

# **COMPANION POLICY**

## **44-101**

### **SHORT FORM PROSPECTUS DISTRIBUTIONS**

#### **PART 1 INTRODUCTION AND DEFINITIONS**

##### **1.1 Introduction and Purpose**

**Introduction and Purpose** - National Instrument 44-101 (the "National Instrument") replaces National Policy Statement No. 47 Prompt Offering Qualification System ("NP47") and sets out the substantive test for an issuer to qualify to file a prospectus in the form of a short form prospectus. The purpose of the National Instrument is the same as NP47's: to shorten the time period in which, and streamline the procedures by which, qualified issuers and their selling security holders can obtain access to the Canadian capital markets through a prospectus offering.

British Columbia, Alberta, Ontario, Manitoba and Nova Scotia have adopted the National Instrument by way of rule. Saskatchewan has adopted it by way of regulation. Quebec has adopted it by way of policy. All other jurisdictions have adopted National Instrument 44-101 by way of related blanket ruling or order. Each jurisdiction implements the National Instrument by one or more instruments forming part of the law of that jurisdiction (referred to as the "implementing law of the jurisdiction"). Depending on the jurisdiction, the implementing law of the jurisdiction can take the form of regulation, rule, ruling or order.

This Companion Policy to the National Instrument (also referred to as "this Companion Policy" or this "Policy") provides information relating to the manner in which the provisions of the National Instrument are intended to be interpreted or applied by the Canadian securities regulatory authorities, as well as the exercise of discretion under the National Instrument. Terms used and not defined in this

Companion Policy that are defined or interpreted in the National Instrument or a definition instrument in force in the jurisdiction should be read in accordance with the National Instrument or definition instrument, unless the context otherwise requires.

To the extent that any provision of this Policy is inconsistent or conflicts with the applicable provisions of the National Instrument in those jurisdictions that have adopted the National Instrument by way of related blanket ruling or order, the provisions of the National Instrument prevail over the provisions of this Policy.

## 1.2 Interrelationship With Local Securities Legislation

**Interrelationship With Local Securities Legislation** - The National Instrument, while being the primary instrument regulating short form prospectus distributions, is not exhaustive. Issuers are reminded to refer to the implementing law of the jurisdiction and other securities legislation of the local jurisdiction for additional requirements that may be applicable to the issuer's short form prospectus distribution.

## 1.3 Interrelationship with MRRS

**Interrelationship with MRRS** - National Policy 43-201 Mutual Reliance Review System for Prospectuses and AIFs ("National Policy 43-201") describes the practical application of the mutual reliance review system relating to the filing and review of prospectuses, including mutual fund and shelf prospectuses, amendments to prospectuses, annual information forms and related materials. While use of the MRRS is optional, the MRRS represents the only means by which an issuer can enjoy the benefits of co-ordinated review by the Canadian securities regulatory authorities in the various jurisdictions in which the issuer has filed a short form prospectus or an AIF. Under the MRRS, one Canadian securities regulatory authority or regulator as defined in National Instrument 14-101 Definitions, as applicable, acts as the principal regulator for all materials relating to a filer.

The provisions of this Policy relating to clearance of a short form prospectus or review of an AIF apply only to filings for which the issuer has not elected to use MRRS.

## 1.4 Interrelationship with Selective Review

**Interrelationship with Selective Review** - The Canadian securities regulatory authorities in Ontario, British Columbia and Alberta have adopted a system of selective review of certain documents,

including AIFs, short form prospectuses and amendments to short form prospectuses. Under the selective review system, these documents are subject to an initial screening to determine whether they will be reviewed and, if reviewed, whether they will be subject to a full review, an issue oriented review or an issuer review. Application of the selective review system, taken together with MRRS, may result in certain AIFs, short form prospectuses and amendments to short form prospectuses not being reviewed beyond the initial screening.

## **1.5 Interrelationship With Shelf Distributions (National Instrument 44-102)**

**Interrelationship With Shelf Distributions (National Instrument 44-102)** - Issuers qualified under the National Instrument to file a prospectus in the form of a short form prospectus and their security holders can distribute securities under a short form prospectus using the shelf distribution procedures under National Instrument 44-102 Shelf Distributions. The Companion Policy to National Instrument 44-102 Shelf Distributions explains that the distribution of securities under the shelf system is governed by the requirements and procedures of the National Instrument and securities legislation, except as supplemented or varied by National Instrument 44-102. Therefore, issuers qualified to file a prospectus in the form of a short form prospectus and selling security holders of those issuers that wish to distribute securities under the shelf system should have regard to the National Instrument and this Policy first, and then refer to National Instrument 44-102 and the accompanying policy for any additional requirements.

## **1.6 Inter-relationship With PREP Procedures (National Instrument 44-103)**

**Inter-relationship With PREP Procedures (National Instrument 44-103)** - National Instrument 44-103 Post-Receipt Pricing contains the post receipt pricing procedures (the "PREP procedures"). All issuers and selling security holders can use the PREP procedures of National Instrument 44-103 to distribute securities. Issuers and selling security holders that wish to distribute securities under a prospectus in the form of a short form prospectus using the PREP procedures should have regard to the National Instrument and this Policy first, and then refer to National Instrument 44-103 and the accompanying policy for any additional requirements.

## 1.7 Definitions

- (1) **Approved rating** - Cash settled derivatives are covenant-based instruments that may be rated on a similar basis to debt securities. In addition to the creditworthiness of the issuer, other factors such as the continued subsistence of the underlying interest or the volatility of the price, value or level of the underlying interest may be reflected in the rating analysis for cash settled derivatives. These additional factors may be described by a rating agency by way of a superscript or other notation to a rating. The inclusion of such notations for covenant-based instruments that otherwise fall within one of the categories of an approved rating does not detract from the rating being considered to be an approved rating for the purposes of the National Instrument.

A rating agency may also restrict its rating to securities of an issuer that are denominated in local currency. This restriction may be denoted, for example, by the designation "LC". The inclusion of such a designation in a rating that would otherwise fall within one of the categories of an approved rating does not detract from the rating being considered to be an approved rating for the purposes of the National Instrument.

- (2) **Asset-backed security** - The definition of "asset-backed security" is virtually identical to the definition adopted in the October, 1992 amendments to Form S-3 of the 1933 Act, permitting issuers of "investment grade" asset-backed securities access to the U.S. short-form registration statement and related procedures.

The definition is designed to be flexible to accommodate future developments in asset-backed securities. For example, it does not include a list of "eligible" assets that can be securitized. Instead, the definition is broad, referring to "receivables or other financial assets" that by their terms convert into cash within a finite time period. These would include, among other things, notes, leases, instalment contracts and interest rate swaps, as well as other financial assets, such as loans, credit card receivables, accounts receivable and franchise or servicing arrangements. The reference to "and any rights or other assets..." in the definition is sufficiently broad to include "ancillary" or "incidental" assets, such as guarantees, letters of credit, financial insurance or other instruments provided as a credit enhancement for the securities of the issuer or which support the underlying assets in the pool, as well as cash arising upon collection of the underlying assets that may be reinvested in short-term debt obligations.

The term, a "discrete pool" of assets, can refer to a single group of assets as a "pool" or to multiple groups of assets as a "pool". For example, a group or pool of credit card receivables

and a pool of mortgage receivables can, together, constitute a "discrete pool" of assets. The reference to a "discrete pool" of assets is qualified by the phrase "fixed or revolving" to clarify that the definition covers "revolving" credit arrangements, such as credit card and short-term trade receivables, where balances owing revolve due to periodic payments and write-offs.

While typically a pool of securitized assets will consist of financial assets owed by more than one obligor, the definition does not currently include a limit on the percentage of the pool of securitized assets that can be represented by one or more financial assets owing by the same or related obligors (sometimes referred to as an "asset concentration test").

- (3) **Principal Obligor** - The term "principal obligor" is defined to mean, for an asset-backed security, a person or company that is obligated to make payments, has guaranteed payments, or has provided alternative credit support for payments, on financial assets that represent a third or more of the aggregate amount owing on all of the financial assets underlying the asset-backed security. This term applies to a person or company that is obligated by the terms of the asset, eg. a receivable, to make payments. It does not include a person or company acting as "servicer" that collects payments from an obligor and remits payments to the issuer. Nor does the term include a seller, ie. a person or company that has sold the financial assets comprising the pool to the issuer. Sellers of financial assets have assigned to the issuer the right to receive payments on the financial assets; they are not the ones contractually obligated to make payments on the financial assets.
- (4) **Probable Acquisition of a Business and Probable Acquisition of Related Businesses** - See section 5.4.
- (5) **Regulator** - The regulator for each jurisdiction is listed in Appendix D to National Instrument 14-101 Definitions. In practice, that person has often delegated his or her powers to act under the National Instrument to another staff member of the same Canadian securities regulatory authority or, under the relevant statutory framework, another person is permitted to exercise those powers. Generally, the person exercising the powers of the regulator for the purposes of the National Instrument holds, as of the date of this Policy, the following position in each jurisdiction:

<b>Jurisdiction</b>	<b>Position</b>
Alberta	Director, Capital Markets
British Columbia	Director, Corporate Finance (except for applications for exemptions from Part 2

	of the National Instrument, for which the regulator is the Director, Exemptions and Orders)
Manitoba	Director, Corporate Finance
New Brunswick	Administrator of Securities
Newfoundland	Director of Securities
Northwest Territories	Deputy Registrar of Securities
Nova Scotia	Director of Securities
Nunavut	Registrar of Securities
Ontario	Manager, Corporate Finance
Prince Edward Island	Registrar of Securities
Quebec	Commission des valeurs mobilières du Québec
Saskatchewan	Deputy Director, Corporate Finance (except for applications for exemptions from Part 2 of the National Instrument, for which the regulator is the Saskatchewan Securities Commission)
Yukon Territory	Registrar of Securities

Further delegation may take place among staff or under securities legislation.

- (6) **Successor Issuer** - The definition of "successor issuer" requires that the issuer exist "as a result of a reorganization". In the case of an amalgamation, the amalgamated corporation is regarded by the Canadian securities regulatory authorities as existing "as a result of a reorganization". Also, if a corporation is incorporated for the sole purpose of facilitating a reorganization, the Canadian securities regulatory authorities regard the new corporation as "existing as a result of a reorganization" despite the fact that the corporation may have been incorporated before the reorganization. The definition of "successor issuer" also contains an exclusion applicable to divestitures. For example, an issuer may carry out a reorganization that results in the distribution to security holders of a portion of its business or the transfer of a portion of its business to another issuer. In that case, the entity that carries on the portion of the business that was "spun-off" is not a successor issuer within the meaning of the definition.

## PART 2

# QUALIFICATION TO FILE A PROSPECTUS IN THE FORM OF A

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# SHORT FORM PROSPECTUS

## 2.1 Basic Qualification Criteria

- (1) **Reporting Issuers in Local Jurisdiction that have been Reporting Issuers for 12 Months in a Jurisdiction other than the Local Jurisdiction (Clause 1(a)(ii) of section 2.2 of the National Instrument)** - Clause 1(a)(ii) of section 2.2 of the National Instrument provides that a reporting issuer in the local jurisdiction that is, and has been for the 12 calendar months preceding the date of the filing of its most recent AIF, a reporting issuer under Canadian securities legislation in at least one jurisdiction, other than the local jurisdiction, satisfies the reporting issuer criterion for being qualified to file a prospectus in the form of a short form prospectus if it has filed in the local jurisdiction all continuous disclosure documents that it was required to file during the 12 calendar months preceding the date of the filing of its most recent AIF under the Canadian securities legislation of any jurisdiction in which it has been a reporting issuer. An issuer that has already filed with the Canadian securities regulatory authority of the local jurisdiction some or all of the continuous disclosure documents contemplated in this clause is not required to file those documents again.
  
- (2) **Issuers not Reporting Issuers in Local Jurisdiction that are and have been Reporting Issuers for 12 Months in a Jurisdiction other than the Local Jurisdiction (Subparagraph 1(b) of section 2.2 of the National Instrument)** - Subparagraph 1(b) of section 2.2 of the National Instrument provides what an issuer that is not a reporting issuer in the local jurisdiction must do to be qualified to file a prospectus in the form of a short form prospectus in that jurisdiction if the issuer is, and has been for the 12 calendar months preceding the date of the filing of its most recent AIF, a reporting issuer under Canadian securities legislation in at least one jurisdiction, other than the local jurisdiction, and if the securities regulatory authority is unable to deem the issuer to be, or designate the issuer as, a reporting issuer. As of the coming into force date of this Policy, only the provinces of Alberta, British Columbia, Ontario, Quebec, Nova Scotia and Saskatchewan have the statutory power to deem an issuer to be, or to designate an issuer as, a reporting issuer.

## 2.2 Alternative Eligibility Criteria: Issuers that have not been Reporting Issuers for 12 Months in any Jurisdiction (Sections 2.3, 2.5, 2.6, 2.7, and 2.8 of

## the National Instrument

**Alternative Eligibility Criteria Issuers that have not been Reporting Issuers for 12 Months in any Jurisdiction (Sections 2.3, 2.5, 2.6, 2.7, and 2.8 of the National Instrument)** - Issuers that have not been reporting issuers for 12 months in any jurisdiction may nonetheless be qualified to file a prospectus in the form of a short form prospectus under the following alternative qualification criteria of the National Instrument:

1. Section 2.3, which applies to issuers with a public float of \$300,000,000 or more.
2. Section 2.5, which applies to issuers of non-convertible debt securities, non-convertible preferred shares or cash settled derivatives, if another person or company that satisfies prescribed criteria fully and unconditionally guarantees or provides alternative credit support for the payments to be made by the issuer of the securities as stipulated in the terms of the securities or in an agreement governing the rights of holders of the securities.
3. Section 2.6, which applies to issuers of convertible debt securities or convertible preferred shares, if the securities are convertible into securities of a credit supporter that satisfies prescribed criteria and fully and unconditionally guarantees or provides alternative credit support for the payments to be made by the issuer of the securities as stipulated in the terms of the securities or in an agreement governing the rights of holders of the securities.
4. Section 2.7, which applies to issuers of asset-backed securities.
5. Section 2.8, which applies to successor issuers following reorganizations.

