

Securities regulators finalize rules for non-GAAP and other financial measures

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On May 27, the Canadian Securities Administrators (CSA) [announced](#) that they are adopting National Instrument 52-112 *Non-GAAP and Other Financial Measures Disclosure* and related consequential amendments. The new rules will govern how companies present non-GAAP and other financial measures and ratios such as adjusted earnings, adjusted EBITDA, free cash flow, *pro forma* earnings, distributable cash, and earnings before non-recurring items.

What you need to know

- The rules will have the force of law, unlike the existing regulatory guidance on non-GAAP financial measures. This means that Canadian securities regulators will have stronger compliance and enforcement tools if a company's non-GAAP financial measures are misleading.
- Reporting issuers, other than investment funds and certain foreign issuers, will be subject to the new rules when they disclose “specified financial measures” outside the financial statements, including disclosures in news releases, on websites and in social media. The new rules will start applying to documents filed for a financial year ending on or after October 15, 2021. For example, reporting issuers with a December 31st year-end will have to comply with the new rules in respect of any non-GAAP disclosures made on or after January 1, 2022.
- Beginning on January 1, 2022, the rules will apply to non-reporting issuers in respect of certain documents made available to the public.
- We recommend that companies begin reviewing their disclosure documents, such as MD&A and news releases, as well as investor relations documents and website content, as soon as possible, so that, if necessary, they can develop and begin implementing a strategy for how they present non-GAAP and other financial measures once the new regime comes into effect.

Background

The CSA first published proposed rules regarding non-GAAP financial measures in September 2018 and received substantial feedback from stakeholders. The regulators went back to the drawing board and in February 2020, they

published revised draft rules, which simplified their earlier proposal and addressed many of the comments raised¹.

Application of the final rules

- **Reporting issuers.** Unless a specific exception applies, the rules will apply to any non-GAAP financial measures, non-GAAP ratios, and other financial measures (such as capital management measures, supplementary financial measures, and total of segments measures) that a reporting issuer includes in any document that is intended to, or is reasonably likely to be, made available to the public. Note that Canadian reporting issuers that are also SEC registrants must comply with the Canadian rules.
- **Specific exceptions** from the rules for reporting issuers include:
 - disclosures by investment funds;
 - disclosures required under National Instrument 43-101 *Standards of Disclosure for Mineral Projects* or National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* (other than voluntarily disclosed oil and gas metrics under section 5.14 of NI 51-101);
 - financial measures disclosed in compliance with a requirement under Canadian or foreign laws or a requirement of a self-regulatory organization of which the issuer is a member;
 - financial measures presented orally or in transcripts of oral statements; and
 - any report prepared by someone other than the issuer or entity that is the subject of the specified financial measure.
- **New exceptions** added to the final rules for reporting issuers include:
 - any document prepared by a registered firm (such as a dealer or adviser) if that document is provided or is intended to be provided to a client or prospective client of the registered firm, unless the measure relates to the registered firm's financial performance, financial position or cash flow;
 - disclosure of a financial measure where its calculation is derived from a financial covenant in a written agreement;
 - any valuation report or fairness opinion filed or incorporated by reference in a document; and
 - certain disclosures in an issuer's Statement of Executive Compensation.
- **Foreign issuer exception.** The rules will not apply to SEC foreign issuers (i.e., non-investment company reporting issuers that are also subject to the U.S. Securities and Exchange Commission's reporting regime). This is consistent with how the SEC treats Canadian MJDS issuers (i.e., they are generally exempt from U.S. rules on non-GAAP financial measures). In addition, non-SEC foreign issuers with a limited connection to Canada and that are subject to the disclosure requirements of a designated foreign jurisdiction (such as Australia, Hong Kong, Japan, Mexico or the UK, among others) will not be subject to the new rules.
- **Non-reporting issuers.** Unless a specific exception applies, the rules will apply to a non-reporting issuer's disclosures of specified financial measures in a document made available to the public if that document is subject to Canadian prospectus requirements, is filed with a regulator in connection with a distribution under the "offering memorandum" prospectus exemption, or is submitted to a recognized exchange in connection with certain transactions such as a listing application, reverse takeover, significant acquisition, or change of business.

Overview of the final rules

The rules do not prohibit any particular types of non-GAAP measures or impose any industry-specific requirements. Instead, the rules formalize and expand on existing staff guidance. The accompanying companion policy has been expanded and CSA staff also intend to publish a staff notice with more guidance (including examples).

