NON-GAAP MEASURES: BEST PRACTICES

Many companies find that non-GAAP measures are useful in explaining their financial performance to investors. Such measures may be financial or non-financial. Common examples of financial non-GAAP measures include EBITDA, operating earnings, adjusted earnings, adjusted earnings per share, cash flow from operations and free cash flow. Some companies develop specific non-GAAP measures to take into account industry specific or other special circumstances.

Financial statement users generally welcome information that assists in understanding the operations and performance of the company, including non-GAAP measures. Regulators understand that non-GAAP measures can be beneficial to users. However, both regulators and users continue to express concerns over a lack of clarity about non-GAAP measures provided by some companies. This leads to investors being unsure about the information intended to be conveyed by the non-GAAP measure and possibly being misled. FEI Canada's Committee on Corporate Reporting (CCR) has developed the following list of best practices in the use of non-GAAP measures.

Best Practices

1. *Identify all non-GAAP measures.* Users need to be put on notice that certain measures are non-GAAP, do not have standardized definitions and may not be comparable for different companies.
2. *Give GAAP measures greater prominence*. Non-GAAP measures are supplemental to measures determined under GAAP and should not be presented with greater prominence (regulators suggest GAAP measure is presented first).
3. *Explain what each non-GAAP measure is and how it is derived*. For example "operating earnings" may be defined as net earnings excluding specific identified items. A reconciliation of the non-GAAP measure to the most directly comparable GAAP measure should be provided.
4. *Explain why the non-GAAP measure provides useful information.* Users need to understand this before they can use the non-GAAP measure in their evaluation of the company and how it is used by management to assess performance.
5. *Be selective in the number of non-GAAP measures.* Some companies have multiple non-GAAP measures e.g. EBITDA, adjusted EBITDA, normalized EBITDA. Too many related non-GAAP measures can result in confusion between the different GAAP and non-GAAP measures.
6. *Eliminate bias.* Non-GAAP measures should not be designed to only improve results, for example by excluding losses but not gains. Such non-GAAP measures do not provide balanced information.
7. *Be consistent.* The same non-GAAP measures should be presented each reporting period and they should be calculated on the same basis. The comparative non-GAAP measure for the prior

period should also be provided. Users often want to look at information over several years for trending purposes and it is critical that information be consistent.

8. *Review non-GAAP measures on an annual basis.* This should ensure the continued usefulness and relevance of non-GAAP measures used.
9. *Be transparent*. Labelling, language and calculations should be clear and transparent. For example, an item should not be described as non-recurring or unusual if it has occurred in recent years or is likely to occur in the near future. Also the names used for a non-GAAP measure should accurately reflect the non-GAAP measure and clearly distinguish it from any GAAP measure.

10. *Know the rules.* Be familiar with the views of the CSA on non-GAAP measures in CSA Staff Notice 52-306 (Revised January 2016).