



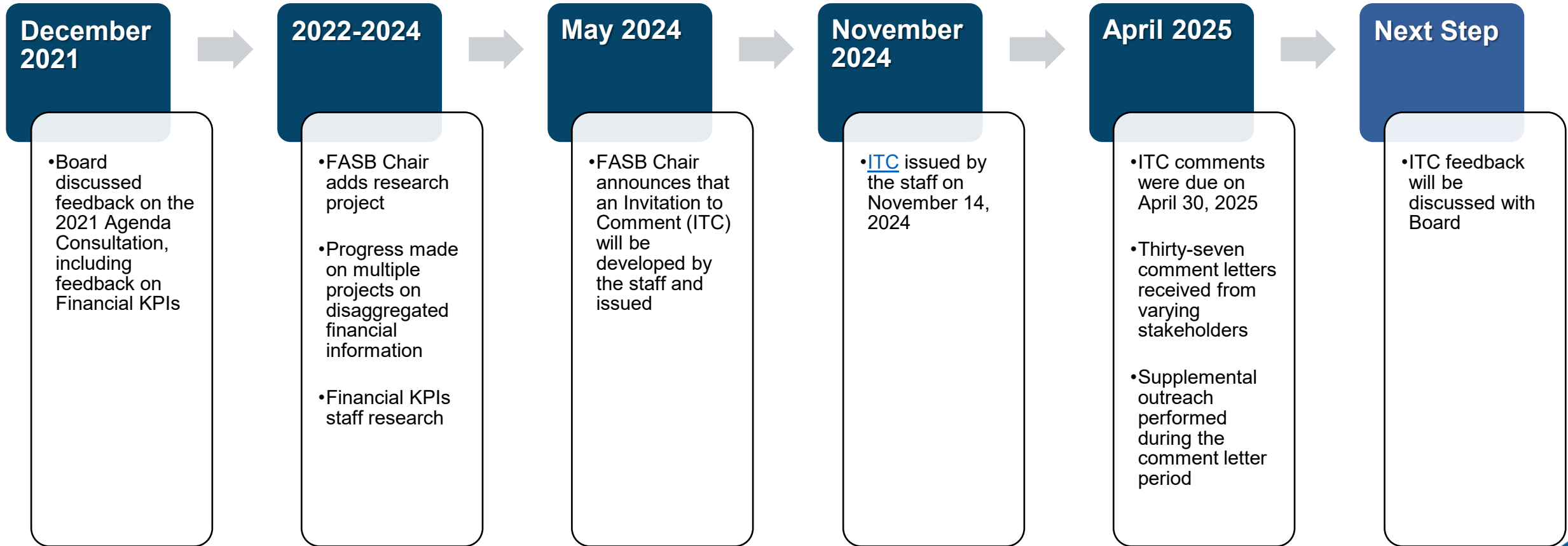
Financial KPIs for Business Entities

FASB | IASB Education Meeting

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This paper has been prepared for discussion at a public education meeting of the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). It is not intended to represent the views of the boards or any individual member of either board or the staff. Comments on the application of IFRS® Accounting Standards or US GAAP do not purport to set out acceptable or unacceptable application of IFRS Accounting Standards or US GAAP. Tentative technical decisions are made in public and reported in FASB Action Alert or in IASB Update. Official positions of the FASB or the IASB are determined after extensive due process and deliberations.

Project Timeline



Research Objective and Scope

■ Research Objective

- To explore the pervasiveness of perceived issues related to Financial KPIs and whether technically feasible solutions exist.

■ What is a Financial KPI (for purposes¹ of the FASB staff's research)

- Any financial measure that is calculated or derived from the financial statements and/or underlying accounting records that is not presented in the GAAP financial statements.
- Do not include:
 - Financial statement performance measures, totals, or subtotals
 - Nonfinancial KPIs.

¹ The FASB is aware that other definitions of Financial KPIs may exist.

Examples

| Financial KPIs | | Financial Statement Performance Measures, Totals, and Subtotals | Nonfinancial KPIs |
|--|---|---|--|
| <ul style="list-style-type: none"> • Return on assets (ROA) • Return on equity (ROE) • Current ratio • Debt-to-equity ratio (D/E) • Adjusted revenue • Adjusted gross profit • Adjusted gross margin • Adjusted EBT • Adjusted net income • Adjusted EPS • Adjusted profit margin • FCF or adjusted FCF • Organic sales growth or adjusted organic sales growth | <ul style="list-style-type: none"> • EBIT or adjusted EBIT • EBITDA or adjusted EBITDA • EBITDAR or adjusted EBITDAR • EBITDAX or adjusted EBITDAX • FFO or adjusted FFO • Refining margin • Return on invested capital (ROIC) | <ul style="list-style-type: none"> • Revenue • Gross profit • Gross margin • Pre-tax income (EBT) • Net income • EPS • Profit margin • Operating cash flows (OCF) | <ul style="list-style-type: none"> • Churn • Same-store sales • Number of subscribers |

2024 Invitation to Comment (ITC)

- The FASB staff solicited feedback on the following:

What should be the relative priority of a project on Financial KPIs?

