https://www.wsj.com/articles/minding-the-gaap-matters-to-investors-11570468261

HEARD ON THE STREET

Minding the GAAP Matters to Investors

Investors have reason to worry as creative accounting metrics have become more prevalent

WeWork's parent's recently pulled public listing shows how straying from generally accepted accounting principles can erode investor trust. PHOTO: JASPER JUINEN/BLOOMBERG NEWS

By Lauren Silva Laughlin

Updated Oct. 8, 2019 5:21 pm ET

What's in an Ebitda? It is anyone's guess nowadays.

Financial accounting metrics at companies ranging from Uber Technologies to Beyond Meat to We Co. have gotten creative, going far beyond the guidelines that fall under generally accepted accounting principles.

Companies claim the made-up metrics are a way for investors to better understand their business, but they create greater discrepancies between the valuations of publicly traded companies. As We's recently pulled public listing shows, they also can erode investor trust.

The tech industry is among the biggest offenders and, not coincidentally, sector participants are highly unlikely to have positive net income according to normal accounting rules. Some companies tweak their top lines as well as their bottom lines. Uber, for example, uses non-GAAP "core platform adjusted net revenue," which attempts to strip out recurring costs it incurs to grow in competitive markets.

Beyond Meat is slightly more conservative, though it messes with an already alternate measure of profits—earnings before interest, taxes, depreciation, and amortization—by adjusting it further. WeWork's parent took creativity to a whole new level with new-age sounding but also much ridiculed financial metric "community adjusted Ebitda," which it later amended to "contribution margin excluding noncash GAAP straight-line lease cost."

The number of companies reporting non-GAAP numbers has proliferated. In 1996, only 59% of filers used non-GAAP figures according to firm Audit Analytics. By 2017, that had grown to 97%. A gander at the wide range of valuations that non-GAAP creativity implies shows just how dangerous creative accounting can be for investors, too. Zion Research Group recently calculated Ebitda in four different, but often used, ways for companies in the S&P 500 by sector. The communications sector produced the widest range between the lowest and highest figures—a difference of $25 billion for the sector as a whole between the most and least flattering techniques.

Companies have reason to reconsider their markings on their own accord. Earlier this year a report from Wachtell, Lipton, Rosen & Katz warned that the Securities and Exchange Commission was increasing its scrutiny over non-GAAP numbers.

Investors may beat regulators to it. Investor skepticism about We's pulled listing initially arose because of concern about creative measures. Sticking to GAAP could translate into greater investor acceptance, too.

Corrections & Amplifications

Uber Technologies uses a non-GAAP metric called "core platform adjusted net revenue" which attempts to strip out recurring costs it incurs to grow in competitive markets. An earlier version of this article misstated the name of the metric. (Oct. 8, 2019)