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This study aims to investigate whether the adoption of Say-on-Pay regulation motivates managers to report non-GAAP[1] metrics opportunistically in Canada. Both Say-on-Pay and non-GAAP reporting are two recent key changes in corporate norms that have drastically changed the financial governance of organizations in Canada. Last March, an amendment to the Canada Business Corporations Act (CBCA) was proposed in the Federal Government's new Budget Implementation Bill C-97. Under the proposed amendment, certain CBCA corporations would be required to disclose their approach to executive remuneration and to hold an annual non-binding shareholder Say-on-Pay vote. On the one hand, proponents consider Say-on-Pay to be an effective governance mechanism that provides shareholders with a voice on executive pay [1, 2]. On the other hand, opponents argue that non-binding votes may be ignored and, worse, may even be viewed as an interference in board's role and its expertise in determining what constitutes fair pay [3, 4]. While Say-on-Pay has yet to become a legal requirement in Canada, its adoption has been on the rise among Canadian public firms, reaching 78 percent of TSX 60 firms and 48 percent of TSX listed issuers in 2018 [5]. In this context, Canadian corporations would be wise to leverage the learning experiences of these early adopters to determine the effectiveness of Say-on-Pay as a governance mechanism and potential safeguards to mitigate unintended consequences.

Importantly, in their December (2019) study, the Canadian Coalition for Good Governance (CCGG) reported a significant increase in the prevalence of non-GAAP measures in incentive compensation plans among Canadian public firms [6]. The CCGG also reported that several Canadian firms had adjusted their metrics in order to inflate firm performance thereby leading to higher compensation awards. From a governance perspective, the widespread use of non-GAAP performance metrics in the determination of executive compensation raises several concerns. For instance, in contrast to GAAP metrics, non-GAAP metrics are typically unaudited, thus raising questions as to their reliability. Moreover, CEOs facing shareholders' votes on compensation plans may use non-GAAP measurements opportunistically to emphasize firms' earnings and performance. In an effort to control the opportunistic use of non-GAAP reporting, on February 13, 2020, the Canadian Securities Administrators (CSA) published a second notice and request for comment on revisions to the proposed rule for Non-GAAP and Other Financial Measures (Proposed National Instrument 52-112). The CSA's Proposed Instrument would provide clear and comprehensive requirements for the presentation of non-GAAP measures to ensure that they do not misrepresent a firm's core operations and performance to investors. However, the proposal may not necessarily offer a complete long-term solution to mitigate the aforementioned concerns [7].

Against this backdrop, I expect that managers in firms adopting Say-on-Pay will be more willing to report non-GAAP metrics as compared to non-adopters. Moreover, I expect that the reported metrics would be of lower quality as managers are more likely to exclude recurring items from their GAAP metrics. To examine these hypotheses, I will consider a sample of Canadian firms that voluntarily adopt Say-on-Pay and a control sample of non-adopters. Non-GAAP earnings per share metrics will be collected from these firms' financial statements. The quality of non-GAAP metrics will be measured by the difference between total exclusions and special items, where total exclusions are the difference between GAAP earnings and non-GAAP earnings. Using these metrics, I will compare managers' non-GAAP reporting behaviour during the pre- and post-adoption period of Say-on-Pay.

The expected results of this study will help policy makers to determine the effectiveness of Say-on-Pay as a governance mechanism and, by extension, the value of moving forward with the CBCA's proposed amendment. Moreover, I expect the results to provide additional support for the ethical concerns raised by non-GAAP reporting and the CSA's efforts in regulating these metrics. Finally, this research could shed light on managers' intentions to mislead shareholders of firm performance in order to gain votes.

[1] GAAP: Generally Accepted Accounting Principles

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