Shareholder Letters: Accounting Themes

"Adjusted" earnings

Berkshire letters: 2016

Jaeyoon Yu, Ph.D.
Central Michigan University

What the Letter Says

> *“Too many managements … are looking for any means to report, and indeed feature, “adjusted earnings” that are higher than their company’s GAAP earnings.”*
>
> Warren E. Buffett, 2016 letter

- Key letters: 2016
- Course fit: ACC250 Ch3 · ACC531 — · Difficulty: Intro

Step 1: Start with GAAP Net Income

- GAAP net income includes **every** expense GAAP requires.
- “Adjusted” (non-GAAP) earnings: management removes some expenses.

EX. GAAP net income = $80 million.

Step 2: Management's Add-backs

	$ millions
GAAP net income	$80
+ Stock-based compensation	15
+ Amortization of intangibles	10
"Adjusted" earnings	$105

- Adjusted earnings are 31% higher than GAAP net income.

Step 3: Ask: Is It a Real Cost?

Add-back	Real cost?
Stock-based compensation	Yes: employees are paid in stock instead of cash
Amortization of intangibles	Often: the company paid for those assets
One-time charges every year	Then they are not one-time

Back to the Letter

- Buffett (2016): too many managements feature “adjusted earnings” that are higher than GAAP earnings.
- Compensation is compensation, whatever form it takes → it belongs in earnings.

Questions

1. GAAP net income is $80 million. Management adds back $15 million of stock-based compensation and $10 million of amortization. What “adjusted earnings” does it report ($ millions)?
2. Which add-back does Buffett argue is clearly a real cost?

   A. Income tax refund

   B. Gain on sale of land

   C. Dividends paid

   D. Stock-based compensation

Sources

- Warren E. Buffett, 2016 letter (berkshirehathaway.com/letters)
- Reading packet and question sheet for this theme

Letters © Berkshire Hathaway Inc.; quoted for non-commercial teaching. Examples use made-up numbers unless a slide says otherwise. Not affiliated with or endorsed by Berkshire Hathaway Inc.