The Impact of the FMA Guidance Note on Non-GAAP Earnings Disclosures

Abstract
Purpose - It is common practice for companies to disclose earnings measures and other financial information, which is not prepared in accordance with generally accepted accounting practice such as (referred to as non-GAAP earnings and non-GAAP financial information). The New Zealand Financial Markets Authority (FMA) introduced a Guidance Note in 2012 to improve disclosure of non-GAAP information. This study investigates the effect of those guidelines on the number of New Zealand listed companies reporting non-GAAP earnings and the quality of non-GAAP earnings information disclosed.
Design/methodology/approach - A disclosure and prominence index are created to measure any change in company's compliance with the FMA guidance on the presentation of non-GAAP information and the level of prominence given to non-GAAP earnings.
Findings - The findings show that the guidelines, despite not being mandatory, are modifying corporate disclosure behaviour. Companies have improved the way they disclose non-GAAP earnings information and there has been a reduction in the emphasis given to non-GAAP earnings as opposed to audited statutory profit. However, the study also highlights areas for improvement, including the depth of explanation of non-GAAP earnings calculations and adjustments, and concern about multiple non-GAAP earnings measures used to explain performance.
Originality/value - There has been no academic research on the impact of the FMA Guidance Note on company disclosure practice. This study contributes to the developing research on non-GAAP earnings by extending the research to a small country with different institutional and market features and policy responses to disclosure of non-GAAP earnings

Keywords – non-GAAP earnings, disclosure, FMA Guidance Note
Paper type Research paper

1. Introduction

New Zealand listed companies have been reporting non-GAAP earnings measures that are not determined according to generally accepted accounting practice (GAAP) earnings for a number of years (Rainsbury *et al.*, 2015). Non-GAAP earnings are disclosed by senior management in annual reports and other communications. Managers are free to use alternative measures of performance without applying common standards, as there are for reporting GAAP earnings, which has raised concerns about the appropriateness of their use and the transparency of the information disclosed (FMA, 2012). Regulators acknowledge that while non-GAAP earnings may provide more information to markets there is the potential for managers to report opportunistically which may mislead investors and undermine market confidence (FMA, 2012; International Organisation of Securities Commissions, 2014; European Securities and Markets Authority, 2015). Consequently in various jurisdictions regulators have introduced regulations, recommendations or guidelines for issuers to follow when disclosing non-GAAP earnings.

In 2012, the New Zealand Financial Markets Authority (FMA) introduced a Guidance Note on the disclosure of non-GAAP earnings information for listed companies effective from 1 January 2013. The aim of the guidelines is to promote meaningful communication of financial information to users and reduce the potential for non-GAAP information to be misleading (FMA, 2012). Non-GAAP earnings measures: (1) should not be given undue prominence in investor communications, (2) are to be reconciled to the audited GAAP earnings, and (3) are to be unbiased and calculated consistently from period to period (FMA, 2012).

This paper investigates the effect of the Guidance Note on the number of companies reporting non-GAAP earnings and on the quality of non-GAAP earnings information disclosed.

This study contributes to the developing research on non-GAAP earnings in different countries. Research on non-GAAP earnings has been predominantly conducted in the United States, however, institutional and market features may differ from country to country which may change managers' incentives to report non-GAAP earnings (Isidro and Marques, 2015). In this respect, capital market regulators responses differed in terms of the policy approaches taken to improve the disclosure of non-GAAP earnings information. In larger jurisdictions, such as the United States, regulations were introduced to improve reporting while in smaller jurisdictions, such as Australia and New Zealand, guidelines have been introduced. Although New Zealand's share market is small by international standards, it is appropriate to examine the impact of the policy approach taken by the FMA on influencing the reporting of non-GAAP earning measures in New Zealand given the potential for non-GAAP earnings to be used opportunistically by companies to mislead investors. To date, there has been little research on the impact of guidelines compared with regulations to improve disclosure of non-GAAP information. Similarly, there has been no independent academic research on the impact of the New Zealand FMA Guidance Note.

The study finds that the FMA Guidance Note has had little impact on reducing the number of companies disclosing non-GAAP earnings. The disclosure of non-GAAP earnings information as guided by the FMA has improved for New Zealand listed companies between 2012 and 2014. In addition, firms now give less prominence to non-GAAP earnings compared with audited earnings. However, there are concerns about the various definitions and terms used for non-GAAP earnings which may make it difficult for users to compare non-GAAP earnings over time and between companies. The conclusion is that the Guidance Note has had an influence in improving disclosure practices.

Section Two of the paper gives background research on non-GAAP earnings and a summary of capital market regulators policy approaches relating to the disclosure of non-GAAP information. Section Three poses the research questions and Section Four provides a description of the sample and research method. The results and discussion are presented in Section Five and Section Six presents the conclusions.

