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The Secretary  
Ontario Securities Commission  
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December 4<sup>th</sup>, 2018

*Submitted via electronic email*

***Re: CSA Notice and Request for Comment – Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure, Proposed Companion Policy 52-112, Related Proposed Consequential Amendments and Changes***

Dear Ontario Securities Commission,

Thank you for the opportunity to comment on the *CSA Notice and Request for Comment – Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure, Proposed Companion Policy 52-112, Related Proposed Consequential Amendments and Changes*.

The Real Property Association of Canada (“REALPAC”) is Canada’s senior-most voice for Canada’s commercial investment real estate industry. Our members include the largest publicly traded real estate companies and real estate investment trusts (REITs) in Canada.

REALPAC and its members support providing quality information to investors, analysts and other financial measures users. In 2004, REALPAC issued non-authoritative guidance on Funds from Operations (FFO), one of the industry-wide standard measures of a real estate entity’s operating performance. Since the introduction of the definition, the term has come to be widely used by Canadian public companies and REITs<sup>1</sup>. Over time, many investors and analysts made adjustments to FFO in order to better evaluate the dividend/distribution policy of these entities, entitling this measure Adjusted Funds from Operations (AFFO). In 2017, when, in consultation with users and preparers, it was determined there was diversity in how AFFO was calculated and utilized, REALPAC and its members responded, developing a standard definition of AFFO and introducing a new metric: Adjusted Cashflow from Operations (ACFO).

As an industry we strive to provide useful, consistent and transparent information to our investors and other users and respond to their changing needs. As such, we support the goal to improve disclosures across all industries and provide quality information to investors and other financial measures users.

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<sup>1</sup> Additionally, the term FFO is widely employed by the much larger U.S. publicly-traded real estate sector and it has become a widely recognized metric by listed property investors around the globe.



Our specific comments on the *CSA Proposed National Instrument 52-112* (and its accompanying Companion Policy and Consequential Amendments and Changes) follow.

**1. Labelling and Prominence of non-GAAP financial measures: Proportionate Share of Joint Ventures**

Regarding Proposed National Instrument 52-112 PART 2 DISCLOSURE REQUIREMENTS Non-GAAP financial measures:

*3. An issuer must not disclose a non-GAAP financial measure in a document unless all of the following apply:*

*(a) the non-GAAP financial measure is labelled appropriately given its composition and in a way that distinguishes it from totals, subtotals and line items presented in the primary financial statements;*

and

PROPOSED COMPANION POLICY 52-112

NON-GAAP AND OTHER FINANCIAL MEASURES DISCLOSURE - Paragraph 3(b) –

Prominence of a non-GAAP financial measure:

*The following are examples that we view as causing a non-GAAP financial measure to be more prominent than the most directly comparable measure presented or disclosed in the financial statements:*

- Presenting a full statement of profit or loss and other comprehensive income of non-GAAP financial measures without presenting it in the form of a reconciliation of each non-GAAP financial measure to the most directly comparable measure, sometimes referred to as a single column approach;*

**REALPAC comments:**

In the real estate industry, a common disclosure in an entity's Management Discussion and Analysis involves providing information on its proportionate share in joint arrangements.

As a result of common legal structures used in many jurisdictions for real estate projects, many real estate joint arrangements are classified under IFRS as joint ventures and therefore recorded as a one-line net equity investment in the statement of financial position. However, investments in joint ventures are not passive investments for real estate entities. They are typically actively managed as part of ongoing, operating activities. One of the most significant adjustments made by real estate investors and analysts to value the earnings of a real estate entity is an adjustment to include the proportionate share of the revenue and expenses from these joint arrangements. This adjustment is made to acknowledge that management teams, investors and analysts all view the proportionate share of profit and loss from these joint ventures as part of operating profit. In supplementary documents, preparers include the revenue and expenses from joint ventures and consolidated entities in order for investors and analysts to calculate operating income from real estate operations that more accurately represents the entity's operating business. Despite legal structures around the arrangements, real estate entities run the operating activities within joint operations and



joint ventures the same way, and as such, preparers, investors and analysts view the revenues and expenses from these activities as part of the regular operating business of the entity – regardless of IFRS-mandated of accounting construct.

