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c/o

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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Dear Sirs/Mesdames:

RE: CSA Second Notice and Request for Comment, Proposed National Instrument 52-112 *Non-GAAP and Other Financial Measures Disclosure*, Proposed Companion Policy 52-112 *Non-GAAP and Other Financial Measures Disclosure*, Related Proposed Consequential Amendments and Changes

Chartered Professional Accountants of Canada (CPA Canada) appreciates the opportunity to respond to the Canadian Securities Administrators (CSA) on Proposed National Instrument 52-112 *Non-GAAP and Other Financial Measures Disclosure* (the Proposed Instrument or the proposals), the accompanying Proposed Companion Policy and related proposed consequential amendments and changes (collectively the Proposed Materials).

In formulating our response on the Proposed Materials, we reviewed current disclosure practices of Canadian companies and performed some field testing of the proposals. In addition, we have listened to several presentations by CSA staff and solicited the input of strategic advisors to CPA Canada and our extensive network of volunteers representing small, medium and large issuers, investors, and auditors.

As noted in our letter¹ responding to the first request for comment, we support the CSA's efforts to formalize disclosure expectations around non-GAAP and other financial measures through the development of a rule. We have worked closely with CSA staff on outreach activities related to the Proposed Materials and we would welcome the opportunity to discuss our comments in greater detail and answer any questions you may have related to them as you progress this important work.

We acknowledge that there have been improvements in some areas from the previous proposals, however, we still have concerns. We do not believe the proposals are well suited to current reporting practices. In our view, applying the proposals would result in a significant amount of unnecessary regulatory burden and disclosure of a significant amount of information that is not helpful to investors.

Overall, the more that we have gotten into the details of the Proposed Materials and looked at practice, it has struck us that there is a need to step back and reassess strategic aspects of the proposals. That would involve a rethink of what the important issues are and how they can be addressed in a way that meets user needs without resulting in excessive disclosure and unnecessary regulatory burden.

If you wish to proceed with what you have proposed, we believe it would be better to work more closely with the approach in CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* (staff notice). Most investors we consulted during our outreach did not have strong negative views about the disclosure under the staff notice. Lack of standardization continues to be the main issue investors have with the disclosure of financial measures in the current reporting environment but we understand you are not attempting to achieve standardization.

Below is a summary of the key issues we have identified in the Proposed Materials and some of our recommendations which we elaborate on in the sections that follow:

- Readability of the Proposed Materials is still a significant challenge. Failure to improve the readability will increase the cost of complying with the Proposed Instrument and may lead to inconsistent and inappropriate practices.
- The inclusion of additional categories of financial measures (e.g., non-GAAP ratio, supplementary financial measures, capital management measures, totals of segments measures) with different disclosure requirements remains confusing and unhelpful to investors. We believe the distinctions and the different approaches to them are not logical. There should be a reconsideration of the need for so many categories and why there are different requirements for them.
- There are inconsistencies between the Proposed Instrument and the Proposed Companion Policy, and these inconsistencies need to be resolved.

¹ https://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20181204_52-112_bealq.pdf

- To enhance understandability and promote consistent application, there is a need for more guidance and more complex examples. Examples dealing with simple and obvious circumstances are not always helpful. We also suggest that further guidance be issued after the release of final materials as circumstances change similar to what the U.S. Securities and Exchange Commission (SEC) has done.²
- We are concerned with the extent to which it is difficult to compare the Proposed Materials with SEC requirements and believe there may be significant differences between them. The CSA should consider publishing detailed guidance that compares the CSA requirements to the current SEC requirements at a specified date. We do not believe this comparison would need to be updated for changes in requirements.
- It appears that the impact of the International Accounting Standards Board (IASB®) Exposure Draft *General Presentation and Disclosures* (Exposure Draft) is being underestimated. The CSA should monitor the progress of the Exposure Draft and not issue a rule that is likely to require significant change in a short period of time.
- To properly address the issues noted above, we believe it is necessary for the CSA to conduct field testing of the proposals to help determine the changes necessary before finalizing the rule.

Readability of the Proposed Instrument

There have been some helpful but isolated improvements to the drafting of the Proposed Instrument. This is evident in the fact that we heard some complementary feedback on the changes from the previous proposals. However, we heard from a number of experts that the changes did not rectify the fundamental issue of the poor readability of the Proposed Materials. We agree with this perspective.