2. Literature Review

2.1 Background

Research on voluntary disclosure of non-GAAP earnings shows that it is a means of communicating information about firm performance in order to improve the predictability of financial results (Bhattacharya *et al.*, 2003; Graham *et al.*, 2005). Research studies show that managers remove temporary or one-off items from earnings to provide information about core earnings to assist with predicting long-term performance and future cash flows (Brown and Sivakumar, 2003; Black and Christensen, 2009). Research also suggests that non-GAAP measures are used by managers to inform the market when GAAP earnings are less informative, such as for technology firms and firms with prior losses (Bowen *et al.*, 2005; Lougee and Marquardt, 2004).

However, research findings also show that non-GAAP earnings are disclosed to enhance firm performance such as to meet earnings benchmarks. Graham *et al.* (2005) show that managers consider it very important for current earnings to meet earnings benchmarks in order to build credibility in the capital market, to maintain and increase share prices and build the external reputation of management. Not meeting these benchmarks creates uncertainty for stakeholders about the future prospects of the company. Research studies find that managers select non-GAAP earnings measures to increase earnings, smooth earnings or to meet analyst's forecasts to convey a more favourable impression of firm performance (Bowen *et al.*, 2005). Research studies find evidence of non-GAAP earnings measures that: (1) exclude recurring expense items (Black and Christensen, 2009; Barth *et al.*, 2012), (2) reclassify recurring items as transitory (Kolev *et al.*, 2008), and (3) include transitory gains (Baumker *et al.*, 2014). Strategies are also used by managers to emphasise non-GAAP earnings in press releases when GAAP earnings fall short of strategic benchmarks in order to emphasise a positive performance (Marques, 2010).

Reporting non-GAAP earnings to enhance perceptions of performance can affect unsophisticated investors adversely as they are more likely to assess earnings and stock performance as being higher (based on a higher disclosed non-GAAP earnings) and trade on this information, while sophisticated investors do not (Fredrickson and Miller, 2004; Elliot, 2006; Bhattacharya *et al.*, 2007).

2.2 Regulators' Responses

Given the potential of non-GAAP earnings to impact the market both favourably and unfavourably, regulators have taken different approaches to implementing requirements for the growing number of listed companies reporting non-GAAP earnings.

In Australia and New Zealand, market regulators have issued guidelines for voluntary disclosure of non-GAAP earnings. In September 2012, New Zealand's FMA released a Guidance Note on the disclosure of non-GAAP financial information for issuers, directors, and preparers of financial information. The Guidance Note defines non-GAAP information and the range of corporate communications to which it is to apply. Its purpose is to provide meaningful financial information to the market, to ensure that non-GAAP financial information is not misleading.

The ten disclosure guidelines in the Guidance Note are listed in Table 1.

[Insert Table 1]

The first principle is that directors explain why the measure is provided and how it is useful to investors. Non-GAAP figures are not to be given prominence over GAAP earnings and to be appropriately labelled to distinguish them from GAAP information.

Non-GAAP earnings need to be defined, for example, EBIT (earnings before interest and taxation), so that users can understand how it is calculated and reconciled to GAAP earnings. Calculations must be consistent from year to year and prior year comparatives need to be provided along with a statement as whether they were extracted from the audited or reviewed financial statements. Non-GAAP earnings must be reconciled to net profit after tax and significant adjustments cross-referenced to the financial statements. In communicating non-GAAP earnings a clear statement is to be made if the financial information has been taken from reviewed or audited financial statements.

The Australian Securities and Investment Commission's Regulatory Guide 230 (ASIC, 2011) does not allow non-GAAP earnings to be disclosed on the face of the income statement. Non-GAAP earnings are permitted in other corporate communications, such as directors' reports, press releases, and analyst briefings, but they must not be misleading or be given greater prominence than GAAP financial information. Non-GAAP earnings are to be calculated consistently from period to period and comparative figures provided. A reconciliation between non-GAAP and GAAP earnings is also required along with explanations of the adjustments.

In the United States and Europe, stricter regulatory approaches exist. In March 2003, the United States Securities and Exchange Commission (SEC) issued SEC Regulation G (SEC, 2003) requiring any public company that discloses a non-GAAP financial measure to provide (1) a directly comparable GAAP measure; and (2) to reconcile the differences between the non-GAAP measure and the GAAP measure. Firms must also give reasons why management considers the non-GAAP information to be useful to investors and the additional purposes for which the financial measure is used.

In Europe recommendations governing reporting of non-GAAP earnings were issued in 2005 by the Committee of European Securities Regulators (CESR) (now the European Securities and Markets Authority (ESMA)). In 2015, ESMA revised the guidelines to overcome disclosure weaknesses including the use of uncommon non-GAAP measures, non-GAAP measures not being defined and reported in a biased manner.

The revised guidelines are intended to be mandatory. The level of disclosure will be increased to promote transparency, neutrality and comparability of information provided to users. All non-GAAP earnings measures are to be defined and applied consistently and the relevance of the measure explained to users. Adjustments to earnings are to be explained and prior year comparative figures provided. Non-GAAP earnings are to be displayed with less prominence than GAAP measures and must be reconciled to the financial statements.

