

Blakes Bulletin

Securities Regulation

Results of CSA Continuous Disclosure Review Program

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The Canadian Securities Administrators (the CSA) released Staff Notice 51-332 – *Continuous Disclosure Review Program Activities for the Fiscal Year Ended March 31, 2010* on July 9, 2010. The notice summarizes the results of the CSA's continuous disclosure review program of issuers (other than investment funds) for fiscal 2010.

BACKGROUND

The CSA's continuous disclosure review program is designed to identify material disclosure deficiencies that affect the reliability and accuracy of the disclosure record of issuers. The program's fundamental objectives are education and compliance.

CSA Staff used a risk-based approach to select issuers for review and to determine whether to conduct a full or issue-oriented review. The risk-based approach for selection focuses on accounting issues and disclosure areas where the CSA view non-compliance as probable or foresee a need for increased compliance.

In fiscal 2010, the CSA completed 527 full reviews and 824 issue-oriented reviews of the approximately 4,200 reporting issuers in Canada (other than investment funds and issuers that have been cease-traded). The reviews were generally of issuers considered to be at a higher risk of non-compliance.

REVIEW OUTCOMES

The CSA required 72% of issuers reviewed to take action to improve their disclosure including:

- requiring issuers to make changes or enhancements in subsequent filings to address deficiencies identified (43% of reviews);
- advising issuers of certain disclosure enhancements that should be considered in the issuer's next filing given specific risk profiles (9% of reviews);
- requiring issuers to amend and refile certain continuous disclosure documents (16% of reviews); and
- noting issuers in default, issuing cease-trade orders or referring matters to enforcement (4% of reviews).

No action was required as a result of 28% of the reviews conducted.

COMMON DEFICIENCIES IN FULL REVIEWS

The CSA identified the following common deficiencies found in financial statements, Management's Discussion & Analysis (MD&A) and oil and gas disclosure.

Financial statement deficiencies

- The CSA noted that a clear and concise description of an issuer's significant accounting policies is considered an integral part of the issuer's financial statements.

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Highlights

- In fiscal 2010, the Canadian Securities Administrators (CSA) completed 527 full reviews and 824 issue-oriented reviews of the approximately 4,200 reporting issuers in Canada (other than investment funds and issuers that have been cease-traded)
- The CSA required 72% of issuers reviewed to take action to improve their disclosure
- The CSA identified common deficiencies in financial statements, Management's Discussion & Analysis and oil and gas disclosure

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• The CSA identified the following common deficiencies with respect to measurement issues:

- *Financial instruments* – Failure to measure financial instruments in accordance with appropriate standards and omission of: (i) methods and assumptions applied in determining fair values; (ii) complete information on credit and liquidity risk; (iii) aging analysis of past due accounts receivable balances; and (iv) sensitivity analysis related to market risks.
- *Revenue recognition* – Failure to clearly set out the basis for recognizing revenue from each product or service, including disclosure of any credit terms, rights of return or conditions.
- *Goodwill* – Inadequate disclosure of the methodology used to conduct goodwill impairment testing.
- *Capital disclosure* – Failure to disclose summary quantitative data about capital management and whether the issuer has met its objectives for managing capital.

MD&A

• The CSA noted that MD&A remains the area with the most compliance issues and that MD&A often includes boilerplate disclosure rather than entity-specific disclosure that would enable a reader to assess the current financial condition of the issuer and its future prospects.

• The CSA identified the following common deficiencies in MD&A:

- *Operations* – Lack of meaningful analysis and discussion of operating results, financial condition and liquidity and failure to provide a quantitative and qualitative explanation of material movements in the income statement.
- *Liquidity – Working capital deficiency* – Failure to provide plans to remedy a working capital deficiency.
- *Risks* – Failure to discuss the effects of the current economic environment on financial condition, operations and liquidity.
- *Related party transactions* – Failure to disclose the business purpose of related party transactions, including both the quantitative and qualitative aspects of such transactions as necessary for investors to understand the economic substance and business purpose of such transactions.

- *Critical accounting estimates* – Failure to provide an adequate discussion of the methodology and assumptions used in determining critical accounting estimates.

Oil and Gas Disclosure

• The CSA identified the following common deficiencies with respect to oil and gas disclosure:

- Use of technical terms not recognized by the Canadian Oil and Gas Evaluation Handbook (the COGEH).
- Combination of terms in a way that is potentially misleading to investors.