One of the key measures used by investors and analysts for real estate entities in several jurisdictions is Net Operating Income (NOI). In supplemental documents provided by management, the proportionate share of profit and loss from joint arrangements is included in the calculation of Net Operating Income (NOI). NOI is a well established and ingrained management performance metric in the real estate industry that is used for many purposes, including purchase decisions for investment properties, monitoring ongoing operating performance, and comparing real estate entities across asset classes and jurisdictions.

Real estate entity management teams, investors and analysts around the globe agree that the proportionate share of profit and loss from joint ventures is a significant and integral part of a real estate entity's operating profit and should be presented and analyzed as such.

As noted by the IASB in their current Primary Financial Statements project, "users of financial statements told us they need information that aides them in assessing the persistence or sustainability of an entity's financial performance and management performance measures are useful for that purpose." For real estate entities, developing the most appropriate calculation of this measure necessitates the inclusion of their proportionate share of operating profit from joint arrangements that are operated in the same manner as fully-owned properties. In recognition of this challenge – and not only limited to the real estate industry – one of the tentative decisions in the IASB's project to date is to require entities to separately disclose the results of integral and non-integral joint ventures and associates directly in the statement of financial performance.

Current practice by many real estate entities is to present this information in a "two-column approach", reconciling the full income statement and balance sheet to show the entity's proportionate share in joint arrangements that are part of regular business operations. Real estate entities are frequently users of debt, and debt is often utilized at the joint venture level. Presentations that do not go beyond the IFRS requirements fail to disclose the use of financial leverage at the joint venture level. Therefore, an additional benefit of the two-column approach is to better disclose IFRS off-balance sheet debt to users of reporting. It is our understanding that this presentation will continue to be acceptable under the *CSA Proposed National Instrument 52-112* (and its accompanying Companion Policy and Consequential Amendments and Changes), provided that the reconciling items and proportionate share amounts are labelled as non-GAAP and not given more prominence than the discussion on GAAP amounts. We support continuing to allow this reconciliation.

## **2. Reconciliation of Non-GAAP Financial Measures to Most Directly Comparable GAAP Amounts**

Regarding [PROPOSED COMPANION POLICY 52-112](#)



NON-GAAP AND OTHER FINANCIAL MEASURES DISCLOSURE – Subparagraph 3(d) (iv): *Subparagraph 3(d)(iv) of the Instrument requires a quantitative reconciliation between the non-GAAP financial measure and the most directly comparable financial measure. An issuer may satisfy this requirement by providing a reconciliation in a clearly understandable way, such as a table. An issuer must ensure that its disclosure is not misleading and will have to consider the level of detail required to provide the necessary context. The Instrument does not define the “most directly comparable financial measure” and therefore the issuer needs to apply judgment in determining the most directly comparable financial measure. In applying judgment, it is important for an issuer to consider the context of how the non-GAAP financial measure is used. For example, where the non-GAAP financial measure is discussed primarily as a performance measure used in determining cash generated by the issuer or its distribution-paying capacity, its most directly comparable GAAP measure will be from the statement of cash flows. In practice, earnings-based measures and cash flow-based measures are used to disclose operational performance. If it is not clear from the way the non-GAAP financial measure is used what the most directly comparable measure is, consideration should be given to the nature, number and materiality of the reconciling items.*

**REALPAC comments:**

In January 2015, the OSC published *Staff Notice 51-724 Report on Staff’s Review of REIT Distribution Disclosure*. In response to this notice, many REITs provided enhanced disclosure around AFFO, including a reconciliation to cash flow from operations.

Subsequently there has been some confusion on the disclosure requirements around AFFO where it is utilized by management as an earnings measure rather than as a cash flow measure. Where REITs have adopted REALPAC’s guidance on AFFO and view AFFO as an earnings measure, it is our understanding that AFFO should only be reconciled to GAAP net income (with a subtotal for FFO), and not GAAP cash flow from operations as well, as, in these circumstances, net income is the most directly comparable GAAP amount.

We would appreciate any additional guidance from the OSC to clarify this point, so as to eliminate confusion on the interplay between *Staff Notice 51-724* and *CSA Proposed National Instrument 52-112*.

In addition, we seek clarification whether or not items such as “rent per square foot” amounts are required to be reconciled to a GAAP measure, and guidance on how this could be performed. For example, amounts such as “average expiring rent per square foot” and “average net rent per occupied square foot” are based on contractual rent at a point in time. We are unclear on if and how these amounts should be reconciled to IFRS rental revenue on a quarterly basis, and question how this could be presented in a clear and useful manner to users.

