



Contents

- [Introduction](#)
- [Considerations Related to Reflecting COVID-19 Impacts in Non-GAAP Measures](#)
- [Potential COVID-19-Related Adjustments](#)
- [Important Disclosures Associated With Non-GAAP Measures](#)
- [Alternatives to Non-GAAP Measures](#)
- [Disclosure Controls and Procedures Related to Non-GAAP Measures](#)
- [Income Statement Classification Considerations](#)

COVID-19 and Non-GAAP Measures

Introduction

As a result of the ongoing uncertainty associated with the unprecedented nature of coronavirus disease 2019 (“COVID-19”), 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 attributable to, or as a direct result of, the pandemic and related economic conditions. Registrants that are considering reflecting these items in their non-GAAP measures should be mindful of the various requirements and interpretations related to the use of non-GAAP measures in [SEC Regulation G](#); [SEC Regulation S-K, Item 10\(e\)](#); recently issued CF Disclosure Guidance (DG) [Topics 9](#) and [9A](#);¹ and the SEC staff [compliance and disclosure interpretations](#) (C&Dis) on non-GAAP measures.

Although adjustments to non-GAAP measures related to the effects of COVID-19 were not common in first-calendar-quarter filings, we believe that they may become more widely used as the effects of COVID-19 and the associated economic conditions persist and become more pronounced. Therefore, we also expect the SEC staff to focus on these non-GAAP measures to ensure that they adhere to the aforementioned requirements and interpretations.

This publication discusses considerations for registrants related to reflecting specific impacts of COVID-19 in their non-GAAP measures. It also addresses (1) important disclosures associated with the presentation of non-GAAP measures, (2) alternatives to non-GAAP measures, (3) disclosure controls and procedures related to non-GAAP measures, and (4) income statement classification considerations.

¹ CF Disclosure Guidance Topic No. 9, *Coronavirus (COVID-19)*, and Topic No. 9A, *Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources*.

For more detailed information about non-GAAP measures and related SEC guidance as well as financial reporting considerations related to COVID-19, see Deloitte's [A Roadmap to Non-GAAP Financial Measures](#) and [Financial Reporting Alert](#), "Financial Reporting Considerations Related to COVID-19 and an Economic Downturn."

Considerations Related to Reflecting COVID-19 Impacts in Non-GAAP Measures

While some of the key SEC requirements and interpretations related to non-GAAP measures address the prominence, reconciliation, clear labeling, usefulness, and purpose of such measures, an overarching theme of the guidance is that they should not be misleading, regardless of whether the measures are used in a filing (e.g., Form 10-K) or elsewhere (e.g., press release). As described in [Section 100](#) of the C&DIs, non-GAAP measures that could potentially mislead investors may include those that:

- Exclude normal, recurring cash operating expenses necessary for business operations.
- Are presented inconsistently between periods (e.g., adjusting for an item in the current reporting period but not doing so for a similar item in the prior period without appropriately disclosing the change and explaining 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.

Further, when evaluating whether a COVID-19-related adjustment is appropriate in a non-GAAP measure, a registrant should consider several factors including, but not limited to, whether the adjustment is:

- Directly related to COVID-19 or the associated economic downturn.
- Incremental to normal operations and nonrecurring (i.e., it is not expected to become the "new normal").
- Objectively quantifiable, as opposed to an estimate or projection.

Potential COVID-19-Related Adjustments

Listed below are potential COVID-19-related adjustments that registrants might consider in their non-GAAP measures. While we have categorized the adjustments into three groups, each registrant must consider its own facts and circumstances in light of the SEC's rules and guidance. For example, an entity that has seen an increase in revenues because of COVID-19 may want to be cautious about adjusting for COVID-19-related costs. A registrant must also take into account the purpose and use of the resulting non-GAAP measure and the context in which it is presented, as discussed further in the [Important Disclosures Associated With Non-GAAP Measures](#) section.

The categories of adjustments are as follows:

- Likely to be consistent with SEC requirements and interpretations.
- ▼ Proceed with caution; may not be consistent with SEC requirements and interpretations.
- ✗ Unlikely to be consistent with SEC requirements and interpretations.

Adjustments that **are likely** to be consistent with SEC requirements and interpretations include those related to:

- Impairment of goodwill, indefinite-lived intangible assets, and other long-lived assets.
- Contract termination costs (e.g., lease breakage costs).
- Facility or location shutdown costs.
- Cleaning costs (if they will be temporary and not become the “new normal”).
- Employee-termination or other restructuring costs.
- Salary costs (e.g., hazard pay) to compensate for risk assumed by employees (if such costs will be temporary and not become the “new normal”).
- Government grants or insurance recoveries.



