Deloitte.

Non-GAAP Financial Measures
Views from Deloitte's Securities Centre of Excellence

What management and boards of public companies should take away from the proposed securities legislation on non-GAAP financial measures

The Canadian Securities Administrators have issued a CSA Second Notice and Request for Comment for Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure (Proposed NI) with comments due on May 13, 2020.

Currently, CSA Staff Notice 52-306 Non-GAAP Financial Measures (CSA SN) provides guidance to companies on how to ensure that non-GAAP financial measures are not misleading. The Proposed NI incorporates much of the guidance from the CSA SN, though now codified into law, and also has new requirements. Further significant changes to the Proposed NI are unlikely unless regulators receive new information that was not considered in their first consultation period.

Takeaway:
Canadian securities regulators will have new compliance and enforcement tools to address their concerns with disclosures around non-GAAP financial measures.

The scope of the Proposed NI includes all reporting issuers (aside from investment funds, SEC foreign issuers and designated foreign issuers) as well as issuers that are filing an offering document, and applies to all written documents, with limited exceptions (such as transcripts of oral statements).

Takeaway:
The scope is purposefully very broad so ensure that you have procedures in place to ensure that all written communication, including their websites and investor decks, are compliant.

Fortunately, regulators have decided to permit the use of cross-referencing in documents (aside from press releases). This means that, rather than repeating required disclosures in each document in which a non-GAAP financial measure is used, companies can cross-reference to the MD&A. Certain disclosures (such as identifying the measure as non-GAAP, explaining that it has no standardized composition, and describing the composition of the measure) will still need to be made in each document.

Takeaway:
Ensure that the MD&A contains all the required disclosures to take advantage of the ability to cross-reference, and remember that press releases are not eligible for using cross-referencing.

The Proposed NI has separate disclosure requirements for historical non-GAAP financial measures, forward-looking non-GAAP financial measures, non-GAAP ratios, totals of segment measures, capital management measures, and supplementary financial measures.

Takeaway:
Determine what category your measure fits into to determine the detailed disclosures required.

For historical non-GAAP financial measure, the disclosure requirements include using an appropriate label, presenting comparative information and not presenting the non-GAAP financial measure with more prominence than the most comparable GAAP measure. The Proposed NI requires certain disclosures to be in close proximity to the first use of the non-GAAP measures, including identifying the measure as being non-GAAP, a quantitative reconciliation back to the closest GAAP measure, an explanation of the composition, and a description of the informational value being provided to investors by the measure.

Takeaway:
Most of these disclosure requirements are consistent with the current CSA SN. However, if you put all non-GAAP financial measure disclosure at the end of the document, you may need to move some specific items.

Forward-looking non-GAAP financial measures can only be used to the extent that the measure is also used on a historical basis and is labelled in the same way. These measures cannot be more prominently used than the historical measure and must include a description of any differences in composition between the historical and forward-looking measure (though the latter requirement can be incorporated by reference). SEC issuers are scoped out of the requirements for forward-looking non-GAAP financial measures.

Takeaway:
Do not come up with a new measure that is only being used on a forward-looking basis.

Non-GAAP ratios must be labelled appropriately, presented with no more prominence than similar measures presented in the primary financial statements, and include comparative information. The first time that the measure is used in a given document, the composition must be explained, each non-GAAP measure which is a component of the ratio must be identified, and the fact that the ratio is not standardized or comparable to other issuers must be disclosed. In addition, disclosure or incorporation by reference is required to explain how the non-GAAP measure provides useful information and to explain any changes in composition from a prior period.

Takeaway:
Securities regulators have regularly raised issues with ratios which include non-GAAP financial measures. They will be looking for compliance with these new requirements once they are effective.

Regulators have identified concerns over the lack of transparency when certain segment measures and capital management measures are used outside of the financial statements. The new Proposed NI has required disclosures for these items.

The Proposed NI focuses on 'Total of segment measures' and requires disclosure of the most comparable financial measure presented in the primary financial statements of the entity, a comparative period measure, and, in proximity to the first use, a quantitative reconciliation or incorporation by reference. The measure cannot be presented with more prominence than the most comparable GAAP financial measure.

Capital management measures have their own set of requirements. These include an explanation of the composition, the inclusion of a comparative prior period measure, and the requirement that the measure not be presented with more prominence than similar measures presented in the primary financial statements. If not included in the notes to the financial statements or cross-referenced, an explanation of how the capital management measure provides useful information to investors and a quantitative reconciliation to the most comparable financial measure must be presented in the primary financial statements (unless the measure is a ratio, fraction or percentage).

Takeaway:
As these are new requirements, ensure that you have procedures in place to identify the use of these measures outside of the financial statements and are including appropriate disclosures.

Supplementary financial measures is a catch-all category for measures that may not fit easily into one of the other categories. These measures must be labelled appropriately and, in proximity to the first use of a measure, the composition must be explained.

Takeaway:
The regulators are trying to ensure that measures that are not addressed in the earlier sections have some limited disclosures around them.

Overall takeaway: Ensure that you identify all financial measures used outside of the financial statements and understand which bucket each fits into as the disclosure requirements differ. There is still an opportunity to provide comments. Please reach out if you have any questions related to the Proposed NI.

Contacts

Lara Gaede
Partner
(403) 267-3294
lgaede@deloitte.ca

Patrick Ho
Senior Manager
(604) 640-5073
patrho@deloitte.ca

Nicholas Lauriault
Senior Manager
(514) 393-5350
nlauriault@deloitte.ca

Deloitte Securities Centre of Excellence provides expert securities advice, thought leadership, and quality deliverables to our teams and clients on all securities matters.