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Audit Committees Bridging the GAAP

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When properly used and presented, non-GAAP financial measures can be a useful tool for a company to provide investors with insight into how management analyzes business performance, and can supplement financial information prepared in accordance with GAAP. On the other hand, misuse of non-GAAP financial measures can manipulate and mislead investors. The Securities and Exchange Commission's (SEC) attention over the years to the use of these measures by public companies has been reflected in the evolution of its rules and regulations, guidance, comment letters and enforcement actions. As the Staff continues to monitor non-GAAP financial disclosures, and as companies continue to scrutinize their measures for regulatory compliance, recent attention has focused on audit committees and the important oversight role they can play in bridging the gap between management and investors when providing non-GAAP financial information. For example, in a recent speech on the advancement of financial reporting, SEC Chief Accountant Wesley Bricker highlighted the importance of audit committees in the context of non-GAAP financial measures, and in March, the Center for Audit Quality (CAQ) published "Non-GAAP Financial Measures: A Roadmap for Audit Committees."

SEC Chief Accountant Bricker: Governance and Culture

In a speech (available here) covering a number of financial reporting topics at the 2018 Baruch College Financial Reporting Conference, SEC Chief Accountant Bricker addressed governance and culture in financial reporting, and highlighted the important role that audit committees can play in ensuring the integrity of non-GAAP financial measures. Audit committees that understand and probe their use and presentation are an "indicator of a strong compliance and reporting culture." Specifically, audit committees can undertake the following processes:

- Review non-GAAP measures with management to understand how management evaluates performance.
- Review whether the measures are consistently prepared and presented from period to period.
- Review the related disclosure policies with management.

An informed and active audit committee can assist a public company in complying with its required disclosure controls and procedures as they relate to the non-GAAP measures, and have a "positive effect on the quality of disclosure."

CAQ Roadmap for Audit Committees

Earlier in the year, the CAQ published a roadmap (accessible here) to help audit committees enhance their oversight of and involvement with non-GAAP financial measures. Audit committee oversight is vital, as an audit committee can assess management's reasons for using non-GAAP measures, and evaluate whether they present a fair and balanced view of a company's performance. Judgment is necessarily involved in evaluating the use and proper presentation of non-GAAP measures, particularly when determining how to treat one-time transactions, and audit committees can promote rigorous review through dialogue with company management and internal and external auditors. The roadmap suggests that an audit committee should:

- **Put itself in the investors' shoes** when evaluating whether the presented non-GAAP financial measures and related disclosures align with the company's overall strategy and performance.

- **Engage with investors directly or through investor relations** to ensure that the presented non-GAAP financial measures aid investors' understanding of the company's performance.
- **Ask management whether it has an internal policy** that provides guidelines for determining how non-GAAP financial measures are generated, calculated and presented, including the rationale for the measures and adjustments that it presents and excludes. If there is no policy, the committee should encourage management to create one.
- **Discuss with management how the company makes changes to non-GAAP financial measures it presents** and the rationale for why it would or would not make changes.
- **Seek the perspective of counsel** on non-GAAP financial measures.
- **Request the company to compare or benchmark** its non-GAAP financial measures to those of its peers.
- **Determine what disclosure controls and procedures are in place** as they relate to non-GAAP financial measures that are presented.
- **Question the external auditors on their responsibilities for non-GAAP financial measures**, and whether that responsibility is different depending on where non-GAAP financial measures are presented.
- **Ask the external auditors for perspectives** on how non-GAAP financial measures that the company presents generally compare with those of other companies.
- **Discuss with the external auditors their views on the company's non-GAAP financial measures**, including whether the measures are consistent with the auditor's understanding and knowledge of the company's performance.

In addition, some companies follow leading practices in connection with the presentation of non-GAAP financial information that other companies might consider implementing, including:

- ***Disclosure controls*** – establishing robust and documented disclosure controls specific to non-GAAP measures. This could help mitigate risks, and drive more consistency and transparency, in the preparation and presentation of non-GAAP measures.
- ***Non-GAAP policies*** – establishing policies and guidelines to follow when preparing and presenting non-GAAP measures. This could help promote consistency in how such measures are calculated and presented, and also help with decisions on the treatment of one-time or new transactions or events.
- ***Audit committee disclosure*** – voluntarily disclosing the existence of any non-GAAP policies (even without relevant details of such policies). This could help demonstrate to investors the company's attention and commitment to the transparency and consistency of its non-GAAP measures.

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The recent attention on audit committees in the continuing conversation on non-GAAP financial measures recognizes that audit committees are uniquely situated to act as bridges between management and investors. Through rigorous review and active dialogue with management and auditors, an audit committee can support investor confidence in the transparency, consistency and integrity of a company's properly presented non-GAAP financial measures.

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