OFFICE OF THE CHIEF ACCOUNTANT

Financial Reporting Bulletin

An update on:

Disclosure of key performance indicators in the oil and gas industry

Alberta Securities Commission

JANUARY 2018

In December 2016, the Office of the Chief Accountant (OCA) of the Alberta Securities Commission (ASC) published a Financial Reporting Bulletin to bring attention to key oil and gas industry financial performance indicators and provide guidance on how to appropriately communicate these indicators. This Bulletin provides an update based on subsequent research of adoption of our guidance by a sample of 40 reporting issuers (RIs).

This Bulletin discusses the more commonly disclosed measures of funds flow and netbacks. The guidance will assist preparers in ensuring that investors are not confused or misled by disclosure of these measures. We encourage RIs to consider how this guidance may apply to other key performance indicators (KPIs).

Key messages for disclosure of KPIs

- Relevant industry measures should have consistent labels and compositions. If the composition of a common KPI deviates from the commonly attributed definition, label as “adjusted” to avoid confusion in disclosures outside the financial statements.
- Our regulatory view is measures labelled using the term “adjusted” do not meet the IFRS requirement to ensure labels are clear and understandable and should not be presented on the face of the financial statements.
- Labels should not cause confusion and should be sufficiently distinguishable from the GAAP measure.
- Labels such as “results from operating activities” which exclude operating items can be misleading.
- Ratios may be calculated using one or multiple non-GAAP financial measures (NGMs). The NGM component of a ratio should comply with the guidance provided in CSA Staff Notice 52-306 (Revised) Non-GAAP Financial Measures (SN 52-306).
- Ratios disclosed in isolation may be unclear or misleading without a clear explanation about their composition.
- NGMs must not be disclosed with greater prominence than the most directly comparable GAAP measure.

Funds flow – improvements observed

Was the funds flow label sufficiently distinguishable from the GAAP measure?

WHAT WE SAID

A label should be meaningful, understandable and sufficiently distinguishable from the IAS 7 Statement of Cash Flows measure of Cash, Cash Flows, and Cash Flows from Operating Activities. Labels using these, or similar terms may be confusing, and can be misleading. Using labels such as Cash Flow and Cash flows from Operations is not sufficiently distinguishable from the GAAP measure.

WHAT WE SAW

2015		Q1 2017
24% used Cash in the label	›	3% used Cash in the label

We are encouraged with the significant reduction of confusing labels.

How was funds flow reconciled?

WHAT WE SAID

To comply with SN 52-306, funds flow should be reconciled to the most directly comparable measure specified, defined or determined under the issuer's GAAP that is presented in its financial statements. For funds flow, this measure is cash flows from operating activities.

WHAT WE SAW

2015		Q1 2017
89% reconciled to cash flows from operating activities	›	97% reconciled to cash flows from operating activities

We are encouraged with the improvements in the number of RIs that provided a clear quantitative reconciliation to the most directly comparable measure under GAAP.

Funds flow – room for improvement

Despite encouraging observations, there continue to be areas where investors can benefit from improved disclosure of KPIs.

What was the composition of funds flow?

WHAT WE SAID

Funds flow as a key performance indicator should be labelled as such and be comprised of cash flows from operating activities before non-cash changes in working capital. It would be helpful to have a common composition and label for funds flow. Any variation from this composition would be disclosed as adjusted funds flow, and the composition clearly disclosed and explained.

WHAT WE SAW

Q1 2017
18% followed the guidance discussed above regarding labelling and composition of funds flow and 20% described variations using "adjusted" label

In our view, relevant industry measures should have consistent labels and compositions to promote transparency, comparability and usefulness. While we observed some RIs use of the word "adjusted" in labelling a KPI when it deviates from the commonly attributed definition, the majority of RIs did not meet our expectations. The term "adjusted" signals that a user should spend more time understanding management's composition. We would like to see further improvement in disclosures around adjusted funds flow measures.

Was the funds flow measure labelled appropriately?

WHAT WE SAID

Disclosing this performance measure excluding normal, recurring cash operating expenses necessary to operate a RI's business can be misleading when "from operations" is included in the label. We consider whether adjustments are appropriate based on the facts and circumstances of the RI's operations.

WHAT WE SAW

Q1 2017
63% of RIs who included "from operations" within the label described a measure which removed normal operational costs (i.e. decommissioning expenditures)

Funds flow from operations and adjusted funds flow from operations were the most common labels, accounting for 80% of the labels used by RIs in the sample. For the upstream oil and gas sample reviewed, excluding spending on decommissioning liabilities from the measure is inconsistent with what the performance indicator is intended to represent when labelled with "from operations". If the adjusted funds flow measure removes activities that would normally be regarded as operating, the label should not include terms such as "from operations".

Was funds flow presented with more prominence than the GAAP measure?

WHAT WE SAID

SN 52-306 requires that a RI's NGM not be presented with greater prominence than that of the RI's directly comparable GAAP measure. In our view, the most directly comparable GAAP measure is cash flows from operating activities. Examples of disclosures that would cause a NGM to be more prominent include, but are not limited to:

- presenting funds flow using a presentation style (e.g., bold, larger font) that attracts more attention than the comparable GAAP measure;
- omitting the comparable GAAP measure from a news release, headline or caption that includes funds flow; and
- focusing the discussion or analysis of performance on funds flow, while providing less of a discussion of cash flows from operating activities or providing the discussion in a location with greater prominence.

WHAT WE SAW

Q1 2017

80% did not meet our expectations with respect to prominence due to omitting a discussion on cash flows from operating activities

We continue to observe a significant number of instances where RI's presentation of its GAAP measures and accompanying discussion and analysis lack balance, and focus instead on NGMs.

Netbacks

Did RIs meet the disclosure practices in SN 52-306?

WHAT WE SAID
An RI should be able to explain why netback is a meaningful measure. When multiple variations of netback are presented, management should explain how each is providing useful information to investors. Each variation of netback presented should be appropriately named, and have a clear quantitative reconciliation from the NGM to the most directly comparable measure specified, defined or determined under GAAP.
WHAT WE SAW
Q1 2017 65% of RIs met our expectations by appropriately applying the practices in SN 52-306

Since our previous publication, we noted that more than half of the RIs within our sample presented at least two variations of netbacks. Of these, 25% failed to explain the usefulness of each variant. When multiple NGMs are disclosed for the same or similar purpose, RIs should carefully consider how each provides useful information to investors. The second most common issue was a failure to disclose that netback does not have a standardized meaning and is unlikely to be comparable to similar measures presented by other RIs.

OCA consultations

As part of its on-going efforts to promote high quality financial reporting, the Office of the Chief Accountant communicates with entities and their advisors by providing consultations in advance of filing financial statements with the ASC on unusual or complex technical accounting issues and on financial statement disclosure. Our expectation is that entities will have consulted with their advisors and have an proposed approach prior to conferring with us.

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