CAQ Releases New Non-GAAP Measures Tool for Audit Committees

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While the frequency of SEC comments on companies' disclosure of non-GAAP measures has subsided, it remains important for audit committees to ensure their companies' disclosures comply with applicable non-GAAP disclosure rules. To assist in this regard, the Center for Audit Quality has released a new report titled *Non-GAAP Measures: A Roadmap for Audit Committees*. The report summarizes general themes emerging from three roundtable discussions that the CAQ hosted in 2017 regarding the presentation and use of non-GAAP measures and provides some guidance for audit committees to consider when reviewing their companies' preparation and disclosure of non-GAAP measures. Notably, use of the term "non-GAAP measures" in the report refers to measures defined as "non-GAAP" under SEC rules and also to key performance indicators (KPIs), which are not directly subject to the SEC's non-GAAP rules but which the SEC staff has suggested may need to be accompanied by similar disclosures.

Themes from 2017 Roundtables. Each of the CAQ's 2017 roundtable discussions were attended by 20 to 25 individuals representing audit committee members, management, investors, securities attorneys and public company auditors. The discussions explored the following five areas:

- why management discloses non-GAAP measures;
- how management approaches preparing and presenting non-GAAP measures;
- how audit committees oversee that process;
- how investors and others use non-GAAP measures; and
- what, if anything, could be done to enhance trust and confidence in non-GAAP measures.

It was clear from the roundtable discussions that audit committees across industry sectors engage in discussions about non-GAAP measures with company management and, to some extent, with their external auditors. As the report states, "[f]rom these roundtables, broad, shared themes coalesced regarding why the information is presented and how non-GAAP measures are used. More importantly, the challenges non-GAAP measures present—and the opportunities for ways to approach improving trust and confidence in these measures—were also consistent across industries."

Roundtable participants generally found non-GAAP measures to be useful and identified demand from investment analysts and a desire among management to tell a company's story among the primary drivers for presenting non-GAAP measures. Participants generally viewed GAAP information as a useful "bedrock" or "starting point" that allows for comparability from one company to the next. While participants identified the lack of consistency in non-GAAP measures as a challenge, management participants expressed some concern that standardizing non-GAAP measures may limit the ability to effectively communicate a company's story to investors. Some participants expressed beliefs that certain changes to GAAP reporting could reduce the number of non-GAAP measures that companies present. Participants did agree that it generally is useful for non-GAAP measures to meet the following criteria in addition to satisfying applicable SEC disclosure requirements:

- be calculated and presented consistently;
- be transparently disclosed; and
- be comparable to measures disclosed by other companies.

Roundtable participants also agreed that increased audit committee oversight and involvement with non-GAAP measures can play a vital role in the quality of non-GAAP measures presented. In this regard, the report highlights the added rigor that audit committees can promote by engaging in dialogue with management and their companies' internal and external auditors. As the report notes, "this dialogue would be for the audit committee to set clear expectations regarding the roles and responsibilities—relative to non-GAAP measures—of each member of the financial reporting supply chain."

Leading Practices. Among the areas of general consensus emerging from the CAQ's roundtable discussion are the following leading practices to support the presentation of non-GAAP measures that reflect a balanced view of a company's performance:

- **Disclosure controls**. Roundtable participants "generally agreed that non-GAAP measures should be subject to robust disclosure controls." Such controls should be documented and comprehensive enough to facilitate control testing. Having such controls in place could improve consistency and transparency regarding a company's non-GAAP measures.
- **Non-GAAP policies**. Management representatives participating on the CAQ's roundtables noted that they generally have adopted guidelines for preparing and presenting non-GAAP measures, which can help guide decision-making surrounding the treatment of new transactions within a company's existing non-GAAP measures. The guidelines also enhance consistency in the preparation and presentation of a company's non-GAAP measures.
- **Disclosure about Non-GAAP policies**. The report notes that "[f]ew, if any, companies currently disclose their non-GAAP policies." While roundtable participants did not reach consensus about whether disclosure of a company's non-GAAP policies (or disclosure that a company has a non-GAAP policy) would be a good practice, the report indicates that there could be benefits to disclosing that a company has adopted a non-GAAP policy (without disclosing the details of the policy). The report suggests that "[s]uch disclosure could demonstrate to investors the importance of this information to the audit committee

and that policies are in place to support the metrics being consistent, transparent, and comparable."

Roadmap of Discussion Topics. Recognizing the audit committee's important responsibility to oversee the financial reporting process and external audit, the report highlights that the audit committee is well positioned to bridge management communications with investors and can assess management's rationale for presenting non-GAAP measures. The audit committee is also well positioned to question management regarding whether proposed non-GAAP measures are fair and balanced. For purposes of engaging with management, the report suggests that audit committees may want to consider the following roadmap of topics:

- **Putting itself in the investors' shoes** when evaluating if the presented non-GAAP measures and related disclosures align with the company's overall strategy and performance.
- **Engaging with investors directly or through investor relations** to ensure that the presented non-GAAP measures aid investors' understanding of the company's performance.
- **Asking management whether it has an internal policy** that provides guidelines for determining how non-GAAP measures are generated, calculated, and presented, including the rationale for the measures and adjustments that it presents and excludes. If there is no policy, encourage management to create one.
- **Discussing with management how the company makes changes to non-GAAP measures it presents**, and the rationale for why it would or would not make changes.
- **Seeking the perspective of counsel** on non-GAAP measures.
- **Asking the company to compare or benchmark** its non-GAAP measures to those of its peers.
- **Finding out what disclosure controls and procedures are in place** as they relate to the information that is presented and disclosed.
- **Asking the external auditors what their responsibilities are for non-GAAP measures**, and whether that responsibility is different depending on where non-GAAP measures are presented.
- **Asking the external auditors for perspectives** on how non-GAAP measures that the company presents generally compare with those of other companies.
- **Discussing with the external auditors what their views are on the company's non-GAAP measures**, including whether the measures are consistent with the auditors' understanding and knowledge of the company's performance.

External Auditor Considerations. As a reminder for audit committees, the report notes that external auditors do not audit non-GAAP measures in connection with an audit of a company's financial statements or internal control over financial reporting. Applicable auditing standards, however, recommend that auditors should read non-GAAP measures presented in documents containing the financial statements (e.g., annual or quarterly reports) and consider whether such measures are materially inconsistent with information appearing in the financial statements or otherwise contain a material misstatement of fact. The report suggests that audit committees and management may want to consider engaging the external auditor to perform certain procedures (e.g., testing controls regarding the preparation and disclosures of non-GAAP measures) to bolster trust and confidence in a company's non-GAAP measures.

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