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Analyzing Differences between GAAP and Non-GAAP Income

EXECUTIVE SUMMARY

In this study, we review reconciliations between GAAP and non-GAAP net income in order to determine the nature and impact of the adjustments that companies are making to GAAP income to derive non-GAAP income. Our sample consists of the firms in the S&P 100 and their reporting of GAAP and non-GAAP net income for fiscal year 2013.

Seventy-five of the 100 S&P firms report some measure of non-GAAP income for 2013. A total of 74.7% of the sample report non-GAAP income figures that exceed their GAAP earnings. For the sample, median non-GAAP income is 111.21% of GAAP income.

In terms of adjustment frequency, income tax items occur most frequently, followed by adjustments for restructuring and productivity related charges, impairment charges and litigation expenses. Adjustments for non-cash compensation, while not the most frequently employed adjustment, did have the greatest effect in altering GAAP income, raising non-GAAP income by the median value of 13.75%.

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Georgia Tech Financial Analysis Lab

The Georgia Tech Financial Analysis Lab conducts unbiased research on issues of financial reporting and analysis. Unbiased information is vital to effective investment decision-making. Accordingly, we think that independent research organizations, such as our own, have an important role to play in providing information to market participants.

Because our Lab is housed within a university, all of our research reports have an educational quality, as they are designed to impart knowledge and understanding to those who read them. Our focus is on issues that we believe will be of interest to a large segment of stock market participants. Depending on the issue, we may focus our attention on individual companies, groups of companies, or on large segments of the market at large.

A recurring theme in our work is the identification of reporting practices that give investors a misleading signal, whether positive or negative, of corporate earning power. We define earning power as the ability to generate a sustainable stream of earnings that is backed by cash flow. Accordingly, our research may look into reporting practices that affect either earnings or cash flow, or both. At times, our research may look at stock prices generally, though from a fundamental and not technical point of view.

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Analyzing Differences between GAAP and Non-GAAP Income

Introduction

GAAP income refers to net income measured in accordance with generally accepted accounting principles. Non-GAAP income is GAAP income adjusted to exclude discretionary items viewed by management as being non-recurring or not representative of the company's underlying performance for a reporting period. In a recent article, Sam Ro looks at differences between GAAP and Non-GAAP earnings for the companies in the S&P 500 and notes, "Companies haven't fudged their numbers this much since the financial crisis."[1]

When saying that differences exist between GAAP and Non-GAAP income, questions arise as to what is causing the differences. That is, what are companies excluding from their GAAP income to derive non-GAAP income? This research study is designed to answer that question.

For a sample consisting of the 100 firms comprising the S&P 100 we examine earnings releases for the fourth quarter of 2013, including disclosures of GAAP and non-GAAP earnings. In particular, we review reconciliations between GAAP and non-GAAP values in order to determine the nature of the adjustments that companies are making. In addition, we seek to understand the impact of the adjustments on non-GAAP earnings.

While companies have discretion in selecting which specific GAAP financial measures are reported in a non-GAAP manner, our focus is on a single GAAP-based financial measure, net income, or that measure of GAAP income that we considered to be most closely aligned with net income. We review corporate 8-K filings, which is a current report filed with the SEC, for the fourth quarter of fiscal year 2013 for the inclusion of non-GAAP measures of net income for fiscal year 2013.

Results

Prevalence of Non-GAAP Reporting

In reviewing the prominence given to GAAP income, we find that of the S&P 100 for fiscal year 2013, 75 companies report non-GAAP income and 25 companies do not report non-GAAP income. A list of companies not reporting non-GAAP income for this reporting period is provided in Table 1.

[1] Ro, Sam. "Companies Haven't Fudged Their Numbers This Much Since the Financial Crisis." *Yahoo Finance,* March 21, 2016.

Table 1: A List of Companies in the S&P 100 That Did Not Report Non-GAAP Income for the Fiscal Year, 2013

3M Co
Amazon.com Inc
Apple Inc.
Capital One Financial
Caterpillar Inc
Chevron Corp
Costco Wholesale Corp
CVS Caremark Corp.
Exxon Mobil Corp
Freeport McMoRan Copper & Gold
General Dynamics
Goldman Sachs Group Inc
Home Depot Inc
Intel Corp
Lockheed Martin
Lowe's Cos Inc
McDonald's Corp
NIKE Inc B
Norfolk Southern Corp
Texas Instruments Inc
Union Pacific Corp
Unitedhealth Group Inc
US Bancorp
Visa Inc
Wells Fargo & Co

Source: S&P 100 Companies, Form 8-K Special Reports to the Securities and Exchange Commission, fiscal year 2013.

