

**NOTICE OF
NATIONAL INSTRUMENT 44-101,
FORMS 44-101F1, 44-101F2 AND 44-101F3 AND COMPANION POLICY 44-101CP
SHORT FORM PROSPECTUS DISTRIBUTIONS**

1. Implementation of Instrument and Expiry of National Policy Statement

The Manitoba Securities Commission (the "Commission") and other members of the Canadian Securities Administrators (the "CSA") have implemented National Instrument 44-101 Short Form Prospectus Distributions ("NI 44-101"), Form 44-101F1 AIF ("Form 1"), Form 44-101F2 MD&A ("Form 2"), Form 44-101F3 Short Form Prospectus ("Form 3") and Companion Policy 44-101CP (the "Companion Policy"). In this Notice, Form 1, Form 2 and Form 3 are referred to collectively as the "Forms" and NI 44-101, the Forms and the Policy are referred to collectively as the "Instrument".

The Commission has made NI 44-101 and Forms a Rule under the *Securities Act* (the "Act") and has adopted the Companion Policy as a Policy under the Act. The Instrument is intended to come into force on or before April 1, 2001 (the "Effective Date").

National Policy Statement No. 47 Prompt Offering Qualification System ("NP 47") will expire as a deemed rule in Ontario on the Effective Date.

2. Purpose and Substance of the Instrument

The Instrument prescribes conditions for the use of a short form prospectus to distribute securities to the public. It replaces NP 47, which has governed the use of a short form prospectus in CSA jurisdictions other than Québec since 1993.

Central to the short form prospectus distribution system (referred to in NP 47 as the "POP System" or "prompt offering qualification system") is the use of a short form prospectus which incorporates by reference, rather than restates, information contained in the issuer's annual information form ("AIF"), financial statements and other continuous disclosure. The system, and the more concise offering document, were designed to enable qualifying issuers to respond more quickly to market opportunities without diminishing the information and protection available to investors.

The CSA are of the view that the regulatory regime established by NP 47 has operated efficiently and effectively. Their broader CSA project of reformulating policies and other instruments has, however, provided an opportunity to reconsider and update substantive and administrative elements of the short form prospectus distribution system under NP 47. The Instrument largely preserves the substance of NP 47 but is intended to better serve the CSA's original objectives through clarifying and simplifying important aspects of the system, broadening access to the system and modifying disclosure and other requirements in a manner consistent with other developments and initiatives of the CSA and member jurisdictions.

3. Prior Publication and Public Comment

Earlier versions of the Instrument were published for comment in February 1998 (the "1998 Proposal", July 1999 (the "July 1999 Proposal") and December 1999 (the "December 1999 Proposal"). Changes from NP 47 were summarized in the notices accompanying publication of the 1998, July 1999 and December 1999 Proposals. The notices accompanying the July 1999 and December 1999 Proposals also summarized public comments on the respective preceding proposals and CSA responses to those comments.

The CSA received comments on the December 1999 Proposal from the seven commenters identified in Appendix A to this Notice. A summary of their comments and the CSA's responses to those comments are set out in Appendix B to this Notice.

In addition to considering public comments, the CSA also considered proposed Ontario Securities Commission Rule 41-501 General Prospectus Requirements (the proposed "OSC Rule"), which was published for comment by the Ontario Securities Commission (the "OSC") on May 2, 1997, July 23, 1999 and December 17, 1999. The OSC has now finalized the OSC Rule, which will also become effective on the Effective Date unless rejected or returned by the Ontario Minister of Finance to the OSC for further consideration. Given the extensive similarities in the subject matter of the Instrument and the proposed OSC Rule, many of the comments received by the OSC on the proposed OSC Rule and the OSC's responses to those comments are also relevant to the Instrument. A list of commenters on the December 17, 1999 version of the proposed OSC Rule, a summary of their comments on the proposed OSC Rule and the OSC's responses are contained in Appendices C and D to this Notice.

4. Summary of the Instrument

Mandatory elements of the Instrument are set out in NI 44-101 and the Forms. Explanation and guidance are provided in the Policy.