The difficulty around readability is due to a number of reasons such as the frequent need to jump from one part to another to understand how to apply the requirements, the complexity of much of the wording, the use of imprecise or unclear wording, and the use of counterintuitive terms like non-GAAP ratios when it is commonly understood that there are no GAAP ratios. We believe that this will make it challenging for preparers to implement the proposals in a cost-effective manner.

Multiple categories of non-GAAP and other financial measures

A benefit of the approach in the staff notice is that entities have only one choice to make – is a measure non-GAAP or not. In many cases, companies have handled this quickly and easily by describing some measures as non-GAAP even when they may not meet that definition. Dealing with multiple categories will be much more difficult and will, among other things, add complexity and compliance costs.

In addition, we do not see a coherent rationale for many of the differences in disclosure requirements for the categories in the proposals.

Total of segments and capital management measures

We do not agree with making distinctions on whether disclosures are required or not based on whether information is in the financial statements or in the notes since the primary financial statements, together

² <https://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>

with information in the notes, are all subject to audit. We believe these categories unnecessarily expand the scope of the existing staff notice.

We also believe that imposing requirements for these categories results in a difference from the requirements of the SEC,³ which state that non-GAAP financial measures do not include financial measures, such as segment measures, that are required to be disclosed by GAAP. (We acknowledge the SEC makes an exception with respect to segment disclosures in their application guidance but believe this exception results in a narrower requirement than that in the proposals.)

Furthermore, we found the readability of both the capital management and segment measures sections in the Proposed Materials unclear and difficult to interpret.

Supplementary financial measures

In the proposed definition of supplementary financial measures, the Proposed Instrument states, among other things, that financial measures disclosed on a “periodic basis” are considered supplementary financial measures. We do not see why the disclosure requirements should be different depending on the frequency with which a financial measure is reported. In addition, it is not clear how the term “periodic basis” should be determined. For example, if a measure is reported in a quarter and then in an MD&A for an annual period, would the disclosure in the interim period mean that the measure is now being disclosed on a periodic basis?

Non-GAAP ratio

The use of the term non-GAAP ratio is counterintuitive and adds to the complexity of the proposals since there are no GAAP ratios. Based on our field testing, we found many ratios are calculated using more than one non-GAAP measure. We are unclear why a non-GAAP ratio is limited to a ratio where one of the components is a non-GAAP financial measure. If there is a rationale for this approach, we believe it should be explained in the Companion Policy.

Need for more guidance and more complex examples

More and better examples are needed for most aspects of the proposals. This could be done in a question and answer format as the SEC has done or in the Proposed Companion Policy. We suggest providing examples ranging from simple ones to illustrate principles to the more complex ones with which preparers will struggle.

Our field testing

Our field testing has helped us greatly in identifying issues related to the staff notice and the Proposed Materials. We read the annual filings of more than 40 Canadian companies (as well as interim filings for many of them) and six U.S. companies that are only SEC registrants. This included companies of different sizes and in different sectors. We believe this supports the tentative views which follow but acknowledge that more field testing would be necessary to form definitive ones.

This section reports only a small portion of our analysis and findings. It focuses primarily on specific disclosures of six Canadian companies related to liquidity measures used by many companies.

³ U.S. Securities and Exchange Commission. (April 4, 2018). *Non-GAAP Financial Measures; Questions and Answers of General Applicability*, Question 104.01. <https://www.sec.gov/divisions/corpfin/guidance/nongAAPinterp.htm>

- **Working capital**

Working capital is a common financial measure understood as the difference between current assets and current liabilities and is referred to in requirements such as those in NI 51-102 *Continuous Disclosure Obligations*. A number of companies reported this as a non-GAAP measure, but a number did not.

This measure does not appear to meet the definition of a non-GAAP financial measure in the Proposed Instrument. Based on our interpretation of the Proposed Companion Policy, since working capital is calculated by combining financial information that originates from different line items from the primary financial statements, the Proposed Companion Policy indicates that working capital is a non-GAAP measure. This inconsistency between the Proposed Instrument and Proposed Companion Policy needs to be resolved.

Under SEC Regulation G *Conditions for Use of Non-GAAP Financial Measures*, this measure would not be considered a non-GAAP financial measure. We agree with this position.

We do not believe the disclosures of the usefulness of a working capital measure and how it is used by management are helpful to investors. We also do not see the purpose or benefit of requiring a reconciliation of this measure to the most comparable financial measure presented in the primary financial statements. The only disclosure requirement that might be a logical one would be to disclose the composition of working capital.

We believe working capital is not a non-GAAP measure and that the Proposed Companion Policy should be amended to be consistent with this position.

