CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

Sent by email only

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Subject: Guidance published by CPA Canada's Canadian Performance Reporting Board (CPRB*) Improved Communication with Supplementary Financial Measures – General Principles and Guidance for Reporting Net Free Cash Flow and EBITDA.*

Dear CPRB Members:

The Canadian Securities Administrators (CSA) is an organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets. The CSA Chief Accountants Committee is comprised of the Chief Accountants from the provinces of Quebec, Ontario, Alberta and British Columbia. We are submitting this letter to you in response to your request for comment on the draft guidance published by CPRB *Improved Communication with Supplementary Financial Measures – General Principles and Guidance for Reporting Net Free Cash Flow and EBITDA* (the Guidance).

We appreciate the opportunity to comment on the Guidance. We recommend that the CPRB post on its website all comments received on the Guidance to promote transparency and stakeholder engagement.

We acknowledge the CPRB's desire to promote improved comparability and transparency of financial measures such as Net Free Cash Flow and EBITDA. However, we have identified three areas of significant concern in the Guidance, related primarily to Part I of the Guidance, which was the focus of our review.

1. Relationship to CSA guidance on additional GAAP measures and non-GAAP measures

We are very concerned that the Guidance may create confusion about CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures and Additional GAAP Measures* (CSA Staff Notice). Section I.2 of the Guidance states that the Guidance "will expand on the CSA material and provide a framework for disclosure," however, we have noted several instances in the Guidance where the relationship between the CSA Staff Notice and the Guidance is unclear or inconsistent. One factor contributing to this confusion is terminology in the Guidance that is internally inconsistent or inconsistent with the CSA Staff Notice. In addition, the Guidance appears to contradict the CSA Staff Notice by suggesting lower standards for non-GAAP measures. Finally, the Guidance blends content from the CSA Staff Notice with additional CPRB content, which may create confusion about CSA guidance.

We strongly recommend that the CPRB amend the Guidance to remove inconsistencies and distinguish between guidance within the CSA Staff Notice and additional CPRB guidance. We also recommend adding a statement to the preface of the Guidance to explain that the document provides guidance, is not authoritative, represents the views of the CPRB, and has not been endorsed by the CSA. Without these changes, we will consider other ways to address potential confusion created by the Guidance in respect of the CSA Staff Notice.

2. Guidance on financial measures required by IFRS

We are concerned that the Guidance includes extensive material on the application of accounting standards. Page v of the Preface to the Guidance indicates that the CPRB material provides guidance about measures presented within financial statements prepared in accordance with IFRSs. The Guidance discusses financial measures that are required by IAS 1 – "*additional line items, headings and subtotals in the statement of financial position" or "in the statement(s) presenting profit or loss and other comprehensive income"* and , information in the notes when the additional items or information are "*relevant to an understanding of*" the financial statements. The CPA Canada website describes the mandate and key activities of the CPRB including *"development, publication and dissemination of guidance related to performance reporting matters, except guidance related to the application of accounting standards."* Our view, consistent with the website description, is that CPRB should not provide guidance on the application of accounting standards. We note that some groups sponsored by CPA Canada discuss or publish materials relating to accounting standards (e.g. Mining Industry and Oil and Gas Industry Task Force on IFRS). However, the primary purpose and processes of those groups focus on accounting standards, which does not appear to be the case for the CPRB. Also, publications by those groups include prominent disclosure that the views expressed are non-authoritative and have not been formally endorsed by CPA Canada or other organizations represented by group members. We strongly recommend that the CPRB amend the Guidance to remove its opinions and recommendations relating to financial measures required by IFRS.

3. References to the IASB Conceptual Framework

The Guidance contains references to the application of the IASB Conceptual Framework (the Framework) that appear to be inconsistent with the Framework or raise questions about interpretation of the Framework.

The attached appendix identifies some specific examples in the Guidance relating to the three issues noted above. If you have any questions concerning these comments, please do not hesitate to contact us.

Yours truly,

The CSA Chief Accountants Committee

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Appendix

1. Relationship to CSA guidance on additional GAAP measures and non-GAAP measures

a) Terminology issues

The CSA Staff Notice uses the term "**additional GAAP measures**" (AGMs) to refer to financial measures that are required by IAS 1 – *"additional line items, headings and subtotals in the statement of financial position" or "statement(s) presenting profit or loss and other comprehensive income"* and , information in the notes when the additional items or information are *"relevant to an understanding of"* the financial statements. The CSA Staff Notice uses the term "**non-GAAP financial measures**" (NGMs) to refer to numerical measures of financial performance, financial position or cash flow, that do not meet the GAAP criteria for presentation in financial statements and that either exclude or include amounts included in similar measures that are presented in the financial statements.

