to those used for GAAP financial measures.
- *Usefulness and purpose* — Registrants should disclose why they believe the non-GAAP measure provides useful information to investors and, to the extent material, provide a statement disclosing the additional purposes, if any, for management's use of the non-GAAP measure.

[1] SEC Regulation S-K, Item 10(e)(2), 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, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of comprehensive income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or
(ii) Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented."

The SEC staff has frequently cited its C&DI on prominence, Question 102.10, when commenting on non-GAAP measures. Accordingly, it may be helpful for a registrant to note the following:

- 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. For example, if a registrant wants to use certain non-GAAP measures in its discussion of results of operations, it should consider the order of presentation and discuss the GAAP results 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.
- The registrant should not present a non-GAAP measure in more detail, or emphasize it more, than the comparable GAAP measure.
- The disclosures related to non-GAAP purpose and use should not state or imply that the non-GAAP 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 full non-GAAP income statement, are prohibited.
- If non-GAAP measures are presented in a chart or graphic, the chart or graphic should include the most directly comparable GAAP measures or they should be displayed in an equally prominent location.

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. Section 100 of the C&DIs also provides examples of potentially misleading non-GAAP measures, including those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.[2]
- 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 addition to the examples discussed in the C&DIs, various other presentations could be considered misleading depending on the facts and circumstances.

For more information, see Deloitte's Roadmap *Non-GAAP Financial Measures and Metrics*.

[2] Section 100.01 of the C&DIs states, in part, that "[w]hen evaluating what is a normal, operating expense, the staff considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment. The staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring."

5.10.2 Metrics and KPIs

Financial or operational metrics, sometimes called KPIs, may also be included in a registrant's SEC filing to illustrate the size, profitability, and growth of the business or other relevant trends such as customer acceptance or retention. Metrics used by technology entities could include items such as:

- Annual recurring revenue.
- Bookings.
- Weighted average duration of contracts.
- The number of Web page views.
- Total customers or subscribers, the number of those who are active, or changes in either number.
- Operating or contribution margin.
- Customer retention rates (e.g., net revenue retention or core customer retention).
- Average revenue per user.
- Daily or monthly (1) number of active users or (2) usage.
- Number of "likes."
- Total impressions.

The SEC has indicated that registrants should consider the need to disclose KPIs or metrics that management uses in managing its business within MD&A, because such information may be material to an investor's understanding of the registrant's performance. For example, if a registrant that operates a gaming platform discloses online users and there are subsets of those online users that are material to an investor's understanding of the registrant's results of operations and financial position, the registrant should consider disclosing the subsets and explaining any differences between them. For some platforms, the monetization of U.S. users may differ from that of international users, and the monetization of mobile users may differ from that of desktop users. In addition, if a registrant that operates a marketplace platform discloses the number of visitors to its Web site, it should disclose how that metric is clearly and directly related to its results of operations and financial position. The registrant may disclose the number of individuals who visited its Web site but fail to note how this number differs from the number of visitors who actually purchased goods. Further, some e-commerce retailers disclose gross merchandise volume when they do not own the merchandise sold on their Web sites and record revenue on a net basis. Such disclosures should discuss why this metric is important and how it is linked to the registrant's results.

Metrics may be based on GAAP amounts, non-GAAP amounts, nonfinancial amounts, or any combination thereof. When using metrics, registrants should first consider whether an existing regulatory framework applies. For example, metrics based on non-GAAP measures would be subject to the requirements in SEC Regulation G and SEC Regulation S-K, Item 10(e). If metrics are not subject to an existing framework, registrants should consider what additional information they may need to present for investors to understand the metric presented. As clarified in interpretive guidance issued by the SEC in January 2020, the SEC would generally expect the following disclosures to accompany all KPIs and metrics in MD&A:

- A clear definition of the metric and how it is calculated.
- A statement indicating the reasons why the metric provides useful information to investors.

- A statement indicating how management uses the metric in managing or monitoring the performance of the business.
- Whether there are estimates or assumptions underlying the metric or its calculation that may be important for investors to understand.
- Disclosures accompanying any changes in the calculation or presentation of KPIs and metrics from period to period.