### **3. Usefulness of Non-GAAP Financial Measures Disclosures**

Regarding [PROPOSED COMPANION POLICY 52-112](#)

[NON-GAAP AND OTHER FINANCIAL MEASURES DISCLOSURE Subparagraph 3\(d\)\(iii\) – Usefulness of non-GAAP financial measure disclosure](#)



*The Instrument does not define the term "useful". The term "useful" is intended to reflect how management believes that presentation of the non-GAAP financial measure provides incremental information to investors regarding the issuer's financial position, financial performance or cash flows. The level of detail is a matter of judgment, which takes into account the complexity of the information and how familiar a reasonable person would be with the measure.*

**REALPAC comments:**

We are concerned with the use of the term "incremental" in the context of requiring information to be incremental in order to be considered "useful". For accounting purposes, the term "incremental" can be a powerful word. By using the term "incremental" we have concerns that this is intended (or could be read) to preclude disclosure of similar measures that we consider to be important and useful to investors and other users.

For example, some entities use multiple measures to explain "operating performance" – such as "net operating income" (NOI) and "funds from operations" (FFO). While both include aspects of operating income, FFO takes into account several more deductions to represent a recurring economic earnings measure.

While it is our understanding that the term "incremental" is not intended to be such a high hurdle, we would like to have clarification on the applicability of this term in the context of determining whether or not information is considered to be "useful" under the Proposed National Instrument 52-112 (and its accompanying Companion Policy and Consequential Amendments and Changes) if it is not also "incremental."

In addition, regarding:

[PROPOSED COMPANION POLICY 52-112](#)

[NON-GAAP AND OTHER FINANCIAL MEASURES DISCLOSURE](#)

[PART 2 DISCLOSURE REQUIREMENTS Paragraph 3\(b\) – Prominence of a non-GAAP financial measure](#)

*The following are examples that we view as causing a non-GAAP financial measure to be more prominent than the most directly comparable measure presented or disclosed in the financial statements:*

- *Multiple non-GAAP financial measures being used for the same purpose thereby obscuring disclosure of the most directly comparable measure;*

We are also concerned that this will limit disclosure on common metrics disclosed and used by investors and others, such as NOI, FFO, AFFO and ACFO.

While it is our understanding that this clause is not meant to indirectly restrict the common industry metrics noted above, we would like to have clarification on the applicability of this clause.

#### **4. Definition of Non-GAAP**

Regarding [Proposed National Instrument 52-112 PART 1 DEFINITIONS AND APPLICATION: Definitions - "non-GAAP financial measure" means](#)

*(a) a financial measure of financial performance, financial position or cash flow that is not disclosed or presented in the financial statements and that is not a disaggregation, calculated in accordance with the accounting policies used to prepare the financial statements, of a line item presented in the primary financial statements*

and

PROPOSED COMPANION POLICY 52-112

NON-GAAP AND OTHER FINANCIAL MEASURES DISCLOSURE

Section 1 – Definition of a non-GAAP financial measure

*Paragraphs 55 and 85 of IAS 1 Presentation of Financial Statements require the presentation of additional subtotals when such presentation is relevant to an understanding of the issuer’s financial position or financial performance. An issuer that presents an additional subtotal in the primary financial statements, such as Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”), would be presenting the subtotal in accordance with the accounting policies used to prepare its financial statements, if it has determined such presentation is relevant to an understanding of its financial performance. That financial statement measure would not meet the definition of a non-GAAP financial measure if it were also disclosed outside the issuer’s financial statements.*

*Disaggregation of subtotals and totals presented in the primary financial statements are captured by the definition of non-GAAP financial measures. For example, if EBITDA is not presented in the primary financial statements, it would be inappropriate to conclude that it is not a non-GAAP financial measure on the basis that it is a disaggregation of profit as presented in the statement of profit or loss. Likewise, a measure calculated by combining numbers disaggregated from different line items would also meet the definition of a non-GAAP financial measure, unless that measure is separately disclosed in the notes to the financial statements, for example, when expenses in the statement of profit and loss are presented by function and then also presented by nature in the notes to the financial statements.*

**REALPAC comments:**

It is our understanding from reading these sections that where, for example, EBITDA is disclosed in the IFRS financial statements, it is defined as a GAAP measure, and where it is not disclosed in the IFRS financial statements, it is defined as non-GAAP measure. This distinction will result in EBITDA being a GAAP measure for some entities and a non-GAAP measure for others – across different entities, different industries and across entities within the same industry. This will result in inconsistencies that are most likely to be confusing to investors and other users. These inconsistencies also have the potential to result in unintended consequences for reporting issuers. We suggest that the CSA may want to simplify and clarify how non-GAAP measures are defined or consider whether a principles-based approach (such as that which exists in *CSA Staff Notice 52-306 (Revised) Non-GAAP Financial Measures*) is easier and more practical for entities to apply.