Reconciliations of GAAP Income to Non-GAAP Income

Table 2 presents the reconciliations of GAAP income to Non-GAAP income for the 75 companies in our sample who report non-GAAP income. All income measures cover the 2013 fiscal year. For cross-sectional comparability, GAAP income, non-GAAP income and all adjustments are measured as a percentage of 2013 GAAP income. GAAP income is first adjusted by several non-recurring items that occurred for the sample firms throughout the year. The non-recurring items are grouped into twelve general categories: acquisition/divestiture charges, asset disposal (gains)/losses, employee separation charges, impairment charges, income tax items, investment (gains)/losses, litigation expenses, non-recurring transaction gains/losses, non-cash compensation, other non-recurring (gains)/losses, pension plan (gains)/losses and restructuring and productivity-related charges. The net of these adjustments is added to GAAP income to derive non-GAAP income (after non-recurring adjustments).

While most companies employ a non-GAAP income measure that is GAAP income adjusted for nonrecurring items, some companies also exclude the effects of certain recurring items from non-GAAP income, such as depreciation and amortization expense, interest expense, the provision for income taxes, and preferred distributions and dividends. Further, in some instances, non-GAAP income is adjusted to remove income attributable to non-controlling interests.[2] For these companies, the net of these additional adjustments is added to the non-GAAP income (after non recurring adjustments) to derive non-GAAP income (after all adjustments). This final non-GAAP income measure is the income amount that is compared with GAAP income.

A review of Table 3 below finds that 74.7%, or 56 of the 75 reconciliations listed result in non-GAAP income measures that exceed their comparable GAAP income figure. There are 25.3%, or 19 of 75 reconciliations that result in non-GAAP income measures that are less than their comparable GAAP earnings value. Such results indicate that non-GAAP adjustments are used far more frequently to increase earnings than to reduce them.

[2] GAAP net income includes income attributable to non-controlling interests. Adjustments to remove income attributable to non-controlling interests are designed to report as non-GAAP income an income amount that is available for controlling shareholders, that is, shareholders of the parent company.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013

Company	Abbott Laboratories[a]	AbbVie Inc.	Accenture plc[b]	Allstate corp	Altria Group Inc	American Express Co	American International Group
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses							1.29%
Asset disposal (gains)/losses				22.76%			
Employee separation charges		3.91%					
Impairment charges							
Income tax items			-6.84%		-1.33%		-26.92%
Investment (gains)/losses				-16.08%			0.88%
Litigation expenses					-9.29%	0.77%	-5.06%
Non recurring transaction gains/losses		8.20%					
Non-cash compensation							
Other non recurring (gains)/losses	15.02%			8.88%	15.93%		4.25%
Pension plan (gains)/losses							
Restructuring and productivity related charges		1.56%	-7.71%	2.43%			
Total net adjustments (non recurring)	15.02%	13.67%	-14.54%	17.98%	5.31%	0.77%	-25.57%
Non-GAAP Income (after non recurring adjustments)	115.02%	113.67%	85.46%	117.98%	105.31%	100.77%	74.43%
Recurring Adjustments							
Depreciation and Amortization	18.98%	8.98%					
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)	18.98%	8.98%					
Non-GAAP Income (after all adjustments)	134.00%	122.66%	85.46%	117.98%	105.31%	100.77%	74.43%

Source: Current reports of earnings releases to the Securities and Exchange Commission on Form 8-K for fiscal year 2013.
[a] No detail is given for a breakdown of the EPS adjustment on the 8-K. The breakdown of individual EPS adjustments used on this table is calculated as the proportions of total adjustments used in the non-GAAP reconciliation of "Earnings from Continuing Operations before taxes" from the 8-K.
[b] Fiscal year ended 8/31/13.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Amgen Inc	Anadarko Petroleum Corp[c]	Apache Corp	AT&T Inc	Bank of America	Baxter Intl Inc	Berkshire Hathaway Inc
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses		37.20%	0.91%				
Asset disposal (gains)/losses				-0.59%			
Employee separation charges				1.77%			
Impairment charges		62.67%	29.64%				
Income tax items		-3.87%	7.09%	-1.47%			
Investment (gains)/losses		-24.47%	6.36%				-22.27%
Litigation expenses		68.79%					
Non recurring transaction gains/losses							
Non-cash compensation	14.46%						
Other non recurring (gains)/losses		13.11%			0.29%	27.58%	
Pension plan (gains)/losses				-25.96%			
Restructuring and productivity related charges							
Total net adjustments (non recurring)	14.46%	153.43%	44.00%	-26.25%	0.29%	27.58%	-22.27%
Non-GAAP Income (after non recurring adjustments)	114.46%	253.43%	144.00%	73.75%	100.29%	127.58%	77.73%
Recurring Adjustments							
Depreciation and Amortization							
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)							
Non-GAAP Income (after all adjustments)	114.46%	253.43%	144.00%	73.75%	100.29%	127.58%	77.73%