Under sections 2.5, 2.6 and 2.7 of the National Instrument, an issuer is not required to be a reporting issuer in any jurisdiction in order to qualify to file a prospectus in the form of a short form prospectus. Under section 2.8 of the National Instrument, a successor issuer must be a reporting issuer in at least one jurisdiction. However, it is not necessary for it to have been one for 12 months, as the successor issuer may rely on the reporting history of one of the participants in the reorganization. Paragraph 1 of section 2.3 requires the issuer to be a reporting issuer or, if the issuer is not a reporting issuer in the local jurisdiction, it must be a reporting issuer under Canadian securities legislation in a jurisdiction other than the local jurisdiction, and satisfy the criterion in subparagraph 5 of paragraph 1(b) of section 2.2 of the National Instrument.

## **2.3 Calculation of the Aggregate Market Value of an Issuer's**



## Equity Securities (Section 2.9 of the National Instrument)

- (1) Section 2.9 of the National Instrument sets out how to determine whether an issuer satisfies the market value criteria contained in Part 2 of the National Instrument. Subsection 2.9(2) requires certain securities to be excluded when calculating the total number of equity securities outstanding, and subsection 2.9(3) requires a subset of those excluded securities to be included nonetheless, despite subsection 2.9(2). The following examples are provided to assist issuers and their advisers in determining which securities are to be excluded in accordance with subsections 2.9(2) and (3):

*Example (1):*

A portfolio manager manages a pension fund. The pension fund holds 11% of the equity securities of the issuer.

*Result:* These equity securities must be excluded in calculating the market value of the issuer's equity securities.

*Example (2):*

A portfolio manager (not an affiliate of the issuer) manages three mutual funds each of which holds 3% of the equity securities of the issuer. An affiliate of the portfolio manager (not an affiliate of the issuer) manages two mutual funds each of which holds 3% of the equity securities of the issuer.

*Result:* The aggregated equity securities (15%) do not have to be excluded in calculating the market value of the issuer's equity securities.

*Example (3):*

The facts are the same as in Example (2) above, except that the portfolio manager is an affiliate of the issuer.

*Result:* The aggregated equity securities must be excluded in calculating the market value of the issuer's equity securities.

*Example (4):*

A portfolio manager (not an affiliate of the issuer) manages three non-redeemable investment funds (A, B and C). A holds 12% of the equity securities of the issuer. B and C each hold 6% of the equity securities of the issuer.

*Result:* The equity securities of the issuer held by A must be excluded in calculating the market value of the issuer's equity securities but the equity securities held by B and C (12% in the aggregate) need not be excluded in calculating the market value of the issuer's equity securities.

- (2) Instalment receipts that evidence the beneficial ownership of outstanding equity securities (subject to an encumbrance to secure the obligation of the instalment receipt holder to pay future instalments) and other similar receipts that evidence beneficial ownership of outstanding equity securities are not, themselves, equity securities. Consequently, the market value of such a receipt may not be included in the market value calculation of an issuer's outstanding equity securities (subject to the exception in paragraph 2.9(1)(b) of the National Instrument). The market value of the equity securities evidenced by the receipt, may however, be included, subject to subsections 2.9(2) and 2.9(3) of the National Instrument.

The exclusions set out in subsection 2.9(2) of the National Instrument refer to equity securities of an issuer that are beneficially owned, or over which control or direction is exercised by persons or companies that, alone or together with their respective affiliates and associated parties, beneficially own or exercise control or direction over more than 10 per cent of the outstanding equity securities of the issuer. Instalment receipt transactions typically involve a custodian holding a security interest in the securities the beneficial ownership of which is evidenced by instalment receipts. The Canadian securities regulatory authorities do not regard the custodian, by virtue of holding a security interest, as exercising "control or direction" over the securities for the purposes of subsection 2.9(2) of the National Instrument if the custodian is not entitled to exercise any voting rights attached to the securities or dispose of the securities without the beneficial owner's consent.

## **2.4 Alternative Qualification Criteria for Substantial Issuers (Section 2.3 of the National Instrument)**

### **Alternative Qualification Criteria for Substantial Issuers (Section 2.3 of the National Instrument)**

- Subparagraph 1(b) of section 2.3 of the National Instrument requires substantial issuers, that are not reporting issuers in the local jurisdiction, to be reporting issuers under Canadian securities legislation in a jurisdiction, other than the local jurisdiction, and to satisfy the criterion in subparagraph 5 of
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paragraph 1(b) of section 2.2. That criterion requires the issuer to have provided an undertaking to the securities regulatory authority that it will file all continuous disclosure documents that it would be required to file under securities legislation if it were a reporting issuer from the time of the filing of its most recent AIF until the issuer becomes a reporting issuer.

## **2.5 Alternative Qualification Criteria for Issuers of Guaranteed Debt Securities, Preferred Shares and Cash Settled Derivatives (Sections 2.5 and 2.6 of the National Instrument)**

**Alternative Qualification Criteria for Issuers of Guaranteed Debt Securities, Preferred Shares and Cash Settled Derivatives (Sections 2.5 and 2.6 of the National Instrument)** - Sections 2.5 and 2.6 of the National Instrument allow an issuer to qualify to file a prospectus in the form of a short form prospectus based on a full and unconditional guarantee or alternative credit support. The Canadian securities regulatory authorities are of the view that a person or company that provides the full and unconditional guarantee or alternative credit support is not, simply by providing that guarantee or alternative credit support, issuing a security.

## **2.6 Alternative Qualification Criteria for Asset-Backed Securities (Section 2.7 of the National Instrument)**

- (1) In order to be qualified to file a prospectus in the form of a short form prospectus under section 2.7 of the National Instrument, an issuer must have been established in connection with a distribution of asset-backed securities. Ordinarily, asset-backed securities are issued by special purpose issuers established for the sole purpose of purchasing financial assets with the proceeds of one or more distributions of these securities. This ensures that the credit and performance attributes of the asset-backed securities are dependant on the underlying financial assets, rather than upon concerns relating to ancillary business activities and their attendant risks. Qualification to file a prospectus in the form of a short form prospectus under this section has been limited to special purpose issuers to avoid the possibility that an otherwise ineligible issuer would structure securities falling within the definition of "asset-backed security".
- (2) The qualification criteria for a distribution of asset-backed securities under a prospectus in the form of a short form prospectus are intended to provide sufficient flexibility to accommodate

future developments. To qualify under section 2.7 of the National Instrument, the securities to be distributed must satisfy the following two criteria:

1. First, the payment obligations on the securities must be serviced primarily by the cash flows of a pool of discrete liquidating assets such as accounts receivable, instalment sales contracts, leases or other assets that by their terms convert into cash within a specified or determinable period of time.
2. Second, the securities must (i) receive an approved rating on a provisional basis, (ii) not have been the subject of an announcement regarding a downgrade to a rating that is not an approved rating, and (iii) not have received a provisional or final rating lower than an approved rating from any approved rating organization.

The qualification criteria do not distinguish between pass-through (i.e., equity) and pay-through (i.e., debt) asset-backed securities. Consequently, both pay-through and pass-through securities, as well as residual or subordinate interests, may be distributed under a prospectus in the form of a short form prospectus if all other applicable requirements are met.

## **2.7 Reorganizations (Section 2.8 of the National Instrument)**

- (1) Section 2.8 of the National Instrument provides alternative qualification criteria for a successor issuer to qualify to file a prospectus in the form of a short form prospectus even though it has not been a reporting issuer in any jurisdiction for 12 months. It may qualify if, among other things, it is a reporting issuer under Canadian securities legislation and, at the time of the reorganization, at least one of the participants in the reorganization satisfied the 12 month reporting issuer criterion in paragraph 1 of section 2.2 of the National Instrument.
- (2) An issuer that was previously qualified to file a prospectus in the form of a short form prospectus under the basic qualification criteria set out in section 2.2 of the National Instrument, including the \$75,000,000 market value requirement, and is the subject of a reorganization that results in that issuer becoming a wholly-owned subsidiary of another entity, will not be qualified to file a prospectus in the form of a short form prospectus under section 2.2. This is because it cannot satisfy the \$75,000,000 market value requirement. It may continue to be qualified to file a prospectus in the form of a short form prospectus under section 2.4 or section 2.5 of the National Instrument (approved rating or guaranteed securities) or section 2.7 of the National Instrument (asset-backed securities).

- (3) An entity that carries on the portion of the business that was "spun-off" is not a successor issuer within the meaning of the definition. The Canadian securities regulatory authorities have, from time to time, granted relief allowing the "spun-off" entity to file a prospectus in the form of a short form prospectus even though it may not otherwise satisfy certain of the qualification criteria. In those situations where the Canadian securities regulatory authorities have granted relief, there has been substantial audited segmented disclosure of the "spun-off" entity in the market place for at least one year before the reorganization. In addition, the Canadian securities regulatory authorities will generally look at whether the spun-off entity is described in the AIF and MD&A of the parent company. Applications for relief will be considered on a case by case basis.
- (4) Market participants are also reminded that if an issuer files a prospectus or other offering document following a material reorganization, take-over bid or acquisition of assets, the prospectus or offering document is required to contain, either directly or, if permitted, through incorporation by reference, appropriate disclosure concerning the reorganization, take-over bid or acquisition of assets and its effect on the issuer in order for the prospectus or other offering document to contain full, true and plain disclosure of all material facts.

## **2.8 Adoption by Successor Issuer of a Participant's AIF Following a Reorganization (Section 2.10 of the National Instrument)**

**Adoption by Successor Issuer of a Participant's AIF Following a Reorganization (Section 2.10 of the National Instrument)** - Section 2.10 of the National Instrument enables a successor issuer to adopt as its own AIF the AIF of a participant in the reorganization, if the AIF was a current AIF of the participant at the time of the reorganization. By adopting the AIF of a participant, the successor issuer is deemed under section 2.10 to have a current AIF for the purposes of securities legislation. It is not relevant whether the participant that filed the AIF continues to exist after the reorganization. If the participant continues to exist after the reorganization, the adoption by the successor issuer of the current AIF of the participant does not preclude the participant from having the AIF in order to, itself, qualify to file a prospectus in the form of a short form prospectus. Under section 2.10 of the National Instrument, a successor issuer may choose to adopt the current AIF of more than one participant in the reorganization that gave rise to the successor issuer. This may be appropriate in circumstances where the successor issuer succeeded to the businesses of two participants where each participant had a current AIF. A successor issuer may always file its own AIF in order to have a current AIF.

## **PART 3**

### **AIF**

#### **3.1 Initial AIF Review Procedures (Section 3.1 of the National Instrument)**

- (1) An AIF filed by either an issuer that has not previously had an AIF accepted for filing in the local jurisdiction or an issuer that previously had a current AIF in the local jurisdiction and no longer has one is treated as an initial AIF for the purpose of review by the POP regulator.
- (2) An initial AIF and supporting documents will be reviewed by the Canadian securities regulatory authorities, including the CVMQ, in accordance with the procedures described in the MRRS if the issuer has elected to use the MRRS. Compliance by issuers with the MRRS procedures, although not mandatory, will generally result in the most expeditious treatment of initial AIFs on a national basis. If an issuer does not elect MRRS, the review of the initial AIF will not be co-ordinated among the various jurisdictions in which the issuer has filed the AIF, nor is the review subject to any particular time frame.
- (3) An issuer filing in more than one jurisdiction should file the initial AIF, together with any supporting materials, as nearly as may be practicable, contemporaneously in each of the jurisdictions in which the issuer wishes to become qualified to file a prospectus in the form of a short form prospectus. Contemporaneous filing is automatic for issuers using SEDAR. An issuer should file in each jurisdiction an AIF identical in form and content, including the date, except that French language documents filed in Quebec need not be filed in the other jurisdictions, except as required under subsections 3.1(3) and (4) of the National Instrument. The review of documents filed in Quebec in the French language, apart from substantive comments applying to both English and French language versions, will ordinarily be dealt with between Quebec and the issuer or the issuer's agent in Quebec directly.

#### **3.2 Renewal AIF Filing and Review Procedures (Section 3.2 of the National Instrument)**

- (1) An issuer that has a current AIF for its second most recently completed financial year and

wishes to have a current AIF for its most recently completed financial year must file a renewal AIF in accordance with section 3.2 of the National Instrument.

- (2) An issuer that does not have a current AIF in the local jurisdiction, yet has a current AIF in another jurisdiction, and wishes to file a short form prospectus in the local jurisdiction may file, as an initial AIF under section 3.1 of the National Instrument in the local jurisdiction, either (i) the new AIF that it is filing as a renewal AIF in the other jurisdiction, or (ii) the AIF that is a current AIF in the other jurisdiction. The issuer should notify all the other jurisdictions in which it already has a current AIF that it is filing an initial AIF in a new jurisdiction.
- (3) An issuer filing in more than one jurisdiction should file a renewal AIF, together with any supporting materials, as nearly as may be practicable, contemporaneously in each of the jurisdictions in which the issuer wishes to remain qualified to file a prospectus in the form of a short form prospectus. Contemporaneous filing is automatic for issuers using SEDAR. An issuer should file an AIF in each jurisdiction identical in form and content, including the date, except that French language documents filed in Quebec need not be filed in the other jurisdictions, except as otherwise provided in subsections 3.2(8) and (9) of the National Instrument.
- (4) A renewal AIF, if selected for review, will be reviewed by the Canadian securities regulatory authorities in accordance with section 3.2 of the National Instrument and the procedures described in MRRS, if the issuer has elected to use MRRS.
- (5) This subsection applies to an issuer that files a renewal AIF and has not elected to use the MRRS. If an issuer's renewal AIF has been selected for review and the issuer files a preliminary short form prospectus, both the issuer's preliminary short form prospectus and its renewal AIF will be reviewed at the same time. In these circumstances, comments arising in the course of the review of the renewal AIF will be taken into account during the review of the preliminary short form prospectus. The notice that the review of the renewal AIF has been completed will be issued before, or concurrently with, the issuance of the receipt for the short form prospectus. A receipt for the short form prospectus will not be issued until the review of the renewal AIF has been completed. No particular time frame applies to this review.

### **3.3 Supporting Documents (Section 3.3 of the National Instrument)**

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- (1) Any material incorporated by reference in an AIF is required under paragraph 3.3(1)(a) of the

National Instrument to be filed with the AIF unless it has been previously filed. When an issuer using SEDAR files a previously unfiled document with its AIF, the issuer should ensure that the document is filed under the appropriate SEDAR filing type and document type specifically applicable to the document, rather than generic type "Documents Incorporated by Reference". For example, an issuer that has incorporated by reference an information circular in its AIF and has not previously filed the circular should file the circular under the "Management Proxy Materials" filing subtype and the "Management proxy/information circular" document type.