In addition, it is unclear whether certain aggregations of amounts fall into the definition of non-GAAP measures: such as rolling 12-month information of a line item in the IFRS financial statements or an annualized balance.



## **5. Disclosure Requirements for Ratios**

Regarding Proposed National Instrument 52-112 PART 2 DISCLOSURE REQUIREMENTS – Non-GAAP financial measures that are ratios

*4. (3) Subparagraph 3 (d)(iv) does not apply if:*

*(b) the first time the ratio appears in the document, the document describes how the ratio is calculated and*

*(ii) provides a quantitative reconciliation to the ratio as calculated using the most directly comparable financial measures presented in the primary financial statements.*

In the real estate industry, it is common to disclose payout ratios for any combination of FFO, AFFO and ACFO (where relevant) to show the amount of distributions to unitholders as a percentage of funds from operations or cashflows. Under IFRS, there is no comparable payout ratio (i.e. the concept of payout ratio does not exist under IFRS). We question whether the above noted reference from the Proposed National Instrument 52-112 requires preparers to create a "GAAP" payout ratio, such as, for ACFO, to compare it to cash flow from operations and distributions (as a ratio). If this is the requirement, there are two specific issues with this:

- 1) As noted in our comment above, it is our understanding that where a financial measure or ratio is not reported or disclosed in the IFRS financial statements, reporting it outside the financial statements thereby defines it as a "non-GAAP" measure. Since there is no IFRS defined payout ratio (and therefore payout ratio is not included in a real estate entity's IFRS financial statements), creating a "GAAP" payout ratio (such as distributions as percentage of cash flow from operations) would essentially be creating an additional non-GAAP measure and comparing it to another non-GAAP measure; and
- 2) Reporting a payout ratio using distributions as a percentage of cash flow from operations is misleading to investors and users because of the inclusion or exclusion of some amounts under IFRS. For example, cash flow from operations as calculated under IFRS does not include maintenance capital expenditures, which will tend to overestimate cash available for distribution; nor does it include the results of joint ventures, which will tend to understate cash available for distribution. In addition, distributions on Limited Partnership B units are classified as interest expense for an open-ended REIT and are not classified as distributions for IFRS purposes.

In addition, preparers include ratios such as debt to gross book value or debt service ratio in supplemental documents. These ratios provide key information that is valued by investors and analysts because of the use of leverage in the real estate industry. Most REITs also disclose debt to assets, where the debt included in the ratio may reasonably exclude some liabilities from the IFRS financial statements. Similar to payout ratios, they have no comparable "GAAP" measure in the IFRS financial statements to which they can be reconciled.

It is our understanding that the intended purpose of this requirement is not to "create" a GAAP ratio outside the financial statements, however clarification is required on the applicability of this clause.

## **6. Reducing Regulatory Burden**

In 2017, in publishing the *CSA Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*, it was noted that a key initiative of the CSA's 2016-2019 Business Plan was to review the regulatory burden on reporting issuers, and that the purpose of the consultation was to identify and consider areas of securities legislation applicable to non-investment fund reporting issuers that could benefit from a reduction of undue regulatory burden. REALPAC and its members are very supportive of the CSA's initiative to ease the regulatory burden on non-investment fund reporting issuers and submitted a comment letter supporting several of the suggestions.

Other jurisdictions are also considering ways to decrease regulatory burdens. In the U.S., the Securities and Exchange Commission ("SEC") recently acknowledged that public companies are weighed down with too much regulation, and that increased disclosures and other burdens are making the public markets less attractive. In his address on July 2017, SEC Chairman Jay Clayton stated that, "(w)hile there are many factors that drive the decision of whether to be a public company, increased disclosure and other burdens may render alternatives for raising capital, such as the private markets, increasingly attractive to companies that only a decade ago would have been all but certain candidates for the public markets. And, fewer small and medium-sized public companies may mean less liquid trading markets for those that remain public. Regardless of the cause, the reduction in the number of U.S.-listed public companies is a serious issue for our markets and the country more generally."

