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Mind the GAAP: Avoid Getting Tripped Up by New Non-GAAP Disclosure Requirements

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[Read the complete report.](#)

The Canadian Securities Administrators (CSA) has, for the first time, proposed a set of rules to govern non-GAAP and other financial measures. These rules, which will replace guidance previously issued by the CSA, will require issuers to adhere to rigid disclosure requirements when publicly disclosing non-GAAP financial measures. The rules will also expand the universe of regulated financial measures requiring supplemental disclosure beyond traditional “non-GAAP financial measures.” Although these proposed rules may change before being implemented, issuers should expect that whatever their final form, the new rules will require more detailed disclosure and additional time and resources to ensure compliance.

Recap of the Existing Regime

There are currently no Canadian securities regulations specific to the disclosure of non-GAAP and other financial measures outside of an issuer’s financial statements. There is only the CSA’s guidance in Staff Notice 52-306 (Revised), *Non GAAP Financial Measures* (SN 52-306), which was first issued in 2003 and last updated in 2016. The purpose of this guidance is to help issuers disclose non-GAAP financial measures in a more consistent manner that is transparent and not misleading to investors. To this end, when reporting a non-GAAP financial measure, SN 52-306 provides that issuers should, among other things,

- state that the non-GAAP financial measure has no standardized meaning under GAAP;
- name it in a way that distinguishes it from a GAAP measure and is not otherwise misleading;
- explain why it provides useful information to investors;
- present with equal or greater prominence the most directly comparable GAAP financial measure;
- provide a quantitative reconciliation from the non-GAAP financial measure to the most directly comparable GAAP measure; and
- present the non-GAAP financial measure on a consistent basis from period to period.

Despite these and a number of other seemingly prescriptive requirements, SN 52-306 is regulatory guidance, not binding law. As a result, issuers have some degree of flexibility in how they apply this guidance to their specific circumstances when disclosing non-GAAP financial measures, provided that their disclosure is not misleading to investors.

New Rules-Based Framework

Despite the existing guidance, the CSA has found that disclosure practices still vary materially among issuers. To address this disparity, and in response to ongoing concerns identified by certain investors and other stakeholders, the CSA published Proposed National Instrument 52-112, *Non-GAAP and Other Financial Measures Disclosure* (Proposed Instrument), in September 2018 to replace SN 52-306. The Proposed Instrument would impose mandatory disclosure in respect of non-GAAP and certain other specified financial measures when these are publicly disclosed in writing, including in postings on websites and social media. Because it mandates disclosure through rules rather than guidance, the Proposed Instrument will eliminate issuer flexibility with respect to the presentation and

disclosure of non-GAAP and other specified financial measures and enable the CSA to take enforcement action against issuers that fail to comply.

Generally speaking, the requirements imposed by the Proposed Instrument in respect of non-GAAP financial measures are aligned with the current guidance under SN 52-306. However, there are a few notable differences. In some cases, these differences stem from an acknowledgment that a different approach may be appropriate (as a practical or principled matter) in prescribed circumstances. A good example is the Proposed Instrument's exception that allows for a qualitative discussion of certain forward-looking non-GAAP financial measures in lieu of a quantitative reconciliation to a forward-looking GAAP measure.

Unfortunately, some elements of the Proposed Instrument fail to provide appropriate exceptions and impose new disclosure practices that are impractical, unduly burdensome or otherwise unnecessary to ensure the investing public is not misled. For example, the Proposed Instrument requires that when disclosure of a non-GAAP financial measure is made, the "same" non-GAAP financial measure must also be presented for the comparative period. This approach differs from SN 52-306, which requires only that non-GAAP financial measures be consistent from period to period.

As noted in our [comment letter](#) to the CSA, in several circumstances it would be impossible or impractical for issuers to present disclosure on exactly the same basis for comparative periods. In these circumstances, absent an express exception (none are currently proposed) or exemptive relief, an issuer would be in breach of the Proposed Instrument even if the issuer were to provide transparent disclosure that ensured investors were not misled. The CSA has suggested that exemptive relief may be available in some of these circumstances; however, even if available, there may be insufficient time to obtain this relief in the context of event-driven or other current disclosure. In our comment letter, we suggested that the CSA reconsider its proposal to deal with these circumstances by exemptive relief, given the costs and delays that it can impose on an issuer.

Another concerning aspect of the Proposed Instrument is the proposed regulation of three "new" categories of financial measures – namely "segment measures," "capital management measures" and "supplementary financial measures." In broad terms, these "other financial measures" are distinct from non-GAAP financial measures but, in the CSA's view, give rise to similar policy concerns if not accompanied by appropriate disclosure. Given that there has never been any regulation of these "other financial measures," or any clear guidance from the securities regulators as to the specific concerns with their use, there is a very real risk of confusion among investors and issuers alike as to the precise meaning of each new disclosure category and the kind of incremental disclosure that is necessary to comply with the Proposed Instrument's requirements. This risk is exacerbated by an absence of clarity in the Proposed Instrument's companion policy as currently drafted.

Finally, the Proposed Instrument would apply to all issuers (including investment funds), with an exception only for "SEC foreign issuers." As a result, an "SEC issuer" reporting in Canada that does not qualify as a "SEC foreign issuer" would need to comply with both U.S. and Canadian disclosure requirements regarding financial measures. Although the regulation of non-GAAP financial measures in the United States and Canada is similar, the regimes are not identical. Furthermore, the Proposed Instrument will apply to other financial measures that are not subject to specific U.S. regulation.

For additional detail on the Proposed Instrument, please see our [previous commentary](#).

What Happens Next?

The comment period for the Proposed Instrument closed in December 2018. The CSA received over 40 comment letters from a variety of market participants who identified a broad range of concerns with the Proposed Instrument. In addition to the concerns noted above, Davies' [comment letter](#) also suggests improvements to create a more streamlined and modern disclosure regime.

The Proposed Instrument involves a significant shift in the manner in which disclosure of financial measures is regulated under Canadian securities laws. We expect the CSA will take the time necessary to carefully consider the views and concerns expressed by all the commenters before moving forward with the Proposed Instrument.

Although it is unclear at this time whether any changes will be made to the Proposed Instrument, we expect that the CSA will ultimately implement rules governing non-GAAP and possibly certain other financial measures in one form or another. Accordingly, issuers should be prepared to make changes to their disclosure practices regarding these financial measures. They can also expect that these changes will require the dedication of increased time and resources to ensure compliance.

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