- (2) There is no regulatory requirement for auditor involvement with respect to the preparation of an AIF. No solicitor's, auditor's, accountant's, engineer's, appraiser's or other consent is required to be filed with an AIF. However, reporting issuers may choose to involve their auditors. The auditing profession's standards may require limited auditor involvement in certain circumstances. Section 10.4 of the National Instrument requires the filing of consents of experts with a short form prospectus. In order to be able to provide the necessary consent letter on a short form prospectus, an auditor will be obliged to comply with applicable requirements of the Handbook and of Canadian securities legislation of the jurisdictions in which the AIF is filed.

## **PART 4 FINANCIAL MATTERS**

### **A. ISSUERS AND SIGNIFICANT ACQUISITIONS**

#### **4.1 Financial Statement Requirements - Explanation of the 60 and 90 Day References**

- (1) The financial statement disclosure requirements for an issuer and any business acquired or to be acquired are often described with reference to 60 or 90 day periods. A reporting issuer is required to file interim financial statements 60 days after the last day of an interim period on a continuous disclosure basis. The interim financial statement disclosure requirements in the National Instrument are based on these continuous disclosure reporting time frames. Annual audited financial statements are required to be filed 140 days after year end on a continuous disclosure basis. However, if a preliminary short form prospectus is filed more than 90 days after year end, the audited financial statements are required to be included in the short form prospectus.



- (2) Section 1.10 of the National Instrument states that unless otherwise stated, a reference to a short form prospectus in the National Instrument includes a preliminary short form prospectus. Consequently, the 60 and 90 day period references discussed in subsection (1) should be considered as at the date the preliminary short form prospectus is filed and again at the date of the final short form prospectus is filed for both the issuer and any business acquired or to be acquired. Depending on the period of time between the dates of the preliminary and final short form prospectuses, an issuer may have to include more recent financial statements.
- (3) However, in order for an issuer to distribute securities using the short form prospectus system, sections 2.2, 2.3, 2.4, 2.5, 2.6, 2.7 and 2.8 of the National Instrument each require the issuer to file financial statements for its most recently completed financial year only if the issuer files a preliminary short form prospectus more than 90 days after its most recently completed financial year. If the issuer files a preliminary short form prospectus less than 90 days after the end of its most recently completed financial year and files the final short form prospectus more than 90 days after the end of the issuer's most recently completed financial year, the issuer is not required to include in the short form prospectus the financial statements for its most recently completed financial year. The Canadian securities regulatory authorities recognize that issuers generally anticipate that the period of time between the filing a preliminary and a final short form prospectus will be relatively brief. Accordingly, imposing the requirement on an issuer to update its prospectus to reflect the results of its most recently completed financial year because those financial statements were filed between the dates of the preliminary and final short form prospectus could significantly delay the completion of an offering thus diminishing the benefits of the short form prospectus offering regime.
- (a) For example, assume an issuer has a December 31 year end and files a preliminary short form prospectus on March 28, year one. If the issuer has not filed audited financial statements for its most recently completed financial year by March 28 and files its final short form prospectus on April 5, the issuer will not be required to file and incorporate by reference its audited financial statements for its most recently completed year nor will it be required to update the final short form prospectus to reflect the results for the most recently completed financial year. However, if the issuer filed the preliminary short form prospectus on or after April 1, it would be required to include the audited financial statements for its most recently completed financial year.
- (4) Despite subsection (3), the Canadian securities regulatory authorities are of the view that directors of issuers should endeavor to review and approve financial statements in a timely manner and should not delay the approval and release of the financial statements in order to avoid their inclusion in a short form prospectus.

## **4.2 Additional Financial Statements or Financial Information Filed or Released**

**Additional Financial Statements or Financial Information Filed or Released** - If annual or interim financial statements of a business acquired or to be acquired, more recent than those that would otherwise be required to be included in a short form prospectus, have been filed before a short form prospectus is filed, sections 4.7 and 5.3 of the National Instrument require those financial statements to be included in the short form prospectus and the short form prospectus to be updated accordingly. However, if information derived from more recent annual or interim financial statements is released to the public by the issuer before the financial statements are filed, the short form prospectus should include the information included in the news release or public communication. There is no specific requirement in the National Instrument to otherwise update the short form prospectus or *pro forma* financial statements to reflect the more recent information.

## **4.3 Auditor's Report for All Financial Statements Included in the Short form Prospectus**

**Auditor's Report for All Financial Statements Included in the Short form Prospectus** - The National Instrument requires that all financial statements included in a short form prospectus be accompanied by an auditor's report without a reservation of opinion, except financial statements specifically exempted in the National Instrument. Issuers are reminded that this requirement extends to financial statements of subsidiaries and other entities even if the financial statements are not required to be included in the short form prospectus but have been included at the discretion of the issuer.

## **4.4 Exemption from Auditor's Report if not Previously Included in a Short form Prospectus**

**Exemption from Auditor's Report if not Previously Included in a Short form Prospectus** - If an issuer received a receipt for a final short form prospectus that included financial statements of a business acquired or to be acquired for a financial year that were not accompanied by an auditor's report, section 4.15 of the National Instrument provides that if the issuer includes any of those unaudited financial statements in a subsequent short form prospectus, the issuer will not be expected to

include an auditor's report on those financial statements unless they were audited subsequent to obtaining the final receipt for the previous short form prospectus. The Canadian securities regulatory authorities recognize that requesting an issuer to obtain an auditor's report that it was permitted to exclude from a previous final short form prospectus could create undue hardship for the issuer.

## **4.5 Timing of Requests for Exemptions from the Financial Statement Requirements**

**Timing of Requests for Exemptions from the Financial Statement Requirements** - Requests for exemptions from Parts 4 and 5 of the National Instrument and Item 12.1 of Form 44-101 F3 should be made in accordance with Part 15 of the National Instrument which requires the issuer to make submissions in writing along with the reasons for the request and the proposed alternative disclosure. Written submissions should be filed at, or preferably before, the time the preliminary short form prospectus is filed, in order to permit the issue to be resolved in a timely manner. Issuers filing a short form prospectus in more than one jurisdiction are encouraged to consult National Policy 43-201 Mutual Reliance Review System for Short form prospectuses and Annual Information Forms for more guidance on pre-filing applications.

### **B. ISSUERS**

## **4.6 Applications for Exemption from Requirement to Include Financial Statements of the Issuer**

- (1) The Canadian securities regulatory authorities are of the view that relief from the requirement to provide audited historical financial statements should be granted only in unusual circumstances not related to cost or the time involved in preparing or auditing the financial statements. If in unusual circumstances relief is granted, conditions will likely be imposed, such as a requirement to include audited divisional statements of income or cash flows, financial statements accompanied by audit reports containing a reservation of opinion or audited statements of net operating income.
- (2) In view of the reluctance of the Canadian securities regulatory authorities to grant exemptions from the requirement to include audited historical financial statements, issuers seeking relief should consult with staff on a pre-filing basis.

- (3) Relief may be granted in appropriate circumstances to permit the auditor's report on financial statements to contain a reservation relating to opening inventory if there is a subsequent audited period of at least six months on which the auditor's report contains no reservation and the business is not seasonal.
- (4) Considerations relevant to granting an exemption from the requirement to include financial statements, generally for the years immediately preceding the issuer's most recently completed financial year, may include the following:
- (a) The issuer's historical accounting records have been destroyed and cannot be reconstructed. In this case, as a condition of granting the exemption, the issuer may be requested by the Canadian securities regulatory authorities to
- (i) represent in writing to the Canadian securities regulatory authorities, no later than the time the preliminary short form prospectus is filed, that the issuer made every reasonable effort to obtain copies of, or reconstruct, the historical accounting records necessary to prepare and audit the financial statements, but such efforts were unsuccessful; and
- (ii) disclose in the short form prospectus the fact that the historical accounting records have been destroyed and cannot be reconstructed.
- (b) The issuer has emerged from bankruptcy and current management is denied access to the historical accounting records necessary to audit the financial statements. In this case, as a condition of granting the exemption, the issuer may be requested by the Canadian securities regulatory authorities to
- (i) represent in writing to the Canadian securities regulatory authorities, no later than the time the preliminary short form prospectus is filed, that the issuer has made every reasonable effort to obtain access to, or copies of, the accounting records necessary to audit the financial statements but that such efforts were unsuccessful; and
- (ii) disclose in the short form prospectus the fact that the issuer has emerged from bankruptcy and current management is denied access to the historical accounting records.
- (c) The issuer has undergone a fundamental change in the nature of its business or

operations affecting a majority of its operations and all, or substantially all, of the executive officers and directors of the company have changed. The evolution of a business or progression along a development cycle will not be considered to be a fundamental change in an issuer's business or operations. Relief from the requirement to include financial statements of the issuer required by the National Instrument for the year in which the change occurred, or for the most recently completed financial year if the change in operations occurred during the issuer's current financial year, generally will not be granted

## **4.7 Reverse Take-overs**

**Reverse Take-overs** - When an issuer has been involved in a business combination accounted for a reverse take-over, Item 12.7 of Form 44-101F3 requires that financial statements referred to in Item 12.1(1) of Form 44-101F3 be provided for the legal subsidiary which is the accounting parent, as those terms are used in the Handbook.

# **PART 5 DISCLOSURE IN A SHORT FORM PROSPECTUS OF FINANCIAL STATEMENTS FOR SIGNIFICANT ACQUISITIONS, SIGNIFICANT DISPOSITIONS AND MULTIPLE ACQUISITIONS**

## **A. GENERAL**

### **5.1 Financial Statement Disclosure of Significant Acquisitions and Multiple Acquisitions**

**Financial Statement Disclosure of Significant Acquisitions and Multiple Acquisitions** - Appendix A to this Policy is a chart outlining the key obligations for financial statement disclosure of significant acquisitions and multiple acquisitions. Appendix B includes examples which illustrate the application of certain Parts of the Instrument related to financial reporting requirements.

## 5.2 Acquisition of a Business

**Acquisition of a Business** - Part 4 of the National Instrument requires an issuer that has made a significant acquisition or is proposing to make a significant probable acquisition to include in its short form prospectus certain financial statements of each business acquired or to be acquired. Part 5 of the National Instrument has similar requirements for an issuer that has made or is proposing to make multiple acquisitions that are not related or individually significant. For this purpose, the term "business" should be evaluated in light of the facts and circumstances involved. The Canadian securities regulatory authorities generally consider that a separate entity, a subsidiary or a division is a business and that in certain circumstances a lesser component of a person or company may also constitute a business, whether or not the subject of the acquisition previously prepared financial statements. Continuity of business operations is considered in determining whether an acquisition constitutes the acquisition of a business. Other factors that will be considered include

- (a) whether the nature of the revenue producing activity or potential revenue producing activity will remain generally the same after the acquisition; and
- (b) whether any of the physical facilities, employees, marketing systems, sales forces, customers, operating rights, production techniques or trade names are acquired by the issuer instead of remaining with the vendor after the acquisition.

## 5.3 Acquisition of an Interest in an Oil and Gas Property

(1) The Canadian securities regulatory authorities consider the acquisition of an interest in an oil and gas property ("property") to constitute the acquisition of a business as discussed in section 5.2 of the Policy. However, it is recognized that in certain situations, limited availability of, or access to, audited financial statements or financial information of the acquired property makes it difficult to comply with the financial statement disclosure requirements outlined in Parts 4 and 5 of the National Instrument. The Canadian securities regulatory authorities have also considered that, unique to the oil and gas industry, relevant operating information is often publicly available. Accordingly, the Canadian securities regulatory authorities may consider granting an exemption from the disclosure requirements of Parts 4 and 5 of the National Instrument if

- (a) the issuer has not accounted for the acquisition as a reverse take-over;
- (b) the property does not constitute a "reportable segment" of the vendor, as defined in

section 1701 of the Handbook, at the time of the acquisition; and

- (c) the prospectus includes acceptable alternative disclosure in respect of the property as outlined in subsection (2).

(2) Alternative Disclosure

- (a) The Canadian securities regulatory authorities are of the view that alternative disclosure in a short form prospectus, to be acceptable for the purposes of subsection (1)(c), should include at least an audited operating statement of the property acquired or to be acquired for each of the years required by Parts 4 and 5 of the National Instrument. The operating statements should each present, at a minimum, the following line items:

- gross revenue;
- royalty expenses;
- production costs; and
- operating income.

In applying Parts 4 and 5 of the National Instrument for purposes of this paragraph, the significance of an acquired property or of a probable acquisition of a property shall be determined based on the investment and income tests outlined in section 1.2 of the National Instrument, except that for purposes of the income test, "operating income" should be substituted for "consolidated income from continuing operations".

- (b) In addition to the information in paragraph (a), the following information may also be required to be included in the short form prospectus.
  - (i) Information with respect to reserve estimates and estimates of future net revenue and production volumes and other relevant information regarding the property, if material.
  - (ii) Actual production volumes of each of the properties for each of the three most recently completed years.
  - (iii) Estimated production volumes of each of the properties for each of the next three years based on information in the respective reserve reports.

(3) **Relief from the requirement to Audit Operating Statements** - Despite subsection (2)(a), the

Canadian securities regulatory authorities may permit an issuer to exclude an audit opinion on the operating statements referred to in subsection (2)(a) if

- (a) the property was acquired prior to December 31, 2000 and the issuer provides written submissions prior to filing the final short form prospectus which establish to the satisfaction of the Canadian securities regulatory authorities that, despite making reasonable efforts, the issuer was unable to obtain audited operating statements because the vendor refused to provide such audited statements or to permit access to the information necessary to audit the statements; or
- (b) during the 12 months preceding the date of the acquisition or the proposed date of the probable acquisition, the daily average production of the property on a barrel of oil equivalent basis (with gas converted to oil in the ratio of six thousand cubic feet of gas being the equivalent of one barrel of oil), is less than 20 per cent of the total daily average production of the vendor for the same or similar periods and
  - (i) the issuer provides written submissions prior to filing the final short form prospectus that establish to the satisfaction of the Canadian securities regulatory authorities that despite reasonable efforts during the purchase negotiations, the issuer was prohibited from including in the purchase agreement the rights to obtain an audited operating statement of the property;
  - (ii) the purchase agreement includes representations and warranties by the vendor that the amounts presented in the operating statement agree to the vendor's books and records; and
  - (iii) the issuer discloses in the short form prospectus its inability to obtain an audited operating statement, the reasons therefore, the fact that the representations and warranties referred to in item (ii) have been obtained, and a statement that the results presented in the operating statements may have been materially different if the statements had been audited.

