

## CSA Staff Notice 51-328

### Continuous Disclosure Considerations Related to Current Economic Conditions

#### Purpose of Notice

Current economic conditions present more than normal challenges for many issuers in preparing their financial statements and Management's Discussion and Analysis (MD&A). Because of the unusual economic conditions, the Canadian Securities Administrators (CSA or we) are highlighting some specific areas for which disclosure will likely be important to help investors understand the risks and circumstances facing issuers.

A detailed discussion of the specific areas can be found in Appendix A which is in the form of an illustrative continuous disclosure letter to the issuer. As part of our continuous disclosure review program, we examine disclosure and financial reporting and provide specific comment letters for individual issuers selected for review (refer to CSA Staff Notice 51-312 *Harmonized Continuous Disclosure Review Program*).

#### Overview

This notice addresses the following topics:

- MD&A, including:
  - general considerations
  - liquidity and capital resources
  - distributed cash
  - critical accounting estimates
  - forward-looking information
- going concern
- impairment of goodwill, intangible assets and long-lived assets
- financial instruments
- capital disclosures
- defined benefit pension plans
- non-GAAP financial measures
- additional considerations for junior resource companies

Although this notice discusses topics likely to affect many issuers, it does not provide an exhaustive list of all requirements. Each reporting issuer should consider the accounting and disclosure issues specific to its circumstances in the current economic environment.

## For more information

For more information, contact one of the following people:

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**January 8, 2009**

## Appendix A

January 2009

Name  
Chief Financial Officer  
ABC Issuer  
Address

### Dear Chief Financial Officer:

The current economic uncertainty and financial market volatility make it especially important for your company<sup>1</sup> to disclose clearly the current and anticipated impacts of market conditions on your company's operations, financial condition, liquidity and future prospects. Below, we have provided examples of the accounting and disclosure areas that the CSA are focusing on when reviewing continuous disclosure filings. Your company should ensure compliance with these existing accounting and regulatory requirements, where applicable, when preparing continuous disclosure filings.

### I. MD&A

#### A. General Considerations

MD&A should identify and evaluate information that would give investors an accurate understanding of your company's current and prospective financial position and operating results. This would include the potential effects of known trends, commitments and uncertainties that have arisen due to the current market conditions.

Items 1.2 *Overall Performance* and 1.4 *Results of Operations* of Form 51-102F1 *Management's Discussion & Analysis of Regulation 51-102 respecting Continuous Disclosure Obligations* require a detailed discussion of the specific economic factors currently affecting or anticipated to affect your company's industry and performance. Disclosures should provide a qualitative and quantitative discussion of how market conditions have affected:

- the demand for products and services, including any changes or expected changes to volume, selling prices or other revenue drivers;
- costs, including changes in prices or constraints on supply, volume discounts, inventory adjustments or other factors that alter the relationship between costs and revenues;
- revenue and expenses, due to changes in interest rates, borrowing costs, foreign exchange rates and commodity prices;
- financial results, due to unusual transactions or events including charges, gains or losses that have not been typically reflected in historical results;
- the company's overall strategy or changes to strategies, including cost saving measures, restructuring initiatives or a realignment of operational and financial resources; and
- any other relevant factors not mentioned above.

Provide this discussion for any operating segments or other parts of the business that have a significant impact on revenues, income or cash needs in the current

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<sup>1</sup> Wherever this illustrative letter uses the word "company", the term includes other types of business organizations such as partnerships, trusts and other unincorporated business entities.

environment. Part 1(b) *Date of Information* of Form 51-102F1 also requires that, in preparing MD&A, you take into account information available up to the date of the MD&A and that you ensure the disclosure is current so that it will not be misleading when it is filed.

