

Non-GAAP earnings disclosures and IFRS

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Annual Report 2009

'09 report

2009 results at a glance



Underlying profit \$772 million

AMP delivered an underlying profit of \$772 million in 2009, with earnings momentum in the second half of the year. This compares with an underlying profit of \$810 million in 2008. Underlying profit is AMP's key measure of business profitability as it removes investment market volatility and is the earnings base from which dividends are derived.

Profit attributable to shareholders \$739 million

Profit attributable to shareholders in 2009 was \$739 million, compared with \$580 million in 2008.

Dividend 16 cents per share

The final dividend for 2009 is 16 cents per share, bringing the total dividend for 2009 to 30 cents per share. The final dividend will be 50% franked and will be paid on 14 April 2010. This is a final payout of 80% of underlying earnings, which is within AMP's target payout range of between 75% and 85% of underlying profits.

Another example...

Financial Highlights	FY11 (\$m)	FY12 (\$m)	Variance
Statutory Revenue	3,293	3,634	10 %
Statutory EBITDA ¹	679	1,057	56 %
Underlying EBITDA ^{1,2}	840	1,048	25 %
Statutory EBIT ¹	222	593	168 %
Underlying EBIT ^{1,2}	383	584	52 %
Statutory NPAT ^{1,3}	361	441	22 %
Underlying NPAT	172	420	144 %
Statutory EPS (cps) ¹	15.4	18.1	18 %
Total Dividends (cps)	3.7	8.3	124 %

¹ FY11 comparative restated due to a retrospective application of a voluntary change in accounting policy relating to mechanised Ballast undercutting.

² Underlying EBITDA and EBIT in FY12 were adjusted by \$8.8m relating to the reversal of stamp duty. Underlying EBITDA and EBIT in FY11 were adjusted for one-off IPO related costs and voluntary redundancy expenses totalling \$161.7m.

³ FY11 statutory NPAT includes \$281m tax benefit.

- Release of non-GAAP earnings has increased following adoption of IFRS



In 2010, 83 percent (2009: 83 percent, 2008: 81 percent) of ASX 100 companies reported some form of non-statutory profit.

Adjustments include remeasurements and non-recurring items.

- What does the increase in non-GAAP reporting imply about the quality and usefulness of non-GAAP reporting?

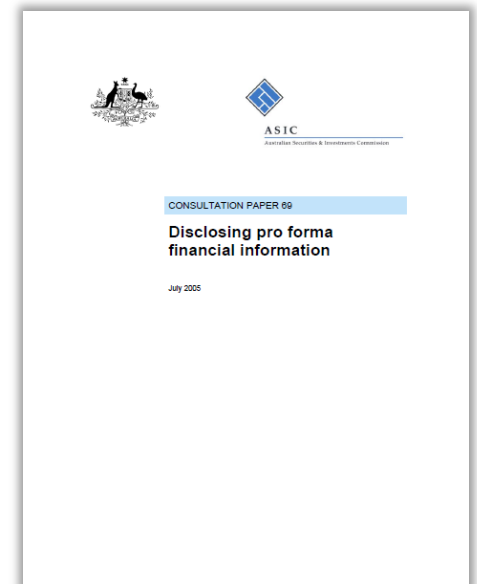
Motivation



FINSIA and AICD...“believe that the market is better informed if a company can provide an ‘underlying profit’ result ... thereby clearly present the underlying value being created for shareholders.”

‘While pro forma financial information can provide useful information to investors ..., it also has the potential to be misleading’

ASIC’s Deputy Chief Accountant, Mr Doug Niven



Research questions

- To what extent is the release of non-GAAP earnings associated with IFRS remeasurements?
- To what extent are non-GAAP adjustments for IFRS remeasurements useful for market participants?

IFRS remeasurements

Release of non-GAAP earnings

- Financial instruments
- Revaluation of investment property and agricultural, pension and insurance assets
- Impairment

- Financial statement items
- Analyst adjustments

Research questions

- To what extent is the release of non-GAAP earnings associated with IFRS remeasurements?
- To what extent are non-GAAP adjustments for IFRS remeasurements useful for market participants?