## 5.4 Probable Acquisitions

- (1) The definitions of "probable acquisition of a business" and "probable acquisition of related businesses" in the National Instrument both include the phrase "where a reasonable person would believe that the likelihood of the acquisition being completed is high". The Canadian



securities regulatory authorities interpret this phrase having regard to section 3290 of the Handbook "Contingencies". It is the view of the Canadian securities regulatory authorities that the following factors may be relevant in determining whether the likelihood of an acquisition being completed is high

- (a) whether the acquisition has been publicly announced;
  - (b) whether the acquisition is the subject of an executed agreement; and
  - (c) the nature of conditions to the completion of the acquisition including any material third party consents required.
- (2) The test of whether a proposed acquisition is a "probable acquisition of a business" or "probable acquisition of related businesses" is an objective, rather than subjective, test in that the question turns on what a "reasonable person" would believe. It is not sufficient for an officer of an issuer to determine that he or she personally believes that the likelihood of the acquisition being completed is or is not high. The officer must form an opinion as to what a reasonable person would believe in the circumstances. In the event of a dispute as to whether an acquisition is a probable acquisition, an objective test requires an adjudicator to decide whether a reasonable person would believe in the circumstances that the likelihood of an acquisition being completed was high. By contrast, if the definition relied on a subjective test, the adjudicator would assess an individual's credibility and decide whether the personal opinion of the individual as to whether the likelihood of the acquisition being completed was high was an honestly held opinion. Formulating the definition using an objective test rather than a subjective test strengthens the basis upon which the regulator may object to an issuer's application of the definition in particular circumstances.
- (3) A completed acquisition of a business and a proposed acquisition of a business will constitute a probable acquisition of related businesses defined in section 1.1 of the National Instrument if, among other things, each acquisition is contingent on a single common event. Common financing is one example of a single common event contemplated by the definition.

## **5.5 Significant Acquisitions Completed During the Issuer's Three Most Recently Completed Financial Years**

### **Significant Acquisitions Completed During the Issuer's Three Most Recently Completed**

**Financial Years** - If an issuer made a significant acquisition during its three most recently completed financial years, the balance sheets of the business as at a date prior to the date of the acquisition will be reflected in the issuer's most recent audited balance sheet included in the prospectus. In addition, the allocation of the purchase price to the assets acquired and liabilities assumed should also be disclosed in the issuer's audited financial statements. Accordingly, there is no requirement under subsection 4.2(1) of the National Instrument for the financial statements of the business included in the prospectus to include a balance sheet. The corresponding exception for individually insignificant, unrelated acquisitions is provided in subsection 5.2(4) of the National Instrument. The Canadian securities regulatory authorities recognize that a balance sheet will normally have been prepared and will not object if the financial statements of a business included in the prospectus include a balance sheet.

## **5.6 Significant Acquisitions Completed During the Issuer's Current Financial Year**

**Significant Acquisitions Completed During the Issuer's Current Financial Year** - If an issuer has made a significant acquisition during its current financial year, and the acquisition is accounted for using the purchase method, section 4.11 of the National Instrument requires an issuer to include disclosure about the acquisition, including a purchase price allocation, in a subsequent event note to the issuer's financial statements. At the time the short form prospectus is filed, the allocation of the purchase price may not yet be finalized so it may be impracticable to provide a detailed purchase equation. However, the issuer will know the assets and liabilities it has acquired and is expected to estimate an allocation of the purchase price to those assets and liabilities, at least on an aggregate basis.

### **B. APPLICATION OF THE SIGNIFICANT TESTS**

## **5.7 Timing of Significance Tests**

- (1) Section 1.2 of the National Instrument sets out the significance tests for determining whether an acquisition of a business by an issuer is a "significant acquisition". The first test measures the assets of the acquired business against the assets of the issuer. The second test measures the issuer's investments in and advances to the acquired business against the assets of the issuer. The third test measures the income from continuing operations of the acquired business against the income from continuing operations of the issuer. If any one of these three tests is satisfied at the 20 per cent level, the acquisition is considered "significant" to the issuer. The tests must be

applied at the time of the acquisition using the most recent audited financial statements of the issuer and the business. This is consistent with the requirement of the Securities and Exchange Commission of the United States of America and provides issuers with certainty that if an acquisition is not significant at the time of the acquisition, then no financial statements of the business will be required to be included in the prospectus.

- (2) If an acquisition is determined under subsection 1.2(2) of the National Instrument to be significant on the date of acquisition, an issuer has the option under subsection 1.2(3) of the National Instrument of applying the tests using the more recent financial statements for the 12 months ended on the last day of the most recent interim period financial statements included in the short form prospectus and the financial statements of the business for a coterminous period ending on the same day as the issuer's financial statements. However, for the purposes of applying the investment test under subsection 1.2(3)2 of the National Instrument, the issuer's investments in and advances to the business should be the amount used to calculate the significance as at the date of the acquisition and not the amount as at the date of the issuer's financial statements used to recalculate the significance.
- (3) The option under subsection 1.2(3) of the National Instrument has been included in order to recognize the possible growth of an issuer between the date of acquisition and the date of a short form prospectus offering and the corresponding potential decline in significance of the acquisition to the issuer. If the significance of an acquisition increases at the second date under subsection 1.2(3), only the financial statements required when the tests are applied at the first stage under subsection 1.2(2) of the National Instrument, are required to be included in the short form prospectus. Applying the significance tests at the second date is not intended to increase the level of significance of an acquisition and thereby the number of years of financial statements.
- (4) The significance tests at the second date are an option available to all issuers. However, depending on how or when an issuer integrates the acquired business into its existing operations and the nature of post-acquisition financial records it maintains for the acquired business, it may not be possible for an issuer to apply the tests at the second date.

## **5.8 Acquisition of a Business when the Financial Statements of the Business are prepared in accordance with a Foreign GAAP**

**Acquisition of a Business when the Financial Statements of the Business are prepared in accordance with a Foreign GAAP** - Subsection 1.2(9) of the National Instrument states that where the financial statements of the business or related businesses are prepared in accordance with foreign GAAP, for purposes of applying the significance tests, the relevant financial statements should be reconciled to Canadian GAAP. It is unnecessary for the reconciliation to be audited for the purpose of the test as the Canadian securities regulators recognize that this could be onerous, particularly if the business or related businesses are determined not to be a significant acquisition.

## 5.9 Acquisition of a Previously Unaudited Business

**Acquisition of a Previously Unaudited Business** - Section 1.2(2) of the National Instrument requires the significance of an acquisition to be determined using the most recent audited financial statements of the issuer and the business acquired or to be acquired. If the business was a private company prior to the acquisition and it did not engage an auditor to audit its annual financial statements then, for the purpose of applying the significance tests, subsection 1.2(6) of the National Instrument permits use of the unaudited financial statements of the business prepared in accordance with GAAP. If the acquisition is determined to be significant, then the financial statements for the number of periods required by Parts 4 and 5 of the National Instrument must be audited.

## 5.10 Application of the Significance Tests when the Financial Year Ends of the Issuer and the Acquired Business are Non-Coterminous

**Application of the Significance Tests when the Financial Year Ends of the Issuer and the Acquired Business are Non-Coterminous** - Subsection 1.2(2) of the National Instrument requires the significance of an acquired business to be determined using the most recent audited financial statements of both the issuer and the acquired business. For the purpose of applying the tests under this subsection, the year ends of the issuer and the acquired business need not be coterminous. Accordingly, neither the audited financial statements of the issuer or the business should be adjusted for the purpose of applying the significance tests. However, if an acquired business is determined to be significant and *pro forma* income statements are prepared in accordance with Part 4 or 5 of the National Instrument, and if the last day of the business' year end is more than 93 days from the last day of the issuer's year end, the business' reporting period so required under subsection 4.5(4) of the National Instrument should be adjusted to reduce the gap to 93 days or less. Reference is made to section 5.17 of this Companion Policy for further guidance.

## 5.11 Application of Investment Test for Significance of an Acquisition

**Application of Investment Test for Significance of an Acquisition** - Subsections 1.2(2) and, if applicable, 1.2(3) of the National Instrument set out when an acquisition of a business by an issuer is a "significant acquisition". One of the tests is whether the issuer's consolidated investments in and advances to the business or related businesses exceeds 20 per cent of the consolidated assets of the issuer as at the date of the audited financial statements of the issuer, for the most recently completed financial year ended prior to the date of the acquisition. In applying this test, the "investments in" the business should be determined using the total cost of the purchase, as determined by generally accepted accounting principles, which includes consideration paid or payable and the costs of the acquisition. If the acquisition agreement includes a provision for contingent consideration, for the purpose of applying the test, the contingent consideration should be included in the total cost of the purchase unless the likelihood of payment is considered remote at the date of the acquisition. In addition, any payments made in connection with the acquisition which would not constitute purchase consideration but which would not have been paid unless the acquisition had occurred, should be considered part of investments in and advances to the business for the purpose of applying the significance tests. Examples of such payments include loans, royalty agreements, lease agreements and agreements to provide a pre-determined amount of future services.

## 5.12 Application of Income Test for Significance of an Acquisition

- (1) The third significance test set out in subsection 1.2(2)3 of the National Instrument is whether the issuer's proportionate share of the consolidated income from continuing operations of the business or related businesses exceeds 20 per cent of the consolidated income from continuing operations of the issuer based on the audited financial statements of the issuer and the acquired business for the most recently completed financial year ended before the date of the acquisition. Subsection 1.2(3)3 of the National Instrument sets out an optional calculation using more recent financial statements. In applying the income test, the income from continuing operations of the business should be determined using the accounting policies applied by the issuer.
- (2) Subsections 1.3(3), (4) and (5) of the National Instrument permit the issuer to use the average income of its three most recently completed fiscal years or 12 month periods, respectively, if the

income from continuing operations for the most recently completed fiscal year is positive and at least 20 per cent lower than the average for the three most recently completed years. The averaging option is not available if the issuer has incurred a loss from continuing operations during its most recently completed year or more recent 12 month period. If the averaging option is available to the issuer but it incurred a loss from continuing operations in the second and/or third most recently completed fiscal years or 12 month periods, subsection 1.3(6) of the National Instrument states that for purposes of calculating the average consolidated income from continuing operations for the three fiscal years or 12 month periods, the loss must be treated as zero in the numerator and as one in the denominator.

## C. FINANCIAL STATEMENTS OF ACQUIRED BUSINESSES

### 5.13 Financial Statements for Interim and Pre-acquisition Periods

**Financial Statements for Interim and Pre-acquisition Periods** - Subsections 4.2(1), 4.3(1) and 4.4(1) of the National Instrument require that a short form prospectus include financial statements for the most recently completed interim period of the acquired business that ended prior to the date of acquisition, in the case of a completed acquisition, and in any case, more than 60 days before the date of the short form prospectus. In some circumstances, the acquired business may not have been a reporting issuer and therefore may not have prepared financial statements for the required interim periods. In connection with its sale, a business may prepare financial statements for the period commencing with the first day of its current year up to the date of the acquisition, or a day prior to the date of the acquisition. Subsections 4.2(1)2(a)(ii) and 4.3(1)3(a)(ii) of the National Instrument permit an issuer to satisfy the requirement for interim financial statements by filing financial statements for a period longer than an interim period provided that period ends no more than 30 days before the date of the acquisition. The period covered by these financial statements is defined in the National Instrument as the "pre-acquisition period". If the issuer elects to include pre-acquisition period financial statements in the short form prospectus, it is not also required to include the interim financial statements for the most recently completed interim period ended more than 60 days prior to the date of the short form prospectus. The pre-acquisition period financial statements may be used to prepare the *pro forma* financial statements of the issuer required under Part 4 of the National Instrument.

### 5.14 Acquisition of Related Businesses

**Acquisition of Related Businesses** - Subsections 4.2(2), 4.3(2) and 4.4(2) of the National Instrument require that if an issuer is required to include in its short form prospectus financial statements for more than one business because the significant acquisition involves an acquisition of related businesses or a probable acquisition of related businesses, the financial statements required under these subsections should be presented for each business except for the periods during which the businesses have been under common control or management, in which case the issuer may present the financial statements on a combined basis. Although one or more of the related businesses may be insignificant relative to the others, separate financial statements of each business for the same number of periods required must be presented. Relief from the requirement to include financial statements of the least significant related business or businesses may be granted depending on the facts and circumstances.

## **5.15 Financial Statement Disclosure for Unrelated Individually Insignificant Acquisitions**

- (1) When an issuer acquires unrelated businesses that are determined by the significance tests to be individually insignificant, section 5.2 of the National Instrument requires the significance of the acquisitions to be tested again by combining the results of the businesses. The significance tests should be applied using the financial results of the businesses on a combined basis. If the businesses satisfy any of the significance tests at a threshold of 50 per cent or more, then financial statements shall be provided for the businesses that constitute more than 50 per cent of the test satisfied at the highest level of significance. For example, if the acquisitions satisfy the asset, investment and income tests at thresholds of 40 per cent, 80 per cent and 60 per cent, respectively, then the investment test is the most significant. Accordingly, financial statements of the individual businesses which comprise 50 per cent of the dollar value of the combined investments in and advances to the businesses must be included in the short form prospectus. Audited financial statements must be presented for the most recently completed financial year of each business plus interim financial statements. Depending upon the number of acquisitions, there may be several combinations of businesses whose financial statements would satisfy the requirement. Any combination may be included in the short form prospectus. For further guidance, refer to example 4 in Appendix B to this Companion Policy.
- (2) Subsection 1.3(2) of the National Instrument states that if one or more of the unrelated businesses have incurred losses from continuing operations while others have earned income from continuing operations, the losses should not offset the income. Instead, the businesses

with losses should be evaluated separately from those with income for the purpose of applying the income test. The absolute value of the aggregate losses should be used to calculate the significance. For further guidance, refer to example 5 in Appendix B to this Companion Policy.