## **B. Liquidity and Capital Resources**

Items 1.6 *Liquidity* and 1.7 *Capital Resources* of Form 51-102F1 require an analysis of your company's ability to generate sufficient cash and to access financial resources to meet operating needs in the current market environment. This discussion should not include "boilerplate" statements. It should disclose and quantify the following in sufficient detail for investors to understand the company's financial circumstances:

- cash necessary to fund current operations and the ability to satisfy obligations including debt maturities;
- commitments or planned expenditures necessary to maintain growth objectives and performance targets such as acquisition targets, new product launches or project milestones;
- future cash requirements associated with known trends and uncertainties due to current market conditions;
- additional liquidity risks associated with financial instruments where trading volumes have declined;
- significant risks of default on dividend payments, debt payments, debt covenants or other contractual obligations;
- movements in working capital accounts such as accounts receivable, inventory and accounts payable explaining any changes in terms or internal policies contributing to these movements;
- past and future funding sources from credit facilities, public offerings, related parties and other sources including what may impact the availability of such funding; and
- for an existing or expected working capital deficiency, the ability to meet obligations as they come due and how the deficiency is expected to be remedied.

## **C. Discussion of Distributed Cash**

As set out in Part 6.5.2 of *Policy Statement 41-201 respecting Income Trusts and Other Indirect Offerings*, income trust issuers should provide disclosure that compares cash distributions paid to cash flow from operating activities and net income. Where cash distributions paid exceeds cash flow from operating activities and net income, a discussion of how the resulting shortfall will be funded and whether cash distributions will continue to exceed net income or cash flow from operating activities in the foreseeable future is required. Income trust issuers must also discuss whether this level of cash distribution is sustainable or whether cash distributions are anticipated to be suspended in the foreseeable future.

## **D. Critical Accounting Estimates**

If your company is not a venture issuer, the current market conditions may result in a requirement for you to disclose additional critical accounting estimates from the prior year. The MD&A should discuss the specific impact of current market conditions on critical accounting estimates such as allowance for credit losses, fair value of financial instruments, inventory, revenue recognition, contingencies, goodwill and asset impairments, pensions, future income tax assets and stock-based compensation.

Disclosure under Item 1.12 *Critical Accounting Estimates* of Form 51-102F1 does not end with a discussion of the methodology and assumptions used in determining critical accounting estimates. Item 1.12 also requires insightful information on:

- your company's assessment of trends, events or uncertainties that may affect the methods and assumptions used to determine critical accounting estimates;
- how sensitive the estimate is to a change in assumptions;
- the likelihood that estimates might change with evolving economic conditions; and
- the impact of and rationale for changes made to critical accounting estimates during the period.

MD&A disclosure should supplement and build on the financial statement disclosure and not simply reiterate the accounting policy disclosed in the financial statements.

#### **E. Forward-Looking Information**

Recent economic and market events will cause actual results for many issuers to differ significantly from previously disclosed material forward-looking information. If this has happened to your company, you are required under Part 5.8 *Disclosure Relating to Previously Disclosed Material Forward-Looking Information* of Regulation 51-102 to discuss in the MD&A or in a press release these events and circumstances and the expected differences between actual and forecasted results.

## **II. Going Concern**

In light of current economic conditions, you should consider the recent amendments to CICA HB Section 1400.08A-08C *General Standards of Financial Statement Presentation*. The amendments apply to interim and annual financial statements for fiscal years beginning on or after January 1, 2008 and require a company to carefully assess and disclose in the financial statements the material uncertainties that may put into question its ability to continue as a going concern. Examples of material uncertainties include: continued and expected operating losses, negative operating cash flows, a failure to obtain or renew financing, a significant decline in the demand for a company's products, declining prices, substantial refinancing requirements and an inability to make scheduled payments on debt.

If your company faces material uncertainties about its ability to continue as a going concern, your MD&A should (as set out in Instruction (ii) of Item 1.2 *Overall Performance* of Form 51-102F1) supplement the financial statement disclosure and provide further insight into:

- management's reasons for determining the ability of the company to continue as a going concern in light of these uncertainties; and
- planned strategies or known events that may mitigate the uncertainties.