[c] We use individual quarter end reconciliations from all four 8-Ks in aggregate to calculate total year income and adjustments.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Biogen Idec[d]	Boeing Co	Bristol-Myers Squibb[d]	Cisco Systems Inc[d,e]	Citigroup Inc	Coca-Cola Co[f]	Colgate-Palmolive Co
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses			-0.25%	0.98%	-1.36%		
Asset disposal (gains)/losses							
Employee separation charges							
Impairment charges	-0.02%			0.71%		4.21%	
Income tax items				-9.85%	-1.27%	-0.53%	
Investment (gains)/losses							
Litigation expenses			-0.59%	1.29%			1.67%
Non recurring transaction gains/losses						-3.16%	
Non-cash compensation	0.39%			8.46%			
Other non recurring (gains)/losses	1.09%		0.46%		1.53%	4.21%	
Pension plan (gains)/losses		18.62%	4.10%				
Restructuring and productivity related charges			5.76%			3.68%	23.33%
Total net adjustments (non recurring)	1.46%	18.62%	9.48%	1.60%	-1.09%	8.42%	25.00%
Non-GAAP Income (after non recurring adjustments)	101.46%	118.62%	109.48%	101.60%	98.91%	109.47%	125.00%
Recurring Adjustments							
Depreciation and Amortization	13.26%		8.31%	7.25%			
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)	13.26%		8.31%	7.25%			
Non-GAAP Income (after all adjustments)	114.71%	118.62%	117.79%	108.85%	98.91%	109.47%	125.00%

[d] All adjustments in the reconciliation are pre-tax except for an income tax adjustment to make the non-GAAP value post-tax. For comparability purposes, we incorporate the income tax adjustment into all pre-tax adjustments based on their proportion of adjustments to show all adjustments as after-tax.
[e] Fiscal year ended 7/27/13.
[f] Non-GAAP value shown here is taken from the 8-K. Adjustments do not sum to this value due to rounding.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Comcast Corp	ConocoPhillips	Devon Energy Corp	Dow Chemical	DuPont	eBay Inc.[d]	Eli Lilly
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses						0.23%	
Asset disposal (gains)/losses		-12.87%				-1.94%	
Employee separation charges							1.39%
Impairment charges		2.94%	4.83%	2.99%	5.87%		0.46%
Income tax items	-2.34%	-0.01%		6.25%	-0.52%		
Investment (gains)/losses	3.52%		63.29%			0.05%	
Litigation expenses		-1.29%			1.64%		
Non recurring transaction gains/losses	-5.47%	-11.74%		-9.78%			
Non-cash compensation						16.49%	
Other non recurring (gains)/losses		-0.36%	46.86%	-32.61%	7.89%	-0.39%	-6.02%
Pension plan (gains)/losses	0.78%	0.45%			12.57%		
Restructuring and productivity related charges			0.97%	0.27%	-0.10%	-0.16%	
Total net adjustments (non recurring)	-3.52%	-22.88%	115.94%	-32.88%	27.35%	14.30%	-4.17%
Non-GAAP Income (after non recurring adjustments)	96.48%	77.12%	215.94%	67.12%	127.35%	114.30%	95.83%
Recurring Adjustments							
Depreciation and Amortization						10.21%	
Interest expense							
Net income attributable to non-controlling interests					-0.49%		
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)					-0.49%	10.21%	
Non-GAAP Income (after all adjustments)	96.48%	77.12%	215.94%	67.12%	126.86%	124.51%	95.83%

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	EMC Corp	Emerson Electric Co[g]	Exelon Corp	Facebook Inc	FedEx Corp[h]	Ford Motor Co	General Electric Co
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses							
Asset disposal (gains)/losses	-0.73%						
Employee separation charges						11.96%	
Impairment charges		28.26%			4.04%		
Income tax items	-1.42%			-19.80%		-30.15%	
Investment (gains)/losses			-36.21%				
Litigation expenses							
Non recurring transaction gains/losses							
Non-cash compensation	22.01%			66.60%			
Other non recurring (gains)/losses			3.45%			9.95%	
Pension plan (gains)/losses							11.23%
Restructuring and productivity related charges	5.40%		3.45%		22.61%		
Total net adjustments (non recurring)	25.27%	28.26%	-29.31%	46.80%	26.65%	-8.23%	11.23%
Non-GAAP Income (after non recurring adjustments)	125.27%	128.26%	70.69%	146.80%	126.65%	91.77%	111.23%
Recurring Adjustments							
Depreciation and Amortization	9.48%		15.52%				
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)	9.48%		15.52%				
Non-GAAP Income (after all adjustments)	134.75%	128.26%	86.21%	146.80%	126.65%	91.77%	111.23%