2.3 Impact of Regulators' Responses

The introduction of disclosure regulations in the United States has resulted in improved practices. There has been a decline in the number of companies reporting non-GAAP earnings that exceed GAAP earnings (Entwistle *et al.*, 2006), and that beat analyst forecasts (Heflin and Hsu, 2008). Companies also give less emphasis to discussing non-GAAP earnings in press releases (Entwistle *et al.*, 2006). The quality of items excluded from non-GAAP earnings has improved. Excluded items are more transitory and not part of core earnings (Kolev *et al.*, 2008) signifying that the primary motivation of managers for disclosing non-GAAP earnings is to inform the market (Curtis *et al.*, 2014). Higher quality reconciliations between the non-GAAP earnings and the GAAP figures are also found to reduce mispricing of securities (Zhang and Zheng, 2011).

Market reaction to non-GAAP earnings is higher in the post-regulation period indicating that investors are more confident in the reporting, but they are more sensitive to aggressive (benchmark-beating) reporting (Black *et al.*, 2012). Overall the US research indicates that SEC Regulation G has had a positive impact on the quality of non-GAAP disclosures, although there is still evidence of opportunistic behaviour (Baumaker *et al.*, 2014).

There has been limited research on the impact of the European recommendations. One study finds that the recommendations have had little impact on disclosure practices in non-GAAP earnings in press releases for a sample of large companies listed on the Frankfurt Stock Exchange (Hitz, 2010). Nonetheless, high quality non-GAAP earnings reconciliations are found to reduce the mispricing of securities for a sample of companies listed on the Euro STOXX Fixed Index (Aubert and Grudnitski, 2014)

To date, no research is available on the impact of the ASIC guidelines. Prior to the implementation of the guidelines, Cameron *et al.* (2012) examine the emphasis given to GAAP versus non-GAAP earnings in annual reports of listed companies from 2007-2009. Non-GAAP earnings are emphasised in preference to statutory profit and in sixty per cent of cases non-GAAP earnings are higher than audited earnings. They conclude that "impression management" is the most common motivation for managers to emphasise non-GAAP earnings.

3. Research Questions

The first research question focuses on the impact of the FMA Guidance Note on the number of companies reporting non-GAAP earnings. The implementation of SEC Regulation G in the United States resulted in a drop in the number of companies reporting non-GAAP earnings but the decline was temporary (Brown *et al.*, 2012). Today non-GAAP earnings are used widely. For example, Larcker and Tayan (2010) document that around half of the companies listed in the Dow Jones Industrial Average Index reported adjusted earnings.

In New Zealand, the FMA does not prohibit the disclosure of non-GAAP earnings and companies not following the FMA Guidance Note will not necessarily breach the law (FMA, 2012). It is, therefore, unclear what impact the FMA Guidance Note will have on the number of companies reporting non-GAAP earnings.

The first research question is:

Has the reporting of non-GAAP earnings by New Zealand listed companies declined since 2013?

The FMA guidelines apply to disclosures of non-GAAP earnings in annual reports (excluding the financial statements), market announcements, and presentations to analysts or investors. The second research question examines whether the introduction of the FMA Guidelines has impacted corporate disclosure behaviour.

The second research question is:

Has the disclosure of non-GAAP information in annual reports changed after 2013?

4. Sample and Research Method

The population consists of all firms listed on New Zealand's stock exchange (NZX) in 2014, the year the Guidance Note was introduced. Listed companies that disclosed non-GAAP earnings from 2012 to 2014 are identified. The three-year period covers one year prior to and after the implementation of the Guidance Note in 2013. A period of three years is considered long enough to be able to assess any changes in disclosures as an extended time series may be impacted by a number of other factors (Heflin and Hsu, 2008).

From the 2014 NZX population, 114 listed companies are selected. Six companies are excluded – three companies delisted, two were overseas companies and one lacked sufficient information – resulting in a final sample of 108 companies (see Table 2). The initial sample of 108 drops to 104 companies in 2013 and 99 companies in 2012 due to changes in company listings. A total of 311 annual reports are examined and 57 companies identified as reporting non-GAAP earnings for each year from

2012 to 2014. This number of companies represented is between 53 to 58% of the total number of NZX companies in each year.

[Insert Table 2]

Non-GAAP earnings information is hand collected from the annual reports of each company. Annual reports were selected as they include financial reports which are an important source of information for investors, lenders and regulators. In a recent survey, users of financial statements relied on the financial statements and management commentary and analysis including directors' reports XRB (2016).

The data was collected from various sections of the annual report including reports of the Board and Managing Director as well as performance highlights and financial summaries. In a limited number of cases, non-GAAP earnings information such as reconciliations with GAAP earnings were included in the audited financial statements.