Release of non-GAAP earnings

Usefulness for market participants

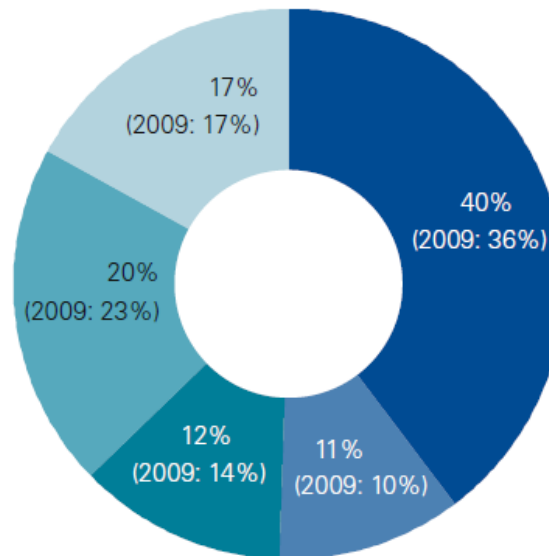
- Analyst forecasts accuracy
- Forecast dispersion

Non-GAAP earnings definition

- Non-GAAP earnings are figures reported by management and analysts that exclude items required to be recognised under accounting standards.
 - Other common names include: non-statutory, underlying and core profit/earnings



Non-statutory profit – terminology



■ Underlying ■ Normalised ■ EBITDA/EBIT
■ Other ■ Adjusted/Before/Excl. etc

- Prior studies investigate many aspects of non-GAAP reporting, particularly with regard to whether non-GAAP earnings provide useful information for evaluating companies' performance and predicting earnings
 - (Venter, Emanuel, and Cahan 2014; Bhattacharya et al. 2003; Bradshaw and Sloan 2002; Landsman, Miller, and Yeh 2007).
- Other studies have focused on the opportunistic use of non-GAAP reporting to influence analysts' forecasts and investors' decision making
 - (Bhattacharya et al. 2003; Black and Christensen 2009; Doyle, Jennings, and Soliman 2013; Guillamon, Isidro, and Marques 2013).
- This paper is the first to explore the link between non-GAAP reporting and the specific measurement requirements of IFRS.

Hypotheses

- If IFRS remeasurements are potentially uninformative and non-GAAP earnings are used to improve the information environment, we expect:

H1 Disclosure of non-GAAP earnings is more likely for companies with higher (a) incidence and (b) magnitude of FS items reflecting gains and losses on fair value measurements and impairment expenses.

H2 Companies disclosing non-GAAP earnings are more likely to have a higher (a) incidence and (b) magnitude of analyst adjustments for FS items reflecting gains and losses on fair value measurements and impairment expenses.

H3 Companies releasing non-GAAP earnings are more likely to have lower forecast error and less forecast dispersion in the following year.

- Sample from S&P's ASX200 in 2008 to 2010 – 576 firm years.
- Copies of Annual Report, year end Investor Relations Presentations and Preliminary Final Report collected via SIRCA database.
 - Non-GAAP earnings identified using text search for terms e.g., “underlying earnings” and “normalised profits”.
- Data for firms with analysts collected from the I/B/E/S database.

Table 1 – Sample & Descriptive Statistics

Panel A		Total
	Initial Sample	655
Less:	Delistments	-42
	Missing Data	-37
		576
	Releasing Pro Forma	371
	Proportion	64%

Panel B	NonGAAP	NonGAAP	NPAT	NG_DIFF\$
All Years (n=371)	(FS)	(AA)		
	(\$m)	(\$m)	(\$m)	(\$m)
Mean	653.2	588.6	420.8	232.4
Median	151.2	130.5	78.9	43.1

- Financial statement and analyst adjustments from MorningStar Datanalysis database (previously Aspect Huntley).
 - FININST - gains or losses on the remeasurement of financial instruments to fair value through profit and loss
 - under AASB 139 *Financial Instruments: Recognition and Measurement*
 - IMPAIR - impairment expenses
 - under AASB 136 *Impairment of Asset*
 - REVAL - revaluation of investment property, agricultural assets, pension assets and insurance assets
 - under AASB 140 *Investment Property*
 - under AASB 141 *Agriculture*
 - under AASB 119 *Employee Benefits*
 - under AASB 4 *Insurance Contracts*
- Manager's adjustments from non-GAAP reconciliation statements