[g] Fiscal year ended 9/30/13.
[h] Fiscal year ended 5/31/13.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	General Motors Company	Gilead Sciences Inc[f]	Google Inc[c]	Halliburton Co	Hewlett-Packard Co[i]	Honeywell Intl Inc	Intl Business Machines Corp
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses					0.43%		4.53%
Asset disposal (gains)/losses							
Employee separation charges							
Impairment charges		1.66%					
Income tax items			-5.98%		-10.95%		
Investment (gains)/losses							
Litigation expenses							
Non recurring transaction gains/losses							
Non-cash compensation		6.08%	25.13%				
Other non recurring (gains)/losses	26.98%		-5.46%	31.91%			
Pension plan (gains)/losses						1.02%	4.42%
Restructuring and productivity related charges			1.41%	3.13%	19.36%		
Total net adjustments (non recurring)	26.98%	7.73%	15.10%	35.04%	8.84%	1.02%	8.95%
Non-GAAP Income (after non recurring adjustments)	126.98%	107.73%	115.10%	135.04%	108.84%	101.02%	108.95%
Recurring Adjustments							
Depreciation and Amortization		3.87%			26.85%		
Interest expense	2.33%						
Net income attributable to non-controlling interests							
Preferred distributions and dividends	41.80%						
Provision for income taxes	56.42%						
Total net adjustments (recurring)	100.56%	3.87%			26.85%		
Non-GAAP Income (after all adjustments)	227.53%	111.60%	115.10%	135.04%	135.69%	101.02%	108.95%

[i] Fiscal year ended 10/31/13.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Johnson & Johnson	JP Morgan Chase & Co	Mastercard Inc A	Medtronic Inc[j]	Merck & Co Inc[d]	Metlife Inc[f]	Microsoft Corp[k]
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses				-1.47%	95.87%		
Asset disposal (gains)/losses		-6.24%					
Employee separation charges							
Impairment charges							
Income tax items	-5.11%					-22.08%	
Investment (gains)/losses						63.64%	
Litigation expenses	11.90%	48.12%	1.96%	6.78%			
Non recurring transaction gains/losses	3.49%						
Non-cash compensation							
Other non recurring (gains)/losses	4.50%	-12.21%		1.64%	-0.22%	33.77%	1.55%
Pension plan (gains)/losses							
Restructuring and productivity related charges				4.24%	41.48%		
Total net adjustments (non recurring)	14.79%	29.67%	1.96%	11.19%	137.13%	75.32%	1.55%
Non-GAAP Income (after non recurring adjustments)	114.79%	129.67%	101.96%	111.19%	237.13%	175.32%	101.55%
Recurring Adjustments							
Depreciation and Amortization							
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)							
Non-GAAP Income (after all adjustments)	114.79%	129.67%	101.96%	111.19%	237.13%	175.32%	101.55%

[j] Fiscal year ended 4/26/13.
[k] Fiscal year ended 6/30/13.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Mondelez International Inc.	Monsanto Co.[b]	Morgan Stanley	National Oilwell Varco Inc	Occidental Petroleum	Oracle Corp[d,h]	PepsiCo Inc
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses	6.40%					-3.84%	
Asset disposal (gains)/losses							
Employee separation charges							
Impairment charges					6.59%		
Income tax items	-1.56%	-0.43%					-3.10%
Investment (gains)/losses				0.34%			
Litigation expenses				-4.38%			
Non recurring transaction gains/losses				6.36%	-12.61%		
Non-cash compensation						4.59%	
Other non recurring (gains)/losses	1.08%	-0.43%	16.08%		0.92%	0.46%	2.42%
Pension plan (gains)/losses							
Restructuring and productivity related charges	10.73%					2.24%	1.91%
Total net adjustments (non recurring)	16.65%	-0.87%	16.08%	2.32%	-5.10%	3.45%	1.23%
Non-GAAP Income (after non recurring adjustments)	116.65%	99.13%	116.08%	102.32%	94.90%	103.45%	101.23%
Recurring Adjustments							
Depreciation and Amortization						15.15%	
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)						15.15%	
Non-GAAP Income (after all adjustments)	116.65%	99.13%	116.08%	102.32%	94.90%	118.60%	101.23%

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Pfizer Inc	Philip Morris International	Procter & Gamble[k]	QUALCOMM Inc[l]	Raytheon Co	Schlumberger Ltd	Simon Property Group Inc
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses	1.74%			4.09%			
Asset disposal (gains)/losses	-48.28%						
Employee separation charges							
Impairment charges	14.30%	2.28%	2.59%			6.43%	
Income tax items		0.38%		-1.02%	-1.34%		
Investment (gains)/losses							
Litigation expenses			1.30%				
Non recurring transaction gains/losses			-5.44%				
Non-cash compensation				13.04%			
Other non recurring (gains)/losses	1.72%		1.81%	-0.51%	8.39%	-13.32%	-6.93%
Pension plan (gains)/losses							
Restructuring and productivity related charges			4.66%				
Total net adjustments (non recurring)	-30.52%	2.66%	4.92%	15.60%	7.05%	-6.90%	-6.93%
Non-GAAP Income (after non recurring adjustments)	69.48%	102.66%	104.92%	115.60%	107.05%	93.10%	93.07%
Recurring Adjustments							
Depreciation and Amortization							114.45%
Interest expense							
Net income attributable to non-controlling interests							-0.58%
Preferred distributions and dividends							-0.34%
Provision for income taxes							
Total net adjustments (recurring)							113.54%
Non-GAAP Income (after all adjustments)	69.48%	102.66%	104.92%	115.60%	107.05%	93.10%	206.61%