The guidance also reminds registrants of the importance of maintaining effective disclosure controls and procedures related to KPIs and metrics, including maintaining consistency and accuracy of disclosures.

For more information about the presentation and use of metrics and KPIs, see Section 2.4 of Deloitte's Roadmap *Non-GAAP Financial Measures and Metrics*.

5.10.3 SEC Comment Letter Trends

SEC comments have continued to cover a wide range of matters related to non-GAAP measures and metrics.

Although there has been a decline in the number of comments related to prominence of non-GAAP measures, that topic has remained a focus of the staff. Comments have also focused on enhancing the disclosure related to the purpose and use of such measures, reconciliation requirements, and clear labeling. For example, a registrant in the technology industry may disclose revenue excluding traffic acquisition costs (ex-TAC) as a key non-GAAP measure. The SEC staff may request that the registrant reconcile the amount to GAAP gross profit (instead of revenue) and revise the title of the non-GAAP measure to better reflect the measure's nature (e.g., the registrant may decide to change the title to contribution ex-TAC). In addition, if a registrant does not present a gross profit subtotal on the face of the income statement but discusses cost of sales excluding depreciation and amortization in MD&A, it should disclose that the measure is a non-GAAP measure and comply with the applicable disclosure requirements. Further, the SEC has questioned the nature of certain adjustments that may be potentially misleading, such as those that use individually tailored accounting principles.

With respect to metrics and KPIs, SEC comments often request disclosures explaining or clarifying how a metric is calculated, why the metric provides useful information to investors, and how management uses the metric in managing the business. In addition, the SEC staff may raise questions when changes are not appropriately quantified and it is unclear whether metrics represent KPIs. Because of the vast volume of metrics used, the SEC staff has been concerned that (1) metrics may not be presented with appropriate context and (2) the link between registrants' key metrics and their income and future profitability may not be clear. Registrants should review their metrics to ensure that the metrics are clearly defined, portray a balanced discussion, and remain relevant.

For more information, see Sections 3.4 and 6.5.1.4 of Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights*.

Appendix A — Titles of Standards and Other Literature

AICPA Literature

Accounting and Valuation Guide

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Audit and Accounting Guide

Revenue Recognition

Practice Aid

Accounting for and Auditing of Digital Assets

FASB Literature

ASC Topics

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 235, *Notes to Financial Statements*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 325, *Investments — Other*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 450, *Contingencies*

ASC 460, *Guarantees*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 705, *Cost of Sales and Services*

ASC 710, *Compensation — General*

ASC 712, *Compensation — Nonretirement Postemployment Benefits*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 848, *Reference Rate Reform*

ASC 860, *Transfers and Servicing*

ASC 940, *Financial Services — Brokers and Dealers*

ASC 944, *Financial Services — Insurance*

ASC 946, *Financial Services — Investment Companies*

ASC 985, *Software*

ASUs

ASU 2014-01, *Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2018-07, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

ASU 2018-11, *Leases (Topic 842): Targeted Improvements*

ASU 2018-15, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* — a consensus of the FASB Emerging Issues Task Force

ASU 2019-08, *Compensation — Stock Compensation (Topic 718) and Revenue From Contracts With Customers (Topic 606): Codification Improvements — Share-Based Consideration Payable to a Customer*

ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

ASU 2020-06, *Debt — Debt With Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

ASU 2021-02, *Franchisors — Revenue From Contracts With Customers (Subtopic 952-606): Practical Expedient*

ASU 2021-04, *Earnings per Share (Topic 260), Debt — Modifications and Extinguishments (Subtopic 470-50), Compensation — Stock Compensation (Topic 718), and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options* — a consensus of the FASB Emerging Issues Task Force

ASU 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers*

ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848*

Concepts Statements

No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

No. 8, *Conceptual Framework for Financial Reporting — Chapter 4,* Elements of Financial Statements

Proposed ASU

No. 2022-ED300, *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*

IRC

Section 382, "Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change"

Section 409A, "Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans"

IFRS Literature

IFRS 15, *Revenue From Contracts With Customers*

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

SEC Literature

FRM

Topic 7, "Related Party Matters"