The Guidance uses the term "**supplementary financial measures**" to refer to both AGMs and NGMs. However, it appears that in some cases the Guidance uses the term "supplementary financial measure" or the term "supplementary measure" when the context appears to apply only to an AGM or alternatively only to a NGM. This is confusing and in some cases inaccurate. Examples include the following:

> Page 1: *"Unlike measures prescribed by an accounting framework, supplementary financial measures do not have generally accepted definitions."* The phrase "prescribed by an accounting framework" is confusing because IAS 1 requires AGMs.
>
> Page 11: *"…supplementary financial measures…will have one or more of the following characteristics: lack of a standard definition, selectivity, and subjectivity"* Additional sub-totals presented on the face of financial statements (a sub-category of AGMs) often do not have one of the three characteristics listed.

b) Lower standards for NGMs than AGMs

Page 9 of the Guidance states: *"In the CPRB's view, supplementary measures presented outside the financial statements do not need to meet the same objective criteria as additional GAAP measures. While non-GAAP financial measures still need to meet the test of fair presentation, the tests of relevance, faithful representation, and verifiability can be less rigorous and considered from the perspective of providing management's views."*

We are very concerned that these statements appear to contradict the CSA Staff Notice which states: *"in order to ensure that a NGM does not mislead investors, an issuer should clearly define the measure, explain its relevance, and …present the measure on a consistent basis from period to period or explain any changes"*.

We note that an example of a NGM on page 10 contemplates adding back ‘non-recurring’ costs but not [removing] corresponding ‘non-recurring’ revenues. This example contradicts the CSA Staff Notice which states that a non-GAAP financial measure may be misleading if it includes positive components of the most directly comparable measure calculated in accordance with the issuer’s GAAP and presented in its financial statements but omits similar negative components.

c) Standardized measures

Parts II and III of the Guidance recommend “standardized measures” for Net Free Cash Flow and EBITDA. The Guidance’s references to “standardized measures” and “standard definitions” are confusing. For example, mid page 11 states “when available present a “Standardized Measure” (term is not defined), while the bottom of page 11 includes the phrase “in view of the absence of standard definitions”, and page 12 states “Parts II and III …propose standardized definitions”. Page 36 of the Guidance mentions that the basis for the CPRB’s definition of EBITDA can be found in the CSA Staff Notice although the CSA does not use the term ‘standardized”. We would like to specify that in the CSA Staff Notice we did not attempt to “standardize” the meaning of EBITDA. Furthermore, the CSA Staff Notice indicates that in order to avoid misleading investors, a NGM should be accompanied by an explicit statement that the non-GAAP measure does not have any standardized meaning prescribed by the issuer’s GAAP. To avoid confusion about disclosure specified in the CSA Staff Notice and proposals in the Guidance, we recommend that the Guidance refer to the proposed measures in Parts II and III as CPRB definitions and also emphasize that CPRB’s proposed definitions of Net Free Cash Flow and EBITDA do not have standardized meanings prescribed by GAAP.

d) Disclosure

Pages 11 to 14, 24-25, 27, 36, 37 and 39 of the Guidance discuss disclosure that should accompany supplementary financial measures. The material includes features of the CSA Staff Notice but does not distinguish them from additional CPRB guidance. To avoid confusion, we recommend redrafting these sections to distinguish between features of the CSA Staff Notice and additional CPRB guidance.

The material on pages 11 to 14 does not distinguish between disclosure for AGMs and disclosure for NGMs. It appears that some of the disclosure items listed would apply only to an AGM or alternatively only to a NGM. We recommend clarifying which disclosures apply to AGMs, NGMs or both.

2. Guidance on financial measures required by IFRS

The Guidance includes extensive discussion of the application of accounting standards including the following:

Page 2 – 7: CPRB views on analyzing qualities of AGMs

Page 7 - 9: CPRB views on assessing whether a measure has the necessary attributes for presentation as an AGM

Page 11- 14: CPRB views on disclosure of AGMs

Page 22 – 23: CPRB views on whether a net free cash flow measure qualifies as an AGM

Page 33 – 34: CPRB views on whether EBITDA qualifies as an AGM

As we noted in our cover letter, and consistent with the CPA Canada website description of the CPRB's mandate and activities, our view is that CPRB should not provide guidance on the application of accounting standards.

3. References to the IASB Conceptual Framework and Interpretation of Qualitative Characteristics

Page 3 of the Guidance acknowledges that the IASB Conceptual Framework states that the qualitative characteristics (described in the Framework) apply to information provided in financial statements as well as to financial information provided in other ways. Given this statement in the Framework, the CPRB should not express its *view* on whether the Framework is a useful basis for assessing AGMs and NGMs, as stated on page 2. We are unclear as to the purpose of this sentence.

