MIND THE (NON-)GAAP: REVIEW OF FINANCIAL MEASURES DISCLOSURE UNDER NI 52-112

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The Canadian Securities Administrators ("**CSA**") recently published CSA Staff Notice 51-364 *Continuous Disclosure Review Program Activities for the fiscal years ended March 31, 2022 and March 31, 2021* (the "**Staff Notice**")[1] to assess compliance with disclosure requirements under applicable securities legislation, including National Instrument 52-112 *Non-GAAP and Other Financial Measures Disclosure* ("**NI 52-112**")[2] and its companion policy, Companion Policy 52-112 *Non-GAAP and Other Financial Measures Disclosure* ("**CP 52-112**", and together with NI 52-112, the "**Rules**")[3]. The purpose of the Staff Notice is to clarify disclosure obligations for reporting issuers.

The Rules came into force on August 25, 2021 to standardize disclosure obligations and provide guidance for non-GAAP financial measures, non-GAAP ratios and other specified financial measures. The Rules were intended to improve the quality of information available to investors, so that they may better evaluate these financial measures and make informed investment decisions. For more information on the Rules, please see McMillan's bulletin, Making Sense of Non-GAAP Financial Measures, which summarizes the background and application of NI 52-112 as well as the disclosure requirements and guidance described therein.

To assess compliance with NI 52-112, the CSA reviewed certain disclosure documents (i.e. annual MD&As, related earnings releases and investor presentations) of approximately 85 reporting issuers with financial years ended on or after October 15, 2021 and flagged common deficiencies as outlined below:

1. Earnings Release[4]

If an earnings release discloses a non-GAAP financial measure (historical or forward-looking), a total of segments measures or a capital management measure, then it must include the required quantitative reconciliation. The earnings release cannot incorporate by reference a quantitative reconciliation previously disclosed in an MD&A.

Furthermore, a non-GAAP financial measure should not be presented more prominently than the most directly comparable GAAP measure in the reporting issuer's primary financial statements. While this is a matter of judgment, CP 52-112 provides guidance on determining the relative prominence of financial measures. Factors that may obscure disclosure and increase the prominence of a non-GAAP financial measure over its comparable GAAP measure include:

- typographical emphasis (e.g. bold, underlined, italicized or larger font);
- tabular or graphical disclosure; and
- the location of discussion and analysis (e.g. more central or visible).

2. Non-GAAP Financial Measures that Constitute Forward-Looking Information ("Non-GAAP FLI")[5]

There must be disclosure describing the significant differences between the Non-GAAP FLI and its equivalent historical non-GAAP financial measure. It is insufficient to disclose the material factors and assumptions used to develop the forward-looking information, though this disclosure may supplement the disclosure of the significant differences between the two financial measures.

For example, if a reporting issuer discloses projected 2023 adjusted net income of $200 (forward-looking), it must also disclose:

i. its 2022 adjusted net income of $150 (historical) with the required disclosures complying with section 6 of NI 52-112; and
ii. the significant differences between the two financial measures. For example, the expected increase of $50 in projected adjusted net income is due to the expansion of the issuer's facility and the subsequent increased adjusted net income of $50 (from sales of $120 less cost of sales of $70, with no material increase in operating expenses).[6]

3. Total of Segments Measures[7]

A total of segments measure is disclosed in the notes to the reporting issuer's financial statements and consequently in accordance with the reporting issuer's GAAP. Improper identification of a total of segments measure may lack the required disclosure and lead to a classification of that financial measure as a non-GAAP financial measure if disclosed outside of financial statements. Accordingly, section 9 of NI 52-112 provides the disclosure requirements if such financial measures are disclosed outside of financial statements.

4. Supplementary Financial Measures[8]

If disclosed, a supplementary financial measure must be identified using the appropriate term given its composition. It would otherwise be confusing if a supplementary financial measure was described using a well-established term with a composition inconsistent with the measure's composition.

For example, "backlog" generally represents a firm purchase order and would therefore be an inappropriate label for a supplementary financial measure with a composition that includes other orders such as letters of intent or proposals outstanding. In such cases, “adjusted backlog” should be used instead.

5. Investor Presentation[9]

An investor presentation must only incorporate by reference information that is publicly filed and available for investors to examine. Therefore, an MD&A that is incorporated by reference must (i) be filed for an investor to be able to examine the referenced information; and (ii) include information about the specific financial measure disclosed in the investor presentation. The investor presentation must in turn specify the location of the information in the MD&A with the specific section or page reference or a hyperlink to same. A general statement referring to the MD&A will not suffice.

6. Other[10]

When providing non-GAAP financial measures, a reporting issuer must provide required comparative information, such as a quantitative reconciliation, for all comparative periods presented.

A reporting issuer must also disclose each non-GAAP financial measure that is used as a component of the non-GAAP ratio, including those that contain forward-looking information. Per NI 52-112, a “non-GAAP ratio” is a ratio, fraction, percentage or similar form that has a non-GAAP financial measure in its components and is not disclosed in the issuer’s financial statements. Commonly disclosed non-GAAP ratios are “adjusted EBITDA per share” and “free cash flow per ounce”.

Takeaways for Issuers

Issuers that use non-GAAP financial measures, non-GAAP ratios and other specified financial measures should carefully consider the findings of the Staff Notice to ensure that the relevant disclosure is compliant with the requirements of the Rules. Based on common deficiencies flagged in the Staff Notice, reporting issuers should be keenly aware of the following:

- Include quantitative reconciliation for an earnings release that discloses a non-GAAP financial measure.
- Present the most directly comparable GAAP measure with equal or greater prominence than its comparable non-GAAP financial measure.
- Describe the significant differences between forward-looking and historical non-GAAP financial measures.
- Properly identify total of segments measures.
- Label a supplementary financial measure with a term reflecting its composition.
- Incorporate by reference only publicly filed information for investor presentations.

[1] Staff Notice, CSA Staff Notice 51-364 (3 November 2022), (2022) 45 OSCB 9349.

[2] NI 52-112 (24 August 2021), online (pdf): *British Columbia Securities Commission*.
[3] CP 52-112 (12 August 2021), (2021) 44 OSCB 6889, online (pdf): *Ontario Securities Commission.*
[4] *Supra* note 1 at 18.
[5] *Ibid*.
[6] *Ibid*.
[7] *Supra* note 1 at p. 19.
[8] *Ibid*.
[9] *Supra* note 1 at pp. 19-20.
[10] *Supra* note 1 at 20.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.