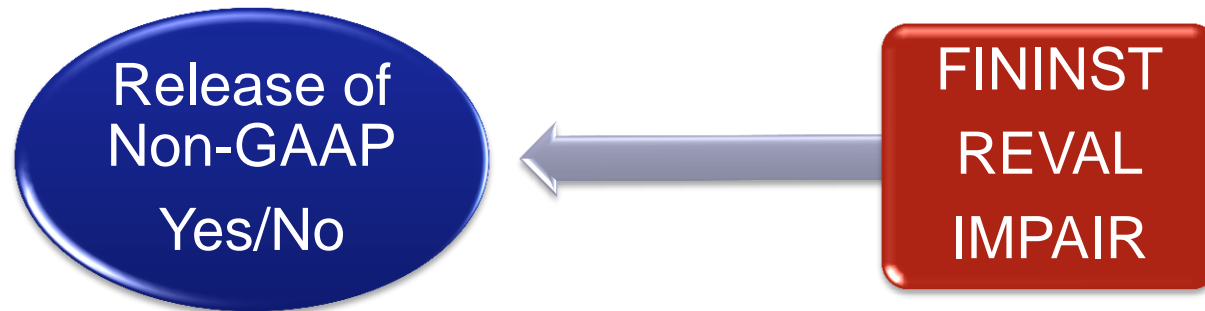
Table 2 - Summary statistics of items

	Financial Statements	Managers' Adjustments	Analyst Adjustments
All firms (n=576)			
<i>FININST (\$m)</i>	-4.45	-10.0	-10.9
<i>REVAL (\$m)</i>	-12.78	-30.1	-28.6
<i>IMPAIR (\$m)</i>	-97.05	-60.3	-82.4
<i>MAGNIT (\$m)</i>	-114.29	-100.4	-121.9
<i>COUNT</i>	1.57	0.6	0.7
Firms with analyst adjustments (n=371)			
<i>FININST (\$m)</i>	-11.40	-14.5	-16.96
<i>REVAL (\$m)</i>	-22.07	-46.2	-44.39
<i>IMPAIR (\$m)</i>	-140.26	-88.3	-127.90
<i>MAGNIT (\$m)</i>	-173.73	-149.0	-189.26
<i>COUNT</i>	1.75	0.8	1.11

Table 4 - Magnitude and occurrence P&L items

	Number with non-zero items		
	Non-GAAP (n=371)	Other (n=205)	χ^2
Panel A Financial statements			
FININST (\$m)	298	161	0.260
REVAL (\$m)	85	19	16.610***
IMPAIR (\$m)	250	93	26.578***
Panel B Analysts' adjustments			
FININST (\$m)	124	36	16.560***
REVAL (\$m)	63	9	19.138***
IMPAIR (\$m)	144	35	29.138***

Non-GAAP Release - Logit Models



$$\text{prob}(NONGAAP_{i,t}) = \beta_0 + \beta_1 \text{COUNT}_{i,t} + \text{controls} + \varepsilon_{i,t} \quad (1)$$

$$\text{prob}(NONGAAP_{i,t}) = \gamma_0 + \gamma_1 \text{MAGNIT}_{i,t} + \text{controls} + \varepsilon_{i,t} \quad (2)$$

$$\begin{aligned} \text{prob}(NONGAAP_{i,t}) = \alpha_0 + \alpha_1 \text{FININST}_{i,t} + \alpha_2 \text{REVAL}_{i,t} + \alpha_3 \text{IMPAIR}_{i,t} \\ + \text{controls} + \varepsilon_{i,t} \end{aligned} \quad (3a) \ \& \ (3b)$$

Table 6 - Non-GAAP Earnings Logit Models Results (Release of Non-GAAP)

