

Going Public: The Benefits and Pitfalls of Non-GAAP Metrics*

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The use of non-GAAP or adjusted financial metrics is ubiquitous among public firms and has become increasingly common in the financial disclosures of private firms going public. Indeed, recent evidence shows that the use of non-GAAP metrics in the prospectus filings of U.S. initial public offerings (IPOs) has almost tripled over the last two decades. This trend is even more striking for technology¹ IPOs often generate large losses during the early stages of the company's life cycle. For these firms, tailored financial metrics can serve as useful tools to better tell the company's story and to show signals of eventual future profitability. However, the presentation of non-GAAP metrics in prospectus and other disclosure filings can lead to several problems such as lack of comparability with industry peers, misinterpretation by investors, and heightened scrutiny by regulators and the business media. Thus, entrepreneurs and managers need to strike the right balance when choosing to rely on adjusted financial metrics when taking a company public. This article provides key insights by discussing the history of non-GAAP reporting, relevant U.S. and international disclosure guidelines, current trends in practice, and common benefits and pitfalls of non-GAAP disclosures.

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¹ Consistent with prior research, I use the term "technology" to refer to IPOs in the science, technology, engineering, and math (STEM) industries (see Brown et al. 2020; Fedyk et al. 2017).

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What is a Non-GAAP Financial Measure?

A non-GAAP financial metric is a financial performance measure that does not conform to generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS)². These measures adjust a firm's historical or future financial performance by excluding (or adding back) amounts from a comparable measure prepared according to GAAP or IFRS. In most cases, firms will start with GAAP net income or earnings per share and add back expense components that are deemed irrelevant for assessing core financial performance. Common non-GAAP measures are core or adjusted operating income, adjusted earnings per share (EPS), earnings before interest, tax, and depreciation (EBITDA), adjusted EBITDA, free cash flow, and, to some extent, adjusted revenues. In terms of frequency rates, Audit Analytics report that 82% of the S&P 500 disclosed an adjusted operating income measure, while 79% disclosed some type of adjusted EPS measure (Usvyatsky and Coleman 2018).³

Note that non-financial and statistical measures (also known as key performance indicators or KPIs) such as number of subscribers, customer churn, and same-store sales are not considered non-GAAP measures as they are not derived directly from a GAAP or IFRS measure. Operating and financial measures disclosed for segment reporting purposes are also excluded as such measures are provided following GAAP or IFRS. Figure 1 depicts the types of measures that fall within the general scope of the non-GAAP definition.

History of Non-GAAP Reporting and the U.S. Regulatory Background

The non-GAAP phenomenon is not new as adjusted financial metrics started to appear in corporate disclosures and equity analyst reports from the mid-1990s (see Black et al. 2018 for discussions of the history of non-GAAP disclosure in U.S. and international capital markets). While the introduction of non-GAAP metrics has been attributed to several factors, the use of these metrics increased dramatically during the Internet or dot-com stock market bubble (Brown et al. 2012)⁴ - and became in fashion among technology firms, especially those in technology-related business services such as online information services and computer programming services (Bhattacharya et al. 2004). Many of these firms were young, loss-generating entities with higher-than-average market capitalization. Thus, critics of non-GAAP reporting surmise that the use of adjusted metrics grew out of the need for young, high-growth, technology companies to demonstrate firm value by converting GAAP losses to more palatable measures of profitability.

2 The term "non-GAAP" is used in U.S. regulatory mandates to refer to adjusted financial metrics that do not conform to U.S. GAAP. The same term is used in practice to refer to adjusted metrics that are not prepared under IFRS or other home-country accounting standards. The terms "non-IFRS" or "alternative performance measures (APMs)" are also used in international settings.

3 These statistics are based on information collected from annual earnings press releases issued in 2017.

4 See Figure 2 of Brown et al. (2012) for graphical evidence of the sharp increase in non-GAAP disclosure during the dot-com bubble

During this timeframe, non-GAAP measures were unregulated, low-quality in nature, and perceived as misleading to investors. In the wake of the dot-com crash and several high-profile accounting frauds, U.S. regulators responded with cautionary warnings and legislative mandates to reign in opportunistic non-GAAP practices and enhance the transparency and usefulness of adjusted measures. Specifically, in December 2001, the U.S. Securities and Exchange Commission (SEC) issued a cautionary advice warning investors of the pitfalls of relying on non-GAAP financial metrics. The Sarbanes-Oxley Act of 2002 (Section 401b) further outlined congressional directives aimed at (1) prohibiting the disclosure of misleading non-GAAP metrics and (2) improving transparency by requiring companies to reconcile the non-GAAP metric to the relevant GAAP figure. These directives were later implemented by the SEC under Regulation G, promulgated in January 2003, followed by a series of non-authoritative interpretive guidance published as Compliance and Disclosure Interpretations (C&DIs).⁵

Regulation G applies to all U.S. public companies including cross-listed foreign firms and private firms undergoing an initial public offering. The guidelines apply to all public disclosures or releases containing non-GAAP financial metrics, including disclosures made in print, orally, telephonically, electronically, by webcast, or by any other means. The general mandates of Regulation G prohibit the public disclosure of non-GAAP information that could be perceived as misleading based on untrue or omitted facts and require companies to present the most directly comparable GAAP metric along with a quantitative reconciliation of the differences between the non-GAAP and GAAP metrics. Regulation G also made amendments to specific SEC disclosure rules that govern information furnished to the SEC, such as earnings press releases (see Item 2.02 of Form 8-K) and public firm filings such as periodic quarterly and annual financial reports, as well as IPO registration statements and prospectus filings (see Item 10e of Regulation S-K). These amendments require companies to present the most directly comparable GAAP metric with equal or greater prominence than the non-GAAP metric and to discuss why management views the non-GAAP metric as useful to investors and how the metric is used internally by management in operating the business.⁶ Table 1 illustrates the applicable non-GAAP guidelines for all disclosures, as well as SEC filings and information furnished to the SEC on a Form 8-K.

As noted earlier, foreign firms that are cross-listed on U.S. exchanges are subject to the same prohibitions and requirements as Regulation G.⁷ These firms are also subject to the Item 10e requirements of Regulation S-K concerning the disclosure of non-GAAP metrics in Form 20-F filings and registration statements for public offerings in the U.S. That is, U.S.-listed foreign firms must provide a quantitative non-GAAP reconciliation and the most directly comparable GAAP metric with equal or greater prominence. They must also discuss why the measure is useful to investors and how the measure is used internally by management.

5 For comprehensive details on Regulation G, see Topic 8 of the SEC Financial Reporting Manual available at <https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml>. The initial set of C&DIs on Regulation G was issued in January 2010 and updated in July 2011, May 2016, October 2017, and April 2018. While the C&DIs are non-authoritative, they are generally viewed by practitioners as providing strict guidelines on non-GAAP usage.

6 Note that these requirements do not extend to non-GAAP metrics disseminated orally, telephonically, or via electronic venues such as social media. However, by analogy to the notes to Item 2.02 of Form 8-K, a firm can comply with the Item 10(e) requirements by hyperlinking to the SEC filing, earnings press release, or to the information on the firm's website. See Brown et al. (2019) for further details on non-GAAP disclosures on social media.

7 There are some limited exemptions. Specifically, cross-listed foreign firms are exempt from Regulation G if all of the following three conditions are met: (1) the company's stock or debt securities are listed on an exchange outside of the U.S., (2) the non-GAAP metric is not derived from or based on a measure prepared and presented under U.S. GAAP, and (3) the non-GAAP metric was disclosed outside of the U.S. These exemption criteria will still apply even if the non-GAAP metric is disclosed concurrently or shortly thereafter in the U.S., as long as individuals located in the U.S. are not the intended primary target of the disclosure communication.

International Regulatory Background

The usage of non-GAAP disclosures is more widespread on the international front and companies are afforded much more latitude in how they present and compute these metrics (see Marques 2017 for an overview of non-GAAP practices and disclosure guidance in international jurisdictions such as the United Kingdom, the European Union, Australia, Canada, and South Africa). For instance, the IFRS standard, IAS 33 – *Earnings Per Share*, permits companies to present an adjusted earnings per share (EPS) measure in the notes of the financial statements as long as the metric is accompanied by a quantitative reconciliation and computed using the same number of shares as the standard EPS metric.

As a part of its *Primary Financial Statements* project, the IASB recently proposed to expand the disclosure of certain non-GAAP metrics in the financial statements. The December 2019 Exposure Draft *General Presentation and Disclosures* outlines several proposed standard updates that would permit the disclosure of “management performance measures” in a single note of the financial statements or on the face of the income statement if certain conditions are met.⁸ The overarching goal of the proposed amendments is to improve the transparency, credibility, and consistency of non-GAAP communications in international markets by bringing these measures to a single location in the audited financial statements.

The non-GAAP disclosure guidance in the IASB’s exposure draft is similar in many respects to the requirements in Regulation G. The definition of management performance measures is in line with the non-GAAP definition discussed earlier, but with one key exception. The IASB’s proposed definition is limited to subtotals of income and expenses and scopes out other adjusted financial measures such as adjusted revenues, free cash flows, and adjusted balance sheet measures. Thus, the proposed amendments still leave room for management to disclose other non-GAAP metrics outside of the financial statements. Similar to Regular G, the IASB’s proposal mandates that adjusted income and expense subtotals should faithfully represent the company’s financial performance and should not mislead investors. Companies must also provide a quantitative reconciliation and discuss how the adjusted measures are useful to investors.

The IASB’s proposed guidance also goes beyond Regulation G and tackles several weaknesses that persist in the U.S. regulatory context. First, adjusted metrics disclosed in IFRS financial statements will now be audited as these metrics will be presented under IFRS standards, similar to segment performance measures. Second, the proposed guidance requires firms to separately disclose the income tax effect and the effect on non-controlling interests for each item in the quantitative reconciliation. Lastly, firms must also disclose comparative calculations for the previous fiscal period and provide explanations whenever management changes the computation of an adjusted metric, introduces a new metric, or discontinues the use of a previously-disclosed metric.

⁸ The proposed IFRS guidance permits companies to disclose a management performance metric as a subtotal in the income statement if the metric: (1) fits into the new proposed structure of the income statement, (2) does not disrupt the presentation of operating expenses based on either the function or nature of the expenses, and (3) is comprised of amounts that are recognized and measured under IFRS standards. Given these strict conditions, the IASB expects that non-GAAP metrics would rarely be presented on the face of the income statement (see paragraph BC165 of the Basis of Conclusions to the Exposure Draft).

In the U.S. context, auditors do not have responsibilities to audit non-GAAP financial metrics since these measures appear outside of the GAAP financial statements. U.S. auditors should, however, read the non-GAAP information disclosed elsewhere in the annual report (e.g., in the MD&A section) and consider whether the information or its presentation is materially inconsistent with information appearing in the financial statements.⁹ Audit standard setters in the U.S., namely the PCAOB and the AICPA, are concurrently deliberating the expansion of auditors' responsibilities concerning non-GAAP disclosures contained in annual reports. A sizable proportion of surveyed financial statement users are in favor of expanding these responsibilities. In fact, a 2016 CFA Institute survey reports that 50% of portfolio managers and equity analysts believe that non-GAAP financial metrics should be audited at the same level as GAAP line items.¹⁰

The opacity of income tax adjustments as well as inconsistencies in firms' non-GAAP calculations over time have posed several challenges for U.S. regulators. The SEC's C&DIs warn that inconsistencies in a firm's non-GAAP computations across time can be misleading to investors.¹¹ However, research evidence suggests that a sizable number of firms vary their adjustments from year to year, with some firms engaging in this practice for opportunistic reasons. Specifically, Black et al. (2020) find that some firms apply inconsistent non-GAAP computations when they rely on non-GAAP adjustments to meet or beat common earnings benchmarks. Thus, the IASB's effort to require management to explain deviations from prior non-GAAP computations is a welcome change as it should mitigate strategic adjustment behaviors.

The treatment of income tax effects when computing non-GAAP measures is an increasingly thorny issue in the U.S. context. The SEC's C&DIs state that non-GAAP adjustments should not be presented "net of tax", rather income taxes should be shown as a separate adjustment in the non-GAAP calculation.¹² However, despite this guidance, the presentation of income tax effects is the second most common non-GAAP comment received by firms during the SEC's filing review process. Indeed, data collected from the S&P 1500 indicate that 23% of the firms that report a non-GAAP metric do not disclose the income tax effect when reconciling the metric to the comparable GAAP figure (Chen et al. 2019). The data further show that, of the firms that separately report the tax effects of their non-GAAP adjustments, a significant number strategically apply a different tax rate to the earnings adjustments *and not* the GAAP effective tax rate or the firm's statutory tax rate. Given these issues, the more-detailed nature of the IASB's proposed requirement for firms to separately disclose the income tax effect for each reconciling line item is a definite plus for enhancing transparency and consistency in international non-GAAP practices.