(a) NI 44-101

Part 1 of NI 44-101 provides definitions and interpretations of certain terms used in the Instrument. Other terms used but not defined in the Instrument have the respective meanings, if any, ascribed to them by National Instrument 14-101 Definitions or by local securities legislation.

Conditions for qualification to file a short form prospectus are set out in Part 2 of NI 44-101. As described in the notices accompanying earlier published versions of the Instrument, these qualification criteria have been expanded beyond those permitted under NP 47. The CSA have also endeavoured to clarify and simplify the qualification conditions, which in some cases have also been modified to align more closely with comparable provisions of United States federal securities legislation.

The Instrument differs from NP 47 in that qualification to make use of the system is to be determined, not annually at the time of filing an AIF, but rather at the time of each prospectus filing. The CSA consider that an issuer's eligibility to use the system is more relevant at the time of a distribution of securities. This approach can also provide greater flexibility for non-qualifying issuers who anticipate achieving the qualification criteria in the near future.

Qualification to file a short form prospectus is, pursuant to Part 2 of NI 44-101, conditional on the existence of a current AIF. Part 3 mandates the form of AIF, prescribing the use of Form 3 or, in specified circumstances, comparable US forms.

Part 3 also sets out certain requirements and procedures relating to the filing of AIFs and supporting documents, and review and amendment of AIFs. The AIF filing procedures set out in Part 3 are somewhat simpler than under NP 47. Regulatory review of a renewal AIF is no longer restricted to the immediate post-filing period. The Policy reminds issuers that procedures specific to the mutual reliance review system are set out in National Policy 43-201 Mutual Reliance Review System for Prospectuses and Annual Information Forms (the "MRRS Policy").

Issuers who make use of the short form prospectus distribution system must comply with the financial statement and other disclosure requirements of local securities legislation, to the extent not expressly varied by the Instrument or a related implementing rule. Parts 4 and 5 of NI 44-101 set out detailed requirements for financial statement disclosure in respect of acquisitions of businesses, proposed or completed, that are significant to the issuer individually or in combination. Part 6 prescribes financial statement disclosure in respect of significant dispositions. The significance of an acquisition or disposition is interpreted in Part 1. These provisions differ from current requirements under NP 47 and other securities legislation, reflecting the evolution of generally accepted accounting principles in Canada, corresponding requirements under US federal securities legislation and ongoing refinement and harmonization of accounting practice recommendations of the chief accountants of CSA members. Among the more significant changes from current requirements, financial statement disclosure for an acquired business may be required for a shorter period, the precise requirements varying with the relative significance of the acquisition to the issuer, but the content of the required disclosure is expanded and specified in greater detail. NI 44-101 also provides exceptions and variations of the requirements available to issuers in specified circumstances.

Additional financial statement disclosure issues are dealt with in Part 7 of NI 44-101. It specifies the circumstances in which financial statements may be prepared in accordance with accounting principles other than Canadian generally accepted accounting principles (Canadian "GAAP"), and disclosure that must accompany the use of financial statements prepared in accordance with foreign GAAP. It also sets out requirements for audit reports and the auditing standards to be applied. Part 8 of NI 44-101 requires review by the issuer's audit committee, if any, and board approval of financial statements included in a short form prospectus.

Under Part 9 of NI 44-101, a short form prospectus is deemed to incorporate by reference, except as modified or superseded, all required documents, whether or not the prospectus so states. This provision is intended to enable investors to rely on the disclosure in all such documents.

Filing requirements and procedures in respect of a short form prospectus and supporting documents are set out in Part 10 of NI 44-101. Among the supporting documents to be filed are material contracts. Part 11 sets out procedures relating to short form prospectus amendments.

Part 12 of NI 44-101 prescribes conditions for the reduction of the offering price of securities distributed under a short form prospectus and for the use of a short form prospectus to distribute securities at a non-fixed price.

Part 13 of NI 44-101 specifies how certain disclosure requirements relating to take-over bids and issuer bids can be satisfied by using or referring to information disclosed under NI 44-101.