## 5.16 Preparation of Divisional and Carve-out Financial Statements

- (1) As discussed in section 5.2 of this Companion Policy, the Canadian securities regulatory authorities generally consider the acquisition of a division of a business and in certain circumstances, a lesser component of a person or company as constituting a business for purposes of the National Instrument, whether or not the subject of the acquisition previously prepared financial statements. In order to determine the significance of the acquisition and comply with the requirements in Parts 4 and 5 of the National Instrument, financial statements must be prepared. This section provides guidance on preparing these financial statements.
- (2) The guidance in this section also applies to the preparation of the financial statements of a completed significant disposition for the purpose of preparing *pro forma* financial statements in accordance with Part 6 of the National Instrument.
- (3) **Interpretations** - In this section of this Companion Policy, unless otherwise stated, the following interpretations apply:
  - (a) A reference to "a business" means a division or some lesser component of another business acquired by an issuer which constitutes a significant acquisition.
  - (b) The term "parent" refers to the vendor from whom the issuer purchased a business.
- (4) **Divisional and Carve-Out Financial Statements** - The terms "divisional" and "carve-out" financial statements are often used interchangeably although a distinction is possible. Some companies maintain separate financial records and prepare financial statements for a business activity or unit which is operated as a division. Financial statements prepared from these financial records are often referred to as "divisional" financial statements. In certain circumstances, no separate financial records for a business activity are maintained; they are simply consolidated with the parent's records. In these cases, if the parent's financial records are sufficiently detailed, it is possible to extract or "carve-out" the information specific to the business activity in order to prepare separate financial statements of that business. Financial statements prepared in this manner are commonly referred to as "carve-out" financial



statements. The guidance in this section applies to the preparation of both divisional and carve-out financial statements unless otherwise stated.

(5) **Preparation of Divisional and Carve-Out Financial Statements**

- (a) When complete financial records of the business acquired or to be acquired have been maintained, those records should be used for preparing and auditing the financial statements of the business. For the purposes of this section, it is presumed that the parent maintains separate financial records for its divisions.
- (b) When complete financial records of the business acquired or to be acquired do not exist, carve-out financial statements should generally be prepared in accordance with the following guidelines:

1. **Allocation of Assets and Liabilities** - A balance sheet should include all assets and liabilities directly attributable to the business.
2. **Allocation of Revenues and Expenses** - Income statements should include all revenues and expenses directly attributable to the business. Some fundamental expenditures may be shared by the business and its parent in which case the parent's management must determine a reasonable basis for allocating a share of these common expenses to the business. Examples of such common expenses include salaries, rent, depreciation, professional fees, general and administration.
3. **Allocation of Income and Capital Taxes** - Income and capital taxes should be calculated as if the entity had been a separate legal entity and filed a separate tax return for the period presented.
4. **Disclosure of Basis of Preparation** - The financial statements should include a note describing the basis of preparation. If expenses have been allocated as discussed in paragraph 2, the financial statements should include a note describing the method of allocation for each significant line item, at a minimum.

- (6) **Statements of Assets Acquired, Liabilities Assumed and Statements of Operations** - When it is impracticable to prepare carve-out financial statements of a business, an issuer may be required to include in its prospectus for the business an audited statement of assets acquired and liabilities assumed and a statement of operations. Such a statement of operations should exclude only those indirect operating costs, such as corporate overhead, not directly attributable

to the business. If these costs were previously allocated to the business and there is a reasonable basis of allocation, they should not be excluded. Issuers are encouraged to submit a pre-filing application when this circumstance arises.

## 5.17 Preparation of *Pro Forma* Financial Statements Giving Effect to Significant Acquisitions

- (1) **Objective and Basis of Preparation** - The objective of *pro forma* financial statements is to illustrate the impact of a transaction on an issuer's financial position and results of operations by adjusting the historical financial statements of the issuer to give effect to the transaction. Accordingly, the *pro forma* financial statements should be prepared on the basis of the issuer's financial statements as they appear elsewhere in the short form prospectus. No adjustment should be made to eliminate extraordinary items or discontinued operations.
- (2) ***Pro Forma* Balance Sheet and Income Statements** - Subsection 4.5(1) of the National Instrument does not require a *pro forma* balance sheet to be prepared to give effect to significant acquisitions which are reflected in the issuer's most recent audited or interim balance sheet included in the short form prospectus. Similarly, if a significant acquisition was completed during the issuer's most recently completed financial year, subsection 4.5(1)2 of the National Instrument does not require a *pro forma* income statement to be prepared for the issuer's most recent interim period for which financial statements are included in the short form prospectus because the results of the acquired business have been consolidated with the issuer's for the entire interim period.
- (3) **Non-coterminous Year-ends**
  - (a) **Reducing the Gap to 93 Days** - For the purpose of preparing a *pro forma* income statement, if the financial year of the business ends on a day which is more than 93 days from the last day of the issuer's financial year, subsection 4.5(4) of the National Instrument requires the income statement of the business to be adjusted to reduce this gap to less than 93 days. Reducing the gap may be accomplished by adding a subsequent interim period to the results of the most recent fiscal year of the acquired business and deducting the comparable interim results for the immediately preceding year.
  - (b) **Consecutive Months** - The adjusted financial period of the business should be

comprised of consecutive months. For example, if the adjusted reporting period is 12 months and ends on June 30, the 12 months should commence on July 1 of the immediately preceding year; it should not begin on March 1st of the immediately preceding year with three of the following 15 months omitted, such as the period from October 1 to December 31, since this would not be a consecutive 12 month period.

- (c) **Disclosure of the Adjusted Financial Period** - The adjusted financial period should be clearly disclosed on the face of the *pro forma* financial statements. In addition, there should be disclosure in a note to the *pro forma* financial statements stating that the financial statements of the business used to prepare the *pro forma* financial statements were prepared for this purpose and do not conform with the financial statements included elsewhere in the prospectus.
  - (d) **Disclosure of Results Reported in Two *Pro forma* Income Statements** - If the financial statements of the business are adjusted in accordance with paragraph (a), it is possible that the results for one or more months may be included in the twelve month and interim period financial statements of the business which are used by the issuer to prepare *pro forma* income statements for its most recently completed financial year and interim period. In this situation, disclosure should be made of the revenue and income for any periods excluded or included in both *pro forma* income statements.
- (4) **Financial Statements of a Business Prepared for the Purpose of Preparing *Pro Forma* Financial Statements** - If, in accordance with subsection (3), an income statement of an acquired business is constructed for the purpose of preparing a *pro forma* income statement, the constructed income statement need not be audited or otherwise included in the short form prospectus except as a separate column in the *pro forma* income statement. However, a comfort letter addressed to the Canadian securities regulatory authorities is required to be delivered in accordance with subsection 10.3(b)1 of the National Instrument.
- (5) **Effective Date of Adjustments**
- (a) ***Pro forma* balance sheet** - Paragraph 1 of subsection 4.5(1) of the National Instrument requires a *pro forma* balance sheet to be prepared to give effect to significant acquisitions as if they occurred on the date of the issuer's most recent balance sheet included in the short form prospectus.
  - (b) ***Pro forma* income statement** - Paragraph 2 of subsection 4.5(1) of the National Instrument requires a *pro forma* income statement to be prepared to give effect to

significant acquisitions as if they had taken place at the beginning of the issuer's current financial year or its most recently completed financial year, depending on when the acquisition occurred. If a short form prospectus includes *pro forma* income statements for the issuer's most recently completed financial year and a subsequent interim period, the acquisition and most of the adjustments should be computed as if the acquisition had occurred at the beginning of the most recently completed financial year and carried through the most recent interim period presented, if any. However, those adjustments related to the allocation of the purchase price, including the amortization of fair value increments and intangibles, should be based on the purchase price allocation arising from giving effect to the acquisition as if it occurred on the date of the issuer's most recent balance sheet included in the short form prospectus.

- (6) **Acceptable Adjustments** - *Pro forma* adjustments shall be limited to those which are directly attributable to a specific completed or proposed transaction for which there are firm commitments and for which the complete financial effects are objectively determinable.
- (7) **Multiple Acquisitions** - If the *pro forma* financial statements give effect to more than one significant acquisition or other event, the *pro forma* adjustments may be grouped by line item on the face of the *pro forma* financial statements provided the details for each transaction are disclosed in the notes.
- (8) **Intervening Periods** - If the issuer prepares a *pro forma* financial statement using a pre-acquisition interim financial statement of the acquired business and that period ends prior to the date of the acquisition, the *pro forma* financial statements should include any significant adjustments necessary to account for the intervening period.

#### D. SIGNIFICANT DISPOSITIONS

### 5.18 Significant Dispositions

- (1) Section 1.6 of the National Instrument states that the term "significant disposition" refers to a disposition of a business, a business segment or a significant portion of a business, either by sale, abandonment or distribution to shareholders. A disposition is determined to be significant in subsection 1.6(2) of the National Instrument if it satisfies the asset or income test at at least the 20 per cent significance level.
- (2) Separate financial statements of a significant disposition are not required to be included in the

short form prospectus. If an issuer decides to include the financial statements, they should be prepared following the guidance in section 5.16 of this Companion Policy and should not be for more periods than the most recently completed financial year and interim period of the issuer for which financial statements are included in the short form prospectus.

## 5.19 Preparation of *Pro Forma* Financial Statements Giving Effect to Significant Dispositions

- (1) **Businesses and Business Segments** - Part 6 of the National Instrument requires inclusion in an issuer's short form prospectus of *pro forma* financial statements which give effect to significant dispositions completed during the issuer's most recently completed financial year or current financial year. The disposition of a business segment, as defined by section 3475 of the Handbook, is excluded from the *pro forma* requirements because the financial statement presentation of a discontinued business segment is addressed by the Handbook.
  - (2) **Objective and Basis of preparation** - The basis for preparing *pro forma* financial statements which give effect to a significant disposition is very similar to the guidance outlined in section 5.17 of this Companion Policy which discusses the preparation of *pro forma* financial statements which give effect to significant acquisitions. The *pro forma* financial statements should be prepared using the issuer's financial statements as if the significant disposition occurred at the beginning of an issuer's current or most recently completed financial year, as appropriate.
  - (3) ***Pro Forma* Balance Sheets** - Section 6.2(1) of the National Instrument does not require a *pro forma* balance sheet if the significant disposition is reflected in the issuer's most recent balance sheet included in the short form prospectus.
  - (4) ***Pro Forma* Income Statements**
    - (d) If a significant disposition was completed during the issuer's most recently completed financial year, subsection 6.2(2)(a) of the National Instrument does not require inclusion of a *pro forma* income statement for the most recent interim period for which financial statements are included in the short form prospectus because the results of the disposed business have been excluded from the issuer's results for the entire interim period.
    - (e) A *pro forma* income statement prepared to give effect to significant dispositions should not present results below the level of income from continuing operations.
-

- (5) **Constructed Financial Statements of the Business for the Purpose of Preparing the *Pro forma* Financial Statements** - If an income statement of the disposed business is constructed or otherwise carved out from the issuer's financial statements in accordance with the guidance in section 5.16 of this Companion Policy, for the purpose of preparing a *pro forma* income statement, the constructed income statement need not be audited or otherwise included in the prospectus except as a separate column in the *pro forma* income statement. However, a comfort letter addressed to the Canadian securities regulatory authorities is required to be delivered in accordance with subsection 10.3(b)1 of the National Instrument.
- (6) **Effective Date of Adjustments** - *Pro forma* balance sheets should be prepared as if the disposition had occurred on the date of each balance sheet presented. If a short form prospectus includes *pro forma* income statements for the issuer's most recently completed financial year and a subsequent interim period, the acquisition and adjustments should be computed as if the disposition had occurred at the beginning of the most recently completed financial year of the issuer only and carried toward the most recent interim period presented, if any.
- (7) **Acceptable Adjustments** - *Pro forma* adjustments should be limited to those which are directly attributable to a specific completed or proposed transaction for which there are firm commitments and for which complete financial effects are objectively determinable.
- (8) **Multiple Dispositions** - If the *pro forma* financial statements give effect to more than one significant disposition, the *pro forma* adjustments may be grouped by line item on the face of the *pro forma* financial statements provided the details for each transaction are disclosed in the notes.

## E. EXEMPTIONS

### 5.20 Exemptions from Parts 4 and 5 of the National Instrument

- (1) Despite Parts 4 and 5 of the National Instrument, an issuer may be permitted by the Canadian securities regulatory authorities to exclude an audit opinion on the financial statements of an acquired business for any of the years for which financial statements are required other than the most recently completed year of the acquired business if
  - (a) the business was acquired prior to December 31, 2000;

- (b) the issuer provides written submissions prior to filing the short form prospectus which establish to the satisfaction of the regulator that, despite making reasonable efforts, the issuer was unable to obtain audited financial statements because the vendor refused to provide such audited financial statements or to permit access to the information necessary to audit the financial statements; and
  - (c) the issuer discloses in the prospectus that despite making reasonable efforts, the issuer was unable to obtain audited financial statements because the vendor refused to provide such audited financial statements or to permit access to the information necessary to audit the financial statements.
- (2) The Canadian securities regulatory authorities are of the view that relief from the financial statement requirements of Parts 4 and 5 of the National Instrument should be granted only in unusual circumstances not related to cost or the time involved in preparing and auditing the financial statements.
- (3) If relief is granted from the requirements of Parts 4 and 5 of the National Instrument to include in a short form prospectus audited financial statements of an acquired business, conditions will likely be imposed, such as a requirement to include audited divisional or partial income statements or divisional statements of cash flow, financial statements accompanied by an auditor's report containing a reservation of opinion such as an inventory qualification or an audited statement of net operating income for a business.
- (4) Relief may be granted in appropriate circumstances to permit the auditor's report on financial statements of a business acquisition to contain a reservation relating to opening inventory. In certain situations, such as when any of the significance tests are satisfied at 40 per cent or higher, the issuer may be requested to include in the prospectus audited financial statements of the business for a subsequent period of at least six months on which the auditor's report contains no reservation of opinion and the business is not seasonal.
- (5) Considerations relevant to granting an exemption from the requirement to include interim financial statements for the comparable period in the immediately preceding financial year may include the fact that an acquired business was, before the filing of the short form prospectus, a private entity that did not prepare interim financial statements.
- (6) If an issuer acquired a business or is proposing to acquire a business, considerations relevant to granting an exemption from the requirement to include financial statements of the business for

any one or more of the years required to be included in the short form prospectus may include the following:

- (a) The business's historical accounting records have been destroyed and cannot be reconstructed. In this case, as a condition for granting the exemption, the issuer may be requested by the Canadian securities regulatory authorities to
  - (i) represent in writing to the Canadian securities regulatory authorities, no later than the time the preliminary short form prospectus is filed, that the issuer made every reasonable effort to obtain copies of, or reconstruct, the historical accounting records necessary to prepare and audit the financial statements, but such efforts were unsuccessful; and
  - (ii) disclose in the short form prospectus the fact that the historical accounting records have been destroyed and cannot be reconstructed;
- (b) The business has recently emerged from bankruptcy and current management of the business and the issuer is denied access to the historical accounting records necessary to audit the financial statements. In this case, as a condition of granting the exemption, the issuer may be requested by the Canadian securities regulatory authorities to
  - (i) represent in writing to the Canadian securities regulatory authorities, no later than the time the preliminary short form prospectus is filed, that the issuer made every reasonable effort to obtain access to, or copies of, the historical accounting records necessary to audit the financial statements but that such efforts were unsuccessful; and
  - (ii) disclose in the short form prospectus the fact that the business has recently emerged from bankruptcy and current management of the business and the issuer are denied access to the historical accounting records.
- (c) The business has undergone a fundamental change in the nature of its business or operations affecting a majority of its operations and all, or substantially all, of the executive officers and directors of the company have changed. The evolution of a business or progression along a development cycle will not be considered to be a fundamental change in the issuer's business or operations. Relief from the requirement to include audited financial statements of the business for the year in which the change in operations occurred, or for the most recently completed financial year if the change in



operations occurred during the business's current financial year, generally will not be granted.