The FMA definition of non-GAAP earnings: "non-GAAP …profit information calculated on a basis other than GAAP or calculated in accordance with GAAP and then adjusted" (FMA, p.5), is applied in collecting the data: Examples of non-GAAP earnings include operating earnings figures such as earnings before interest and taxation and adjustments made to the statutory earnings i.e. net profit after tax prepared in accordance with GAAP, to determine underlying or normalised earnings.

Non-GAAP earnings disclosures are evaluated against the FMA Guidance Note using a disclosure index. Disclosure indices are a valid research tool and are used widely in accounting research (Botosan, 1997; Hooks and van Staden, 2011). The limitations of disclosure indices centre on recognition and measurement issues i.e., what disclosures to include in an index and how to define and assess disclosure quality (Botosan, 2004; Leuz and Wysocki, 2008). For this index, these limitations are mitigated in the following ways: Firstly, the selection of disclosure items to be included in the index is defined in terms of the FMA Guidance Note. Secondly, although the FMA Guidance Note applies to disclosures in a range of investor communications, the context is limited to non-GAAP earnings information provided in annual reports such as directors' or management commentary. Thirdly, subjectivity in coding is reduced by referring to the Guidance Note and disclosure illustrations produced by the FMA.

The Disclosure Index is shown in Appendix One. Each of the FMA Guidelines as shown in Table 1 is measured and a disclosure score calculated for the 57 non-GAAP earnings disclosing companies. Appendix One provides references to the relevant literature to support the measure. In most cases the scoring is straightforward with a binary score of 1 used to indicate compliance with the guidelines and zero for non-compliance. For example, 'consistent calculation' (Appendix One, criterion 5) is coded 1 if a consistent approach is applied to the calculation of non-GAAP information or 0 if it is not. A higher score for the index indicates greater compliance with the guidelines with a maximum score of 10.

'Lack of prominence' (Table 1, Criterion 2) is more complex and is measured separately applying an approach used by Entwistle *et al.* (2006). The scale is shown in Appendix Two with scores ranging between 1 and 4. A score of 1 indicates that high prominence is given to non-GAAP earnings, such as when the non-GAAP earnings number is reported in a headline, without reference to GAAP earnings. A score of 4 indicates discussion about GAAP earnings with non-GAAP earnings having secondary importance.

The overall maximum score is 14: (10 for compliance and 4 for prominence). Two researchers independently grade the disclosures with any differences reconciled to agree on a final score.

5. Results and Discussion

Table 2 indicates that the percentage of listed companies reporting non-GAAP earnings remained fairly stable over the three year period, suggesting that the FMA Guidance Notes has had little impact on the frequency of non-GAAP earnings disclosures. This result contrasts with the impact of SEC Regulation G in the United States where the number of companies reporting non-GAAP earnings declined (Entwistle *et al.*, 2006; Heflin and Hsu, 2008)

Table 3 summarises descriptive statistics. Panel A covers the 57 companies that consistently reported non-GAAP earnings and Panel B covers the 51 companies that did not. Companies consistently reporting non-GAAP earnings are statistically significantly larger and more profitable compared with those that did not. Companies disclosing non-GAAP earnings incur a lower percentage of losses and lower gearing compared with other companies, but the differences are not significant (at the 5% level). However, an analysis by industry shows that the differences in firm characteristics are driven by companies in the energy and property sectors. The majority of companies reporting (not reporting) non-GAAP earnings provide services and there are no significant differences in firm characteristics between these two sub-groups. These results are contrary to research in the United States which finds that disclosure of non-GAAP information is more likely for younger companies, companies that incur losses, and companies with high growth, high leverage and high book to market ratios (Bhattacharya *et al.*, 2004).

[Insert Table 3]

Table 4 reports the total disclosure (Panel A) and prominence scores (Panel B) for the 57 companies reporting non-GAAP earnings over the three year period. (Scores by individual company are available on request).

[Insert Table 4]

The disclosure score mean (median) increased from 5.89 (6.00) in 2012 to 7.26 (7.00) in 2014 indicating a significant (1% level) improvement in compliance over that time. The prominence given to GAAP earnings compared with non-GAAP earnings from 2012 to 2014 has also improved. The mean prominence score has improved significantly (1% level) from 2.49 in 2012 to 2.74 in 2014 indicating that equal or greater prominence is given to the GAAP. An analysis of the disclosure and prominence means by industry indicates no significant differences. It is notable that the improvement in prominence occurred between 2013 and 2014, the year the FMA Guidance Note was made effective. Although there was media attention about the disclosure of non-GAAP earnings during 2012 to 2014 which may have influenced corporate behaviour it would appear that the Guidance Note has had a positive impact on disclosure practice.

The New Zealand results are consistent with the impact of SEC Regulation G on reporting of non-GAAP information in market announcements (press releases) in improving prominence in the reporting of GAAP earnings relative to non-GAAP earnings (Marques, 2010). However, CESR recommendations did not reduce the prominence given to non-GAAP earnings relative to GAAP earnings in market announcements for a sample of German listed companies (Hitz, 2010).