How pervasive are Financial KPIs? Are Financial KPIs comparable?

Approach 1:
Standardized
GAAP definitions of
selected Financial
KPIs

Approach 2:
Management
defined Financial
KPIs

Overall preferred
approach and
suggested
disclosures

ITC Comment Letter Respondents

| Type of Respondent | Number of Respondents |
|--------------------------------------|-----------------------|
| Academic | 2 |
| Investor and Investor Advocate Group | 3 |
| Practitioner | 9 |
| Preparer | 7 |
| Professional Association | 3 |
| State Society | 6 |
| Trade Group | 7 |
| Total Respondents | 37 |

Perceived Issues

- Increase in the use of Financial KPIs

| Proportion Reporting a Non-GAAP KPI ² | 2013 | 2022 |
|--|------|------|
| SEC Filers | 26% | 53% |
| S&P 500 | 65% | 85% |



- Lack of comparability among Financial KPIs

- Among a sample of public companies reporting EBITDA reviewed by the staff, the definitions of earnings, interest, depreciation, and amortization were not consistent.

² Data supporting these statistics comes from Calcbench. Calcbench tracks non-GAAP reporting for 12 common measures among SEC filers.

Feedback on Perceived Issues

■ Prevalence

- Financial KPIs are regularly used to assess an entity's performance.
- Surveys and academic research cited that suggests investors frequently use Financial KPIs.

■ Comparability

- Broad agreement that Financial KPIs are not comparable across entities.
- Some noted that entity-specific adjustments were one reason for the lack of comparability.
- Others noted that the level of comparability was sufficient, as management tells their business story through the presentation of Financial KPIs.
- A few noted that SEC regulations help increase transparency for public entities.

Potential Approaches: Approach 1

- Define certain commonly used Financial KPIs (for example, EBITDA and/or FCF)
- Require (or permit) disclosure of those measures in GAAP financial statements

- Key decisions would include:
 - Choose which Financial KPIs to define (commonly used across all entities, industry-specific, or both)
 - Decide whether defined Financial KPIs should be required or optional disclosures in GAAP financial statements.

Potential Incremental Disclosures

- Amounts for each component of the Financial KPI
- Identification of financial statement line item(s) where components of Financial KPIs are included
- Comparative periods

Feedback on Approach 1

- Feedback about the expected benefits of Approach 1 varied, with more indicating that there would not be a benefit.
- Mixed views on whether defined Financial KPIs should be broad or industry specific.
 - Some Financial KPIs are less meaningful in industries such as financial services.
- The most common suggestions for GAAP-defined Financial KPIs were EBITDA, Free Cash Flow, and Current Ratio.
- Many said that disclosure of any defined measures should be optional, not required.

Potential Approaches: Approach 2

- Require (or Permit) Disclosure of Financial KPIs That Management Presents Outside the Financial Statements

- Require (or permit) management to bring Financial KPIs presented outside the financial statements into the notes of financial statements
- Similar approach to the requirements for management performance measures (under IFRS 18, *Presentation and Disclosure in Financial Statements*)
- Key decision would be determining which Financial KPIs would be subject to disclosure (for example, all Financial KPIs that entities present (a) outside the financial statements or (b) in their earnings announcements or other regulatory filings).

Potential Incremental Disclosures

- Reconciliation to the most comparable GAAP requirement
- Amounts for each component of the Financial KPI
- Identification of financial statement line item(s) where components of Financial KPIs are included
- Comparative periods

Feedback on Approach 2

- Many conveyed a lack of support for Approach 2.
- Respondents noted several expected costs of applying this approach and minimal incremental benefits to investors.
 - Expected costs include implementation costs, difficulty to audit, and the possibility of disincentivizing voluntary disclosures.
 - Incremental benefits would be limited; current requirements are viewed as sufficient, and this approach may not respond to investors' needs.
- A few indicated that Approach 2 would increase the reliability of measures that would be presented in the financial statements.
- Some expressed concern about potential interaction with the SEC's existing guidance on reporting non-GAAP measures.

Thank You

Appendix

Appendix A – SEC Guidance for Non-GAAP Financial Measures

- Regulation G and Item 10(e) of Regulation S-K define 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.
- Regulation G and Item 10(e) of Regulation S-K also require registrants to reconcile non-GAAP financial measures to GAAP financial measures. For example, Item 10(e) of Regulation S-K requires:
 - (1)(i)(b) A reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP