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Understanding recent changes to non-GAAP and other financial measure disclosure

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On August 25, 2021, National Instrument 52-112 – *Non-GAAP and Other Financial Measures Disclosure* (the Instrument) comes into force, resulting in new mandatory disclosure requirements for issuers with respect to non-GAAP and other financial measures. Currently, guidance on the use of non-GAAP measures is set out in Canadian Securities Administrators (**CSA**) Staff Notice 52-306 (Revised) – *Non-GAAP Financial Measures* (the Current Staff Notice).

Non-GAAP/non-IFRS financial measures are those that depict the historical or expected future financial performance, financial position or cash flow of an issuer, but do not appear on its financial statements. Typical non-GAAP financial measures include "EBITDA", "adjusted earnings", "adjusted EBITDA", "free cash flow", "pro forma earnings", "cash earnings", "distributable cash", "adjusted funds from operations" and "earnings before non-recurring items".

Compliance required for 2021 annual filings

The Instrument applies to disclosures by reporting issuers for financial years ending on or after October 15, 2021. Accordingly, reporting issuers with a December 31, 2021 year end must initially adopt the Instrument for their 2021 annual filings (i.e., fourth quarter/annual MD&A and earnings news releases) due in early 2022.

This transition period allows reporting issuers to continue to report their 2021 third quarter interim filings on a basis consistent with their earlier filings for the first two quarters of the year. Even if a reporting issuer chooses to disclose forward-looking information regarding periods beyond its current financial year (for example, its views on EBITDA for the 2022 financial year), the Instrument will not apply to that disclosure so long as it is made before its first filing in respect of its 2021 financial year.

Changes in the Instrument

While the Instrument is generally consistent with the guidance contained in the Current Staff Notice, the Instrument and its companion policy clarify and expand on this guidance. For example, the Instrument clarifies the circumstances in which required disclosure can be incorporated by reference from the issuer's MD&A. Instances where incorporation by reference is prohibited include incorporation by reference from one MD&A to another, and the quantitative reconciliation of a financial measure in an earnings release. When incorporating by reference, Issuers must also identify where the required disclosure is specifically located within the MD&A, which will need to include the date of the MD&A, the reporting period, and the specific section or page reference within the MD&A.

Other requirements that are clarified and expanded upon in the Instrument and its companion policy include:

- **Labelling:** An issuer must label a non-GAAP financial measure in a way that describes the measure with consideration to the measure's composition. The label must distinguish the measure from totals, subtotals and line items disclosed in the primary financial statements. In the companion policy, the CSA cautions issuers from choosing labels that are confusingly similar to measures used in an issuer's financial statement; labels that purport to represent "results from operating activities" or a similar title when the measure excludes certain operating items; labels that are overly optimistic (i.e., "guaranteed profit" or "protected returns"); or labels that cause confusion based on the composition of the financial measure. If the label of a non-GAAP financial measure has changed from what was previously disclosed, an explanation of the reason for the change is also required.
- **Identification:** An issuer must clearly identify a non-GAAP financial measure as such. This can be achieved by inserting a footnote identifying the measure as a non-GAAP financial measure and directing readers to refer to a section of the document that includes more information on each non-GAAP financial measure. Depending on the nature and extent of the measure, proper disclosure may require the issuer to identify the measure as a non-GAAP financial measure in each instance it is used.
- **Quantitative Reconciliation:** The Instrument continues to require issuers to disclose a quantitative reconciliation of a non-GAAP financial measure to the most directly comparable financial measure. However, the Instrument adds additional requirements such as requiring a reconciliation for both the current and comparative period (as discussed below) and that such reconciliation be in the permitted format, including an explanation of each reconciling item.
- **Comparative Period**: If the non-GAAP financial measure is disclosed in MD&A or in an earnings release of the issuer, the issuer must disclose the non-GAAP financial measure for a comparative period using the same composition. There is an exception to this requirement if it would be impractical for an issuer to provide such disclosure. The CSA states that they do not consider the cost or the time involved in preparing comparative information to be sufficient rationale for omission.
- **Disclosure of Forward-Looking Measures:** The Instrument specifically provides that, when disclosing a non-GAAP financial measure that is forward-looking information, an issuer must (i) disclose the equivalent historical non-GAAP financial measure; (ii) label the forward-looking non-GAAP financial measure using the same label used for the equivalent historical non-GAAP financial measure; (iii) display the forward-looking non-GAAP financial measure in no more prominence than the equivalent historical non-GAAP financial measure; and (iv) describe any significant differences between the forward-looking non-GAAP financial measure and the equivalent historical non-GAAP financial measure.
- **Extension to Websites and Social Media:** In the companion policy, the CSA clarifies that the Instrument applies to reporting issuers in respect of any document intended to be, or reasonably likely to be made available to the public, including websites and social media.

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Additional metrics addressed by the Instrument

In addition to requiring identification and disclosure of non-GAAP financial measures, the Instrument differs from the Current Staff Notice in that it also specifically requires identification and disclosure for:

- **non-GAAP ratios**, such as “adjusted EBITDA per share” or “funds flow per barrel of oil equivalent”;
- **total of segments measures**, which total financial measures for two or more reportable segments of an issuer;
- **capital management measures**, which are financial measures intended to enable the reader to evaluate an issuer’s objectives, policies and processes for managing its capital, such as “annualized adjusted EBITDA”; and
- **supplementary financial measures**, which are disclosed on a periodic basis to depict historical or expected future financial performance, financial position or cash flow, such as “same store sales”.

Exceptions

The Instrument contains several exceptions, including that it does not apply to:

- an issuer in respect of disclosure of a specified financial measure if the calculation of the specified financial measure is derived from a financial covenant in a written agreement (e.g., a credit agreement);
- financial measures required to be disclosed under National Instrument 43-101 –*Standards of Disclosure for Mineral Projects*;
- financial measures required to be disclosed under National Instrument 51-101 –*Standards of Disclosure for Oil and Gas Activities* (however, voluntary disclosure of oil and gas metrics would be subject to the Instrument); or
- financial measures that are required to be disclosed by other laws or self-regulatory organizations (for example, earnings coverage ratios prescribed by Item 9 of Form 41-101 – *Information Required in a Prospectus*).