9 See PCAOB Audit Standard 2710 – *Other Information in Documents Containing Auditing Financial Statements*. The auditor's responsibilities to read other information such as non-GAAP financial information applies only to information contained in annual reports or other documents to which the auditor devotes attention at the client's request (AS 2710.02). Thus, auditors' responsibilities do not extend to non-GAAP information appearing in earnings press releases, earnings conference calls, and other venues outside of the annual report.

10 About 30% of survey respondents would prefer some level of audit assurance on whether the controls and procedures for calculating and presenting non-GAAP measures are robust. The full CFA Institute report is available at <https://www.cfainstitute.org/-/media/documents/article/position-paper/bridging-the-gap-ensuring-non-gaap-and-performance-reporting.ashx>.

11 See Question 100.02 of the SEC C&DIs, available at <https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>.

12 See Question 102.11 of the SEC C&DIs, available at <https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>.

The Impact of Non-GAAP Regulation and Guidance

Regulatory efforts in the U.S. have been viewed as being successful in curbing certain non-GAAP abuses and enhancing the transparency and quality of the adjustments made by firms. A wealth of academic research show that the quality of non-GAAP metrics increased significantly after the SEC's 2001 cautionary advice and after the enactment of Regulation G. This body of research also shows that investors place more reliance on non-GAAP metrics in the post-Regulation G era and are less likely to misinterpret these measures. This evidence is broadly consistent with an increase in the quality and transparency of these metrics.¹³ Figure 2 presents a timeline of non-GAAP regulation and non-GAAP disclosure quality in the U.S.¹⁴

Academic evidence on the success of international regulatory efforts is limited since much of the existing guidance is not mandatory or has been enacted only recently. The Australian and New Zealand settings are exceptions as non-mandatory guidelines on non-GAAP disclosures were issued in these countries in 2011 and 2013, respectively, thus allowing for a sufficient post-regulatory period over which to assess the regulatory effects.¹⁵ Studies by Rainsbury (2017) and Yang and Abeysekera (2018) find that the quality of non-GAAP measures improved in these countries following the issuance of non-GAAP guidelines, though the effects are limited given the voluntary nature of the guidelines.

Despite regulatory successes, non-GAAP abuses have ticked up at various points in time, leading regulators to intensify their scrutiny of how these measures are computed and presented to investors. Following the 2008 financial crisis, the usage and prominence of non-GAAP metrics as well as the magnitude of adjustments increased sharply among U.S. IPOs and public firms, sparking renewed concerns by regulators (see Bentley et al. 2018, Brown et al. 2020). These concerns resulted in the SEC issuing multiple warnings in speeches (see e.g., Bricker 2015, White 2015, 2016) and publishing the C&Dis to address a range of issues such as the types of non-GAAP metrics that SEC staff view as misleading, the presentation of the GAAP metric with equal prominence, and the prohibition of certain adjusted per share measures. This resetting of regulatory expectations was largely successful as reports from Audit Analytics indicate that the undue prominence of non-GAAP metrics in earnings press releases declined dramatically after 2016 along with SEC comment letters on this issue (Whalen et al. 2017, Hallas and Usvyatsky 2018).¹⁶

Non-GAAP Trends in IPOs and Public Firms

The use of non-GAAP measures is pervasive across U.S. and international public firms. Recent statistics from Audit Analytics and PwC indicate that 97% of S&P 500 and 95% of the FTSE 100 disclosed at least one non-GAAP financial metric in annual earnings releases or filings (Usvyatsky and Coleman 2018, PwC 2016a). A more comprehensive analysis of U.S. public firms by Bentley et al. (2018) finds that roughly 50% of all SEC filers disclosed a non-GAAP earnings metric in at least one quarterly earnings release as of 2013. Figure 3 presents these statistics and those discussed below.¹⁷

13 This research includes Black et al. (2012, 2017), Marques (2006), Heflin and Hsu (2008), and Kolev et al. (2008).

14 This figure is adapted from Ted Christensen's discussion of Hallman et al. (2018) at the 2017 PCAOB Conference. I thank Professor Christensen for sharing this graphic.

15 The Australian Securities and Investments Commission issued *Regulatory Guide 230: Disclosing Non-IFRS Financial Information* in 2011. New Zealand's Financial Markets Authority issued *Guidance Note: Disclosing Non-GAAP Financial Information* in 2013.