## **PART 6**

### **GAAP, GAAS, AND AUDITOR'S REPORTS**

#### **6.1 Foreign GAAP**

- (1) Subsection 7.1(2) of the National Instrument provides that if a person or company is incorporated or organized in a foreign jurisdiction, the financial statements of the person or company included in the prospectus shall be prepared in accordance with either Canadian GAAP or foreign GAAP. Foreign GAAP is defined in the National Instrument to mean a body of generally accepted accounting principles, other than Canadian GAAP, that are as comprehensive as Canadian GAAP.
- (2) The Canadian securities regulatory authorities are of the view that foreign GAAP are as comprehensive as Canadian GAAP if the foreign GAAP covers substantially the same core subject matter as Canadian GAAP, including recognition and measurement principles and disclosure requirements.
- (3) The National Instrument permits foreign GAAP to be used only if the notes to the financial statements explain and quantify the effect of material differences between the foreign GAAP and Canadian GAAP that relate to measurements and provide disclosure consistent with Canadian GAAP requirements. The Canadian securities regulatory authorities expect that in most cases the reconciliation will be adequate to ensure clear and understandable disclosure for investors in Canada, unless the differences are so pervasive as to render the financial statements misleading.

#### **6.2 Foreign Auditors and Foreign GAAS**

- (1) The National Instrument requires financial statements in a short form prospectus to be accompanied by an auditor's report which by definition is prepared in accordance with generally accepted auditing standards. The National Instrument permits the financial statements of foreign issuers to be audited in accordance with generally accepted auditing standards other than

those applied in Canada, if those auditing standards are substantially equivalent to Canadian auditing standards.

- (2) Issuers should recognize that Canadian securities legislation in some jurisdictions requires the regulator not to issue a receipt for a prospectus if it appears to the regulator that a person or company who has prepared any part of the prospectus or is named as having prepared or certified a report used in connection with a prospectus is not acceptable to the regulator. Therefore, under section 7.5 of the National Instrument, the foreign auditor's report must be accompanied by a statement that the auditing standards applied are substantially equivalent to Canadian GAAS. The statement must also disclose any material differences in the form and content of the foreign auditor's report.
- (3) The Canadian securities regulatory authorities are of the view that in order for auditing standards to be substantially equivalent to Canadian GAAS, they must require underlying audit work that is comparable in scope, nature and timing to the work required in connection with an audit in accordance with Canadian GAAS. For example, auditing standards of foreign jurisdictions such as the United States are known to the Canadian securities regulatory authorities to be substantially equivalent to the standards of the CICA. Foreign issuers using auditors from foreign jurisdictions with auditing standards and supervision that are less well known to the Canadian securities regulatory authorities are encouraged to consult with staff of the Canadian securities regulatory authorities in advance of filing a preliminary prospectus to resolve uncertainty as to whether the Canadian securities regulatory authorities will consider a particular auditor or auditing standards to be acceptable.
- (4) In making a determination of whether the foreign auditing standards applied are substantially equivalent to Canadian GAAS, auditors are referred, in particular to the general standard of Canadian GAAS as set out in section 5100 of the Handbook and its reference to an auditor's "objective state of mind". This standard, when read together with the objectivity standard for auditors contained in the standards of professional conduct applicable to Canadian auditors in each jurisdiction, emphasizes the importance of the independence of the auditor. In the view of the Canadian securities regulatory authorities, auditor independence is an essential element of Canadian GAAS which should be reflected, among other things, in the foreign GAAS applied in order for the foreign GAAS applied and Canadian GAAS to be considered substantially equivalent.
- (5) Subparagraph 7 of paragraph 10.2(b) of the National Instrument requires an issuer, if a financial statement included in a prospectus has been prepared in accordance with foreign GAAP or includes a foreign auditor's report, to deliver a letter from the auditor that discusses the auditor's

expertise to audit the reconciliation of foreign GAAP to Canadian GAAP and, in the case of foreign GAAS other than U.S. GAAS applied by a U.S. auditor, to make the determination that the foreign GAAS applied are substantially equivalent to Canadian GAAS. This provision requires that this comfort letter be delivered with the preliminary prospectus to better facilitate timely resolutions of any issues.

### 6.3 Auditor's Comfort Letters

**Auditor's Comfort Letters** - Subparagraph 1(i) of subsection 10.3(b) of the National Instrument requires a comfort letter to be delivered to the regulators from the auditor of the issuer or the business, as applicable, if an unaudited financial statement of an issuer or a business is included in a final prospectus. If unaudited financial statements of the issuer or the business for more than one interim period are included in the prospectus, a comfort letter with respect to each unaudited financial statement must be delivered. If an unaudited financial statement presents the results of the issuer or the business for the most recently completed interim period and the cumulative results for the current financial year up to the last day of the most recently completed interim period, a comfort letter with respect to both the interim and cumulative periods, including any comparative periods presented, must be delivered.

## PART 7 FILING AND RECEIPTING OF SHORT FORM PROSPECTUS

### 7.1 Confidential Material Change Reports

**Confidential Material Change Reports** - Confidential material change reports cannot be incorporated by reference into a short form prospectus. Accordingly, an issuer may not file a confidential material change report during a distribution. However, if circumstances arise that cause an issuer to file a confidential material change report during the distribution period of securities under a short form prospectus, the issuer should cease all activities related to the distribution until

- (a) the material change is generally disclosed and an amendment to the short form prospectus is filed, if required; or
- (b) the decision to implement the material change has been rejected and the issuer has so notified the regulator of each jurisdiction where the confidential material change report was filed.

## 7.2 Supporting Documents

- (1) Material that is filed in a jurisdiction will be made available for public inspection in that jurisdiction, subject to the provisions of securities legislation in the local jurisdiction regarding confidentiality of filed material. Material that is delivered to a regulator, but not filed, is not required under securities legislation to be made available for public inspection. However, the regulator may choose to make such material available for inspection by the public.
- (2) Any material incorporated by reference in a preliminary short form prospectus or a short form prospectus is required under section 9.1 and 9.2 of the National Instrument to be filed with the preliminary short form prospectus or short form prospectus unless previously filed. When an issuer using SEDAR files a previously unfiled document with its short form prospectus, the issuer should ensure that the document is filed under the SEDAR category of filing and filing subtype specifically applicable to the document, rather than the generic type "Other". For example, an issuer that has incorporated by reference an interim financial statement in its short form prospectus and has not previously filed the statement should file that statement under the "Continuous Disclosure" category of filing, and the "Interim Financial Statements" filing subtype.

## 7.3 Experts' Consent

**Experts' Consent** - Issuers are reminded that securities legislation in Alberta prescribes a form of consent for experts.

## 7.4 Material Contracts

**Material Contracts** - Section 10.7 of the National Instrument requires an issuer to make available all material contracts referred to in a short form prospectus. The Canadian securities regulatory authorities recognize that certain material contracts or portions thereof may contain sensitive operational or financial information, disclosure of which would be competitively disadvantageous or otherwise detrimental to the issuer. The regulator will consider granting relief from the requirement to make these contracts available for public inspection if disclosure would be unduly detrimental to the issuer and the disclosure would not be necessary in the public interest.

## 7.5 Amendments and Incorporation by Reference of Subsequently Filed Material Change Reports

### **Amendments and Incorporation by Reference of Subsequently Filed Material Change Reports -**

The requirement in securities legislation for the filing of an amendment to a preliminary prospectus and prospectus is not satisfied by the incorporation by reference in a preliminary short form prospectus or a short form prospectus of a subsequently filed material change report.

## 7.6 Short Form Prospectus Review

**Short Form Prospectus Review** - No time frame applies to the review of a short form prospectus of an issuer if the issuer has not elected to use MRRS.

## 7.7 "Waiting Period"

**WaitingPeriod** - If the securities legislation of the local jurisdiction contains the concept of a "waiting period" such that the securities legislation requires that there be a specified period of time between the issuance of a receipt for a preliminary short form prospectus and the issuance of a receipt for a short form prospectus, the implementing law of the jurisdiction removes that requirement as it would otherwise apply to a distribution under National Instrument 44-101.

## 7.8 Refusal to Issue Prospectus Receipt

**Refusal to Issue Prospectus Receipt** - The regulator has the discretion under securities legislation to refuse, in the public interest, to issue a receipt for a prospectus. Despite acceptance by a regulator of an issuer's AIF, if, at the time the issuer files a preliminary short form prospectus, a regulator has concerns about the adequacy or timeliness of the disclosure in the AIF and the disclosure is not supplemented in the short form prospectus, the regulator may refuse to issue a receipt for the short form prospectus.

## 7.9 Registration Requirements

**Registration Requirements** - Issuers filing a preliminary short form prospectus or short form prospectus and other market participants are reminded to ensure that members of underwriting syndicates are in compliance with registration requirements under Canadian securities legislation in each jurisdiction in which syndicate members are participating in the distribution of securities under the short form prospectus.

## **PART 8 CONTENT OF AIF**

### **8.1 Issuers of Asset-backed Securities**

- (1) Item 4.2 of Form 44-101F1 AIF specifies additional disclosure applicable to issuers of asset-backed securities that were distributed under a prospectus. Form 44-101F1 leaves to an issuer of asset-backed securities the determination of which other prescribed disclosure is applicable and ought to be included in the AIF. Applicable disclosure for a special purpose issuer of asset-backed securities generally pertains to the nature, performance and servicing of the underlying pool of financial assets. The nature and extent of required disclosure may vary depending on the type and attributes of the underlying pool.

The following factors should be considered by an issuer of asset-backed securities in preparing its AIF:

1. The extent of disclosure respecting an issuer will depend on the extent of the issuer's on-going involvement in the conversion of the assets comprising the pool to cash and the distribution of cash to security holders; this involvement may, in turn, vary dramatically depending on the type, quality and attributes of the assets comprising the pool and on the overall structure of the transaction.
2. Requested disclosure respecting the business and affairs of the issuer should be interpreted to apply to the financial assets underlying the asset-backed securities.
3. Financial information respecting the pool of assets to be described and analyzed in the AIF will consist of information commonly set out in servicing reports prepared to describe the performance of the pool and the specific allocations of income, loss and

cash flows applicable to outstanding asset-backed securities made during the relevant period.

- (2) Item 4.2(b)(i) of Form 44-101F1 AIF requires issuers of asset-backed securities that were distributed by way of prospectus to include information relating to the composition of the underlying pool of financial assets, the cash flows from which service the asset-backed securities. Disclosure respecting the composition of the pool will vary depending upon the nature and number of the underlying financial assets. For example, in a geographically dispersed pool of financial assets, it may be appropriate to provide summary disclosure based on the location of obligors. In the context of a revolving pool, it may be appropriate to provide details relating to aggregate outstanding balances during a year in order to illustrate historical fluctuations in asset origination due, for example, to seasonality. In pools of consumer debt obligations, it may be appropriate to provide a breakdown within ranges of amounts owing by obligors in order to illustrate limits on available credit extended.

## 8.2 Non-corporate Issuers

**Non-corporate Issuers** - Item 8 of Form 44-101F1 AIF requires disclosure concerning the directors and officers of an issuer. An issuer that is not a corporation must refer to the definitions in securities legislation of "director" and "officer". The definition of "officer" may include any individual acting in a capacity similar to that of an officer of a company. Similarly, the definition of "director" typically includes a person acting in a capacity similar to that of a director of a company. Therefore, non-corporate issuers must determine in light of the particular circumstances which individuals or persons are acting in such capacities for the purposes of complying with Item 8 of Form 44-101F1.

# PART 9

## CONTENT OF SHORT FORM PROSPECTUS

### 9.1 Prospectus Liability

**Prospectus Liability** - Nothing in the short form prospectus regime established by the National Instrument is intended to provide relief from liability arising under the provisions of Canadian securities legislation of any jurisdiction in which a short form prospectus is filed if the short form prospectus contains an untrue statement of a material fact or omits to state a material fact that is

required to be stated therein or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

## 9.2 Style of Prospectus

**Style of Prospectus** - Canadian securities legislation requires that a prospectus contain "full, true and plain" disclosure. To that end, issuers and their advisors are reminded that they should ensure that disclosure documents are easy to read, and encourage issuers to adopt the following plain language principles in preparing a prospectus in the form of a short form prospectus:

- use short sentences
- use definite, concrete, everyday language
- use the active voice
- avoid superfluous words
- organize the document into clear, concise sections, paragraphs and sentences
- avoid legal or business jargon
- use strong verbs
- use personal pronouns to speak directly to the reader
- avoid reliance on glossaries and defined terms unless it facilitates understanding of the disclosure
- avoid vague boilerplate wording
- avoid abstractions by using more concrete terms or examples
- avoid excessive detail
- avoid multiple negatives.

If technical or business terms are required, clear and concise explanations should be used. The Canadian securities regulatory authorities are of the view that question and answer and bullet point formats are consistent with the disclosure requirements of the National Instrument.

## 9.3 Firm Commitment Underwritings

**Firm Commitment Underwritings** - If an underwriter has agreed to purchase a specified number or principal amount of the securities to be distributed at a specified price, Item 1.8(4) of Form 44-101F3 requires the short form prospectus to contain a statement that the securities are to be taken up by the underwriter, if at all, on or before a date not later than 42 days after the date of the receipt for the short



form prospectus. If the Canadian securities legislation of a jurisdiction requires that a prospectus indicate that the securities must be taken up by the underwriter within a period that is different than the period provided under the National Instrument, the implementing law of a jurisdiction exempts issuers from that requirement if they comply with the National Instrument.