Topic 10, "Emerging Growth Companies"

Interpretive Release

No. 33-10751, *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*

Regulation S-K

Item 10(e), "General; Use of Non-GAAP Financial Measures in Commission Filings"

Item 103, "Business; Legal Proceedings"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Regulation S-X

Rule 3-13, "Filing of Other Financial Statements in Certain Cases"

Rule 5-03, "Statements of Comprehensive Income"

Rule 11-01, "Presentation Requirements"

SAB Topics

No. 1, "Financial Statements"

- No. 1.B, "Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity"
- No. 1.M, "Materiality"

No. 5.Y, "Miscellaneous Accounting; Accounting and Disclosures Relating to Loss Contingencies"

Securities Exchange Act of 1934

Section 13, "Periodical and Other Reports"

Section 15(d), "Registration and Regulation of Brokers and Dealers; Supplementary and Periodic Information"

Superseded Literature

AICPA Technical Practice Aid

Section 5100.68, "Revenue Recognition: Fair Value of PCS in Perpetual and Multi-Year Time-Based Licenses and Software Revenue Recognition"

EITF Abstract

Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*

FASB Concepts Statement

No. 6, *Elements of Financial Statements* — a replacement of FASB Concepts Statement No. 3 (incorporating an amendment of FASB Concepts Statement No. 2)

Other Literature

FASB TRG Agenda Papers

TRG Agenda Paper 23, *Incremental Costs of Obtaining a Contract*

TRG Agenda Paper 41, *Measuring Progress When Multiple Goods or Services Are Included in a Single Performance Obligation*

TRG Agenda Paper 44, *July 2015 Meeting — Summary of Issues Discussed and Next Steps*

TRG Agenda Paper 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*

TRG Agenda Paper 59, *Payments to Customers*

TRG Agenda Paper 60, *November 2016 Meeting — Summary of Issues Discussed and Next Steps*

Appendix B — Abbreviations

Abbreviation	Description
AI	artificial intelligence
AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
BC	Basis for Conclusions
BCF	beneficial conversion feature
C&DI	SEC Compliance and Disclosure Interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CCF	cash conversion feature
CECL	current expected credit loss
CIMA	Chartered Institute of Management Accountants
CPM	cost per mille
CRM	customer relationship management
DLOM	discount for lack of marketability
DTA	deferred tax asset
DTL	deferred tax liability
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval System
EGC	emerging growth company
EITF	FASB Emerging Issues Task Force
EPS	earnings per share

Abbreviation	Description
ERP	enterprise resource planning
ex-TAC	excluding traffic acquisition costs
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FIFO	first in, first out
FinREC	AICPA Financial Reporting Executive Committee
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IC	independent contractor
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IoT	Internet of Things
IP	intellectual property
IPO	initial public offering
IPR&D	in-process research and development
IRC	Internal Revenue Code
IT	information technology

Abbreviation	Description
JOBS Act	Jumpstart Our Business Startups Act
KPI	key performance indicator
LIBOR	London Interbank Offered Rate
LIFO	last in, first out
LLC	limited liability company
M&A	merger and acquisition
MD&A	Management's Discussion and Analysis
NFT	nonfungible token
NOL	net operating loss
OCA	SEC's Office of the Chief Accountant
OEM	original equipment manufacturer
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCS	postcontract customer support
Q&A	question and answer
R&D	research and development
RMN	retail media network
ROU	right-of-use

Abbreviation	Description
S&P 500	Standard & Poor's 500 stock market index
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
Sarbanes-Oxley	Sarbanes-Oxley Act of 2002
SEC	U.S. Securities and Exchange Commission
Securities Act	Securities Act of 1933
SG&A	selling, general, and administrative
SKU	separate stock-keeping unit
SPAC	special-purpose acquisition company
SRC	smaller reporting company
SSP	stand-alone selling price
TMT	Technology, Media, & Telecommunications
TPA	AICPA Technical Practice Aid
TRG	FASB/IASB transition resource group for revenue recognition
VIE	variable interest entity
XaaS	everything as a service