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FASB Agenda Request: Change to Diluted EPS Reporting

Thank you for the opportunity to submit an agenda request regarding Diluted EPS Reporting.

The PCAOB Investment Advisory Working Group Report on non-GAAP Financial Measures (NGFM) in 2017 expressed concern that *“corporations are selectively reporting one-time and recurring items as Non-GAAP financial Measures that may make “core” operations look more favorable and not disclosing one-time adjustments that would make “core” operations look worse.”* They went on to state that *“The financial reporting models of US and International standards setters and regulators do not require audited performance metrics. Yet management often says these reflect the way they manage companies better than many GAAP measures, and investors continue to demand NGFM and KPIs (Key Performance Indicators). Investors benefit from the increased disclosures provided by NGFM’s, but the lack of standardization and auditing has made NGFM’s potentially dangerous to the stability and efficiency of the markets.”*

This is a pervasive issue that has increased over time. Dirk E. Black, et al. in their 2017 paper - Non-GAAP Reporting: Evidence from Academia and Current Practice discuss how the number of firms reporting non-GAAP information has dramatically increased from a few companies in the 1990’s to 71% of the S&P 500 in 2014. Audit Analytics updated this number in 2017 and reported that 97% of companies used at least one non-GAAP metric in their 2017 reporting.

I recently reviewed the financial reporting of 25 of the largest S&P 500 companies for years ended 2018 and 2019. Reconciling items between fully diluted GAAP EPS and fully diluted non-GAAP EPS differed between corporations and reconciling items were presented in different ways - total by item, per share by item, some were pretax, some were post tax, some companies adjusted income statement categories such as SG&A, Gross Margin for each reconciling item and some companies also presented adjusting items on a segment basis.

During the two-year period I reviewed, some of the GAAP to Non-GAAP adjusting items identified by these companies included:

- Tax Legislation
- Transfer of Intangible Properties
- EMEA Fine
- FTC Charge
- Share Based Comp
- Intangible Amortization
- Goodwill Investment Impairment
- Gain / Loss on Disposals of Investments
- Tax Impact of Non – GAAP Adjustments

Acquisition Related Costs
Unrealized gain / Loss on Equity Investments
Litigation Provision
In-Process Research and Development
Other / Rounding
Restructuring Costs
Contingent Liability Adjustment
Early Debt Extinguishment
Pension Remeasurement

These items are disclosed as non-GAAP. An example disclosure is AbbVie's May 1st press release announcing First Quarter 2020 earnings that included the following statement:

“Non-GAAP Financial Results

Financial results for 2020 and 2019 are presented on both a reported and a non-GAAP basis. Reported results were prepared in accordance with GAAP and include all revenue and expenses recognized during the period. Non-GAAP results adjust for certain non-cash items and for factors that are unusual or unpredictable, and exclude those costs, expenses, and other specified items presented in the reconciliation tables later in this release. AbbVie's management believes non-GAAP financial measures provide useful information to investors regarding AbbVie's results of operations and assist management, analysts, and investors in evaluating the performance of the business. Non-GAAP financial measures should be considered in addition to, and not as a substitute for, measures of financial performance prepared in accordance with GAAP. The company's 2020 financial guidance is also being provided on both a reported and a non-GAAP basis.”

There is a similar statement in every company that reports non-GAAP EPS. The common theme is that non-GAAP adjusted EPS provides useful information regarding the operations of the company by excluding non-cash expenses and other factors that are unusual or unpredictable. As an investor, I agree with managements assertion that non-GAAP adjustments are useful to financial statement users. However the lack of reporting consistency between companies as to which non-GAAP adjustments are highlighted, the lack of reporting consistency within a company from quarter to quarter as to what is disclosed as non-GAAP reconciling items and the fact that non-GAAP EPS reporting is not audited could potentially reduce the usability, reliability and comparability of financial statements.

Bio-Rad Laboratories points out in its 2/13/2020 Earnings press release the inherent issues with non-GAAP financial information.

“From time to time in the future, there may be other items excluded if we believe that doing so is consistent with the goal of providing useful information to investors and management.

There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with generally accepted accounting principles and may be different from non-GAAP financial measures used by other companies. The non-GAAP financial measures are limited in value because they exclude certain items that may have a material impact on our reported financial results. The presentation of this additional information is not meant to be considered in isolation or as a substitute for the directly comparable financial measures prepared in accordance with GAAP in the United States. Investors should

review the reconciliation of the non-GAAP financial measures to their most directly comparable GAAP financial measures as provided in the tables accompanying this press release.”

A great example of the impact of non-GAAP reporting is demonstrated in Bio-Rad Laboratories Q4 2019 earnings release. Bio Rad Laboratories reported Q4 2019 fully diluted EPS of \$18.31 versus Q4 2018 fully diluted loss per share of \$27.73. Q4 2019 adjusted EPS was \$2.32 versus Q4 2018 adjusted EPS of \$2.09. Much of the variance between fully diluted EPS and adjusted EPS related to a positive \$646.0M valuation change in equity owned securities in Q4 2019 versus a negative \$814.1M valuation change in equity owned securities in Q4 2018. This one item created a \$1.46B quarter over quarter variance in fully diluted earnings. (After tax impact not presented) A financial statement user trying to understand the financial results of Bio Rad is unable to rely on fully diluted EPS to get a sense of operating results. Instead, the financial statement user must look to unaudited non-GAAP adjusted EPS to better understand quarterly financial results.

I chose this example due to the extreme size of the adjustment, however unrealized gain / loss on valuation of equity securities impacts many corporations reported EPS, some corporations disclose this information, and some do not. While the unrealized valuation adjustment certainly impacts the value of a corporation's assets, in my opinion it is not a reflection of recurring operating results.

A relatively straight forward modification to GAAP income statements would resolve this. In addition to reporting fully diluted EPS, I suggest creating GAAP fully diluted after tax operating EPS which would exclude FASB proscribed specific non-cash and non-recurring items. These specific items would be reported on a per share after tax basis to reconcile fully diluted operating EPS with fully diluted EPS as currently reported. Current non-GAAP reporting items could be a starting point to discuss which items should be excluded from operating EPS and called out individually to arrive at diluted EPS as currently reported.

Changing EPS reporting to include after tax diluted operating EPS in addition to already reported fully diluted EPS would restore consistency, comparability and reliability to financial statements across companies and periods, increasing user's ability to fully understand corporate financial reporting.

The cost to implement this change would be negligible. GAAP standards would not need to change. This information is already available as part of the quarterly / annual closing process and any cost would be more than offset by the increased value of more reliable and comparable financial information across periods, companies and industries.

This request would not prevent management from continuing to use non-GAAP financial measures to communicate with shareholders or interfere with existing SEC Compliance and Disclosure Interpretations related to Non-GAAP Financial Measures. Requiring companies to report standardized diluted after-tax GAAP operating EPS with reconciling items between Operating EPS and Fully Diluted GAAP EPS as currently reported would simply create GAAP reporting standards codifying what most public corporations already disclose and improve the reliability, consistency and comparability of financial statements.

Thank you for your consideration.

Sincerely,



Rick Fallahee