CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Reporting Alert

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Management Considerations for Effective KPI Disclosure

Background

Most Canadian public companies include key performance indicators (KPIs) in their Management Discussion and Analysis (MD&A) and earnings press releases; KPIs may also be found in other information sources such as investor presentations. KPI is a broad term that can include a measure in any one of the following four categories:

1. generally accepted accounting principles (GAAP) financial measure
2. non-GAAP financial measure
3. other financial KPI
4. non-financial/operational KPI.

Since the first category, GAAP financial measure, is already covered by existing accounting frameworks and subject to annual independent audit, this *Reporting Alert* focuses only on the latter three categories of KPIs.

FIGURE 1: THE BROAD SPECTRUM OF KPIs

	Key Performance Indicators (KPIs)			
	GAAP Financial Measures	Non-GAAP Financial Measures	Other Financial KPIs	Non-Financial/ Operational KPIs
Example	Earnings Per Share	Adjusted Earnings	Dollars of Order Backlog	Barrels of Oil Equivalent per Day
Description	a financial measure presented in the financial statements	a financial measure not presented in the financial statements that is an adjustment to a GAAP financial measure*	a financial measure that is not a GAAP or non-GAAP financial measure	a non-financial measure

* The definition of a non-GAAP financial measure and the related guidance on presentation and disclosure of non-GAAP financial measures for securities regulatory purposes can be found in Canadian Securities Administrators Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures*.

KPIs provide additional insight into aspects of a company's overall performance (e.g., strategic and operational efficiency) that cannot always be described in its financial statements. However, concerns are often raised that these measures lack transparency, comparability within industries, and year-over-year consistency within the same entity.

It is management's responsibility to effectively select and disclose KPIs for the benefit of users of this information.

Purpose of This *Reporting Alert*

Because of the importance of KPIs and the lack of guidance on how to approach them, this *Reporting Alert* aims to provide:

- a description of management's role in relation to KPIs
- six principles to assist management in appropriately selecting and effectively disclosing KPIs.

By applying the principles to their specialized knowledge of the business, management can ensure that the reported KPIs are meaningful and useful to investors and other key stakeholders.

CPA Canada has also published an editable tool entitled *Key Performance Indicators — Tool for Audit Committees* (KPI Audit Committee Tool) to help audit committees evaluate KPIs.[1] In the KPI Audit Committee Tool, six desirable characteristics of KPIs are identified. This publication leverages these characteristics and shifts the focus to the role of management. We encourage management to review the KPI Audit Committee Tool in addition to this publication to better understand the expectations audit committee members have of management in relation to KPIs.

Role of Management

Management is responsible for preparing documents that can contain KPIs (e.g., MD&A, earnings press releases and investor materials). As a result, management should have appropriate controls in place over the selection, preparation, and disclosure of KPIs. It is important to note that external auditors are not required to provide assurance on the contents of the MD&A or other materials produced by management; they only provide an opinion on the financial statements.

Furthermore, National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* requires a certifying officer to make certifications regarding misrepresentations and fair presentation.[2] For non-venture issuers, certifications regarding responsibilities for establishing and maintaining disclosure controls and procedures (DC&P), internal controls over financial reporting (ICFR), and the design of DC&P and ICFR are also required. These certifications pertain to annual and interim filings, which include the financial statements, MD&A and the annual information form (AIF).

Management may establish a disclosure committee as an element of its system of internal controls. This committee is typically comprised of staff from the issuer's finance team (e.g., chief financial officer, controller) but could include legal counsel, the chief operating officer and internal audit. The role of this committee is to review the draft reporting deliverables, including KPIs, and the related disclosure controls and procedures relied upon in producing and presenting the deliverables. The efforts of the disclosure committee help to facilitate the audit committee's review of these deliverables.

Six Principles for Effective KPI Disclosure

In relation to the principles, management should document its policy related to KPI selection and disclosure and how the principles outlined below are applied. This could include but is not limited to documentation of:

- the process for selecting KPIs to disclose
- the controls in place to establish that the KPIs presented comply with regulatory requirements and disclosure is transparent, comparable and consistent

1 www.cpacanada.ca/KPITool

2 The term "certifying officer" is defined in National Instrument 52-109 as: "each chief executive officer and each chief financial officer of an issuer, or in the case of an issuer that does not have a chief executive officer or a chief financial officer, each individual performing similar functions to those of a chief executive officer or chief financial officer."

- an inventory of all KPIs being disclosed, including how they are calculated[3]
- the process for review by the audit committee and board of directors of the company and consideration of the results of that review.

To develop effective disclosure of KPIs and to ensure users view them as useful, management should consider applying the following six principles. The principles are accompanied by considerations which management can address to determine if the related disclosure objectives are being met.

FIGURE 2: PRINCIPLES FOR EFFECTIVE KPI DISCLOSURE

Relevance	**Transparency**
An entity should only report a KPI that is relevant to stakeholders.	Reported KPIs should be easy to understand and include sufficient disclosure to meet regulatory requirements and industry best practices.
Consistency	**Comparability**
KPIs should be calculated in the same way from period to period.	KPIs should be prepared in accordance with any industry standards.
Reliability	**Completeness**
KPIs should be free from error and subject to appropriate internal controls.	KPIs should present a balanced view of the entity's performance.

1. Relevance

An entity should only report a KPI that is relevant to stakeholders.
Relevant information is capable of making a difference in the decisions made by users. Management should have processes in place to establish that the KPIs being reported are relevant. Management should consult internally and engage with external stakeholders when making this determination. As a starting point, it is likely that some KPIs used internally would be helpful to external stakeholders including investors and analysts. For example, do analysts' reports indicate significant differences between the company's KPIs and those of others?