## 9.4 Minimum Distribution

**Minimum Distribution** - If a minimum amount of funds is required by an issuer and the securities are proposed to be distributed on a best efforts basis, Item 6.5 of Form 44-101F3 requires that the short form prospectus state that the distribution will not continue for a period of more than 90 days after the date of receipt for the short form prospectus if subscriptions representing the minimum amount of funds are not obtained within that period unless each of the persons and companies who subscribed within that period has consented to the continuation. If the Canadian securities legislation of a jurisdiction requires that a distribution may not continue for more than a specified period if subscriptions representing the minimum amount of funds are not obtained within that period and the specified period is different than the period provided under the National Instrument, the implementing law of a jurisdiction exempts issuers from that requirement if they comply with the National Instrument.

## 9.5 Distribution of Asset-backed Securities

- (1) Item 8.3 of Form 44-101F3 specifies additional disclosure applicable for distributions of asset-backed securities. Applicable disclosure for a special purpose issuer of asset-backed securities generally pertains to the nature, performance and servicing of the underlying pool of financial assets, the structure of the securities and dedicated cash flows and any third party or internal support arrangements established to protect holders of the asset-backed securities from losses associated with non-performance of the financial assets or disruptions in payment. The nature and extent of required disclosure may vary depending on the type and attributes of the underlying pool and the contractual arrangements through which holders of the asset-backed securities take their interest in such assets.
- (2) The following factors should be considered by an issuer of asset-backed securities in preparing its short form prospectus:
  1. The extent of disclosure respecting an issuer will depend on the extent of the issuer's on-going involvement in the conversion of the assets comprising the pool to cash and the distribution of cash to security holders; this involvement may, in turn, vary dramatically

depending on the type, quality and attributes of the assets comprising the pool and on the overall structure of the transaction.

2. Requested disclosure respecting the business and affairs of the issuer should be interpreted to apply to the financial assets underlying the asset-backed securities.
  3. Disclosure respecting the originator or the seller of the underlying financial assets will be relevant to investors in the asset-backed securities particularly in circumstances where the originator or seller has an on-going relationship with the financial assets comprising the pool. For example, if asset-backed securities are serviced with the cash flows from a revolving pool of receivables, an evaluation of the nature and reliability of the future origination or the future sales of underlying assets by the seller to or through the issuer may be a critical aspect of an investor's investment decision. To address this, the focus of disclosure respecting an originator or seller of the underlying financial assets should deal with whether there are current circumstances that indicate that the originator or seller will not generate adequate assets in the future to avoid an early liquidation of the pool and, correspondingly, an early payment of the asset-backed securities. Summary historical financial information respecting the originator or seller will ordinarily be adequate to satisfy the disclosure requirements applicable to the originator or seller in circumstances where the originator or seller has an ongoing relationship with the assets comprising the pool.
- (3) Item 8.3(d)(i) of Form 44-101F3 requires issuers of asset-backed securities to describe any person or company who originated, sold or deposited a material portion of the financial assets comprising the pool, irrespective of whether the person or company has an on-going relationship with the assets comprising the pool. The Canadian securities regulatory authorities consider 33\_% of dollar value of the financial assets comprising the pool to be a material portion in this context.

## 9.6 Distribution of Specified Derivatives

**Distribution of Specified Derivatives** - Item 8.4 of Form 44-101F3 specifies additional disclosure applicable to distributions of specified derivatives. This prescribed disclosure is formulated in general terms for issuers to customize appropriately in particular circumstances.

## 9.7 Underlying Securities

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**Underlying Securities** - Issuers are reminded that if securities being distributed are convertible into or exchangeable for other securities, or are a derivative of, or otherwise linked to, other securities, a description of the material attributes of the underlying securities would generally be necessary to meet the requirement of securities legislation that a prospectus contain full, true and plain disclosure of all material facts relating to the securities.

## 9.8 Financial Statements

**Financial Statements** - Documents incorporated by reference in a preliminary short form prospectus are required under section 9.1 of the National Instrument to be filed with the preliminary short form prospectus if they have not previously been filed. Section 9.2 of the National Instrument contains a similar provision for a short form prospectus. This may result in financial statements that have been incorporated by reference under Item 12.1 of Form 44-101F3 being filed earlier than would otherwise be the case under the continuous disclosure requirements of securities legislation. The implementing law of each jurisdiction provides relief, if necessary, from the requirement of securities legislation to send these statements concurrently to security holders and, in British Columbia, to file written confirmation of having sent these statements. The conditions to the relief require the issuer to send the financial statements to security holders within the time periods and in accordance with the other provisions of continuous disclosure requirements of securities legislation and, in British Columbia, to file written confirmation of sending to security holders.

# PART 10 CIRCULARS

## 10.1 Fee for Documents

**Fee for Documents** - The CSA are of the view that issuers that charge non-security holders that request copies of the documents referred to in paragraph (a) of section 13.3 of the National Instrument should not charge an amount more than the issuer's reasonable cost of sending the documents. If the issuer's practice is to charge non-security holders for the documents, a statement to that effect should be included in the information circular.

## **PART 11 CERTIFICATES**

### **11.1 Non-corporate Issuers**

- (1) Item 21.1(a) of Form 44-101F3 requires an issuer to include a certificate in the prescribed form signed by the chief executive officer and the chief financial officer or, if no such officers have been appointed, a person acting on behalf of the issuer in a capacity similar to a chief executive officer and a person acting on behalf of the issuer in a capacity similar to a chief financial officer. For a non-corporate issuer that is a trust and has a trust company acting as its trustee, this officers' certificate is frequently signed by authorized signing officers of the trust company that perform functions on behalf of the trust similar to those of a chief executive officer and a chief financial officer. In some cases, these functions are delegated to and performed by other persons (e.g. employees of a management company). If the declaration of trust governing the issuer delegated the trustee's signing authority, the officers' certificate may be signed by the persons to whom authority is delegated under the declaration of trust to sign documents on behalf of the trustee or on behalf of the trust, provided that those persons are acting in a capacity similar to a chief executive officer or chief financial officer of the issuer.
- (2) Item 21.1(b) of Form 44-101F3 requires an issuer to include a certificate in the prescribed form signed on behalf of the board of directors, by two directors of the issuer, other than the persons referred to in Item 21.1(a), duly authorized to sign. Issuers that are not companies are directed to the definition of "director" in securities legislation to determine the appropriate signatories to the certificate. The definition of "director" in securities legislation typically includes a person acting in a capacity similar to that of a director of a company. Issuers that are not companies are also directed to the definition of "person" in securities legislation.

### **11.2 Promoters of Issuers of Asset-backed Securities**

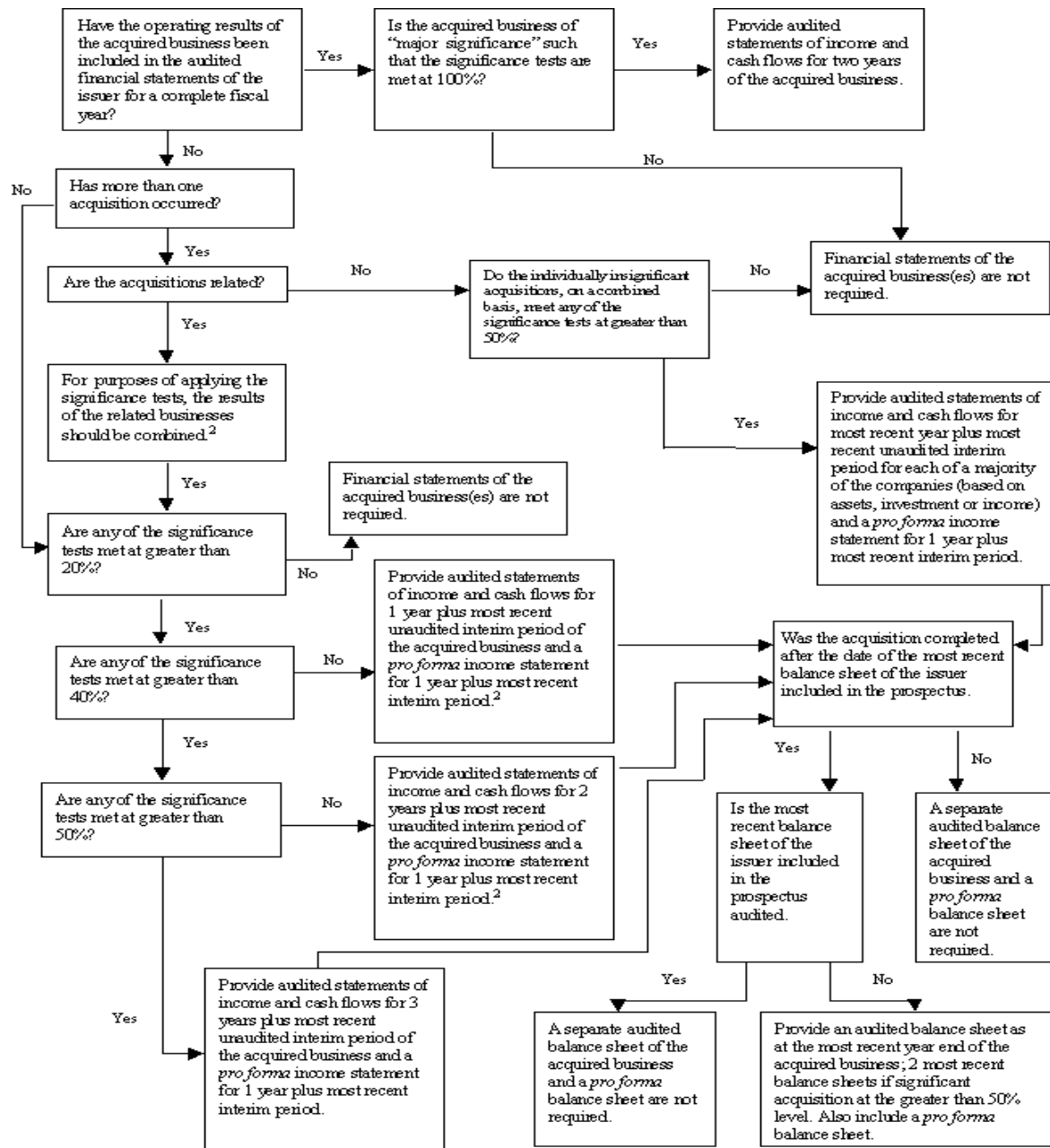
- (1) Canadian securities legislation contains definitions of "promoter" and requires, in certain circumstances, a promoter of an issuer to assume statutory liability for prospectus disclosure. Asset-backed securities are commonly issued by a "special purpose" entity, established for the sole purpose of facilitating one or more asset-backed offerings. The Canadian securities regulatory authorities are of the opinion that special purpose issuers of asset-backed securities

will have a promoter because someone will typically have taken the initiative in founding, organizing or substantially reorganizing the business of the issuer. The Canadian securities regulatory authorities interpret the business of such issuers to include the business of issuing asset-backed securities and entering into the supporting contractual arrangements.

- (2) For example, in the context of a securitization program under which assets of one or more related entities are financed by issuing asset-backed securities (sometimes called a "single seller program"), an entity transferring or originating a significant portion of such assets, an entity initially agreeing to provide on-going collection, administrative or similar services to the issuer, and the entity for whose primary economic benefit the asset-backed program is established, will each be a promoter of the issuer if it took the initiative in founding, organizing or substantially reorganizing the business of the issuer. Persons or companies contracting with the issuer to provide credit enhancements, liquidity facilities or hedging arrangements or to be a replacement servicer of assets, and investors who acquire subordinated investments issued by the issuer, will not typically be promoters of the issuer solely by virtue of such involvement.
- (3) In the context of a securitization program established to finance assets acquired from numerous unrelated entities (sometimes called a "multi-seller program"), the person or company (frequently a bank or an investment bank) establishing and administering the program in consideration for the payment of an on-going fee, for example, will be a promoter of the issuer if it took the initiative in founding, organizing or substantially reorganizing the business of the issuer. Individual sellers of the assets into a multi-seller program are not ordinarily considered to be promoters of the issuer, despite the economic benefits accruing to such persons or companies from utilizing the program. As with single-seller programs, other persons or companies contracting with the issuer to provide services or other benefits to the issuer of the asset-backed securities will not typically be promoters of the issuer solely by virtue of such involvement.
- (4) While the Canadian securities regulatory authorities have included this discussion of promoters as guidance to issuers of asset-backed securities, the question of whether a particular person or company is a "promoter" of an issuer is ultimately a question of fact to be determined in light of the particular circumstances.

# **APPENDIX A**

## **OVERVIEW OF BUSINESS ACQUISITIONS DECISION CHART<sup>1</sup>**



**Notes**

- 1 This decision chart provides general guidance and should be read in conjunction with National Instrument 44-101 and Companion Policy 44-101CP. No reference is made to pre-acquisition periods for the sake of simplicity.
- 2 If an acquisition of related businesses constitutes a significant acquisition when the results of the related businesses are combined, the required financial statements shall be provided for each of the related businesses.



## **APPENDIX B**

### **ILLUSTRATIVE EXAMPLES**

The following examples illustrate the application of certain parts of the National Instrument in determining the financial statements which should be included in a prospectus based on the specific facts and circumstances of the example. Selected explanations are provided to clarify the outcome or results in some cases. The subheading "variations" describes how the requirements would change given a change in certain facts.

Unless otherwise stated, the Issuer is assumed to have a December 31 year end.

Terms and references used throughout the examples are defined as follows:

Year 1 - refers to the current year.

Year 2 - refers to the year immediately preceding Year 1.

Year 3 - refers to the year immediately preceding Year 2.

Year 4 - refers to the year immediately preceding Year 3.

Q1 - refers to the first quarter or 3-month period of a year.

Q2 - refers to the second quarter or 3-month period of a year.

Q3 - refer to the third quarter or 3-month period of a year.

Company A or B or C, etc - refers to a completed or probable acquisition of a business.

#### **EXAMPLE 1**

#### **SIGNIFICANT ACQUISITION OF A COMPANY IN YEAR 1**

##### **Assumptions:**

The Issuer files a prospectus on June 15, Year 1.

The Issuer acquired Company A on April 15, Year 1.

Company A has a December 31 year end.

Company A does not qualify as a short form issuer.

Company A's financial statements for the year ended December 31, Year 2 have been audited.

Company A's financial statements for Q1-Year 1 were filed before the preliminary prospectus is filed.

The significance tests under subsection 1.2(2) of the National Instrument are applied using the

audited financial statements of the Issuer and Company A for the year ended December 31, Year 2. Company A is determined to be significant at 65%, 55% and 35% based on the income test, the investment test, and the asset test, respectively.