[l] Fiscal year ended 9/29/13.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	Southern Co	Starbucks Corp[l,m]	Target Corp[n]	The Bank of New York Mellon Corp	Time Warner Inc[d]	Twenty-First Century Fox, Inc[k]	United Parcel Service Inc B
Non Recurring Adjustments							
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses					0.00%		
Asset disposal (gains)/losses							-4.87%
Employee separation charges					-0.01%		
Impairment charges					0.51%		
Income tax items			-0.98%				
Investment (gains)/losses					-0.11%	-2.40%	
Litigation expenses	-0.73%	20,639.76%		28.97%			
Non recurring transaction gains/losses							4.05%
Non-cash compensation							
Other non recurring (gains)/losses	44.34%		43.65%		-0.53%	-51.58%	
Pension plan (gains)/losses							
Restructuring and productivity related charges	0.97%					0.63%	
Total net adjustments (non recurring)	44.59%	20,639.76%	42.67%	28.97%	-0.14%	-53.36%	-0.82%
Non-GAAP Income (after non recurring adjustments)	144.59%	20,739.76%	142.67%	128.97%	99.86%	46.64%	99.18%
Recurring Adjustments							
Depreciation and Amortization							
Interest expense							
Net income attributable to non-controlling interests							
Preferred distributions and dividends							
Provision for income taxes							
Total net adjustments (recurring)							
Non-GAAP Income (after all adjustments)	144.59%	20,739.76%	142.67%	128.97%	99.86%	46.64%	99.18%

[m] Adjustments are excluded from descriptive statistics in Table 4 as an outlier.
[n] Fiscal year ended 2/1/14.

Table 2. A Reconciliation in Percentage Terms of GAAP Income to Non-GAAP Income for the S&P 100, Fiscal Year 2013 (continued)

Company	United Technologies Corp	Verizon Communications Inc	Wal-Mart Stores[o]	Walgreen Co[b]	Walt Disney Co[f,p]
Non Recurring Adjustments					
GAAP Income	100.00%	100.00%	100.00%	100.00%	100.00%
Acquisition/divestiture expenses				2.45%	
Asset disposal (gains)/losses			1.24%	-0.53%	
Employee separation charges					
Impairment charges					
Income tax items			1.24%	5.06%	-3.55%
Investment (gains)/losses				-4.49%	
Litigation expenses				1.92%	
Non recurring transaction gains/losses		4.50%	1.03%	0.33%	
Non-cash compensation					
Other non recurring (gains)/losses	-2.42%		1.65%	7.14%	1.48%
Pension plan (gains)/losses		-33.75%			
Restructuring and productivity related charges	5.22%		0.21%		2.07%
Total net adjustments (non recurring)	2.80%	-29.25%	5.36%	11.88%	0.00%
Non-GAAP Income (after non recurring adjustments)	102.80%	70.75%	105.36%	111.88%	100.30%
Recurring Adjustments					
Depreciation and Amortization				9.84%	
Interest expense					
Net income attributable to non-controlling interests					
Preferred distributions and dividends					
Provision for income taxes					
Total net adjustments (recurring)				9.84%	
Non-GAAP Income (after all adjustments)	102.80%	70.75%	105.36%	121.71%	100.30%

Source: S&P 100 Companies, Form 8-K Special Reports to the Securities and Exchange Commission

[o] Fiscal year ended 1/31/14.
[p] Fiscal year ended 9/28/13.

Impact of non-GAAP Adjustments

Table 3 below presents descriptive statistics and counts of the individual adjustments used in the reconciliations between GAAP and non-GAAP earnings for our sample. Panel A of Table 4 shows the sample-wide mean, minimum, median and maximum sample measures, calculated as a percentage of GAAP income, for non-GAAP income and for each of the twelve adjustment categories. As presented in the table, mean non-GAAP income (after non-recurring adjustments) is 112.31% of GAAP income and the median value is 107.39%.

In reviewing adjustments made by our sample companies in deriving non-GAAP earnings, we note that fifteen companies make adjustments for items that could be considered to be recurring in nature. For example, in computing non-GAAP income, thirteen companies make adjustments for depreciation and/or amortization expense. Depreciation of property, plant and equipment and amortization of intangibles are both normal operating expenses and on the surface, do not appear to be non-recurring. Some analysts would argue that amortization of intangibles acquired in business acquisitions is a non-recurring item. Of course, the acquiring company is including the results of the acquired entity in revenues and operating profit. Viewed in this light, the cost of the acquisition, including amortization of acquired intangibles, is a recurring expense related to the purchase of those intangibles. Of the thirteen firms adjusting non-GAAP earnings for depreciation and/or amortization expense, five firms, Biogen Idec, Cisco Systems Inc, eBay Inc, Gilead Sciences Inc, and Walgreen Co, specifically mention that the adjustment is for amortization of intangibles acquired through business acquisitions.

