

Goodmans^{LLP} Update

Canadian Securities Regulators Introduce New Rules for Disclosure of Non-GAAP Financial Measures

The Canadian Securities Administrators (CSA) recently published for comment new proposed [rules and related guidance](#) regarding disclosure requirements for non-GAAP financial measures and other financial measures. The proposed rules are open for public comment until December 5, 2018.

Background

The proposed rules are intended to incorporate (for the most part), expand upon and replace CSA Staff Notice 52-306 (Revised) Non-GAAP Financial Measures (“**SN 52-306**”). The proposed rules follow several years of disclosure reviews during which the CSA expressed concern about the use of non-GAAP financial measures and compliance with SN 52-306. See, for example, our [February 10, 2016 Update, CSA Provides Revised Guidance on Disclosure of Non-GAAP Financial Measures](#) and our [April 17, 2018 Update, Canadian Securities Regulators Outline Disclosure Expectations for Real Estate Reporting Issuers](#). If implemented, the proposed rules would have the force of law and provide CSA staff with a stronger tool to take regulatory action where warranted.

Scope

The proposed rules are broad and would apply to non-GAAP financial measures and other financial measures included in documents that are intended to be, or reasonably likely to be, made available to the public, whether or not filed under securities legislation. This includes all written (including electronic) communications, such as press releases, management discussions and analysis, investor presentations, websites and social media posts. All issuers (including private companies and investment funds) other than “SEC foreign issuers” would have to comply with the proposed rules. The proposed rules do not contain specific limitations or industry-specific requirements and instead include comprehensive general disclosure requirements with the goal of improving the quality of information provided to investors. The use of non-GAAP financial measures would continue to be subject to the general requirement that they not be misleading.

Overview

The proposed rules provide that financial disclosure presented or disclosed outside of financial statements is to be categorized as one of four financial measures:

- **Non-GAAP Financial Measure** – Either a: (a) measure of financial performance, financial position or cash flow not disclosed or presented in the financial statements that is not a disaggregation, calculated in accordance with the accounting policies used to prepare the financial statements, of a line item presented in the primary financial statements (e.g., Adjusted EBITDA); or (b) financial outlook for which no equivalent financial measure is presented in the primary financial statements (e.g., 2019E Adjusted EBITDA).
- **Supplementary Financial Measure** – A measure not disclosed or presented in the financial statements and that: (a) is a disaggregation, calculated in accordance with the accounting policies used to prepare the financial statements, of a line item presented in the primary financial statements; and (b) is, or is intended to be, disclosed on a periodic basis to present an aspect of financial performance, financial position or cash flow (e.g., “same store sales”).
- **Segment Measure** – A measure of segment profit or loss, revenue, expenses, assets, or liabilities disclosed in the notes to the financial statements (e.g., “segment operating income”).
- **Capital Management Measure** – A measure disclosed in the notes to the financial statements to enable users of financial statements to evaluate the issuer’s objectives, policies and processes for managing capital (e.g., “normalized debt”).

Non-GAAP financial measures will be subject to the most stringent requirements of the proposed rules, including:

- **Labelling** – A non-GAAP financial measure must be labelled appropriately given its composition and in a way that distinguishes it from totals, subtotals and line items presented in the primary financial statements.
- **Prominence** – Subject to certain exceptions for ratios, a non-GAAP financial measure must be presented with no more prominence than the most directly comparable financial measure presented in the primary financial statements.
- **Comparative Period Disclosure** – The same non-GAAP financial measure must be presented for the comparative period.
- **Explanation and Reconciliation** – The first time each non-GAAP financial measure appears in a document, the document must: (a) subject to certain exceptions for ratios, identify the non-GAAP financial measure as such; (b) state that the non-GAAP financial measure does not have a standardized meaning under the financial reporting framework used to prepare the issuer's financial statements and may not be comparable to similar financial measures presented by other issuers; (c) explain how the non-GAAP financial measure provides useful information to a reasonable person and explains the additional purposes, if any, for which management uses the non-GAAP financial measure; and (d) subject to certain exceptions for ratios and financial outlook, provide a quantitative reconciliation to the most directly comparable financial measure presented in the issuer's financial statements.

Similar (though in many cases less stringent) rules would apply to certain segment measures and capital management measures. Supplementary financial measures must be explained and presented on a comparative basis.

Practical Implications

While consistent in principle with the existing guidance in SN 52-306, the proposed rules and related guidance contain several new requirements and clarifications that are expected to impact disclosure practices:

- **Outlook** – If a non-GAAP financial measure is included in the document as forward-looking “financial outlook” and the document discloses forward-looking financial disclosure in the form of a financial statement (FOFI), the document must contain a quantitative reconciliation to the most directly comparable financial measure presented in the FOFI. If the document does not contain FOFI, the document must instead present the equivalent historical non-GAAP financial measure and describe: (a) each of the material differences (quantitative if possible) between the financial outlook and the most directly comparable financial outlook for which an equivalent historical financial measure is presented in the primary financial statements; or (b) each of the significant components of the financial outlook used in its calculation (which may include quantification of the components and /or the process followed in preparing the financial outlook, including the material factors or assumptions relevant to the financial outlook). While generally consistent with the guidance in SN 52-306 and CSA comments provided in many of its issue-oriented reviews of non-GAAP financial measures and forward-looking information, these requirements represent a departure from the current disclosure practices of many issuers.
- **Comparative Period Disclosure** – The proposed rules require issuers to present non-GAAP financial measures for a comparative period. Where comparative non-GAAP financial measures are presented for a previous period, a reconciliation to the corresponding most directly comparable measure should also be provided for that previous period. The CSA provides guidance on how to determine the relevant comparative period.
- **Prominence** – The proposed guidance contains several examples of a non-GAAP financial measure being more prominent than the most directly comparable measure presented or disclosed in the financial statements. These examples include “omitting the most directly comparable measure from a press release headline or caption that includes a non-GAAP financial measure” and “providing a discussion and analysis of a non-GAAP financial measure in a more prominent location than a similar discussion and analysis of the most directly comparable measure”. The proposed guidance also provides that a location is not more prominent if the non-GAAP financial measure is presented within the previous, same or next page of a document.

- **Social Media** – Issuers should not disclose non-GAAP financial measures, segment measures, capital management measures or supplementary financial measures on social media if character limits would preclude the issuer from satisfying the applicable disclosure requirements.
- **Enforcement Tool** – Under the current regime, the CSA is limited in its ability to enforce the guidance in SN 52-306. The proposed rules provide the CSA with a much stronger tool to take appropriate regulatory or enforcement action against issuers, boards and management teams.

The proposed rules are complex and issuers, their counsel and auditors should review them carefully. It may also be prudent for issuers to review their disclosure in light of the proposed rules to determine what changes may be required if the proposed rules are implemented in their current form.

Please contact any member of our [Corporate Securities Group](#) to discuss these developments.

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