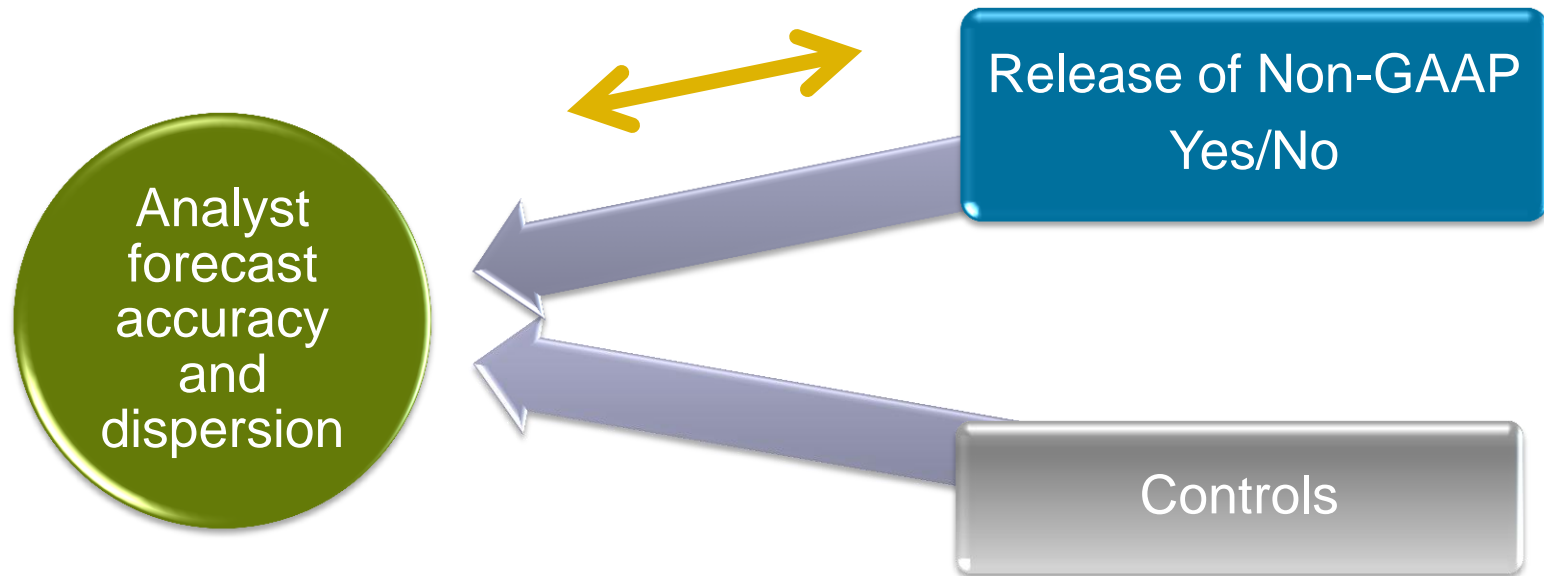
	Coeff.		Coeff.		Coeff.		Coeff.
	(1)		(2)		(3a) Dummy		(3b) Magnitude
Panel A Items in financial statements							
<i>COUNT^{FS}</i>	0.565***						
<i>MAGNIT^{FS}</i>			0.706*				
<i>FININST^{FS}</i>					-0.149		0.001
<i>REVAL^{FS}</i>					1.220***		0.796
<i>IMPAIR^{FS}</i>					0.741***		1.181*

	Coeff.		Coeff.		Coeff.		Coeff.
Panel B	(1)		(2)		(3a) Dummy		(3b) Magnitude
<i>COUNT^{AA}</i>	0.887***						
<i>MAGNIT^{AA}</i>			1.257**				
<i>FININST^{AA}</i>					0.438		3.826**
<i>REVAL^{AA}</i>					1.005**		0.644
<i>IMPAIR^{AA}</i>					0.196		0.412

Table 6 Findings

- Items in financial statements
 - ✓ H1a: Firms with incidence of the item-groups (*COUNT*) are more likely to disclose non-GAAP earnings
 - ✓ H1b: Total amount of the items is associated with non-GAAP earnings disclosure
 - Models 3a & 3b provides some support for the conjecture that occurrence and magnitude of the individual items are related to non-GAAP disclosure
- Analyst adjustments
 - ✓ Results support H2a and H2b.
 - Panel B Model 3 shows the individual items are less associated with companies' non-GAAP earnings disclosure.

Non-GAAP and Analyst forecasts



- Endogeneity – Use two stage least squares
 - First stage - model association of release of non-GAAP (Model 3 with dummy variables) – generate predicted probabilities of non-GAAP disclosure.

Non-GAAP and AFE/FD – 2SLS regression models – Endogeneity

Second stage -

$$\begin{aligned} AFE_{i,t+1} = & \delta_0 + \delta_1 NONGAAP_{i,t} + \delta_2 LOSS_{i,t+1} + \delta_3 VARCFO_{i,t+1} + \delta_4 ACHEARN_{i,t+1} \\ & + \delta_5 PREVAFE_{i,t+1} + \delta_6 NUMEST_{i,t+1} + \delta_7 SIZE_{i,t+1} + \delta_8 ADR_{i,t+1} + \delta_9 PRE_CRISIS_{i,t} \\ & + \delta_{10} POST_CRISIS_{i,t} + \varepsilon_{i,t} \end{aligned} \tag{4}$$

$$\begin{aligned} FD_{i,t+1} = & \varphi_0 + \varphi_1 NONGAAP_{i,t} + \varphi_2 LOSS_{i,t+1} + \varphi_3 VARCFO_{i,t+1} + \varphi_4 ACHEARN_{i,t+1} \\ & + \varphi_5 PREVAFE_{i,t+1} + \varphi_6 NUMEST_{i,t+1} + \varphi_7 SIZE_{i,t+1} + \varphi_8 ADR_{i,t+1} + \varphi_9 PRE_CRISIS_{i,t} \\ & + \varphi_{10} POST_CRISIS_{i,t} + e_{i,t} \end{aligned} \tag{5}$$