16 The percentage of companies that received an SEC staff comment on non-GAAP prominence declined from about 38% in the second half of 2016 to 22% in the first half of 2018.

17 The data sample in Bentley et al. (2018) is comprised of all firms in the Compustat and I/B/E/S universe. The S&P 500 percentage from Audit Analytics is based on annual earnings releases issued in 2017, while the FTSE 100 percentage from PwC is based on data from 2016.

Non-GAAP usage is also common for private firms going public in U.S. capital markets. A recent study by Brown et al. (2020) finds that 61% of the IPOs in 2012 disclosed an adjusted earnings metric in the prospectus, compared to only 23% of the IPOs conducted in 2003. This uptick is quite sharp, representing a 265% increase in non-GAAP usage in IPO registration filings. The trend for technology IPOs is even more striking as roughly 48% disclosed a non-GAAP earnings metric in 2012 compared to 12% in 2003—a fourfold increase in just 10 years. As Brown et al. (2020) documents, the non-GAAP practices of IPO firms diverge significantly from that of already-public firms. Specifically, IPO firms exclude more recurring line items when computing the non-GAAP earnings metric and tend to make earnings adjustments that are not commonly made by public firms. The uncommon adjustments include the exclusion of executive bonuses, acquisition-related expenses, and add-backs of deferred revenues. These practices reflect the greater need for IPOs to signal positive firm value by converting GAAP losses into non-GAAP profits, especially when the firm is generating positive GAAP operating cash flows.

The Benefits and Pitfalls of Using Non-GAAP Metrics

The use of non-GAAP metrics has several pros and cons for firms, especially those that are entering public capital markets for the first time. The following benefits are often put forth by proponents of non-GAAP information and are generally confirmed by academic research.

Shows sustainable or repeatable earnings. Alternative performance measures can provide a useful perspective of a firm's ability to generate repeatable or recurring streams of income. This is especially important for IPO firms that accrue significant amounts of expenses during their growth phase. Table 2 provides a close look at the non-GAAP earnings reconciliations disclosed in the IPO prospectuses of two technology IPOs completed in 2019, Uber and Lyft. Both firms disclosed adjusted EBITDA measures that exclude items deemed transitory or non-recurring, such as restructuring and acquisition-related charges and changes to insurance and regulatory reserves. Adjustments for stock-based compensation also account for a significant proportion of the expenses excluded by both firms, which is not atypical given the extensive use of stock options as a recruiting tool in technology firms and as a way to compensate founders and executives before going public. While some critics view the removal of stock-based compensation from non-GAAP earnings as less-justifiable, there is broad consensus in the academic literature and in practice that adjusting for transitory items is reasonable for demonstrating sustainable earnings. Note that Uber's adjusted EBITDA measures depicted a smoother stream of income over the three-year period compared to the standard GAAP net income figures.

Managers can better tell the firm's story. Non-GAAP metrics not only enable management to signal core, repeatable performance but also allow management to (1) more clearly explain unusual financial effects that are not representative of underlying business trends and (2) better convey financial items that are most important in understanding the company's core operations. Therefore, managers should pay close attention to how they communicate non-GAAP metrics as discussions of why the measure is useful to investors and explanations of the adjustments are key to enhancing investors' ability to understand and use these measures. Discussions of how the adjusted metric is used internally also provide useful insights into how the business is managed; such insights can be difficult to glean from standard GAAP measures.

Removes volatile business effects. Adjusted metrics often remove transitory or non-recurring items that induce volatility in firms' earnings and cash flow streams. The removal of these volatile effects has been shown to enhance investors' ability to forecast firms' future financial performance. Transitory items are, at times, outside of the control of management, and removing these items from GAAP-based performance measures can promote a longer-term view among management. That is, non-GAAP computations can allow management to focus on long-term value-enhancing activities, such as restructurings, without concerns for the short-term costs that might lower financial performance measures. Indeed, research finds that corporate boards are more likely to use adjusted earnings measures for management performance evaluation when GAAP earnings are more volatile (Curtis et al. 2018).

Notwithstanding the benefits discussed above, the use of non-GAAP metrics can pose several problems for firms. The challenges include but are not limited to those discussed below.

