

# To GAAP or To Non-GAAP *What Is The Answer?*

Cirano  
March 21, 2018

Anthony Scilipoti, FCPA, FCA, CPA (Illinois)  
*President & CEO*



VERITAS  
INVESTMENT  
RESEARCH

# Users Comments

- The Audit is Highly Relevant (unanimous agreement)
  - But, detailed knowledge about the Audit scope, Audit process, and Accountabilities is low
  - Investors use a wide variety of information to make their decisions (including a variety of data aggregators)
- While audited GAAP financials are fundamental, investment decisions are increasingly based on unaudited information

Source: Toronto CFA Society Study 2016



# 2013 Buy-Side Study: Veritas/PWC

Most Used Financial Metrics for Investment Decisions:

EBITDA

Free Cash Flow

EPS



# SEARCHING FOR THE ANSWER?

Valuations = Investors rely on them  
Compensation = Based on them  
Oversight = No attestation

Authored Studies  
&  
Given Countless Presentations



# The Reporting Spectrum



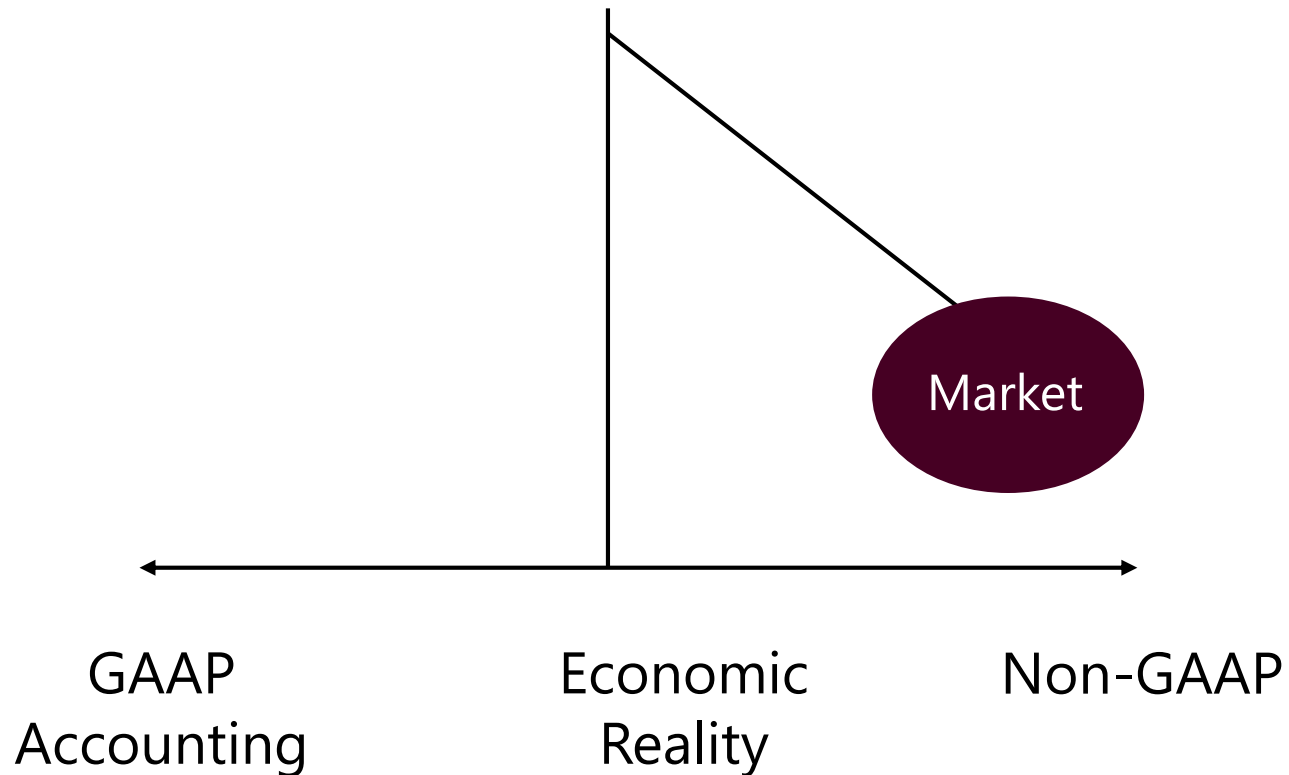
# Non-GAAP Metrics

GAAP	Non-GAAP
Audited	Non audited
Standards	Anything you want
Consistent	Change at will

- *Bridge the gap between past and future*
- *Aggressive non-GAAP metrics are a symptom of underlying operating issues*