Non-GAAP adjustments for interest expense and provision for income taxes are each used once in the sample, both by General Motors Company in the non-GAAP calculation of Earnings Before Interest and Taxes (EBIT). The fact that these adjustments are used so infrequently in the sample suggests that most firms consider interest and taxes to be expenses that should be included in both GAAP income and non-GAAP income. We also identify two instances of companies using non-GAAP adjustments for preferred distributions and dividends. In these instances, General Motors Company again uses the adjustment to reconcile from net income attributable to common stockholders to EBIT and Simon Property Group uses the adjustment in its calculation of a specialized version of non-GAAP income for real estate investment trusts, called Funds From Operations (FFO). Finally, two companies, DuPont and Simon Property Group, deduct non-controlling interests from GAAP income in computing non-GAAP income. Under GAAP accounting, net income is income available for both controlling and non-controlling interests. The companies that deduct non-controlling interests in determining non-GAAP income are measuring non-GAAP earnings as earnings available only for controlling shareholders. They take this step even though the net result is a lower measure of non-GAAP income than would have been the case had the adjustment not been made.

The effects of these recurring adjustments, depreciation and/or amortization expense, interest expense, provision for income taxes, preferred distributions and dividends, and adjustments for non-controlling interests, on GAAP income in deriving non-GAAP income are identified separately from non-recurring items in Tables 2 and 3. Given their recurring quality, these items are inherently different from the non-recurring items that are the subject of most adjustments used to derive non-GAAP income. For this reason, we seek to examine their effects on non-GAAP income separately.

Including the effects of adjustments for recurring items, we see the mean non-GAAP income for our sample rises to 117.20% of GAAP income and the median value increases to

111.21%. Of the companies that include adjustments for recurring items, Simon Property Group has the largest positive aggregate adjustment of such items, with almost 114% in adjustments. The adjustments include over 114% to depreciation and amortization and two slightly negative adjustments to net income attributable to non-controlling interests and preferred distributions and dividends. The median value of all aggregate adjustments for recurring items is 10.21%. Because only one company using adjustments for recurring items had an aggregate negative adjustment, we can see that a vast majority of such adjustments serve to boost non-GAAP earnings. This raises further concerns about their validity in giving a true measure of a company's performance.

Although companies use many different types of adjustments to arrive at non-GAAP earnings, some adjustments are used more frequently than others or have a larger impact on earnings. In reviewing the counts of individual adjustments from Panel A of Table 3, we find that the most commonly used non-recurring adjustment is income tax items, being used in 30 reconciliations. The impact of income tax items ranged from -30.15% to 7.09% as an adjustment of GAAP income, with a median adjustment of -1.45%. Such a spread indicates that the majority of Income tax items adjustments result from removing the effects of favorable tax items that were realized during the year. Restructuring and productivity related charges is the second most commonly used adjustment, with 27 uses. These adjustments range from -7.71% to 41.48% of GAAP income and have a median value of 2.43%, indicating that the majority made a moderate to large positive impact on non-GAAP earnings. Also popular among adjustments to derive non-GAAP income are impairment charges and litigation expenses, both of which are employed 19 times in the sample. For impairment charges, the range is from -.02% to 62.67% of GAAP income with a median value of 4.04% and for litigation expenses, the range is from -9.29% to 68.79% of GAAP income with a median value of 1.47%.

Adjustments for non-cash compensation should be noted because, when used, they have the greatest impact on non-GAAP earnings. Non-cash compensation adjustments are always positive, ranging from 0.39% to 66.60% of GAAP income with a median value of 13.75%. While this adjustment is only used in ten reconciliations, it has a significantly greater impact than any other single adjustment. Other adjustments to note due to their large ranges are investment (gains)/losses, ranging from -36.21% to 63.64%, and acquisition/divestiture expenses, ranging from -3.84% to 95.87%. Depreciation and amortization is the most commonly used adjustment for recurring items, being used thirteen times. Such adjustments range from 3.87% to 114.45%, with a median value of 10.21%.

Panel B of Table 3 presents descriptive statistics and counts of adjustments for sample companies with net positive non-GAAP adjustments. These are the 56 companies with non-GAAP earnings greater than their reported GAAP income. The largest positive adjustment resulted in non-GAAP income that is 20,739.76% of GAAP income. This extremely large value results from Starbucks' $1.7 billion litigation expense adjustment. The value is added to a GAAP net income of only $8.3 million, resulting in an unusually large adjustment. Excluding the Starbucks outlier, the largest positive adjustment results in a non-GAAP income of 253.43% of GAAP earnings for Anadarko Petroleum Corp. Anadarko's large non-GAAP income value primarily results from three large adjustments to acquisition/divestiture expenses, impairment charges, and litigation expenses, combining to add approximately 169% of the value of GAAP income. Anadarko also had an adjustment of -24.47% to investment (gains)/losses.

The median value of all non-GAAP income values greater than its GAAP value is 117.79% and the minimum non-GAAP value greater than GAAP income is 100.29%.

It should also be noted that one company listed in the Panel B sample, Simon Property Group, actually has non-GAAP income (after non-recurring adjustments) of 93.07% of GAAP income, but also has adjustments for recurring items of 113.54%. These recurring adjustments shifted non-GAAP income from being less than GAAP earnings to being greater than GAAP earnings. This is the only instance in our sample where recurring adjustments moved non-GAAP earnings from one side of GAAP earnings to another.