Table 5 provides more details of the disclosure scores.

[Insert Table 5]

Table 5 Panel A gives a break-down of the disclosure scores by category. Areas of strength are that non-GAAP earnings are labelled clearly, calculated consistently and comparatives provided for the non-GAAP adjustments. However, director justifications for disclosing non-GAAP earnings and explanations and calculations of adjustments to GAAP earnings are lacking. Disclosures also lack any reference to whether the information provided is reviewed or audited.

Table 5, Panel B indicates directors' explanations of why disclosing non-GAAP earnings is useful information. The most common justification is that non-GAAP earnings figures are useful to investors and/or other users. Other common reasons are that non-GAAP earnings are a better measure of operations and core business results; that they are used to assess dividend distributions, debt covenant requirements and by management for internal reporting purposes.

Table 5 Panel C provides the number of instances where the calculations behind the non-GAAP earnings figure are explained. While companies are justifying the use of non-GAAP earnings measures, the findings highlight a lack of explanation by management of why adjustments to GAAP earnings are being made. Justifying why items are excluded would enable investors to assess the reasonableness of the treatment (Young, 2014). It is difficult to see how the alternative measures improve understanding of performance unless the purpose and nature of the measures used are clearly defined.

Managers have a great deal of flexibility in what non-GAAP earnings measures to use and as a result, there is a lack of standardisation in the measurement and labelling of non-GAAP earnings. The study shows a variety of measures and different labels are used for non-GAAP earnings. This may be appropriate in order to allow companies to report performance in a way that is suitable to the business but the customisation of earnings measures may cause confusion for investors in comparing non-GAAP earnings across firms and over time. In 2014, 26 of the 57 companies reported more than one non-GAAP earnings performance measure. In one case, a company emphasised four different performance measures in a trend statement: (profit before income tax (normalised), profit after tax (normalised) along with both EBIT (including abnormal costs) and EBITDA (including abnormal costs). Giving prominence to all these measures as well as adjustments to "bottom line" NPAT impacts on the integrity of earnings (Young, 2014).

An encouraging result is that in 2014 all but five of the non-GAAP reporting companies prepared reconciliations of adjustments to GAAP earnings (Table 5, Panel D). Most companies disclosed a numerical reconciliation between GAAP and non-GAAP earnings. The majority of reconciliations are provided in a tabular format moving from the non-GAAP earnings to GAAP earnings figures. The reconciliations provide appropriate descriptions of the adjustments along with prior year comparatives and avoid the use of the term "one-off" adjustments with companies preferring to use the term "non-recurring" instead.

An improved trend noted in 2014 is that reconciliations are not only appearing in the directors/management commentaries but also in the notes to the financial statements with accompanying explanations. This is a positive result as prior research suggests that the disclosure of reconciliations of GAAP to non-GAAP earnings can reduce the emphasis non-sophisticated investors give to non-GAAP earnings (Elliott, 2006). The improved transparency of providing high quality reconciliations also increases the likelihood that sophisticated investors such as analysts will rely on the non-GAAP earnings information in assessing earnings performance of a firm and reduce mispricing of securities (Elliot, 2006; Aubert and Grudnitski, 2014). These results are consistent with improvement in the quality of reconciliations found with the implementation of SEC Regulation G in the United States (Zhang and Zheng, 2011).

However, the quality of the reconciliations can be improved by companies disclosing where the non-GAAP information is derived. Adjustments to GAAP earnings should be able to be retraced to the audited financial statements or details provided of how the adjustments are calculated. This would improve users' perceptions of the reliability of the measure.

The intention of the guidelines is to ensure that "undue prominence, emphasis or authority is not given to non-GAAP financial information" (FMA, 2012, p. 9). The emphasis given to non-GAAP earnings relative to GAAP earnings has diminished over the three year period. Overall, the results suggest a positive trend of managers being more balanced in the discussion of non-GAAP and non-GAAP earnings in annual reports.

To summarise the results indicate that the FMA Guidance Note improved the quality of information presented about non-GAAP earnings although areas of improvement are still required.

6. Conclusion

The disclosure of non-GAAP information is common practice for many listed companies. Capital market regulators have adopted different approaches for improving the quality of reporting. Regulators have tried to balance the desire of companies to provide additional information to the market about earnings against the potential to mislead users and undermine confidence in capital markets. In New Zealand, the approach of the FMA was to issue a Guidance Note.

This study examines the impact of the FMA Guidance Note introduced in 2012 on the disclosure of non-GAAP earnings by New Zealand listed companies. The study identifies trends in non-GAAP reporting for three successive years from 2012 to 2014. The findings from the study show that there has been little change in the number of companies disclosing non-GAAP earnings since the introduction of the Guidance Note. Around one in five New Zealand listed companies disclosing non-GAAP earnings and this has remained consistent over the three year period.