Non-GAAP and analyst forecasts

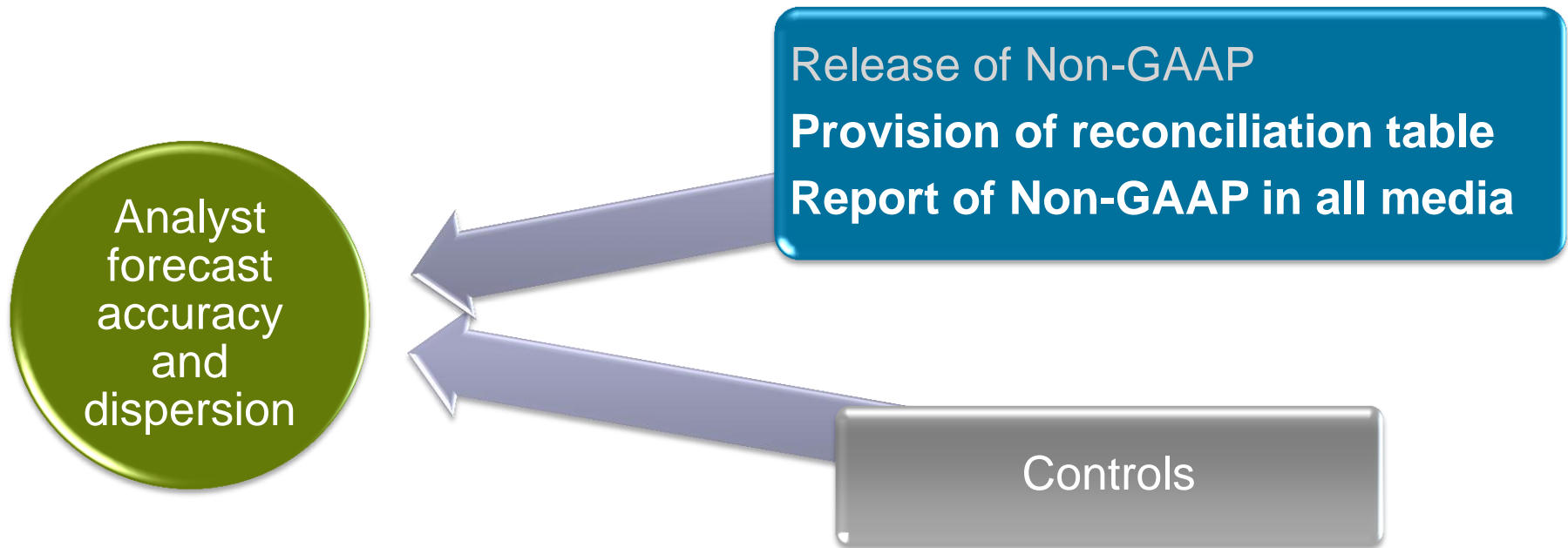


Table 8 - Regression results on analyst forecasts

	(1)	(2)	(3)	(4)
Dependent variable - AFE_{t+1}				
NONGAAP	-0.035***			-0.055***
RECON		-0.037***		
ALLMEDIA			-0.031***	0.027

	(5)	(6)	(7)	(8)
Dependent variable - FD_{t+1}				
NONGAAP	-0.012**			-0.013
RECON		-0.012**		
ALLMEDIA			-0.012**	0.002

Table 8 Findings

- ✓ H3a and H3b supported - find that non-GAAP earnings disclosure is associated with lower forecast error (AFE) and lower forecast dispersion (FD) three months subsequent to year-end
- $NONGAAP_t$ is significant and positive in models using AFE_{t+1} nine months and six months after financial year-end but not in the FD_{t+1} models for the same periods

- Companies and analyst adjustments of the non-recurring and remeasured items raise questions about the requirements of accounting standards.
 - Adjustments to IFRS earnings suggest that they do not see these items as part of underlying earnings.
- We conclude that companies' adjustments to earnings represent a process of communicating with analysts and users of financial reports, consistent with arguments of practitioners.
- Our evidence suggests that the information content of non-GAAP earnings disclosures assists analysts in their forecasting tasks.