Paragraphs OB1 and OB2 of the Framework state that the objective of general purpose financial reporting forms the foundation of the Framework; that objective is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Page 6 of the Guidance indicates three purposes for a measure that relate to "users' decisions and evaluations" (i.e. relevance). It is not clear how to assess relevance if only one or two of the three stated purposes exist. We also question aspects of the first purpose listed - management's use of the measure to allocate, or assess the financial performance of, resources to projects or activities. Page 8 of the Guidance suggests that only when a measure is used by the entity's chief decision makers it can be considered relevant to external users and presented as an AGM. The Guidance focusses on management's use of a measure but the Guidance does not clarify how management's use of a measure relates to relevance for external users. We agree that if management uses a particular measure, it might be relevant for external users, but we do not think that this is a necessary condition for relevance. Section IV of the CSA Staff Notice acknowledges that management may not use a relevant measure: "explain in either the notes to the financial statements or in the corresponding MD&A why the additional GAAP measure provides useful information to investors and the purposes, <u>if any</u>, for which management uses the measure;" (underline added)

Page 9 of the Guidance states: *"In the CPRB's view, supplementary measures presented outside the financial statements do not need to meet the same objective criteria as additional GAAP measures. While non-GAAP financial measures still need to meet the test of fair presentation, the tests of relevance, faithful representation, and verifiability can be less rigorous and considered from the perspective of providing management's views."* We believe that the CPRB's view is inconsistent with the Framework given the statement in IASB Conceptual Framework that the qualitative characteristics apply to information provided in financial statements as well as to financial information provided in other ways. In particular, as noted on page 3 of the Guidance, the Conceptual Framework identifies relevance and faithful representation as the two fundamental characteristics for financial information to be useful. The Framework does not suggest assessing the qualitative criteria with less rigour for information provided outside financial statements than for information provided in the financial statements.

Page 8 of the Guidance states: *"In practical terms, faithful representation should exist when a measure's components are defined with the same precision as other elements of the financial statements. Therefore, a reasonable basis for concluding that a measure is representationally faithful is that the components are defined by IFRSs (i.e. an item of revenue, expense, asset, or liability defined by IFRSs)."* The meaning of this quote is not clear; in particular, the meaning of the phrase "defined by IFRSs" is unclear. Is the CPRB's view that each component of an AGM must be a component of an amount recognized in the statement of financial position, statement of operations, or statement of cash flows? While this would generally be appropriate for an AGM presented in one of the statements, IAS 1 does not impose this restriction for AGMs presented in the notes to the financial statements.

Page 9 of the Guidance provides an interpretation of "verifiability" and states *"if not clear from a measure's caption, the financial statements should state that the components of any AGMs are determined in accordance with specific IFRSs"*. Assuming the CPRB's view is that each component of an AGM must be a component of an amount recognized in one of the financial statements (discussed above), we note that specific IFRSs may include recognition and measurement requirements for a financial statement item, but may not specify requirements for components of that item. Therefore, CPRB's recommended statement may not be appropriate.

Another issue relating to CPRB's view on components appears in the discussion of verifiability of NGMs (page 9): *"A NGM will often include adjustments for items not specified by rules set out in the entity's accounting framework, and accordingly may not be defined and calculated with the same completeness and neutrality as an AGM"*. As discussed above, IFRS may not include requirements for components of an amount presented in a statement. We also note that many IFRSs include principles for recognition and measurement but not "rules". As well, we think the key concern relating to completeness and neutrality is not whether a component is "defined" by IFRS, but is management's discretion to include or exclude components.

4. Other Terminology issues

Page 1: It appears that the CPRB may intend for the term "GAAP measures" to mean minimum line items specified by IAS 1 but the term is not clearly defined as such. The term is confusing because IAS 1 requires AGMs i.e. AGMS *are* GAAP.

Page 2: *"For example, many entities report a supplementary financial measure such as profit before tax expense as a separate financial statement line item";* this sentence should refer to a sub-total not a line item.

Page 2. The title for section I.2 inappropriately includes the term “requirements”; please amend the title to make it consistent with other references to the CSA Staff Notice.

Page 8: *“an AGM should be described in terms that distinguish it from minimum IFRS disclosure requirements.”* The meaning of the last phrase is not clear. Specifically, is it the minimum line items specified by IAS 1 plus financial statement note disclosure items required by IFRSs excluding AGMs?

Page 13: “*Selectivity generally applies when a supplementary financial measure eliminates an item from a measure specified by the accounting framework.”* The meaning of the phrase “item specified by the accounting framework” is not clear.

Page 14*:* “*When an AGM is reported…the note should cite the various GAAP inclusions and exclusions in the measure.”* The meaning of “GAAP inclusions and exclusions” is not clear.

Page 21: “*The major components of New Free Cash Flow are cash measures, relatively free of estimation, whose elements are determined in accordance with a GAAP framework, such as IFRSs.”* The meaning of the second-to-last phrase is not clear.