Data is collected from annual reports applying a disclosure and prominence index. The mean disclosure score index increased from 5.89 in 2012 to 7.26 in 2014 showing that compliance with the disclosure guidelines has improved significantly over that time. The mean prominence score increased from 2.49 in 2012 to 2.74 in 2014 indicating the relative reporting emphasis given to GAAP earnings compared with non-GAAP earnings has improved. Although there was media attention to improve disclosure practices, it is fair to say that the FMA Guidance Note has had a positive impact.

The results identify areas for further improvement. Non-GAAP earnings disclosures need to be supported with information on the nature and purpose of the adjustments to earnings as well as linking adjustments to the financial statements or to the notes to the financial statements. The use of multiple non-GAAP earning measures can result in a lack of comparability and comprehension of financial information and diminish its usefulness.

In conclusion, the findings suggest that the introduction of the FMA Guidance Note has changed the reporting of non-GAAP information by New Zealand listed companies. Overall, companies reporting non-GAAP information are complying more with the disclosure criteria and giving more emphasis to reporting GAAP earns compared with non-GAAP earnings. The policy approach taken by the FMA has in the short term had a positive impact on disclosure behaviour without the need for regulatory intervention.

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Table 1. Financial Market Authority Guidelines on Presentation of non-GAAP Information

	Criteria	
1.	Why information is useful	Directors must explain why disclosure of non-GAAP earnings is useful to investors.
2.	Lack of prominence	Non-GAAP earnings is to be disclosed to NOT give it undue prominence, emphasis or authority.
3.	Appropriate label	Non-GAAP earnings must be labelled appropriately to clearly differentiate it from GAAP earnings.
4.	Calculation	There must be a clear narrative explanation of how non-GAAP earnings is calculated.
5.	Reconciliation	A reconciliation of non-GAAP and GAAP earnings information is to be disclosed. How non-GAAP earnings is calculated is to be explained. Significant GAAP adjustments are to be disclosed separately and linked to the financial statements.
6.	Consistency	Non-GAAP earnings is to be calculated consistently. Any variation in the calculation is to be explained, along with reasons and the financial impact of the change
7.	Adjustments	For each non-GAAP earnings adjustment, the corresponding item must be adjusted in comparative information.
8.	Unbiased	The non-GAAP earnings measure must be unbiased. If should not over (under) state good (bad) news to the market.
9.	One-off items	Non-GAAP adjustments are not to be referred to as “one-off” if they have occurred in the past and are likely to occur in the future
10.	Audited or reviewed	A clear statement is to be made if non-GAAP financial information is taken from audited or reviewed financial statements.

Table 2. Population and Sample

	2012	2013	2014
NZX All Index companies in 2014	114	114	114
Less overseas companies	-2	-2	-2
Less companies listed/delisted	-13	-7	-3
Less company with lack of information	-	-1	-1
Total Sample	**99**	**104**	**108**
Non-GAAP earnings reported	**57 (58%)**	**57 (55%)**	**57 (53%)**

Table 3. Descriptive Statistics 2014

Panel A – *Companies consistently reporting non-GAAP earnings* (n=57)

	Mean	Standard Deviation	25	50	75	Min	Max	Comparison Means Panel A and B p-values
Market capitalisation (000)	974,044	1,375,774	97,183	455,446	1,156,786	4,490	6,060,003	[1]0.019** [2]0.000**
Total assets (000)	1,238,043	1,709,800	134,940	453,885	1,789,414	5,692	6,941,000	[1]0.030* [2]0.000**
Total liabilities (000)	623,964	930,053	55,138	200,980	698,496	2,284	3,531,313	[1]0.045* [2]0.000**
Total equity (000)	614,079	846,111	71,812	249,060	793,152	3,408	3,597,000	[1]0.036* [2]0.001**
Net profit after tax (000)	70,504	99,908	3,560	41,094	99,919	-79,429	460,000	[1]0.002** [2]0.001**
Loss	0.14	0.35	0	0	0	0	1	[1]0.085 [2]0.085
Total liabilities/Total assets	0.47	0.15	0.38	0.47	0.57	0.11	0.80	[1]0.601 [2]0.029*
NPAT/Total assets	0.05	0.13	0.03	0.05	0.07	-0.62	0.57	[1]0.033* [2]0.030*
Market to book	1.95	1.45	0.98	1.47	2.32	0.48	7.77	[1]0.323 [2]0.387

[1] comparing the means of two independent groups and [2]Mann-Whitney test .*5% and **1% significance level

Panel B – *Companies not reporting/consistently not reporting non-GAAP earnings* (n=51)