**Financial Statement Requirements:**

The preliminary prospectus filed on June 15 should include or incorporate by reference, as appropriate, the following financial statements of the Issuer and Company A:

**Issuer:**

Audited statements of income, retained earnings and cashflows for years 2, 3 and 4.  
Audited balance sheets for years 2 and 3.

Unaudited statements of income, retained earnings and cashflows for Q1 of years 1 and 2.  
Unaudited balance sheet as at March 30, Year 1.

*Pro forma* income statements for Year 2 and Q1- Year 1. Each *pro forma* income statement is prepared to give effect to the acquisition of Company A as if it had occurred on January 1, Year 2.

*Pro forma* balance sheet to give effect to the acquisition of Company A as if it had occurred on March 30 -Year1.

**Company A**

Audited financial statements for Years 2, 3 and 4.  
Unaudited statements of income, retained earnings and cash flows for Q1 - Years 1 and 2.  
Unaudited balance sheet as at March 30, Year 1.

**Explanations:**

1. Financial statements would be required for three years which corresponds the level of significance, as outlined in section 4.6 of the National Instrument.
2. A *pro forma* balance sheet is required because the March 30, Year 1 balance sheet of the Issuer does not reflect the acquisition.

**Variations:**

1. If the Issuer filed its preliminary prospectus on April 15, it would be unnecessary to include the Q1 financial statements of the Issuer, including the *pro forma* financial statements, unless those financial statements had been filed, because April 15 is not more than 60 days from March 30, the last day of Q1. However, the Issuer would be required to include audited financial statements for the year ended December 31, Year 2 because that year ended more than 90 days before April 15, the date of the preliminary prospectus.
2. If the Issuer filed its preliminary prospectus on March 25 and its final prospectus on April 5, the issuer would not be required to include the audited financial statements for the year ended December 31, Year 2 in the final prospectus unless those financial statements had been filed.
3. If the Issuer filed its final prospectus on September 10th, the Instrument would require it to include in the prospectus its unaudited financial statements for Q2-Year1 because the interim period ended more than 60 days from the date of the prospectus. The Issuer would be required to update all disclosure in the prospectus, including the *pro forma* financial statements for the interim period, to reflect the Q2 results.

## **EXAMPLE 2**

### **RE-CALCULATING THE SIGNIFICANCE OF AN ACQUISITION AND PREPARING *PRO FORMA* FINANCIAL STATEMENTS WHEN THE YEAR END OF THE ISSUER AND THE BUSINESS DIFFER BY MORE THAN 93 DAYS.**

#### **Assumptions:**

The Issuer files a prospectus on April 15, Year 1.

The Issuer acquired Company A on November 15, Year 2.

Company A is a public company.

Company A does not qualify as a short form issuer.

Company A's year end is June 30.

Company A's financial statements for the year ended June 30, Year 2 have been audited.

Company A filed its Q1-Year 2 financial statements on October 31.

Note: Company A's fiscal year 1 begins on July 1 of the issuer's fiscal year 2 which is also the calendar year. For simplicity, all references will be to calendar years instead of fiscal year. For example, Company A's Q1 financial statements for its fiscal year 1 will be referred to as its Q1-Year 2 financial statements.

The significance tests are applied using the Issuer's audited financial statements for the year ended December 31, Year 3 and Company A's audited financial statements for the year ended June 30,

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Year 2. Company A is determined to be significant at 55% based on the Income test.

Company A became the Issuer's Subsidiary A following the acquisition. Subsidiary A operates much as it did prior to the acquisition and has not been restructured by the Issuer. Separate financial records are maintained.

The Issuer recalculated the significance of Subsidiary A based on the Issuer's financial statements for the year ended December 31, Year 2 after deconsolidating the results of Subsidiary A from the date of acquisition. For the purpose of applying the significance tests at this second date, December 31, Year 2, the financial results of Subsidiary A for the period January 1 to December 31, Year 2 were used. As a result of the calculations, Subsidiary A is significant at 46% based on the income test.

#### **Financial Statement Requirements:**

The prospectus filed on April 15 should include the following financial statements:

##### **Issuer:**

Audited statements of income, retained earnings and cash flows for the years ended Years 2, 3 and 4.

Audited balance sheets as at December 31, Years 2 and 3.

##### **Company A:**

Audited statements of income, retained earnings and cash flows for the years ended June 30, Years 2 and 3.

Audited balance sheets as at June 30, Years 2 and 3.

Unaudited statements of income, retained earnings and cash flows for Q1- Years 2 and 3.

Unaudited balance sheet as at June 30, Year 2.

##### ***Pro forma* Income Statement**

In addition to the financial statements listed above, a *pro forma* income statement of the Issuer must be included in the prospectus. A *pro forma* balance sheet is not required because the acquisition occurred prior to December 31, Year 2, the most recent balance sheet of the Issuer included in the prospectus. The December 31 year end of the Issuer and the June 30 year end of Company A (prior to the acquisition) differ by more than 93 days. The following alternatives are some of those available to the Issuer for the purpose of preparing a *pro forma*

income statement:

- (1) Prepare an income statement for Company A for the period January 1, Year 2 to November 14 and compile these results with the Issuer's audited consolidated income statement for the year ended December 31, Year 2. A comfort letter would be filed with the Securities Regulator(s) in connection with Company A's income statement
- (2) Prepare an income statement for Company A for the period October 1, Year 3 to September 30, Year 2 which period ends not more than 93 days from December 31. This may be accomplished by starting with Company A's income statement for the year ended June 30, Year 2, deducting Q1 of that year (July 1 to September 30, Year 2) and adding Q1 of fiscal year 1 (July 1 to September 30, Year 1). Deduct the post-acquisition results of Subsidiary A from the Issuer's consolidated income statement for the year ended December 31, Year 2. Compile the two income statements. A comfort letter would be filed with the securities regulators with respect to both the Issuer's deconsolidated income statement and Company A's constructed income statement.
- (3) Prepare an income statement for Company A for the period January 1, Year 2 to September 30, Year 2 and add this to the Issuer's consolidated income statement for the year ended December 31, Year 2. The results of Company A for the period October 1 to October 31 would have to be included as a separate column in the *pro forma* income statement. A comfort letter would be filed with the Securities Regulator(s) in connection with Company's A income statement for the period January 1 to September 30 and with respect to the results for the stub period October 1 to November 14, either separately or on a combined basis.
- (4) Prepare an income statement for Company A for the period April 1, Year 2 to March 30, Year 3 and add this to the Issuer's consolidated income statement for the year ended December 31, Year 3. A comfort letter would be filed with the securities regulator(s) in connection with Company's A income statement for the 12 months ended March 30, Year 2.

**Variations:**

1. **Historical Financial Statements of Company A to be included in the Prospectus** - If Company A's year end was December 31 and pre-acquisition financial statements for the period January 1 to November 14, Year 2 were prepared and audited, assuming Company A is significant at the 46% threshold, the audited financial statements for the 10.5 month period

ended November 14 would have satisfied the requirement for one of the two years of audited financial statements otherwise required because they are audited and for a period greater than 9 months. The prospectus would also include audited financial statements of Company A for the year ended December 31, Year 3 however, no interim financial statements would be required.

2. **Pro forma Income Statement** - If Company A's year end was December 31, a pre-acquisition income statement for the period January 1 to November 14 could have been prepared and compiled with the Issuer's audited consolidated income statement for the year ended December 31, Year 2. No other interim financial statements would be required, other than the Year 3 comparative financial statements.

### **EXAMPLE 3**

#### **PREPARING *PRO FORMA* FINANCIAL STATEMENTS TO GIVE EFFECT TO A BUSINESS ACQUIRED DURING THE ISSUER'S CURRENT YEAR WHEN THE YEAR-ENDS OF THE ISSUER AND THE BUSINESS DIFFER BY MORE THAN 93 DAYS.**

##### **Assumptions:**

The Issuer files a prospectus June 10, Year 1.

The Issuer acquired Company A on April 5, Year 1.

The Issuer filed its Q1-Year 1 interim financial statements on May 30.

Company A is a public company.

Company A does not qualify as a short form issuer.

Company A's year end is May 30.

Company A's financial statements for the year ended April 30, Year 1 are not audited as at the time the prospectus is filed.

Company A filed its Q3-Year 1 interim financial statements on April 29, Year 1.

Company A is determined to be significant at 44%.

##### **Financial Statement Requirements:**

The preliminary prospectus filed on June 10 should include the following financial statements:

##### **Issuer:**

Audited statements of income, retained earnings and cash flows for the years ended December 31, Years 2, 3 and 4.

Audited balance sheets as at December 31, Years 2 and 3.  
Unaudited statements of income, retained earnings and cash flows for Q1- Years 1 and 2.  
Unaudited balance sheet as at March 31, Year 1.

**Company A:**

Audited statements of income, retained earnings and cash flows for the years ended April 30, Years 2 and 3.  
Audited balance sheets as at April, Years 2 and 3.  
Unaudited statements of income, retained earnings and cash flows for Q3-Years 1 and 2.  
Unaudited balance sheet as at February 28, Year 1.

***Pro forma* Financial Statements**

In addition to the financial statements listed above, the following *pro forma* financial statements of the Issuer are required to be included in the prospectus because the acquisition occurred subsequent to the date of the most recent financial statements of the Issuer included in the prospectus:

A *pro forma* balance sheet as at March 31, Year 1.  
A *pro forma* income statement for the year ended December 31, Year 2.  
A *pro forma* income statement for the 3 months ended March 31, Year 1.

The December 31 year end of the Issuer and the April 30 year end of Company A (prior to the acquisition) differ by more than 93 days. The *pro forma* balance sheet should be prepared as follows:

***Pro forma* balance sheet** - Combine the Issuer's balance sheet as at March 30, Year 1 with Company A's balance sheet as at February 28, Year 1.

The following is one alternative available to the Issuer for preparing the *pro forma* income statements:

***Pro forma* income statement for the year ended December 31, Year 2** - Combine the Issuer's audited income statement for the year ended December 31, Year 2 with the 12 month income statement of Company A for the period March 1, Year 2 to February 28, Year 1.

***Pro forma* income statement for the 3 months ended March 31, Year 1** - Combine

the Issuer's Q1- Year 1 income statement with the income statement of the Issuer for the three month period ended February 28, Year 1.

The 12 month and 3 month *pro forma* income statements should be prepared to give effect to the acquisition of Company A as if it occurred on January 1, Year 2. Each *pro forma* income statement includes results of Company A for the period December 1, Year 2 to February 28, Year 1. The notes to the *pro forma* financial statements should disclose the fact that the results of Company A for the 3 months ended February 28, Year 1, which were used to prepare the 3 month *pro forma* income statement, are also included in the 12 month *pro forma* income statement. The overlapping period is Company A's third quarter, the results of which are fully disclosed in the 3 month *pro forma* income statement therefore, it is unnecessary to provide additional disclosure about the revenue, expenses, gross profit or income from continuing operations.

**EXAMPLE 4  
APPLICATION OF THE SIGNIFICANCE TESTS FOR INDIVIDUALLY INSIGNIFICANT ACQUISITIONS - ALL COMPANIES HAVE INCOME FROM CONTINUING OPERATIONS**

**Assumptions**

The Issuer acquired five companies, A, B, C, D and E, during Year 2, its most recently completed financial year. The Issuer files a prospectus on April 15, Year 1. Each company reported net income from continuing operations during its most recently completed year ended before the date of the acquisition.

**Discussion**

Section A of the following table presents the consolidated assets and consolidated net income from continuing operations of each company as reported on the audited financial statements of each company for its most recently completed financial year ended prior to the date of its acquisition by the Issuer. The "investment" column presents the Issuer's consolidated investments in and advances to each company as at the date of its acquisition by the Issuer. Section B presents the individual significant of each acquisition as a results of applying the significance tests. Each company acquired is individually insignificant. However, on a combined basis, the acquisitions are significant, satisfying the asset, income and investment tests at 40%, 50% and 75%, respectively.

Company	Section A \$ Millions			Section B % of Issuer's Results		
	Assets	Income	Investment	Assets	Income	Investment





B+C+D	1,800	60%
C+D+E	1,950	65%

**EXAMPLE 5  
APPLICATION OF THE SIGNIFICANCE TESTS FOR INDIVIDUALLY INSIGNIFICANT ACQUISITIONS WHEN SOME OF THE COMPANIES HAVE LOSSES FROM CONTINUING OPERATIONS**

**Assumptions**

The Issuer acquired seven companies, A, B, C, D, E, F and G during Year 2, its most recently completed financial year. The Issuer files a prospectus on May 20, Year 1. Companies A, C, E, and G reported net income from continuing operations during its most recently completed year ended before the date of the acquisition while companies B, D and F reported net losses from continuing operations.

**Discussion**

Section A of the following table show the consolidated net income or net loss reported by each company acquired by the Issuer during the most recently completed financial year of the company ended before the date of the acquisition. For the purposes of calculating the significance of each company, the companies have been segregated. Section B includes the companies which reported consolidated net income while section C includes those companies which reported net losses. The second column of sections B and C illustrate that each company is individually insignificant based on the income test. However, in aggregate, the companies reporting net income are significant at 65% while those reporting net losses are significant at 46%, based on the absolute value of the aggregate net losses. As a result, companies A through G inclusive, are significant at 65% and financial statements should be provided for any combination of companies whose aggregate net income is at least \$485 (ie. 50% of \$970). The combination of companies should be selected using the absolute value of any net losses.

The Issuer should include in its prospectus audited financial statements for each of the companies in the selected combination for the most recently completed financial year and the most recently completed interim period of the company, which ended more than 90 and 60 days before the date of the prospectus, respectively, and before the date of the acquisition.

Note that if the aggregate significance under both sections B and C was less than 50%, then no financial statements of any of the companies would be required.

Company	Section A	Section B		Section C	
	Net Income(Loss) from Continuing Operations	Net Income	Significance	Net Losses	Significance
A	\$ 235	\$235	16%		
B	(200)			\$ (200)	-16%
C	210	210	14%		
D	(245)			(245)	-18%
E	250	250	17%		
F	(250)			(250)	-18%
G	275	275	18%		
	<b>\$ 275</b>	<b>\$ 970</b>		<b>\$ (695)</b>	
Absolute Value		\$ 970		\$ 695	
Issuer's Net Income	<b>\$1,500</b>				
Aggregate significance based on the absolute value of the companies net income(loss) as a % of Issuer's net income		<b>65%</b>		<b>46%</b>	

Décision 2000-C-0701 -- 14 novembre 2000  
(Voir également la décision 2000-C-0702)