THE GLOBE AND MAIL

May 27, 2021

Regulators now equipped to crack down on misleading financial metrics

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After years of work, Canadian regulators have finalized rules designed to force companies to clean up the numbers they present to investors.

The Canadian Securities Administrators said Thursday it's issuing new rules on how companies can use what are called "non-GAAP measures." These are numbers – often calculations of profit – that deviate from generally accepted accounting principles. The concern is that in crafting their own financial metrics, companies could mislead investors about their true health.

The CSA previously had guidelines for the use of non-GAAP numbers, which companies could choose to follow. Now that they're elevated to formal rules, they'll have the power of enforcement behind them. That puts Canada on par with the United States, where the Securities and Exchange Commission's non-GAAP regulations allow it to pursue companies for what it sees as misleading disclosure.

The rules will require companies to label and describe all non-GAAP measures and reconcile them to the official GAAP measures. Also, companies may not give more prominence to a non-GAAP measure than to its GAAP equivalent in a news release.

"We were not satisfied by how they complied with the guidance," said Hugo Lacroix, superintendent for securities markets at Quebec's Autorité des marchés financiers and one of the leads on the CSA project.

Mr. Lacroix said the rules will be a new tool for Canadian securities regulators as they review companies' filings and disclosures. "I think that people who are not abiding by the rules will certainly realize that the tone has changed because it's no longer guidance."

The non-GAAP conversation got louder in Canada in September, 2016, when The Globe and Mail published the results of a report by ***Veritas Investment Research. Veritas*** found 70 per cent of the members of the S&P/TSX 60 stock index of large public companies used some form of "non-GAAP" metric in their results – and many seemed to be violating regulatory guidance on how to report them.

The CSA first laid out its proposed new rules in September, 2018, but a little more than a year later, it said it would go back to the drawing board to republish the rules and obtain a second batch of comments from companies, law and accounting firms, and investor advocates.

Thursday's announcement summarized the feedback it received this go-round – and a number of commenters wanted a watering-down of certain provisions, while others suggested a delay to see what will happen as the International Accounting Standards Board, or IASB, wrestles with the issue.

Said the CSA in response: “We see no reason to delay this project for multiple years and have decided to proceed ... to address the disclosure and reporting concerns ... in the Canadian marketplace.”

The CSA said the changes it made to the rules in response to the feedback were “targeted, non-material, changes.” It tweaked rules for companies that are also subject to SEC rules in the United States and removed metrics that are legally defined by other regulators.

While one commenter suggested the rules do not apply to metrics disclosed on websites or other social media, the CSA rejected that idea.

“I’m impressed that it has more teeth than even the U.S. regulations,” said ***Veritas*** chief executive ***Anthony Scilipoti***, citing the wide range of metrics defined as non-GAAP. “And I’m impressed that they didn’t back down [to critical feedback].”

The rules come into force on Aug. 25, after most companies report earnings for the quarter ending in June. It begins to apply to companies whose fiscal year ends Oct. 15, 2021, or after, meaning it captures Canada’s big banks, whose fiscal years end Oct. 31.

In 2018, the Accounting Standards Board of Canada published its own framework for how all Canadian entities, from companies to non-profits, should use “non-GAAP” numbers. Linda Mezon-Hutter, the board’s chair, has also been communicating the IASB’s views to the Canadian public companies that use International Financial Reporting Standards.

“We think that the quality of any information – non-GAAP or other performance metrics that companies use – is absolutely important,” Ms. Mezon-Hutter said. “We want [companies] to do a good job when they include these other measures when they talk about their results. We’re going to do everything we can to support this.”