	Mean	Standard Deviation	25	50	75	Min	Max
Market capitalisation (000)	441,919	919,623	17,576	124,728	303,897	337	4,981,749
Total assets (000)	601,477	1,279,196	12,169	130,469	476,886	88	5,850,000
Total liabilities (000)	300,433	725,965	4,620	29,761	135,653	256	3,978,000
Total equity (000)	301,044	681,714	10,776	87,703	282,972	-16,925	4,218,000
Net profit after tax (000)	21,974	50,933	-112	7,169	19,153	-35,546	262,000
Loss	0.27	0.45	0	0	0	0	
Total liabilities/Total assets	0.53	0.87	0.19	0.38	0.54	0.004	5.79
NPAT/Total assets	-0.05	0.27	-0.02	0.04	0.06	-1.44	0.42
Market to book	-77.99	572.36	0.83	1.21	2.64	-4,085.13	19.75

Table 4. Disclosure and Prominence Scores (n=57)

Panel A – Disclosure Scores

Companies	Disclosure Score†			Annual Change		p-values	
	2012	2013	2014	2012-2013	2013-2014	2012-2013	2013-2014
Mean Score	5.89	6.46	7.26	0.57	0.80	[1]0.003 [2]0.001	[1]0.000 [2]0.000
Standard Dev	1.61	1.32	1.22				
Median Score	6.00	7.00	7.00	1.00	0.00		
Sum	336	368	414	32	46		
Maximum	8	8	9				
Minimum	1	3	3				

Notes: †Maximum score for disclosure is 10; [1]means of paired samples and [2]Wilcoxon signed rank test with 1% significance level.

Panel B – Lack of Prominence Scores

Companies	Lack of Prominence Score†			Annual Change		p-values	
	2012	2013	2014	2012-2013	2013-2014	2012-2013	2013-2014
Mean Score	2.49	2.39	2.74	-0.10	0.35	[1]0.293 [2]0.334	[1]0.014 [2]0.015
Standard Dev	1.12	1.10	1.06				
Median Score	3.00	3.00	3.00	0.00	0.00		
Sum	142	136	156	-6	20		
Maximum	4	4	4				
Minimum	1	1	1				

Notes: † Scores for prominence range from 1 to 4.; [1]means of paired samples and [2]Wilcoxon signed rank test with 5% significance level.

Table 5. Analysis of Disclosure Score Information

Panel A – Disclosure Scores by Category N=57

	No. of companies meeting criteria			Direction							
				2012 to 2013				2013 to 2014			
Criteria	**2012**	**2013**	**2014**	**Decrease**	**Increase**	**No change 1**	**No Change 0**	**Decrease**	**Increase**	**No change 1**	**No change 0**
1. Why information is useful	13	19	29	2	8	11	36	-	10	19	28
3. Appropriate label	57	57	57	-	-	57	-	-	-	57	-
4. Calculation	36	39	46	-	5	34	18	1	8	38	10
5. Reconciliation	49	51	52	-	3	48	6	-	1	51	5
6. Consistency	45	52	54	-	6	46	5	-	2	52	3
7. Adjustments	44	51	54	-	6	45	6	-	3	51	3
8. Unbiased	44	45	52	1	2	43	11	-	7	45	5
9. One-off items	48	48	53	-	1	47	9	1	6	47	3
10. Audited or reviewed	5	7	15	-	2	5	50	1	9	6	41

Decrease a reduction in a company's disclosure score from 1 to 0; **Increase** an improvement in a company's disclosure score from 0 to 1; **No Change 1** company has met the disclosure criteria for two consecutive years; **No change 0** company has not met the disclosure criteria for two consecutive years

Panel B – Criterion 1. Why information is useful[1]

	2012	2013	2014	TOTAL
Better measure of operations or more indicative of core business results	6	7	9	**22**
Useful for investors and/or other users	4	9	14	**27**
Used by management for internal reporting purposes	2	7	8	**17**
Improves consistency and/or comparability	1	1	2	**4**
Used to assign dividend distribution and debt covenant requirements	5	5	10	**20**
Sub-total	**18**	**29**	**43**	**90**
No justification	44	38	28	**110**
Total	**62**	**67**	**71**	**200**

[1]Some companies gave more than one justification

Panel C – Criterion 4. Calculation

	2012	2013	2014	TOTAL
Explanation within directors or management commentary	20	16	16	**52**
Explanation by footnote	16	23	30	**69**
Sub-total	**36**	**39**	**46**	**121**
No explanation	21	18	11	**50**
Total	**57**	**57**	**57**	**171**

Panel D – Criterion 5. Reconciliation

	2012	2013	2014	TOTAL
Side by side	1	1	1	**3**
Move from GAAP to non-GAAP earnings	15	20	20	**55**
Move from non-GAAP to GAAP earnings	33	30	31	**94**
Sub-total	**49**	**51**	**52**	**152**
No reconciliation	8	6	5	**19**
Total	**57**	**57**	**57**	**171**