Can be perceived as 'window-dressing'. The opportunistic use of non-GAAP measures by some firms has led some investors to be skeptical about management's underlying motives and the value of these measures. Managers can however mitigate such negative perceptions by complying with regulatory guidelines and mandates, communicating adjustments clearly to investors, using consistent non-GAAP computations from period to period, and consistently adjusting for items that decrease and increase the non-GAAP metric. Regulators, standard setters, and practitioners strongly recommend that firms and their audit committees develop non-GAAP disclosure policies to ensure the consistency and transparency of non-GAAP measures (see PwC 2016b, CAQ 2018).

Can confuse novice investors or trigger investor backlash. Studies find that retail or less-sophisticated investors rely more on non-GAAP metrics compared to sophisticated, institutional investors (Bhattacharya et al. 2007). Retail investors are also more likely to misinterpret the adjustments used to compute non-GAAP metrics. These findings are important for public firms with an investor base that tilts towards retail investors. In such cases, management should carefully consider the transparency and consistency of their non-GAAP disclosures to help novice investors better understand the firm's financial performance. While sophisticated investors are less reliant on non-GAAP measures, IPO investors (who are primarily large institutions) appear to use these measures as signals of firm value given the general lack of reliable financial information about private firms outside of the prospectus. But IPO investors can penalize new issuers harshly for aggressive non-GAAP disclosures. Indeed, Brown et al. (2020) find that investors significantly undervalue IPOs that disclose excessive non-GAAP adjustments and that this valuation penalty is more severe for technology IPOs.

Let us revisit the case of Uber and Lyft. As observed in Table 2, Uber's adjusted EBITDA figure for the 2018 fiscal year included five more reconciling line items compared to Lyft's adjusted figure (12 versus 7 line items).¹⁸ Uber also disclosed 11 different non-GAAP financial metrics throughout the prospectus filing, while Lyft presented only 5 non-GAAP figures. Regulators, business media, and the investment community viewed Uber's non-GAAP disclosures as more aggressive and pushing the limits (McKenna 2019). Uber, not surprisingly, trailed its offer price on the first day of trading, closing at \$41.57 compared to a final offer price of \$45. Lyft, on the other hand, exhibited rising share values during the IPO process and closed at a higher share price on the first day of trading (\$78.29 compared to the \$72 offer price).

18 Audit Analytics reports an average of nine reconciling line items (including line items with zero-dollar amounts) for adjusted income metrics presented by S&P 500 firms during 2017 (Usvyatsky and Coleman 2018). A benchmark comparison thus suggests that Uber's non-GAAP adjustments were more excessive compared to already-public firms.

Can increase regulatory scrutiny. Given the controversial nature of non-GAAP metrics, companies should be prepared for heightened regulatory scrutiny if they opt to present adjusted financial metrics in their disclosures. As reported by Audit Analytics, issues surrounding non-GAAP measures account for the second-highest number of SEC staff comments during the filing review process (McKeon and Usvyatsky 2018). Again, management should fully comply with regulatory guidelines and adopt robust non-GAAP disclosure policies and controls to mitigate potential costs associated with regulatory scrutiny. In the IPO context, all prospectus filings are subject to SEC staff review and the presentation of non-GAAP measures in the prospectus can raise red flags, resulting in potential delays in the IPO listing. This was the case with Uber's IPO; the company went through a lengthy comment letter review process (six rounds in total), with many of the comments focusing on Uber's non-GAAP presentations (McKenna 2019).

Lowers comparability across firms. An often-discussed disadvantage of non-GAAP measures is the difficulty in comparing adjusted financial measures across firms. Non-GAAP measures, by their very nature, are not standardized and are individually tailored by management. This can create difficulties for investors to compare the performance of multiple firms. To alleviate these issues, practitioners recommend that firms, including IPOs, try as much as possible to benchmark the non-GAAP calculations and labels of measures commonly used by industry peers (PwC 2014). If the firm's measure deviates from the standard industry computation, then management should clearly explain these deviations so that investors can make the necessary adjustments to make the measures comparable across firms.

Conclusion

Non-GAAP financial metrics are here to stay. The usage is not expected to decline and will continue to increase as more firms find ways to better tell their stories to investors. The quality and transparency of non-GAAP presentations will continue to improve as companies establish robust non-GAAP policies and as regulators and standard setters enhance disclosure guidelines. Non-GAAP financial metrics have general support from regulators and standard setters and many agree that these metrics are useful if disclosed in a disciplined way. As IASB Chairman Hans Hoogervorst notes: "*We do not wish to stamp [non-GAAP] out. [...] It gives additional insight.*"¹⁹

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19 See EACLN (2017) for a summary of the non-GAAP dialogue between Mr. Hoogervorst and audit committee chairs from leading European committees.