In Canada, we are facing similar issues. Many have argued that companies are choosing the private market over public markets when faced with the prospect of producing onerous quarterly reports and increasing regulatory burden. As acknowledged in *CSA Staff Notice 51-353 Update on CSA Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers* in March of this year, the majority of commenters expressed support for the initiative to reduce regulatory burdens. It was noted in the feedback summary that "the indication in some studies that public markets and the number of IPOs are in decline is a concern and we believe that the regulators have a role to play in helping to stem or reverse this trend." We suggest that developing the granular, prescriptive rules as proposed for NI 52-112 does not assist in this goal, but instead increases regulatory burden and costs.

## **7. Exclusion of Oral Statements**

We agree with the proposal to exclude oral statements from the *CSA Proposed National Instrument 52-112*, as including these would prove exceedingly onerous for issuers, and difficult for users to understand.

We seek clarification that the exclusion extends to written transcripts of oral communications that are not issued or referenced directly by the issuer (such as those issued by external parties).

## **8. Background: Comparison to Other Jurisdictions**

In the Background section of the Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure, it is noted that other securities regulators, including IOSCO, ESMA and the U.S. SEC have “recently strengthened” their efforts to regulate the disclosure of certain financial measures. To better understand the nuances of such regulations, we shared the CSA Notice and Request for Comment with our international colleagues and sought their feedback.

### U.S. SEC regulations:

We received feedback from our colleagues in the U.S. that, under existing U.S. law, the SEC does not have rules or regulations related to non-GAAP disclosure that are comparably prescriptive and granular. It was noted that existing U.S. SEC Guidance on non-GAAP disclosure does address similar issues, such as labeling of non-GAAP, comparability, prominence of placement, reconciliation to comparable GAAP metrics, and segment reporting, albeit it less forcefully. SEC regulatory guidance (as opposed to actual regulations) has less “bite” than a formal, SEC adopted prescriptive regulation.

Our colleagues commented that under SEC regulation there are no specific requirements regarding quantitative reconciliation, as set forth in the Proposed National Instrument 52-112; nor is there a comparative “reasonable person” requirement as per *Proposed National Instrument 52-112 PART 2 DISCLOSURE REQUIREMENTS Non-GAAP financial measures 3 (d)(iv)*

*(A) is disaggregated in such a way that it provides a reasonable person an understanding of the reconciling items,*

and

*(C) is explained in such a way that it provides a reasonable person an understanding of each reconciling item,*

We also received feedback that for segment and capital ratios, U.S. Reg G is broader and less prescriptive on things like segment ratios and capital ratios.

### European ESMA guidance:

We received feedback from our European colleagues that the ESMA APM (Alternate Performance Measures) guidance is used by national regulators to assess APMs/non-GAAP. It was noted by our colleagues that this is guidance and not as strict or prescriptive as the Proposed National Instrument 52-112. We reviewed ESMA’s current guidelines and noted that they are principles-based and not as granular nor prescriptive as Proposed National Instrument 52-112. For example, with regards to the presentation of APMs, ESMA guidance simply states: “APMs disclosed should be given meaningful labels reflecting their content and basis of calculation in order to avoid conveying misleading messages to users.” For reconciliations, the guidance simply states: “A reconciliation of the APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period should be disclosed, separately identifying and explaining the material reconciling items.”

Based on our review of the Proposed National Instrument 52-112, discussions with our international counterparts, and review of guidance from the U.S. SEC and ESMA, we



posit that the regulations proposed are too prescriptive and granular and may result in management teams not having enough flexibility to communicate their results to investors, analysts and other users sufficiently. We suggest that the CSA consider more principles-based guidance more similar to that which is developed by ESMA.

We thank the OSC for the opportunity to provide our input on the *CSA Notice and Request for Comment – Proposed National Instrument 52-112, Proposed Companion Policy 52-112, Related Proposed Consequential Amendments and Changes*. If you would like to discuss our comments, please contact Nancy Anderson, REALPAC's Vice President Financial Reporting and Chief Financial Officer, at 416-642-2700 x226.

Respectfully submitted,



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REALPAC