Appendix One. Disclosure Index

	FMA Guideline		Coding	Reference
1	Why information is useful	Directors must explain why disclosure of non-GAAP earnings is useful to investors.	**Disclosure Score** 1=Yes; 0=No **Sub-coding** Code statements. The statements can cover more than one of the categories below: 1. better measure of operations or more indicative of core business results 2. 2 useful to investors and/or other users 3. used by management for internal purposes 4. improves consistency and/or comparability 5. used for assign dividend distribution and debt covenant requirements 6. No justification 7. Other	Webber et al. (2013)
3	Appropriate label	Non-GAAP earnings must be labelled appropriately to clearly differentiate it from GAAP earnings.	**Disclosure Score** 1=Yes –non-GAAP labelled consistently; otherwise 0 **Sub-coding** Classify the terminology given to the non-GAAP earnings figure 1. Non-GAAP earnings 2. Core earnings 3. Adjusted earnings 4. Underlying earnings 5. Earnings after adjustments 6. Normalised 7. Other Label Label used consistently Yes/No	
4	Calculation	There must be a clear explanation of how non-GAAP earnings is calculated.	**Disclosure Score** 1=Yes if calculation is explained; otherwise 0 explained **Sub-coding** Classify how the explanation was given: 1. Explanation within narrative of directors or management commentary 2. Explanation within narrative plus support from director internal policy 3. Explanation by footnote	

	FMA Guideline		Coding	Reference
4(a)	Reconciliation with GAAP financials	A reconciliation of non-GAAP and GAAP information is to be disclosed.	**Disclosure Score** 1=Yes if reconciliation is given explained; 0= if no reconciliation **Sub-coding** 1. Side by side 2. Move from GAAP to non-GAAP showing the adjustments 3. Move from non-GAAP to GAAP showing the adjustments 4. Other	Marques (2010)
4(b)	Significant adjustments explained	Significant adjustments in the calculation of non-GAAP earnings are to be disclosed separately and linked to the financial statements.	**Disclosure Score** 1=Yes if adjustments can be identified in the financial statements or calculation shown; otherwise 0	
4	Consistency	Non-GAAP earnings is to be calculated consistently. Any variation in the calculation is to be explained, along with reasons and the financial impact of the change.	**Disclosure Score** 1 =Same adjustments as prior year, otherwise, 0	
5	Adjustments	For each non-GAAP earnings adjustment, the corresponding item must be adjusted in comparative information.	**Disclosure Score** 1=Yes, 0=No	
6	Unbiased	Non-GAAP earnings measures should not over (under)state good (bad) news to the market.	**Disclosure Score** 1=Neutral: non-GAAP earning presented in an unbiased way in reference to company performance. 0=Good news (Bad news): non-GAAP earnings presented in a positive (negative) way in reference to the company's performance	
7	One-off items	Non-GAAP adjustments are not to be referred to as "one-off" if they have occurred in the past and are likely to occur in the future.	**Disclosure Score** 1=Recurring items are not referred to as "one-off" items , 0 otherwise	
8	Audited or reviewed	A clear statement is to be made if non-GAAP financial information is taken from audited or reviewed financial statements.	**Disclosure Score** 1= a clear statement as to audited or reviewed financial information, otherwise, 0	

Appendix Two. Prominence Index

	FMA Guideline		Coding	Reference
2	Lack of prominence	Non-GAAP earnings is to be disclosed to NOT give it undue prominence, emphasis or authority.	**Disclosure score 1 to 4** 1. Appearance in headline: Non-GAAP earnings in a headline of the directors' report and management commentary but NOT GAAP earnings. Appearance in graphical presentation: Non-GAAP earnings is reported in a graphic in directors report and management commentary but NOT GAAP earnings. 2. Pro Forma dominates: Discussion of non-GAAP earnings clearly takes precedence over GAAP earnings. These include: 2.1 where non-GAAP earnings is mentioned in the first page of the directors or management commentary but NOT GAAP earnings, or 2.2 where commentary on performance given throughout the directors report and management commentary (press release) relates primarily to non-GAAP earnings with few comments on GAAP earnings, or 2.3 GAAP earnings is presented but not commented in directors or management commentary, or 2.4 GAAP profit figure and reconciliation ARE NOT contained in the directors or management commentary 3 GAAP and non-GAAP earnings are equally prominent: Discussion of both measures is mentioned at the same rate. For example, whenever a pro forma measure is mentioned, the equivalent GAAP measure is also mentioned. 4 GAAP dominates: Discussion of GAAP earnings clearly take precedence over non-GAAP earnings. These include 4.1 where GAAP earnings is mentioned in first page in the directors or management commentary but NOT non-GAAP earnings, or 4.2 where commentary on performance given throughout the directors report and management commentary relates primarily to GAAP earnings with few comments on non-GAAP earnings, or 4.3 Non-GAAP earnings is presented but not commented in directors or management commentary, or 4.4 GAAP profit figure and reconciliation ARE contained in the directors or management commentary	Entwistle et al. (2006) and FMA(2012)

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