



# Communicating effectively through Non-GAAP financial measures

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Companies commonly disclose non-GAAP financial measures to supplement and provide further insight into their reported earnings measured under the accounting framework/generally accepted accounting principles ("GAAP") used, such as IFRS or US GAAP.

They believe these non-GAAP measures more accurately reflect their results of operations, financial position and/or liquidity and therefore direct users to evaluate company performance through this lens. Additionally, participants within an industry generally have common non-GAAP measures which are considered key performance indicators that enhance the comparability between companies.

A non-GAAP financial measure is a numerical measure of a company's historical or future financial performance, financial position or cash flows that includes or excludes amounts from the most directly comparable GAAP measure. Non-GAAP financial measures serve as a bridge between corporate reporting under GAAP and reporting tailored to the company's particular industry, or circumstance. Examples of some non-GAAP financial measures include cash earnings, free cash flow, distributable cash, EBITDA, funds from operations, etc. These measures are generally disclosed and discussed in the company's Management Discussion and Analysis (MD&A) in IPO prospectus and continuous disclosure filings, press releases, websites, investor presentations and other marketing materials.

A company has flexibility in terms of which non-GAAP financial measures it chooses to report and how these are calculated. Certain industries have issued specific guidelines for certain commonly used measures. For example, a food store business may report "gross margin ratios" or "same store sales", and a publicly traded partnership or flow through trust may choose to report "distributable cash" or "funds from operations".

## **Are the measures selected useful, consistent and comparable?**

As you go through the preparation phase of the IPO prospectus and select the non-GAAP financial measures



you want to report, it is essential to look at which non-GAAP financial measures have been used in the past by your company, if any, and if they continue to be relevant, what your industry peers are using, and are these comparable to provide a clear picture to the investors.

If you are going through an IPO process and have the opportunity to select for the first time, the non-GAAP financial measures that you will report, consider the following questions:

- Are the non-GAAP financial measures selected telling your equity and/or growth story?
- Are they relevant to your industry?
- Are they comparable, in definition and calculation, to your peers?
- Will you be able to report and discuss your performance against these measures consistently over the long-term?

- Do you have the information and systems to produce and support these measures accurately and on a timely basis, each reporting period?
- Can they be easily reconciled with the most comparable GAAP measure?
- Do you/will you be able to demonstrate to your board/audit committee that sufficient controls and processes are in place to ensure accurate reporting of these measures?
- Do you have the resources to ensure disclosures around these measures comply with respective regulatory requirements?

It is also critical to pay attention to how you define, for the first time, the non-GAAP financial measures selected. Since non-GAAP financial measures are subjective, the definitions should be clear and transparent so that it enables the users to understand how information is calculated. It is also important to remember that once you have selected certain non-GAAP financial measures to report, you will be expected to stand by these, through good times and bad. Deviating from reporting against certain measures when results are unfavourable with result in loss of credibility and raise questions from the regulators.

#### **So what more is needed?**

On a continuing basis, companies should evaluate the effectiveness and usefulness of the non-GAAP financial measures reported. There are instances where the non-GAAP

financial measures also serve as a benchmark to measure management's performance and compensation. From a governance perspective, boards should ensure that there are adequate controls in place to mitigate the inherent risk of management bias in measuring and reporting such measures.

In general, public companies that disclose non-GAAP financial measures, are required by the respective regulators, whether in Canada or US, to comply with certain specific disclosure requirements when disclosing and discussing non-GAAP financial measures, such as reconciling them to the most comparable GAAP measure, presenting the GAAP measure with equal or greater prominence, and explaining why the non-GAAP measure is relevant and useful to investors and management. There has been a noticeable increase in regulatory scrutiny in both Canada and the US related to compliance with the respective disclosure requirements. Investors consider whether the level of consistency, transparency and reliability is sufficient in the company's disclosures.

In summary, selection and reporting of non-GAAP financial measures requires the company – management and the board to ensure the measures selected are useful to their stakeholders, are accurate and reflect the true performance of the company. Companies should strive to continually enhance the usefulness of its non-GAAP financial measures. Companies should also periodically evaluate the effectiveness of these non-GAAP financial measures, the consistency in how these are calculated and measured and the transparency and regulatory compliance of disclosures accompanying the non-GAAP financial measures.

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