Connecting the Dots

Certain provisions of the Coronavirus Aid, Relief, and Economic Security Act may enable a registrant to obtain government grants to help mitigate many of the costs incurred during the pandemic, including those associated with items such as rent, utilities, and salaries. If a registrant obtains a grant (or other similar compensation) and also chooses to include an adjustment or adjustments for COVID-19 in its non-GAAP measure(s), it should consider adjusting its non-GAAP measure(s) for both the costs and corresponding grant income to avoid the appearance of “cherry picking.”

Adjustments that **may not** be consistent with SEC requirements and interpretations include those related to:

- ▼ *Significant accounts receivable (“A/R”) reserves* — Registrants may record A/R reserves that exceed historical levels if their customers have experienced COVID-19-related financial difficulties and liquidity issues. The following examples illustrate factors that a registrant might consider, among others, when evaluating adjustments to a non-GAAP measure for significant increases in A/R reserves:
 - A registrant has historically recorded an A/R reserve of 2 percent of revenue. During the pandemic, the registrant increases the A/R reserve to 5 percent as a result of increased customer liquidity concerns. While the registrant may consider whether the 3 percent increase is directly related to the pandemic, it may be difficult to determine whether a portion of the increase is incremental and objectively quantifiable or whether a portion may be indicative of the “new normal.”
 - A registrant has written off a receivable (e.g., customer bankruptcy, terminated customer relationship), which may indicate that the amount is objectively quantifiable. Alternatively, a registrant’s intent to continue pursuing collection may indicate that the amount may not be objectively quantifiable given the unknown outcome of such pursuit.

A registrant should also be aware that revenues directly tied to the A/R reserves were (or will be) recognized and that a non-GAAP adjustment of such reserves could therefore be inconsistent with SEC requirements and interpretations.



Connecting the Dots

An entity will need to use judgment when determining whether it has offered a price concession or has assumed credit risk. See Deloitte’s [A Roadmap to Applying the New Revenue Recognition Standard](#) for indicators that may suggest whether the entity has offered a price concession (i.e., reduction of revenue) or has assumed credit risk (i.e., bad debt expense).

- ▼ *Expected credit losses* — As a result of the effects of COVID-19 on a registrant’s financial assets, the registrant may incur expected credit losses under the current expected credit losses (CECL) standard (ASU 2016-13²). In such a case, a registrant should carefully assess whether an adjustment is objectively quantifiable. For example, the registrant should consider whether it can differentiate between changes in expected credit losses for financial assets that are (1) directly related to COVID-19 and (2) attributable to other market factors and conditions.



Connecting the Dots

As a result of adopting the CECL standard, entities will recognize impairment of financial assets at the end of each reporting period on the basis of an expected losses model rather than the previous incurred loss model. Entities that adopt the CECL standard may want to disclose losses under the incurred loss model. For such entities, disclosing losses under the incurred loss model is allowable during the fiscal period in which the standard is adopted. However, it would not be appropriate to present non-GAAP measures of profitability or liquidity that are based on the non-GAAP incurred loss amounts.

- ▼ *Unprecedented markdowns* — A registrant whose inventories are seasonal or subject to expiration may be required to record unprecedented markdowns for slow-moving or obsolete merchandise. Since markdowns are typically recurring costs that vary on the basis of multiple factors, a registrant should consider whether it can differentiate between a markdown that is directly related to COVID-19 and one that is attributable to other market factors and conditions.

In addition, determining whether an adjustment is objectively quantifiable could be complicated as a result of uncertainties associated with the ability to sell a product on a future date. For example, a retailer may mark down slow-moving merchandise but still expect to sell that merchandise in a subsequent period for a price that could vary on the basis of several market conditions. Alternatively, a restaurant owner may write off the cost of spoiled food inventory because of the unexpected closure of its restaurants.

- ▼ *Depreciation of idled facilities* — A noncash cost, depreciation expense is a common adjustment in some non-GAAP measures (e.g., EBITDA). Although depreciation expense incurred on an idled facility may be directly related to the pandemic and objectively quantifiable, it is not incremental (i.e., a registrant would have incurred depreciation expense regardless).
- ▼ *Furloughed employees and other related payments to idle employees* — Although compensation may be paid to idled, salaried employees during the pandemic, such cash costs generally are not incremental because they have historically occurred and are expected to be incurred in the future. Alternatively, a registrant may elect to compensate hourly employees for hours not worked, in which case the registrant may consider whether an adjustment is warranted since the compensation may be (1) incremental to the normal practice of compensating hourly employees only on the basis of hours worked and (2) directly related to COVID-19. However, a registrant should also consider that such “voluntary” compensation is not incremental to historical activity and therefore may reflect expected levels of compensation to be incurred after COVID-19.

² FASB Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*.