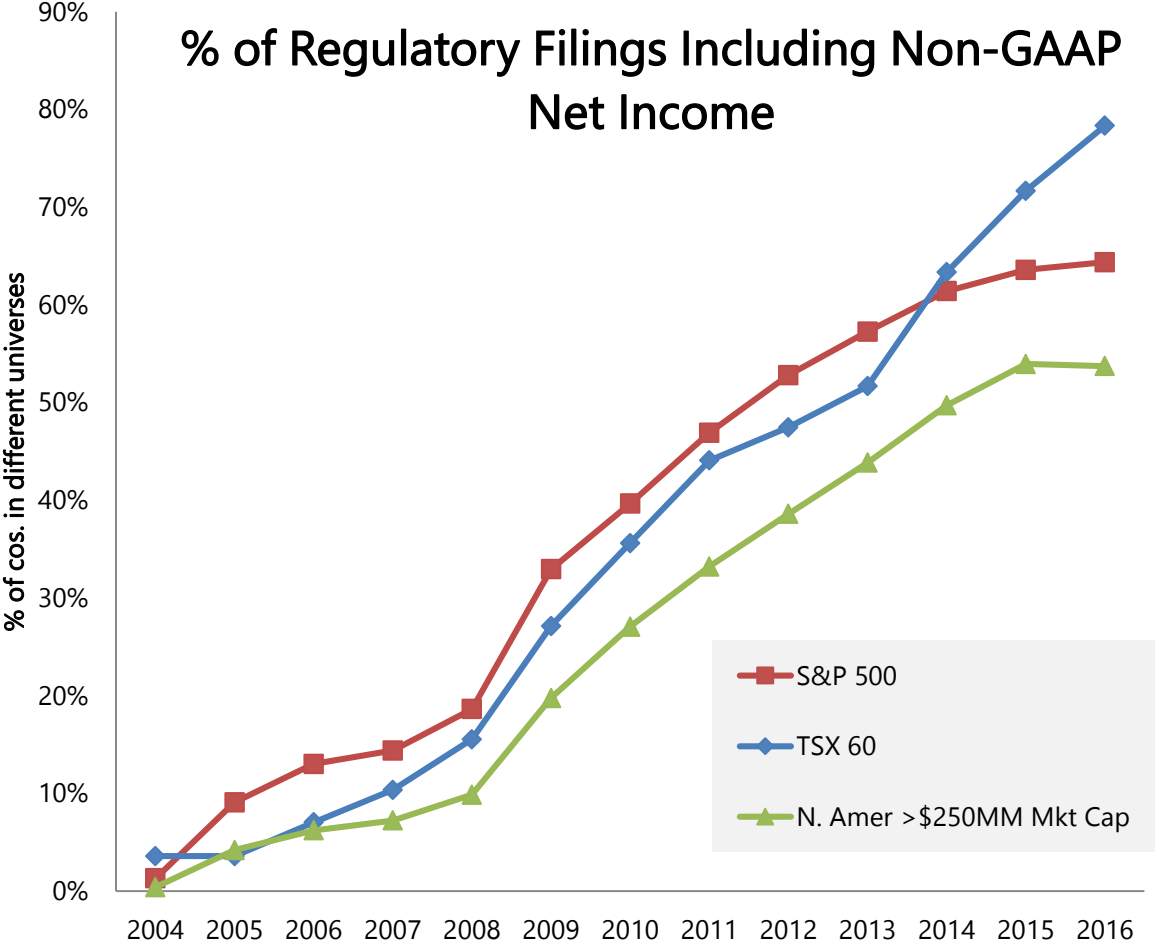
# The Range of Truth



What does the Market believe?



# Current State Of "Truth"



- Only one TSX 60 member (Imperial Oil) uses only GAAP accounting.





# Structural Upward Bias in Adjustments

	EBITDA		Net Income	
	Resource	Non-Resource	Resource	Non-Resource
% increase in adjusted metric vs standard	80%	9%	740%	17%

- Over 80% of adjustments serve to increase the non-GAAP metric over the GAAP metric.
- Difference between non-GAAP and GAAP earnings is material amount.
- If the 'earnings' investors focus on are structurally biased upward, it is logical to assume that valuations follow.