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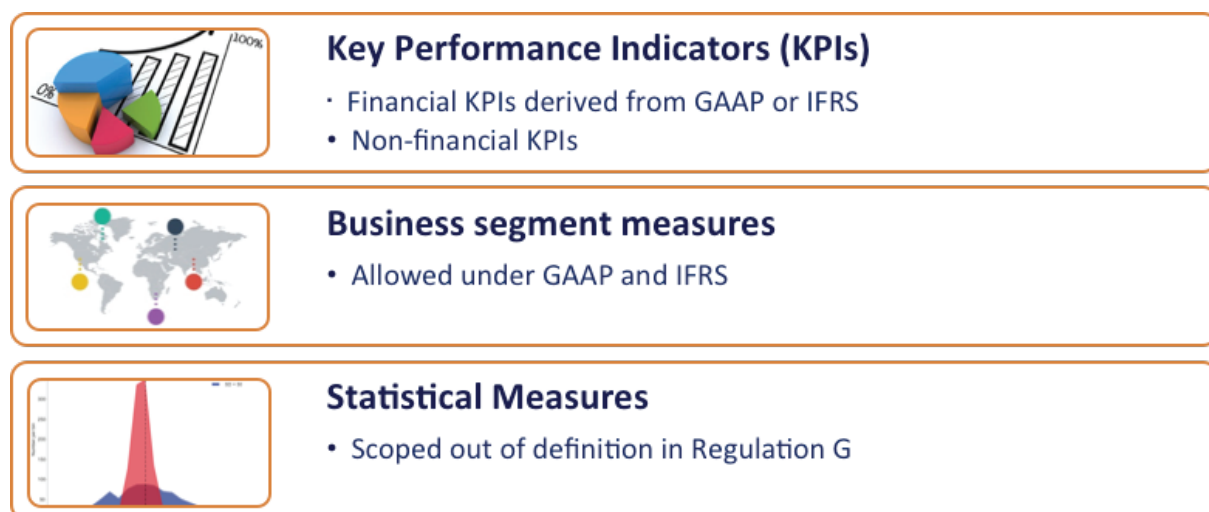


Figure 1. What is (not) a non-GAAP measure?

Note: This illustration is based on the Regulation G definition of a non-GAAP financial metric as outlined in Topic 8 of the SEC Financial Reporting Manual, available at <https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml>.

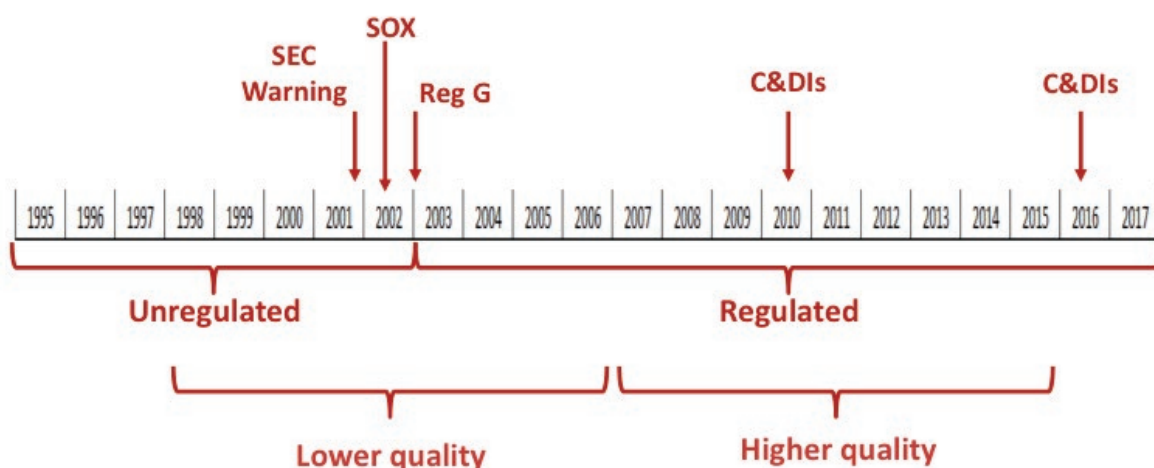


Figure 2. Timeline of U.S. Non-GAAP Regulation and Non-GAAP Quality

Note: This timeline reflects academic research on the quality of non-GAAP measures based on data samples of U.S. firms spanning the period, 1998 to 2015.