Adjustments that **are unlikely** to be consistent with SEC requirements and interpretations include those related to:

- ✗ *Estimated lost revenue or profit* — Amounts cannot be objectively quantified (i.e., the estimate is not an actual cost or benefit).
- ✗ *Nontemporary increases or decreases to salary* — Expenses will become part of the registrant's "new normal."
- ✗ *Excess overhead* — Costs may need to be expensed immediately as opposed to being capitalized into inventory because of abnormally low production. Typically, such overhead expenses are not incremental and may include recurring cash costs.

Important Disclosures Associated With Non-GAAP Measures

Registrants must present a quantitative reconciliation of a non-GAAP measure to the most directly comparable GAAP measure and should transparently describe all adjustments. In DG Topic 9, the SEC staff stated that if complete GAAP financial information is not available at the time of an earnings release because of ongoing consideration of matters related to COVID-19, the staff would not object to a registrant's reconciliation of non-GAAP financial measures to the most directly comparable **preliminary** GAAP measure that reflects either "provisional amount(s) based on a reasonable estimate, or a range of reasonably estimable GAAP results." This position is limited solely to non-GAAP measures that have been provided to a registrant's board of directors to report financial results and does not apply to filings on Form 10-K or Form 10-Q. When relying on this position, a registrant "should explain, to the extent practicable, why the line item(s) or accounting is incomplete, and what additional information or analysis may be needed to complete the accounting."

In addition, disclosures about non-GAAP measures should be transparent and clearly demonstrate (1) the usefulness of the non-GAAP measure to investors and (2) the additional purpose for which management uses such measure. Since many non-GAAP adjustments will be based on specific facts and circumstances, registrants should supplement their non-GAAP measures with transparent and detailed disclosures describing and justifying any new adjustments. For example, instead of describing an adjustment as "Effects of COVID-19," a registrant should specify what the adjustment includes. Further, DG Topic 9 notes that if a registrant elects to adjust for COVID-19-related impacts in its non-GAAP disclosure, "it would be appropriate to highlight why management finds the measure or metric useful and how it helps investors assess the impact of COVID-19 on the company's financial position and results of operations."



Connecting the Dots

A registrant should be consistent in its presentation of non-GAAP measures between periods. Accordingly, when a non-GAAP measure is initially used or subsequently modified, a registrant should consider whether the adjustment(s) materially affected prior periods. If a new adjustment for an item in the current reporting period also occurred in the prior period, the registrant should consider retrospectively adjusting the prior-period non-GAAP measure for consistency purposes. In addition, if new adjustments to non-GAAP measures are added as a result of COVID-19, an entity should ensure that its DCPs address the assessment and approval of the revised non-GAAP measures, including the consistency of presentation between periods and transparent disclosures about any changes.

Many registrants disclose metrics and key performance indicators (KPIs) used to manage their business. Existing metrics and KPIs may be affected by the COVID-19 pandemic, and registrants may establish new or updated metrics related to its impact. For example, the same-store sales metric, which is used throughout certain industries, could be significantly affected by COVID-19. As a result, registrants may need to provide additional disclosures

about, or reassess the usefulness of, that metric. Further, if metrics change or evolve as a result of the impact of COVID-19 or for any reason, registrants should ensure that there is clear and transparent disclosure of the change and that definitions of any affected metrics are updated accordingly. For more information, see the [Metrics and KPIs](#) section of Deloitte's *Financial Reporting Alert*, "Financial Reporting Considerations Related to COVID-19 and an Economic Downturn."

Alternatives to Non-GAAP Measures

Given the potential challenges associated with many of the adjustments discussed above, a registrant may determine that transparent disclosure in MD&A may more effectively inform investors about certain COVID-19-related impacts than non-GAAP measures. For example, if a registrant elects to provide disclosures that simply quantify the estimated impact of COVID-19 on financial statement line items without adjusting the registrant's GAAP results (i.e., without establishing new totals or subtotals), those disclosures are not considered non-GAAP measures. If a registrant provides disclosure that does not adjust a GAAP measure but instead describes unusual or significant activities that occurred during the period, the disclosure would not be subject to the SEC's requirements and interpretations related to non-GAAP measures. When presenting disclosure alternatives, a registrant should disclose individually material COVID-19-related impacts separately.

Further, DG Topic 9 states, "[t]he Division encourages disclosure that is tailored and provides material information about the impact of COVID-19 to investors and market participants. We also encourage companies to provide disclosures that allow investors to evaluate the current and expected impact of COVID-19 through the eyes of management, and that companies proactively revise and update disclosures as facts and circumstances change." For example, an entity may explain COVID-19-related items in a summary within MD&A as follows:

Example

During the period ended March 31, 202X, the Company noted the impacts as a result of COVID-19 as follows:

- The Company increased its inventory obsolescence reserve during the period by \$3 million or 5 percent. Of the \$3 million, the Company believes approximately \$2 million was due to COVID-19-related impacts from slower moving inventory as a result of the government's shelter-in-place order. Such amounts are included within cost of sales in the statement of operations.
- The Company incurred \$1.5 million of hazard-pay costs to employees, which are included within cost of sales; selling, general and administrative expense; and research and development in the statement of operations.