## **III. Impairment of Goodwill, Intangible Assets and Long-Lived Assets**

Accounting guidance for impairment testing of goodwill, intangible assets and long-lived assets can be found in the following CICA HB Sections: Section 3062 *Goodwill and other Intangible Assets* (replaced by Section 3064 *Goodwill and Intangible Assets* for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008) and Section 3063 *Impairment of Long-lived Assets*.

In our view, the current economic and market conditions represent circumstances that are likely to affect the carrying amount of assets. Examples of impairment indicators to consider when testing goodwill, intangible assets and long-lived assets include:

- a significant decrease in the company's share price;
- a significant adverse change in the business climate and/or the industry your company operates in;
- a current-period operating or cash flow loss combined with a history of operating or cash flow losses, or a projection or forecast that demonstrates continuing losses; and
- an accumulation of costs significantly in excess of the amount originally expected for its acquisition or construction.

If your company incurs an impairment charge, your MD&A should not only discuss the financial impact of the charge but also provide meaningful insight into the reasons and business circumstances surrounding the impairment as required by Item 1.2 *Overall Performance* of Form 51-102F1.

#### **IV. Financial Instruments**

There has been additional guidance issued in recent months by regulators and accounting standard setters in Canada, the United States and at the international level on the determination of fair value and disclosures relating to financial instruments in the absence of an active market. You should assess the valuation techniques for your financial instruments to ensure that they are based on assumptions that are appropriate in the current market conditions. The valuation methods you apply now may differ significantly from the methods you used to value financial instruments when you purchased them.

The requirements for financial instrument disclosure are found in CICA HB Section 3862 *Financial Instruments – Disclosures* and Item 1.14 *Financial Instruments and Other Instruments* of Form 51-102F1. It is important to provide disclosure in enough detail to help investors understand the significance, impact and risks of financial instruments to the company's financial position, operations and cash flows. Disclosures for financial instruments should include a detailed discussion of:

- the credit, liquidity and market risks associated with financial instruments, highlighting any changes in these risks given current market conditions;
- financial assets that are past due at the balance sheet date but are not treated as impaired;
- the methodology and assumptions used to determine fair market value including:
  - the observable and unobservable inputs used for the calculations
  - any adjustments made for credit, liquidity and other risks and how adjustments were determined
  - how transaction prices in inactive markets were taken into account in valuation techniques and how the company decided that the market was inactive
- the impact on fair value assessments (sensitivity analysis) if other reasonable assumptions relating to unobservable inputs are used in valuation techniques;
- the nature, impact and rationale of any significant changes made to valuation techniques or assumptions from prior periods;

- the financial statement impact of any reclassification of financial instruments your company chooses to make under the recent amendments to CICA HB Section 3855 *Financial Instruments - Recognition and Measurement*; and

- the factors considered in determining impairment including any trends or uncertainties that are reasonably believed to affect these factors over time.

## V. Capital Disclosures

In respect of CICA HB Section 1535 *Capital Disclosures*, disclosure should include a detailed discussion of how current economic conditions have affected your company's objectives, policies and processes for managing capital. As indicated earlier, Item 1.7 *Capital Resources* of Form 51-102F1 requires an analysis of your company's capital resources in the MD&A.

## VI. Defined Benefit Pension Plans

If your company has a material defined benefit pension plan, the MD&A should discuss:

- the anticipated impact of the funding status on future contributions, cash flows and pension expense as contemplated by Item 1.6 *Liquidity* of Form 51-102F1; and

- the risks associated with the pension plan, which may include:

- the ability of the plan to earn the assumed rate of return

- any expected increase in future contributions that results from market conditions and differs significantly from previous estimates

- the measurement uncertainty reflected in the actuarial valuation process.