- **Working capital ratio**

The Proposed Companion Policy indicates that a working capital ratio would not meet the definition of a non-GAAP ratio since both elements used in its calculation are presented in the primary financial statements. While we agree with this, it also suggests that a working capital measure should not be considered a non-GAAP measure.

- **Net debt and total indebtedness**

The analysis of how these measures are currently treated and how they would be treated under the Proposed Materials is similar to the one described for working capital.

Of the six U.S. companies, only one disclosed a liquidity measure as a non-GAAP measure. Several disclosed measures such as net debt but did not consider them to be non-GAAP measures. The CSA should do field testing to see if approaches differ in applying the staff notice and SEC requirements and why they exist.

Of the six Canadian companies, one disclosed net debt as a non-GAAP measure and one did not. Practices varied for this measure as they did for total indebtedness and similar ones. Disclosures often described the composition of the measure but did not attempt to reconcile to a GAAP measure. We believe this resulted in sufficient disclosure but might not meet the requirement of the staff notice or the Proposed Instrument.

There is a fundamental question of when a financial measure that can often be characterized as a combination of two or more financial statement line items becomes a non-GAAP measure. As noted above, we believe that something like working capital is not a non-GAAP measure while most would

agree that adjusted profit is a non-GAAP measure even though it could be characterized as just the combination of a number of line items in the financial statements. Perhaps the distinction exists because using a term like “adjusted profit” is an attempt to provide a substitute for profit under GAAP. This distinction is not an easy one to make and illustrates the need for more clear guidance and more and better examples

- ***Operating capital expenditures and other similar measures***

We find it difficult to determine whether operating capital expenditures would be categorized as a non-GAAP financial measure versus a supplementary financial measure.

- ***Other***

We reviewed one company that reported 31 non-GAAP measures. In a separate section, they spent four pages describing how each of the measures is useful to investors and used by management. Many of the measures were liquidity measures where it was obvious that the measures were useful. We found the four pages to be of negligible value and were left wondering why the related disclosure requirement exists. It also left us wondering why so many non-GAAP measures were used. In contrast, the six U.S. companies used only 12 non-GAAP measures in total and only one of those was related to liquidity. Again, this raises more questions which merit further consideration.

Alignment with the SEC

Differences with the SEC should not be created unless there is a compelling reason to do so. Because we have so many Canadian companies that are also SEC registrants and our competitive position relative to the U.S. is so important, we believe that the CSA should publish detailed guidance that compares the CSA requirements to the SEC requirements at a date consistent with the release of the rule. We heard from several parties during our outreach that this would be useful.

Impact of IASB Exposure Draft

The Proposed Instrument notes a view that the IASB is only in the early stages of a project on General Presentation and Disclosures. We are concerned that the CSA is not fully considering the potential impacts of the Exposure Draft on the presentation of non-GAAP financial measures. These include, for example, the introduction of new subtotals to be included within the primary financial statements, a new definition of operating income, new distinctions between integrated and non-integrated investees, a definition of unusual items that is not consistent with what is in the Proposed Materials, and note disclosures related to performance measures. These changes would result in difficulties for those attempting to comply with CSA and IASB requirements at the same time.

The CSA should monitor the progress of the Exposure Draft and not issue a rule that is likely to require significant change in a short period of time. It appears likely that final CSA and IASB documents will not be compatible with each other and resolving that problem may be a significant challenge.

Small and medium-sized entities

The CSA seems to expect that issuers will incur only some additional immaterial administrative costs. Based on the comments above, we do not agree and believe that the anticipated costs will exceed those outlined in Annex K by a significant amount for many issuers. This burden may disproportionately fall on the large number of smaller issuers we have in Canada.

During our outreach, we heard concerns that the CSA has not received sufficient feedback from small and medium sized issuers, and we do not expect the CSA will get much input from this population on the Proposed Materials. We believe that targeted field testing of the proposals with smaller issuers may address this issue.

Effective date and transition

Consistent with our comments above, we believe significant effort will be required to implement the proposals. As a result, we believe a lengthy transition period is appropriate

We appreciate the opportunity to participate in this important consultation. Please contact Rosemary McGuire, Director, Research, Guidance and Support (rmcguire@cpacanada.ca) if you have any questions regarding our letter.

Yours truly,

A handwritten signature in black ink, appearing to read "Gordon Beal". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Gordon Beal, CPA, CA, M.Ed.
Vice President, Research, Guidance and Support
Chartered Professional Accountants of Canada