# Non-GAAP Guidelines Could Be More Strictly Enforced

# OSC Guideline	# of potential issues	
	2015	2016
1 State explicitly that the non-GAAP financial measure does not have any standardized meaning under the issuer's GAAP and therefore may not be comparable to similar measure presented by other issuers.	2	1
2 Name the non-GAAP financial measure in a way that distinguishes it from disclosure items specified, defined or determined under an issuer's GAAP and in a way that is not misleading.	5	4
3 Explain why the non-GAAP financial measure provides useful information to investors and the additional purposes, if any, for which management uses the non-GAAP financial measure.	1	1
4 Present with equal or greater prominence to that of the non-GAAP financial measure, the most directly comparable measure specified, defined or determined under the issuer's GAAP presented in its financial statements.	3	1
5 Provide a clear quantitative reconciliation from the non-GAAP financial measure to the most directly comparable measure determined under the issuer's GAAP and presented in its financial statements, referencing to the reconciliation when the non-GAAP financial measure first appears in the document.	14	14
6 Ensure that the non-GAAP financial measure does not describe adjustments as non-recurring, infrequent or unusual, when a similar loss or gain is reasonably likely to occur within the next two years or occurred during the prior two years.	6	10
7 Present the non-GAAP financial measure on a consistent basis from period to period; however, where an issue changes the composition of the non-GAAP financial measure, explain the reason for the change and restate any comparative period presented.	0	0

- Regulation similar between OSC guidelines and SEC regulations.
- Non-GAAP regulations introduced in 2004.
- ~35% of the TSX 60 members have potential regulatory concerns as it relates to non-GAAP metrics based on current guidelines. Some companies, such as BNS and MG, have multiple potential concerns.



# Common Adjustments: Non-GAAP Metrics

	Earnings	Free Cash Flow
Capex		X
Share Based Comp	X	X
Income Tax	X	X
Restructuring	X	X
Minority Interest		X
Discontinued operations	X	X
Development Costs	X	
Working Capital		X
Impairments	X	X
Gains & Loss	X	X
Amortization	X	X



# Other Non-GAAP

- Retailers: Sale Store Sales Growth
- Energy: Funds From Operations
- Mining: Costs Per Ounce
- Health care: Efficacy measures
- Utilities: Contract expiries



# Non-GAAP & Management Compensation

- What gets measured gets managed. What gets paid for gets done.
- CEO Comp = Non-GAAP accounts for ~42% of STIP & ~13% of SBA
- Non-GAAP metrics emphasized to investors (not equal sign) awarding compensation.
- Lack of detailed disclosure and changes in compensation schemes
- Management not only to blame.
- Investors need to stand up.
- Regulators need to crack down.



# Non-GAAP Recommendations to Regulators

- Issue a regulation
- Nomenclature must be labeled “Adjusted” unless as calculated
- All inputs reconciling to GAAP figures must be provided
- Strong regulatory enforcement for non-compliance
- Audit compliance with regulatory standards



# A Word On How Audit Can Help

- Improve image of assurance
- Clearly label what is audited in financial filings
- Expand assurance services
- Compliance with Non-GAAP Regulatory Standards(OSC)
- Compliance with compensation programs



# Questions





*Veritas Investment Research Corporation ("Veritas") its directors, officers, employees and their immediate families are prohibited from trading any position in the securities profiled in a report thirty (30) days before and five (5) days after the publication date where the report involves coverage initiation or a change of opinion (the "Blackout Restriction"). Veritas has not offered any consulting, financial advisory, investment banking or underwriting services to the companies mentioned. Veritas does not accept research fees from the companies profiled herein. The information contained in this report has been obtained from sources believed reliable however the accuracy and/or completeness of the information is not guaranteed by Veritas, nor does Veritas assume any responsibility or liability whatsoever. All opinions expressed are subject to change without notification. This report is for information purposes only and does not constitute and should in no way be construed as a solicitation to buy or sell any of the securities mentioned herein. The contents of this research report do not, in any way, purport to include any manner of legal advice or opinion. The intention of this report is to provide a forthright discussion of business, accounting and financial reporting issues, as well as generally accepted accounting principles and the limits of their usefulness to investors. As such, please do not infer from this report that the accounting policies of any company mentioned herein are not allowed within the broad range of generally accepted accounting principles, or that the policies employed by that company were not approved by its auditor(s). Veritas Asset Management Inc. ("VAM"), an affiliate of Veritas by virtue of being under common control that may also from time to time have certain common directors, officers and/or employees, is registered in Ontario as a Portfolio Manager, Investment Fund Manager and Exempt Market Dealer (with the same or similar registrations in certain other jurisdictions in Canada) and may, from time to time, advise and counsel its investment clients, including one or more investment funds established by VAM, with respect to investments in public companies. VAM is a client of Veritas and receives research reports from Veritas at the same time as Veritas' other clients. Like Veritas' other clients, neither VAM nor its investment clients are subject to the Blackout Restriction. Veritas and VAM have implemented policies and procedures to minimize the potential for and to address conflicts of interest, which are available to clients of Veritas upon request. This report may not be reproduced in whole or in part without the express prior written consent of Veritas. Veritas is a 100% employee owned firm. ©2018 Veritas Investment Research Corporation.*

