

CLAY TOKENS

The Uniform Accounting Monthly Report | November 1, 2023



Deficiencies in GAAP/IFRS vis-a-vis Uniform Accounting

Standards Setters Continue to Ignore the Significance of Discontinued Ops

While typical financial statements like the balance sheet, income statement, and statement of cash flows provide information about performance that has already happened, many companies take performance monitoring a step further by creating "pro forma" financials.

Leveraging historical data and applying assumptions, pro forma financials provide insight into the future outlook for the business, and also how a business might have looked in the past if "things had been different."

That might mean how a company would have looked if it had owned a business it acquired for the full year. Or how it would have looked without a business it was planning on selling.

While pro formas are incredibly helpful tools for financial statement users, they are fundamentally at odds with reported financials, given the dichotomy between what has happened and what will happen.

This can create confusion in understanding the underlying performance of a company when purely looking at financials. Current accounting practices have fallen short in helping financial statement users understand a company's performance, particularly when divestitures are involved.

When public companies prepare to shut down or sell off a significant part of their business, they explicitly outline the tangible parts of the business they are planning to sell in the balance sheet. These items are called "assets held for sale".

For an asset to qualify as "held for sale", it needs to meet certain criteria. A clear plan to sell the asset is needed with potential buyers identified, and the sale must be probable and expected to close within one year. Companies don't list assets as "held for sale" unless they are almost certain they won't be a part of the business going forward.

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Yet the balance sheet is only part of the accounting equation. When management lists assets as held for sale, they also need to address their impact on the income statement, since these assets previously generated revenue for the company.

Income generated from these assets is recorded as “earnings from discontinued operations”.

Earnings from discontinued operations reflect the gain or loss earned from assets held for sale during this time frame.

So when a company is looking to sell a part of its business, it is left with unnecessary items on both its balance sheet and income statement. This can significantly alter the perception of the ongoing business.

When a company lists an asset as held for sale on its balance sheet, there is a clear intention that the asset won't be a part of the business anymore.

The valuation of this sale could be highly relevant for investors and management teams alike, but since the portion of the business being sold won't be a part of the company going forward, its assets shouldn't have a bearing on the understanding and interpretation of the remaining company's performance.

Keeping both assets held for sale and earnings from discontinued operations on financial statements can have a material impact on a company's reported returns and can drastically impact how an investor views the company.

Take eBay (EBAY) for instance. The company made a series of material divestitures in 2020 and 2021. It sold StubHub in 2020 for \$4 billion. eBay then sold its Classifieds Group in June 2021 for \$9.2 billion and eBay Korea in November for over \$3 billion.

Prior to the confirmation and completion of the sale, eBay recorded assets related to these businesses as held for sale in 2020. Earnings from discontinued operations were recorded in 2020 and 2021 to reflect earnings generated from these soon-to-be-sold businesses as well as earnings from the sale itself.

While no longer contributing to ongoing operations, the assets and earnings from these businesses affected the company's financials in both of these years.

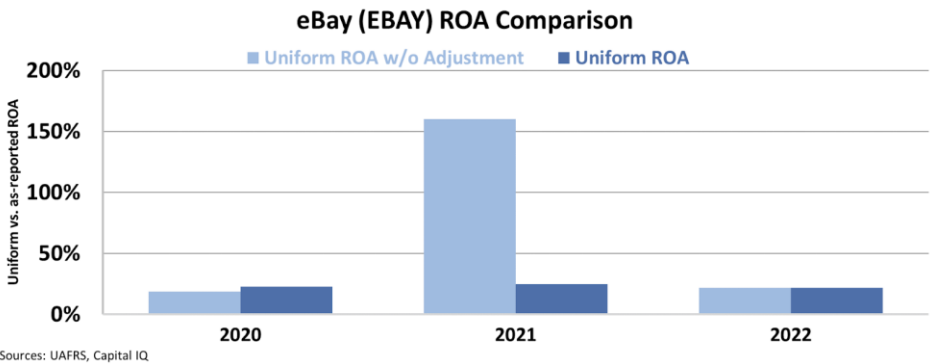
In 2021, eBay reported a net income of \$13.6 billion. Earnings from discontinued operations related to Classifieds and eBay Korea contributed to \$13.4 billion of that total, or 98% of net income. While assets held for sale contributed to over 6% of the company's total assets in 2020.

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These figures had a substantial impact on eBay’s bottom line and distorted eBay’s appearance to investors.

We remove these items from eBay and other companies’ financials in order to create a more accurate picture of the performance of a firm’s ongoing operations.

Without making this adjustment, eBay’s earnings would be grossly overstated, and its Uniform ROA would be a staggering 160% - which would slate it as one of the highest return companies across the US investable universe. That said, when we removed these items, its Uniform ROA for 2021 was 25%, much more in line with online retailer peers and its own historical performance.



The market values companies based on future operations. Being able to accurately understand the likely outcomes for a company is key to making informed investments.

Current accounting practices make this unnecessarily arduous for investors when companies are engaged in divestitures. Assets held for sale and earnings from discontinued operations should generally not weigh on investment decisions. However, under current accounting standards, these line items can drastically alter the interpretation of a company’s profitability.

These items are removed from a company’s financials as a part of the adjustments made under Uniform Accounting. After these adjustments are made, investors are left with a clearer picture of a company’s outlook, since only assets and earnings that are part of the company’s ongoing operations are included in its financial statements.

With a better understanding of what the future operations and profitability of a company may look like, investors are able to make better-informed decisions when evaluating potential investment opportunities.

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