Shareholder Letters: Accounting Themes

Look-through earnings

Berkshire letters: 1990, 1991, 1992

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What the Letter Says

> *"The retained operating earnings of major investees that, under GAAP accounting, are not reflected in our profits."*
>
> Warren E. Buffett, 1991 letter

- Key letters: 1990, 1991, 1992
- Course fit: ACC250 — · ACC531 — · Difficulty: Advanced

Step 1: What GAAP Records

EX. Berkshire owns 10% of a company that earns $500 million and pays $100 million of dividends.

Dec 31:	Cash (+A)	10	
	Dividend Revenue (+R)		10

- Under 20% ownership: Berkshire records only its **dividends** ($ millions).

Step 2: Berkshire's Share of Retained Earnings

	$ millions
Investee net income	$500
− Dividends paid	(100)
Retained earnings	$400
Berkshire's 10% share	$40

- This $40 belongs to Berkshire but is **not** in its profit.

Step 3: Look-through Earnings

	$ millions
Berkshire's reported operating earnings	$1,000
+ Share of investees' retained earnings	40
− Tax if it were paid out	(5)
Look-through earnings	$1,035

Operating earnings and tax are made-up numbers.

Back to the Letter

- Buffett (1990–1994): GAAP leaves out investees' retained earnings, which still work for Berkshire.
- Look-through earnings show the economic earnings of **everything** Berkshire owns.

Questions

1. Berkshire owns 10% of a company that earns $500 million and pays $100 million of dividends. Berkshire records only its dividends as income. Before taxes, how much of the investee's retained earnings belongs to Berkshire but is not in its profit ($ millions)?
2. Look-through earnings add which item to Berkshire's reported operating earnings?

   A. Dividends received

   B. Berkshire's share of investees' retained earnings, less the tax that would be paid if distributed

   C. The market value of all stocks owned

   D. Insurance float

Sources

- Warren E. Buffett, 1990 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 1991 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 1992 letter (berkshirehathaway.com/letters)
- Reading packet and question sheet for this theme

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