

CSA concludes real estate issuers should improve disclosure relating to distributions and non-GAAP financial measures

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The Canadian Securities Administrators (CSA) have concluded that the quality and completeness of disclosure by real estate reporting issuers relating to distributions and non-GAAP financial measures needs improvement. The CSA has provided additional guidance on disclosure expectations and has indicated that CSA Staff will continue to assess these areas during continuous disclosure and prospectus reviews. Real estate reporting issuers should review their continuous disclosure in the context of the most recent guidance from the CSA to avoid adverse regulatory scrutiny which could lead to the restatement and refiling of disclosure documents.

The results of the CSA's review are set out in CSA Staff Notice 52-329 *Distribution Disclosures and Non-GAAP Financial Measures in the Real Estate Industry* (the Staff Notice), a link to which is provided [here](#). The Staff Notice summarizes the CSA's review of 47 real estate reporting issuers' disclosure relating to distributions and the use of certain non-GAAP financial measures. Staff reviewed distribution disclosure relative to National Policy 41-201 *Income Trusts and Other Indirect Offerings* (NP 41-201) and non-GAAP financial disclosures relative to CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* (CSA SN 52-306).

Key findings and outcomes from the review include:

Number of issuers reviewed: The CSA sent comment letters to 72% of the 47 real estate reporting issuers (both real estate investment trusts and real estate operating companies) whose disclosure was reviewed by the CSA. Of the issuers that were reviewed by the CSA, 6% were required to restate their MD&A, and 62% agreed to enhance their disclosure prospectively.

Distribution disclosure: Staff found that real estate reporting issuers generally provide adequate disclosure regarding distributions except when "excess distributions" were made. The CSA found that 45% of real estate reporting issuers had excess distributions in the interim reporting period. Excess distributions occur when distributions declared (including distributions in connection with a distribution reinvestment plan) during a period exceed cash flows from operating activities (net of interest paid, even if classified as a financing activity in the statement of cash flows), creating a shortfall. The Staff Notice notes that:

- Issuers should clearly quantify the amount of excess distributions relative to cash flows from operating activities in each reporting period. Of those issuers with "excess distributions," Staff noted that 68% of the issuers complied with this requirement.
- Issuers should describe the sources of cash used to fund the excess distributions. Staff

noted that 67% of issuers with excess distributions did not disclose sources of cash used to fund the excess, or their description was boilerplate.

- It is not sufficient to simply state that the issuer believes that current distributions are sustainable.
- Staff believe that the risk profile of an issuer that relies on sources other than operating cash flows to fund distributions is inherently different than an issuer that funds distributions solely through operating cash flows, and Staff expect issuers to provide disclosure that addresses these risks.

Non-GAAP financial measures: Staff identified a significant number of disclosures that did not conform to the guidance in CSA SN 52-306 or NP 41-201 for the following reasons:

- There was a lack of transparency and a lack of disclosure about the adjustments made in arriving at non-GAAP financial measures, particularly relating to maintenance capital expenditures and working capital.
- There was a lack of clarity in how management uses each individual non-GAAP financial measure.
- There was a failure to clearly identify the most directly comparable GAAP measure.
- Non-GAAP financial information was presented with greater prominence than the most directly comparable GAAP measure.

The Staff Notice notes that:

- Issuers should ensure that all adjustments are sufficiently explained, including why and how each adjustment was determined. Where an adjustment is an estimate, issuers should provide additional disclosure regarding how the estimate was determined.
- Issuers using a maintenance capital expenditures reserve should provide additional disclosure in their MD&A including (i) the method by which management determined the amount of the reserve; (ii) why a particular method was chosen in determining the reserve and why that method is appropriate; (iii) how the reserve amount compares to actual maintenance capital expenditures in that period and historically; and (iv) an explanation of why management's estimate is more relevant than the actual amount. Issuers should not group together their estimate for maintenance capital expenditures with other amounts estimated by management, such as tenant inducements, tenant expenditures or leasing costs or incentives.
- Working capital adjustments should be supported by a detailed discussion of the nature of the adjustment, a description of the underlying assumptions used in preparing each element, including how those assumptions are supported and a discussion of the specific risks and uncertainties that may affect the assumption.
- Issuers with joint ventures sometimes present a full set of non-GAAP financial statements in the form of a columnar reconciliation within the MD&A that shows separately their pro rata share of the interest in the joint ventures. Staff are of the view that this presentation creates a non-GAAP financial measure for each financial statement line item and effectively unwinds the equity method of accounting required by IFRS 11 *Joint Arrangements*. Issuers holding properties through joint ventures should review the Staff Notice and consider

whether changes are required to the manner in which joint venture interests are disclosed and discussed in MD&A.

- Several issuers gave more prominence to non-GAAP financial measures in news releases rather than directly comparable GAAP measures. Issuers should ensure that equal prominence is being given to the directly comparable GAAP measures in news releases, as well as websites, investor presentations and other social media.
- Issuers should carefully consider the number of non-GAAP financial measures used in their MD&A and avoid using multiple non-GAAP financial measures for the same purpose.

Please contact your lawyer at Osler or either of the authors of this update if you have any questions or would like any assistance in complying with the provisions of this recent CSA guidance or any other aspect of your continuous disclosure documents.