The following should be considered in determining relevant KPIs:
- KPIs used internally to measure the entity's strategic and operational performance
- KPIs used by others in the industry, including any industry guidance on which KPIs to report and how to calculate them
- KPIs used in determining management's compensation
- KPIs based on contractual terms or covenants (e.g., debt covenants).

3 A useful matrix to track this can be found in CPA Canada's KPI Audit Committee Tool: www.cpacanada.ca/en/business-and-accounting-resources/strategy-risk-and-governance/corporate-governance/publications/kpis-a-tool-for-audit-committees

2. Transparency

Reported KPIs should be easy to understand and include sufficient disclosure to meet regulatory requirements and industry best practices.

Management should ensure all KPIs are fully described in an understandable manner. The disclosures should provide sufficient detail for a user to understand what the KPI depicts and how it has been calculated.

On January 14, 2016, the Canadian Securities Administrators (CSA) issued Staff Notice 52-306 (Revised) which provides guidance to issuers that disclose non-GAAP financial measures.[4] It is important for issuers to follow these disclosure guidelines for KPIs classified as non-GAAP financial measures and to be aware of any new guidance or rules that securities regulators may issue in the future. Management should consider guidance for non-GAAP financial measures when developing disclosures for other KPIs as this may be helpful.

Some considerations relating to transparency:

- The disclosure should explain what the KPI represents and how it is calculated, including any key assumptions or estimates involved.
- The number of KPIs disclosed should be considered since using too many could obscure material information.
- The company's approach to the selection, preparation and presentation of KPIs should be disclosed. Such disclosure could include whether the KPI disclosures of others in the industry have been considered and how.
- Disclosure of KPIs should be consistent across core disclosure documents. Management may discuss KPIs during earnings calls or include KPIs in investor or analyst presentations. It is important to review such information for consistency with KPI disclosure in other regulatory filings (e.g., MD&A).

3. Consistency

KPIs should be calculated in the same way from period to period.

Management should ensure that the way KPIs are calculated and which KPIs are reported remain consistent unless there is a valid reason for change. If a change is made, the reason should be disclosed, along with information about the new KPI; the prior-period disclosure should also be restated.

Some considerations relating to consistency:

- The potential impact of any financial statement reclassifications in the current period should be considered. Reclassifications may result in a need to review the KPIs used and how they are calculated. The possible impact on prior-period KPI disclosures also needs to be considered.
- Where discretionary changes are made to the way KPIs are calculated, there should be accompanying disclosure of the reason for the change and the change should be consistently applied to all periods presented.

4 CSA Staff Notice 52-306 (Revised) Non-GAAP Financial Measures **www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20160114_52-306_non-gaap.pdf**

4. Comparability

KPIs should be prepared in accordance with any industry standards.

Users almost always cite comparability with other entities as being important. It is therefore important for management to follow available industry guidance on how particular KPIs are to be calculated. It would also be appropriate to look at the KPIs used by others in the industry and consider whether they should be used.

Some considerations relating to comparability:

- Where a KPI differs from a similar one commonly used in the industry, this fact and the reason for using a different one should be explained.
- The impact of changes made in KPI reporting by others in the industry should be considered, including any changes in industry guidance.

5. Reliability

KPIs should be free from error and subject to appropriate internal controls.

Reliability will vary depending on the extent to which subjective factors, such as whether there is uncertainty on what to include in the determination of the KPI, are involved. There are also some KPIs that are more subjective by their nature (e.g., customer satisfaction). It is a good idea to provide additional disclosures when there are subjective aspects to a KPI or the KPI itself is subjective.

Some considerations relating to reliability:

- Management must be certain that all KPI information is subject to appropriate controls to ensure calculations and disclosures are appropriate.
- The appropriateness of assumptions/estimates used in the calculation of KPIs should be rigorously considered for reasonableness.
- Consideration should be given to whether there is so much uncertainty around estimates/assumptions that the KPI may be unreliable or misleading.
- Disclosures should explain to users the limitations associated with reliance on a particular KPI.

6. Completeness

KPIs should present a balanced view of the entity's performance.

The KPIs disclosed should result in a balanced view of the issuer's performance along with all disclosures necessary for a user to understand what is being depicted. A more balanced use of KPIs results in greater trust between the issuer and stakeholders.

A consideration relating to completeness:

- KPI information should present a balanced and unbiased picture. For example, calculations should not include one-time gains while omitting similar losses.

Summary

As stakeholders continue to put more reliance on KPIs, it is vital for management to recognize the importance of this change and adapt. We believe that if management successfully incorporates the six principles outlined above (i.e., relevance, transparency, consistency, comparability, reliability and completeness), both management and external stakeholders will benefit.

The KPI reporting landscape is in a state of transformation as stakeholders and regulators push for change. Stay tuned for the following two initiatives:

- The Accounting Standards Board of Canada is developing a framework to enhance the quality and reliability of performance measures reported based on best practices. The draft framework is expected to be published in June 2018.
- The Canadian Securities Administrators (CSA) are establishing a rule on the disclosures required for non-GAAP financial measures and other financial information. The proposed rule would replace CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* and is expected to be published for comment in the second half of 2018.

We encourage management to monitor developments closely and contact us with any feedback or insights that could help us develop additional publications on this topic.

Comments

Comments on this *Reporting Alert*, or suggestions for future *Reporting Alerts* should be sent to:

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