The new rules apply to five mutually exclusive categories of “specified financial measures”:

- **Non-GAAP financial measures.** Financial measures, other than ratios, that are presented outside the financial statements, depict historical or expected future financial performance, and either exclude an amount that is included in or include an amount that is excluded from, the composition of the most comparable financial measure presented in the primary financial statements².
- **Non-GAAP ratios.** Ratios that use a non-GAAP financial measure as one of the components, such as “adjusted EBITDA per share” or “funds flow per barrel of oil equivalent”.
- **Total of segments measures.** Subtotals or totals of financial measures of two or more reportable segments of an entity that are presented in the notes to the financial statements of the entity but not presented in its primary financial statements.
- **Capital management measures.** Financial measures disclosed in the notes to the financial statements, but not presented in the primary financial statements, and that are intended to enable a person to evaluate an entity’s objectives, policies and processes for managing its capital.
- **Supplementary financial measures.** Other measures that an entity discloses periodically—often key performance indicators (KPIs) such as same-store sales for a retail company—to depict an entity’s historical or expected future financial performance, financial position or cash flow.

There are common elements in many of the specific disclosure requirements for the various specified financial measures. For example:

- **Labelling.** Non-GAAP financial measures, non-GAAP ratios and supplementary financial measures must be labelled appropriately and distinctly from financial statement items. Labels that may cause confusion based on the financial measure’s composition may be considered misleading and should be avoided. For example, if EBITDA is presented, it should only adjust for interest, taxes, depreciation and amortization. A forward-looking non-GAAP measure must be labelled using the same label as the corresponding historical non-GAAP measure.
- **Prominence.** Non-GAAP financial measures, non-GAAP ratios, total of segments measures and capital management measures must not be presented with more prominence than the comparable measure presented in the financial statements. For example, issuers should not use a style of presentation (e.g., bold, underlined, italicized, or larger font) that emphasizes the non-GAAP measure over the corresponding GAAP measure. In addition, forward-looking non-GAAP measures must not be presented with more prominence in the document than the corresponding historical non-GAAP measure. Equal prominence of GAAP and non-GAAP measures is acceptable.
- **Explanation.** In most circumstances, an issuer that uses a non-GAAP or other financial measure must, in proximity to its first appearance in a document, explain the composition of the measure and why it is used. Some measures (such as non-GAAP financial measures and total of segments measures) must be reconciled to the most comparable financial measure presented in the financial statements. The first time a forward-looking non-GAAP measure appears in the document, a description of any significant differences between the forward-looking and historical non-GAAP measure must be provided.

- **Comparative information.** Non-GAAP financial measures must be presented for comparative periods unless it is impracticable to do so. Increased costs are not a basis for impracticability. Non-GAAP ratios must use the same means of calculation for comparable periods, unless the non-GAAP ratio is forward-looking. Likewise, total of segments measures and capital management measures must be presented using the same composition as prior comparative periods. Changes in non-GAAP financial measures will require both an explanation of the change and a restatement of the non-GAAP financial measure for a comparative period.

Incorporation by reference

Incorporation by reference has been a significant concern as the rules were being developed. Would issuers have to provide all of the prescribed disclosures in every document where a non-GAAP or other financial measure appeared, or would they be able to refer back to other filings?

The final rules confirm that, for all specified financial measures, certain disclosures can be incorporated by reference to the issuer's most recent MD&A (but not prior versions of MD&A or other filings) if:

- the issuer indicates that the information is incorporated by reference;
- the issuer specifies the location of the information in the MD&A; and
- the MD&A is available on the issuer's SEDAR profile.

In response to comments, incorporation by reference for certain disclosures (such as the composition of a financial measure, any changes to its composition, and its use or purpose) has been expanded across all specified financial measures. In addition, an issuer will be permitted to incorporate by reference, into an earnings release, certain required disclosures contained in its most recent MD&A. However, earnings releases must set out the required quantitative reconciliations in full.

With assistance from Emily Stauffer, summer student.

¹ See our bulletins, [Non-GAAP financial measures: Canada's securities regulators propose stricter rules](#) and [Bridging the non-GAAP \(take two\)](#), for discussions of the first and second iterations of the proposed rules.

² Primary financial statements are an entity's statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity, and statement of cash flows.

To discuss these issues, please contact the author(s).

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