THE UPDATE

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Non-GAAP Earnings Measures: Guidance From Securities Regulators

In light of the fact that it has become a common practice for companies to publish earnings determined in manners other than as prescribed by Generally Accepted Accounting Principles ("GAAP"), staff of the Canadian Securities Administrators recently issued a Staff Notice intended to provide guidance on the issue of reporting non-GAAP earnings measures. It is clear that financial reporting issues are receiving increased attention from securities regulators and market participants given recent high profile cases with reporting problems.

Commonly reported non-GAAP earnings measures include "*pro forma* earnings", "operating earnings", "cash earnings", "EBITDA" and "earnings before one-time charges". The regulators do not suggest that companies should stop reporting earnings in this fashion, if doing so will help investors to understand financial results. The regulators are, however, concerned that investors may be confused or even misled by non-GAAP earnings measures, particularly when not accompanied by adequate disclosure.

In an effort to ensure that non-GAAP earnings measures are not presented in a way that confuses or obscures the GAAP measures, the regulators have advised companies that choose to publish non-GAAP earnings to:

- define the measures clearly;
- demonstrate the relevance of reporting earnings in this manner; and
- ensure that the chosen method of reporting does not have the potential to mislead investors.

Regulatory action may be taken against companies that disclose information in a manner considered misleading and therefore potentially harmful to the public interest.

The Staff Notice indicates that inclusion in financial statements of non-GAAP earnings measures is likely to be confusing as readers expect financial statements to be in accordance with GAAP. The risk of confusion is greatest when the additional information is on the face of the income statement where it may compete with the GAAP measure of earnings per share. In staff's view, it is not appropriate to present non-GAAP earnings measures in GAAP financial statements.

Apart from the financial statements, non-GAAP earnings measures may be reported if the above precautions have been satisfied, doing so would assist investors in understanding the financial results of the company and prominence is given to the earnings measured in accordance with GAAP rather than to non-GAAP earnings measures. The Staff Notice advises companies when preparing MD&A to consider whether the separate presentation of non-GAAP earnings measures provides added benefit to readers given that MD&A should highlight the relevant aspects of a company's operations.

The Staff Notice specifically requires companies which report non-GAAP earnings measures to:

- explicitly state that the non-GAAP earnings measures do not have any standardized meanings and are therefore unlikely to be comparable to similar measures presented by other companies;
- present earnings as determined in accordance with GAAP prominently alongside the non-GAAP earnings measures;

- describe the objectives of presenting earnings in a manner inconsistent with GAAP and, in particular, to discuss the reasons for varying from GAAP in excluding items in determining net income or loss;
- reconcile the non-GAAP earnings measures, where they first appear, with the GAAP financial statements;
- limit the number of non-GAAP earnings measures employed and to avoid using multiple, similar, non-GAAP earnings measures that differ from each other only slightly; and
- present the non-GAAP earnings measures on a basis that is consistent from period to period and to explain any changes in the composition of the measures when compared to previously published measures.

We invite you to contact any member of the Goodmans securities team to discuss the presentation of financial results.

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