## VII. Non-GAAP Financial Measures

The CSA continues to monitor the use of non-GAAP financial measures. We have set out in CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures* our view of the steps issuers should take, if they choose to publish non-GAAP financial measures, to ensure that their disclosure is not misleading. If your company discloses a measure like "adjusted earnings" or "earnings before one-time charges," you should consider the guidance set out in the staff notice. In particular you should:

- disclose with the non-GAAP measure the most directly comparable measure calculated in accordance with GAAP, in equal prominence, together with a quantitative reconciliation to the GAAP measure; and

- explain in detail why the non-GAAP financial measure is relevant to investors.

You should also consider carefully the validity of any representation you intend to make, either explicitly or implicitly through a non-GAAP measure, that a charge is non-recurring. For example, it would normally not be appropriate to adjust earnings for a charge identified as non-recurring if a similar charge is likely to occur within the next two years or has occurred during the prior two years.

## VIII. Additional Considerations for Junior Resources Companies

### A. Asset Impairments

If your company is a resource exploration company in the development stage, you need to consider the additional asset impairment guidance in CICA HB Accounting Guideline 11 *Enterprises in the Development Stage* (paragraphs 12 to 20) and in CICA HB EIC-126 *Accounting by Mining Enterprises for Exploration Costs* for capitalized exploration costs. Factors that may indicate the need for a write-down of a capital asset held by an enterprise in the development stage engaged in extractive operations include:

- unfavourable changes in the project economics such as declining metal or oil and gas prices;
- delay in development activity extending beyond three years; and
- poor exploration results and no planned work in the foreseeable future.

These factors would suggest that future benefits are uncertain. Similarly, declining metal or oil and gas prices could result in goodwill being impaired. If an asset's value is impaired, it should be written down immediately, which may be before the project is abandoned.

### B. MD&A Considerations

When operations are not producing significant revenue, the MD&A should focus on the company's expenses and business objectives, as stated in Part 1 (g) *Venture Issuers Without Significant Revenues* and paragraph (d) of Item 1.4 *Results of operations* of Form 51-102F1.

The MD&A should discuss:

- mining or oil and gas property plans including the impact of falling commodity prices on plans or property values;
- progress to date against those plans and remaining expenditures needed to acquire ownership or additional working interest in a property;
- the additional costs and time the company will require to complete plans and the reasons why any plan milestones were not met; and
- the factors that may affect the value of mineral or oil and gas projects and adversely affect estimates of resources or reserves (if price assumptions used to determine estimates are materially different from current prices, discuss in general terms the potential impact).

The following disclosures should be provided when discussing Items 1.6 *Liquidity* and 1.7 *Capital Resources* of Form 51-102F1:

- a quantified and analytical discussion of the company's financial resources and financial requirements, distinguishing those requirements that are committed versus discretionary in nature; and
- a discussion of any difficulties in obtaining financing and how this will affect exploration and development projects.

### C. Specific Oil and Gas Disclosures

In addition to the disclosure identified above, an oil and gas issuer, where applicable, should provide the following disclosure:



- benchmark prices used for each of the first five years for applying the impairment test and any adjustments to prices made to arrive at revenue, as set out in CICA HB Accounting Guideline 16 *Oil and Gas Accounting - Full Cost*;

- the implications of the current economic environment on the company's plans (including timing) for developing proved and probable undeveloped reserves, as set out in Item 5.1(1) and (2) *Undeveloped Reserves* of Form 51-101F1 *Statement of Reserves Data and Other Oil and Gas Information of Regulation 51-101 respecting Standards of Disclosure for Oil and Gas Activities*;

- the expectations as to the sources and costs of funding for estimated future development costs and the effect of those costs of funding on disclosed reserves or future net revenue as required under Item 5.3(2) *Future Development Costs* of Form 51-101F1; and

- if the company expects that the cost of funding could make development of a property uneconomic, the company should disclose that expectation and its plans for the property as required under Item 5.3(2) and (3) *Future Development Costs* of Form 51-101F1.

## **IX. Other**

The topics covered in this letter do not include all accounting and disclosure issues. Your company should consider the accounting and disclosure issues specific to its circumstances in the current economic environment.