ISSUE-ORIENTED DISCLOSURE

The following issue-oriented disclosure reviews were completed in fiscal 2010 by one or more of the securities regulatory authorities of Canada:

- *Certification of Disclosure in Issuer's Annual and Interim Filings* – The CSA issued Staff Notice 52-325 – *Certification Compliance Review* on September 11, 2009 in respect of their review of issuers' certification of disclosure in annual and interim filings. The CSA noted common deficiencies with respect to:
 - Failure to fully disclose conclusions about the effectiveness of disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR) in MD&A.
 - Improper qualification of issuers' conclusions about the effectiveness of DC&P and/or ICFR.
 - Inappropriate amendments to wording on certificates.
 - Reference to a material weakness in ICFR and/or a limitation in the scope of design of DC&P and ICFR that did not exist.
 - Incorrect dates on certificates and failure to file certificates at the correct time.
- *IFRS Transition Disclosure* – The Ontario Securities Commission (OSC) issued Staff Notice 52-718 – *IFRS Transition Disclosure Review* and the Autorité des marchés financiers (AMF) issued *Notice of Autorité des marchés financiers related to disclosure by reporting issuers on changeover to international financial reporting standards* on February 5, 2010 in respect of their review

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of continuous disclosure relating to the transition to International Financial Reporting Standards (IFRS). The OSC and the AMF both noted that issuers are not adequately disclosing in MD&A the key elements of their IFRS changeover plan or their progress toward achieving the plan.

- **Executive Compensation Disclosure** – The CSA issued Staff Notice 51-331 – *Report on Staff's Review of Executive Compensation Disclosure* on November 20, 2009 in respect of their review of continuous disclosure relating to executive compensation. The CSA identified the following common deficiencies:

- Failure to: (i) explain sufficiently in the compensation discussion and analysis (CD&A) how each element of compensation is tied to each named executive officer's performance; (ii) fully or accurately describe the process of making executive compensation decisions; and (iii) tie the discussion in the CD&A to the rest of the company's executive compensation disclosure.
- Failure to provide complete disclosure regarding the use of benchmarks and the determination of performance goals.
- Failure to fully discuss how the trend shown in the performance graph compares to the trend in the compensation of executive officers.
- Inadequate disclosure of pension plan benefits and termination and change of control benefits.

- **Mining Technical Disclosure** – The CSA identified the following common deficiencies, which are consistent with reviews in prior years:

- Failure to include: (i) the name of the qualified person in documents containing scientific and technical information; (ii) the source and date of historical estimates; and (iii) certificates or consents for the qualified person.
- Failure of corporate presentations or website content to comply with National Instrument 43-101 – *Standards of Disclosure for Mineral Projects*.

- **Oil and Gas Technical Disclosure** – The CSA identified the following common deficiencies:

- Failure to provide all of the information required under National Instrument 51-101 – *Standards of Disclosure for Oil and Gas Activities* (NI 51-101).

- Incorrect use of COGEH terminology.

- Failure to disclose important economic factors or significant uncertainties that affect components of the reserves data.

- **Going Concern** – The CSA noted that the majority of issuers to which this disclosure requirement is applicable did not include in their financial statements and MD&A complete disclosure of the risk that the issuer will not be able to continue as a going concern.

- **Asset Impairment** – The CSA conducted a targeted review of issuers in industries with a higher risk of triggering an asset impairment. The CSA noted insufficient disclosure of asset impairments, including inadequate disclosure of critical accounting estimates used in the impairment analysis.

- **Forward-Looking Information** – The CSA issued Staff Notice 51-330 – *Guidance Regarding the Application of Forward-looking Information Requirements under NI 51-102 Continuous Disclosure Obligations* (the FLI Notice) on November 20, 2009 in respect of their review of continuous disclosure relating to forward-looking information (FLI) and identified the following areas for improvement:

- Language identifying FLI should effectively identify its nature.

- Disclosure regarding material risk factors and material factors or assumptions relating to FLI should be discussed and clearly linked to particular FLI. Issuers should avoid "boilerplate disclosure" of such factors and assumptions.

- Inappropriate statements that the issuer does not assume any obligation to update FLI must be avoided.

- An explanation of the purpose of, and cautionary language related to, financial outlook or future-oriented financial information (FOFI) should be included, in addition to material risk factors and material assumptions.

- Disclosure regarding goals and targets could constitute FLI or FOFI and such disclosure should comply with the applicable FLI and FOFI requirements. If an issuer determines that a material target or goal that is disclosed does not constitute FLI, the issuer should consider additional disclosure explaining the purpose of the information.

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- News Releases – The CSA regularly review news releases, websites, corporate presentations and other promotional materials to assess compliance with NI 51-101 and COGEH disclosure requirements, FLI requirements under National Instrument 51-102 – *Continuous Disclosure Obligations* (NI 51-102) and the press release requirement in section 11.5 of NI 51-102 with respect to announcing a refiling or restatement. In respect of this review, the CSA identified the following common deficiencies, in addition to the common FLI issues identified in the FLI Notice discussed above:

- Use of non-compliant reserve and resource classification and disclosure.
- Use of non-compliant oil and gas terminology.

- Defined Benefit Pension Plans – The CSA conducted targeted reviews of several issuers that were identified as having material defined benefit pension plans. The CSA requested enhanced disclosure of the risks related to the issuer's funding status and of the impact of the pension funding obligation on the issuer's capital, liquidity and financial position.

FOCUS FOR FISCAL 2011

The CSA have stated that, for fiscal 2011, issue-oriented reviews will focus on disclosure relating to IFRS transition, material contracts and corporate governance practices and on certification of disclosure in issuers' annual and interim filings.

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