95% FTSE 500	97% S&P 500	50% All SEC Filers	61% U.S. IPOs
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Figure 3. Trends in Non-GAAP Usage by IPOs and Public Firms

Note: The S&P 500 percentage is sourced from Audit Analytics and based on annual earnings releases issued in 2017 (Usvyatsky and Coleman 2018). The FTSE 100 statistic is sourced from PwC UK (2016) and based on data collected from annual reports for year-ends between April 2014 to March 2015. The percentage for all SEC filers is taken from Bentley et al. (2018) and based on data collected from quarterly earnings releases for all firms in the Compustat and I/B/E/S databases. The Bentley et al. (2018) data exclude firms that disclose EBITDA measures as this non-GAAP metric was common long before the non-GAAP trend started in the 1990s. The percentage for U.S. IPOs is taken from Brown et al. (2020) and based on data gathered from the prospectuses of book-built IPOs conducted during 2012.

Table 1

U.S. SEC Non-GAAP Guidelines

Where does non-GAAP appear?	Applicable rule	
<ul style="list-style-type: none"> • earnings calls • media interviews • investor roadshows / webcasts • earnings guidance • social media 	Regulation G	
<ul style="list-style-type: none"> • earnings press releases 	Item 2.02 of Form 8-K	
<ul style="list-style-type: none"> • SEC filings (10-Q/K, IPO filing, etc.) 	Regulation S-K (Item 10e)	
Non-GAAP requirements	All disclosures	SEC Filings & Form 8-K
Not be misleading	X	X
Most directly comparable GAAP metric	X	X
Quantitative reconciliation to GAAP metric	X	X
Equal or greater prominence of GAAP metric		X
Explain why metric is useful to investors		X
How metric is used internally		X

Note: This regulatory summary of Regulation G is based on the detailed guidelines in Topic 8 of the SEC Financial Reporting Manual, available at <https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml>.

Table 2

Non-GAAP Earnings Reconciliations for Uber and Lyft IPOs

	Uber		
	Year Ended December 31,		
	2016	2017	2018
	(in millions)		
Adjusted EBITDA Reconciliation:			
Net income (loss) attributable to Uber Technologies, Inc.	\$ (370)	\$ (4,033)	\$ 997
Add (deduct):			
(Income) loss from discontinued operations, net of income taxes	(2,876)	—	—
Net income (loss) attributable to non-controlling interest, net of tax	—	—	(10)
Benefit from (provision for) income taxes	28	(542)	283
Income (loss) from equity method investment, net of tax	—	—	42
Interest expense	334	479	648
Other income (expense), net	(139)	16	(4,993)
Depreciation and amortization	320	510	426
Stock-based compensation expense	128	137	172
Legal, tax, and regulatory reserves and settlements	49	440	340
Asset impairment/loss on sale of assets	9	340	237
Acquisition and financing related expenses	—	4	15
Restructuring charges	—	7	(4)
Adjusted EBITDA	<u>\$ (2,517)</u>	<u>\$ (2,642)</u>	<u>\$ (1,847)</u>

Lyft

The following table provides a reconciliation of net loss to Adjusted EBITDA:

	Year Ended December 31,		
	2016	2017	2018
	(in millions)		
Net loss	\$ (682.8)	\$ (688.3)	\$ (911.3)
Adjusted to exclude the following:			
Interest income, net	(7.0)	(20.2)	(66.5)
Other income, net	(3.2)	(0.3)	(0.7)
Provision for income taxes	0.4	0.6	0.7
Depreciation and amortization	0.5	2.6	18.8
Stock-based compensation	9.4	9.5	8.6
Changes to insurance reserve attributable to historical periods ⁽¹⁾	17.2	—	3.4
Costs related to acquisitions	—	—	3.5
Adjusted EBITDA	<u>\$ (665.5)</u>	<u>\$ (696.1)</u>	<u>\$ (943.5)</u>

(1) \$17.2 million of insurance expense recorded in 2016 reflects changes to reserves estimates of claims from 2015 and earlier periods and \$3.4 million of insurance expense recorded in 2018 reflects changes to reserves estimates of claims from 2017 and earlier periods.

Notes: The non-GAAP reconciliations for adjusted EBITDA are taken from the IPO prospectuses of Uber (filed May 13, 2019) and Lyft (filed March 29, 2019).