Panel C in Table 3 displays the descriptive statistics and counts of adjustments for the nineteen companies with non-GAAP earnings values less than their GAAP counterparts. Twenty-First Century Fox has the largest negative adjustment, reducing earnings by 53.36% to arrive at a non-GAAP income of 46.64% of GAAP income. Of the nineteen companies with net negative adjustments, non-GAAP values range from 46.64% to 99.86% of GAAP income, with a median value of 85.46%. Exelon Corp is the only company from the sample in Panel C that uses an adjustment for recurring items. Even with a positive adjustment of 15.52% for depreciation and amortization, non-GAAP income remains less than GAAP income due to the large impact of its non-recurring adjustments.

Table 3: Descriptive Statistics for Non-GAAP Income Adjustments, S&P 100 Companies, Fiscal 2013

Panel A: All Adjustments

Non-Recurring Adjustments	Mean	Minimum	Median	Maximum	Count
GAAP Income	100.00%	100.00%	100.00%	100.00%	
Acquisition/divestiture expenses	8.78%	-3.84%	0.98%	95.87%	17
Asset disposal (gains)/losses	-5.20%	-48.28%	-1.33%	22.76%	10
Employee separation charges	3.80%	-0.01%	1.77%	11.96%	5
Impairment charges	9.52%	-0.02%	4.04%	62.67%	19
Income tax items	-4.75%	-30.15%	-1.45%	7.09%	30
Investment (gains)/losses	2.29%	-36.21%	-0.03%	63.64%	14
Litigation expenses	8.54%	-9.29%	1.47%	68.79%	19
Non recurring transaction gains/losses	-1.56%	-12.61%	0.33%	8.20%	13
Non-cash compensation	17.73%	0.39%	13.75%	66.60%	10
Other non recurring (gains/credits) or losses/charges	5.40%	-51.58%	1.65%	46.86%	48
Pension plan (gains)/losses	-0.65%	-33.75%	2.56%	18.62%	10
Restructuring and productivity related charges	5.92%	-7.71%	2.43%	41.48%	27
Total net adjustments (non-recurring) [a]	12.29%	-53.36%	7.39%	153.43%	
Non-GAAP Income (after non recurring adjustments) [a]	112.31%	46.64%	107.39%	253.43%	
Recurring Adjustments					
Depreciation and Amortization	20.17%	3.87%	10.21%	114.45%	13
Interest expense	2.33%	2.33%	2.33%	2.33%	1
Net income attributable to non-controlling interests	-0.53%	-0.58%	-0.53%	-0.49%	2
Preferred distributions and dividends	20.73%	-0.34%	20.73%	41.80%	2
Provision for income taxes	56.42%	56.42%	56.42%	56.42%	1
Total net adjustments (recurring) [a]	24.09%	-0.49%	10.21%	113.54%	
Non-GAAP Income (after all adjustments) [a]	117.20%	46.64%	111.21%	253.43%	

[a] Total net adjustments and Non-GAAP Income reflect company-specific mean, minimum, median and maximum amounts and are not a sum of the amounts presented in the table.

Source: Descriptive statistics of non-GAAP adjustments from S&P 100 companies Form 8-K Special Reports to the Securities and Exchange Commission.

Table 3: Descriptive Statistics for Non-GAAP Income Adjustments, S&P 100 Companies, Fiscal 2013 (continued)

Panel B: Fifty Six Companies with Net Positive Adjustments

Non-Recurring Adjustments	Mean	Minimum	Median	Maximum	Count
GAAP Income	100.00%	100.00%	100.00%	100.00%	
Acquisition/divestiture expenses	11.35%	-3.84%	0.98%	95.87%	13
Asset disposal (gains)/losses	2.43%	-6.24%	-0.63%	22.76%	6
Employee separation charges	3.91%	3.91%	3.91%	3.91%	1
Impairment charges	12.23%	-0.02%	4.12%	62.67%	12
Income tax items	-3.77%	-22.08%	-1.42%	7.09%	21
Investment (gains)/losses	11.08%	-24.47%	0.20%	63.64%	8
Litigation expenses	10.01%	-9.29%	1.65%	68.79%	17
Non recurring transaction gains/losses	1.54%	-5.44%	1.03%	8.20%	7
Non-cash compensation	17.73%	0.39%	13.75%	66.60%	10
Other non recurring (gains/credits) or losses/charges	9.77%	-12.21%	2.42%	46.86%	35
Pension plan (gains)/losses	8.66%	1.02%	7.83%	18.62%	6
Restructuring and productivity related charges	7.09%	-0.16%	3.13%	41.48%	23
Total net adjustments (non-recurring) [a]	22.32%	-6.93%	14.30%	153.43%	
Non-GAAP Income (after non recurring adjustments) [a]	122.34%	93.07%	114.30%	253.43%	
Recurring Adjustments					
Depreciation and Amortization	20.55%	3.87%	10.02%	114.45%	12
Interest expense	2.33%	2.33%	2.33%	2.33%	1
Net income attributable to non-controlling interests	-0.53%	-0.58%	-0.53%	-0.49%	2
Preferred distributions and dividends	20.73%	-0.34%	20.73%	41.80%	2
Provision for income taxes	56.42%	56.42%	56.42%	56.42%	1
Total net adjustments (recurring) [a]	24.70%	-0.49%	10.02%	113.54%	
Non-GAAP Income (after all adjustments) [a]	128.63%	100.29%	117.79%	253.43%	

[a] Total net adjustments and Non-GAAP Income reflect company-specific mean, minimum, median and maximum amounts and are not a sum of the amounts presented in the table.