Disclosure Controls and Procedures Related to Non-GAAP Measures

It is important to understand whether controls over non-GAAP measures are related to disclosure controls and procedures (DCPs), to internal control over financial reporting (ICFR), or to both.

As defined in both SEC and PCAOB rules,³ ICFR focuses on controls related to "the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles." DCPs, on the other hand, are more broadly defined and pertain to all information that must be disclosed by the company.

Because the starting point for a non-GAAP measure is a GAAP measure, it would be relevant for a registrant to consider ICFR up to the point at which the GAAP measure that forms the basis of the non-GAAP measure has been determined. However, it is appropriate to consider

³ See, for example, [Section 270.30a-3](#), "Controls and Procedures," of the Investment Company Act of 1940.

within the realm of DCPs controls over the adjustments to the GAAP measure as well as the related calculation of the non-GAAP measure, including the oversight and monitoring of the non-GAAP measure.

COVID-19 has resulted in changes to many entities' data, models, and assumptions that have in turn affected internal controls. Entities may need to implement controls over the relevance and reliability of data from new sources or to validate changes in their models. In addition, if new adjustments to non-GAAP measures are added as a result of COVID-19, an entity should ensure that its DCPs address the assessment and approval of the revised non-GAAP measures, including the consistency of presentation between periods and transparent disclosures about any changes.



Connecting the Dots

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 — with a disclosure committee or the audit committee or both — the selection and determination of any new adjustments or non-GAAP measures.

Income Statement Classification Considerations

Entities may need to determine whether the financial effects (i.e., incremental operating gains or losses) stemming from the COVID-19 pandemic should be reported or disclosed in the financial statements as a separate component of income from continuing operations.

Under ASC 220-20-45-1,⁴ if an entity concludes that a material event is of an unusual nature or occurs infrequently, the entity must either report the nature and financial effects of the event as a separate component of income from continuing operations or disclose that information in the notes to the financial statements. Under this guidance, “unusual nature” represents a situation in which the underlying event has a high degree of abnormality and is not related to the ordinary activities of the entity. Furthermore, “infrequency of occurrence” represents an event that would not reasonably be expected to recur in the foreseeable future. We believe that most companies will consider COVID-19 to be unusual or infrequent and that a decision about whether to separately disclose related amounts would therefore be based primarily on the materiality of the impact on their financial statements.

ASC 220-20 does not provide guidance on assessing how the financial effects of a qualifying event should be disclosed; accordingly, a registrant may need to use significant judgment when determining the amounts to separately report or disclose. We believe that in determining how to report such amounts, an entity could reasonably conclude that disclosing direct and incremental costs or benefits related to the COVID-19 pandemic would be consistent with the spirit of the guidance above (e.g., asset impairments, cleaning costs, business interruption insurance recoveries). However, as businesses begin to reopen and recover, it may become more difficult for them to objectively determine the unusual costs related to COVID-19. New internal controls may need to be implemented along with such presentation.

SEC Regulation S-X, Rule 5-03, also addresses income statement presentation for commercial and industrial public companies. In certain instances, the SEC has given registrants flexibility in disaggregating the components of required line items on the face of the statement of comprehensive income. Registrants that are significantly affected by the COVID-19 pandemic may consider presenting a separate line item or line items on their statement of comprehensive income to illustrate the impact of this unusual or infrequent event. To the extent that an entity elects to present a separate line item or line items on its statement

⁴ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's “[Titles of Topics and Subtopics in the FASB Accounting Standards Codification.](#)”

of comprehensive income, we encourage it to transparently disclose both the nature and amount of all costs included in the line item(s) in the footnotes to the financial statements and in MD&A.



Connecting the Dots

COVID-19-related items that are presented separately on the face of the income statement may not fully correlate with acceptable adjustments in a registrant's non-GAAP measure (i.e., a line item may be appropriate for separate presentation, but some components of the line item may not be allowable adjustments in a non-GAAP measure). See [discussion](#) above.

Registrants that present a separate line item or line items for the impact of COVID-19 should consider the effect on gross profit or operating income subtotals presented. For example, while a subtotal for gross profit is not required by Rule 5-03, certain costs such as inventory impairment are expected to be part of costs of sales (and therefore included in gross profit) by analogy to ASC 420-10-S99-3. In addition, under Rule 5-03, a subtotal for operating income is not required on the face of the income statement; but if a registrant presents a subtotal for operating income, it should generally present any COVID-19-related line item as part of operating income. Further, we believe that a separately presented COVID-19-related line item should not be preceded by a subtotal such as "income before COVID-19-related amounts" (even if the subtotal is presented without a caption).

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2020 Deloitte Development LLC. All rights reserved.