Source: Descriptive statistics of non-GAAP adjustments from S&P 100 companies Form 8-K Special Reports to the Securities and Exchange Commission.

Table 3: Descriptive Statistics for Non-GAAP Income Adjustments, S&P 100 Companies, Fiscal 2013 (continued)

Panel C: Nineteen Companies with Net Negative Adjustments

Non-Recurring Adjustments	Mean	Minimum	Median	Maximum	Count
GAAP Income	100.00%	100.00%	100.00%	100.00%	
Acquisition/divestiture expenses	0.43%	-1.36%	0.66%	1.74%	4
Asset disposal (gains)/losses	-16.65%	-48.28%	-8.87%	-0.59%	4
Employee separation charges	3.76%	-0.08%	1.58%	11.96%	4
Impairment charges	5.38%	0.46%	3.94%	14.30%	7
Income tax items	-6.22%	-30.15%	-1.37%	6.25%	10
Investment (gains)/losses	-9.56%	-36.21%	-1.64%	3.52%	6
Litigation expenses	-3.18%	-5.06%	-3.18%	-1.29%	2
Non recurring transaction gains/losses	-5.18%	-12.61%	-7.63%	4.50%	6
Non-cash compensation	N/A	N/A	N/A	N/A	0
Other non recurring (gains/credits) or losses/charges	-6.66%	-51.58%	-0.36%	9.95%	13
Pension plan (gains)/losses	-14.62%	-33.75%	-12.76%	0.78%	4
Restructuring and productivity related charges	-0.84%	-7.71%	0.45%	3.45%	4
Total net adjustments (non-recurring) [a]	-16.72%	-53.36%	-14.54%	-0.14%	
Non-GAAP Income (after non recurring adjustments) [a]	83.28%	46.64%	85.46%	99.86%	
Recurring Adjustments					
Depreciation and Amortization	15.52%	15.52%	15.52%	15.52%	1
Interest expense	N/A	N/A	N/A	N/A	0
Net income attributable to non-controlling interests	N/A	N/A	N/A	N/A	0
Preferred distributions and dividends	N/A	N/A	N/A	N/A	0
Provision for income taxes	N/A	N/A	N/A	N/A	0
Total net adjustments (recurring) [a]	15.52%	15.52%	15.52%	15.52%	
Non-GAAP Income (after all adjustments) [a]	84.10%	46.64%	86.21%	99.86%	

[a] Total net adjustments and Non-GAAP Income reflect company-specific mean, minimum, median and maximum amounts and are not a sum of the amounts presented in the table.

Source: Descriptive statistics of non-GAAP adjustments from S&P 100 companies Form 8-K Special Reports to the Securities and Exchange Commission.

Conclusion

The use of non-GAAP earnings in financial reporting is common among U.S corporations. In this study, we examine the earnings releases of the 75 companies from the S&P 100 who report non-GAAP earnings for the 2013 fiscal year. Our objectives is to learn how non-GAAP adjustments impact earnings.

In examining the impact of non-GAAP adjustments on earnings we find that 75% of our sample report non-GAAP income that is greater than GAAP income, with a median non-GAAP income (after all adjustments) of 111.21% of GAAP income for the entire sample. While these findings do not speak to the motives of companies who report non-GAAP earnings, we can conclude that the use of non-GAAP earnings do indeed have a favorable impact for reporting firms.

We also learned that there are several potential adjustments used in the calculation of non-GAAP earnings. Certain adjustments, such as income tax items, are used more frequently than other adjustments, while others, such as non-cash compensation, have a larger impact on earnings when used.

Besides income tax items, other popular adjustment items include restructuring and productivity related charges, impairment charges and litigation expenses. While not as common as some other the other adjustments in terms of frequency, adjustments for non-cash compensation had the greatest impact on non-GAAP earnings.

Analysts and investors should make efforts to be certain of whether earnings are GAAP or non-GAAP, as reporting can sometimes be confusing or misleading. For example, readers should be aware that some adjustments may be for recurring items. These adjustments reflect recurring operations that should be considered to be components of earnings, but that have been removed, creating an inaccurate representation of company performance. For CFOs, these results offer a benchmark to measure non-GAAP earnings against other companies. Regulators should find these results to be useful in better understanding differences between GAAP and non-GAAP earnings.