Prospectus requirements that would otherwise apply to an issuer's solicitation of expressions of interest from prospective investors are modified by Part 14 of NI 44-101 to permit such activities, on specified conditions, prior to the filing of a preliminary short form prospectus.

Provision for exemptions from the Instrument is made in Part 15.

(b) Form 1

Form 1 contains detailed content requirement for the AIF together with instructions designed to assist the preparer.

(c) Form 2

The content of management's discussion and analysis ("MD&A"), required to be included in an AIF (item 6 of Form 1), together with instructions, is now set out separately in Form 2, rather than as an appendix to NP 47 or to Form 1. The separation of MD&A from the AIF form is intended to facilitate the preparation of MD&A for purposes other than the Instrument, by making the MD&A requirements more readily accessible.

(d) Form 3

The form and content of a short form prospectus are set out in Form 3. This form includes prescribed cover page disclosure comparable to the disclosure that will be required for long form prospectuses pursuant to National Instrument 41-101 Prospectus Disclosure Requirements.

(e) The Policy

The Policy provides explanation and guidance for use of the short form prospectus distribution system. It explains the interrelationship of the system to other distribution systems and procedures, notably National Instrument 44-102 Shelf Distributions, National Instrument 44-103 Post-Receipt Pricing and the mutual reliance review procedures under the MRRS Policy.

The Policy contains extensive discussion in Part 4 intended to guide issuers in satisfying the requirements for financial statement disclosure relating to significant business acquisitions. It also discusses factors and conditions likely to be considered in connection with applications for exemption from those requirements.

5. Changes from the December 1999 Proposal

(a) Financial Statement Disclosure for Significant Acquisitions

A number of commenters on the December 1999 Proposal and the July and December 1999 versions of the OSC Rule urged further consideration of the financial statement disclosure requirements proposed for significant acquisitions. Commenters noted in particular that it is often very difficult, if not impossible, for an acquirer of natural resource assets to obtain from the vendor the information necessary to enable the acquirer to comply with the proposed financial statement disclosure requirements, particularly if the acquired assets were not a substantial portion of the vendor's total assets.

The CSA considered very seriously these comments and other issues relating to these proposed disclosure requirements. As noted above, Part 5 of the Policy now provides extensive discussion of the requirements and sets out CSA views on circumstances and conditions that securities regulatory authorities would likely consider in response to applications for relief from these disclosure requirements. In particular, section 5.3 addresses circumstances and disclosure alternatives particular to oil and gas asset acquisitions.

(b) Supporting Documents to be Filed

Part 10 of NI 44-101 has been reorganized to clarify requirements for the documents in support of a short form prospectus. Sections 10.2 and 10.3 require that the issuer deliver to the regulator, when filing the preliminary short form prospectus, copies of all material contracts not previously filed, and that the issuer file with the final short form prospectus any material contract not previously filed. These requirements supplement the requirement under section 10.7 that the issuer make the material contracts available for inspection during the distribution period. With a view to harmonizing filing requirements, limitations on this filing requirement in Ontario and Nova Scotia that formed part of the December 1999 Proposal have been removed.

(c) Risk Factor Disclosure

Form 3 now requires, under Item 17, that a short form prospectus include a description of the risk factors material to the issuer that a reasonable investor would consider relevant to an investment in the securities being distributed. This requirement parallels the corresponding disclosure requirement applicable to long form prospectuses. The CSA consider such information an important element of the full, true and plain disclosure that should be provided by all prospectuses.

(d) Other Changes

The Instrument incorporates a number of other changes from the December 1999 Proposal. In general, these changes are intended to clarify the meaning and application of provisions of NI 44-101. Most of the changes respond to public comment on previously published versions of the Instrument or on similar provisions of the proposed OSC Rule. Many of these changes are also reflected in the requirements relating to long form prospectuses under the OSC Rule.

(i) NI 44-101

A. *Definitions and Interpretation*

The CSA have revised and added definitions in Part 1 of NI 44-101 to add clarity to the Instrument. Revisions include the following:

The definition of "acquisition of related businesses" now includes a third criterion, contingency on a common event, to harmonize the definition with that in the US. Explanatory guidance is provided in subsection 5.4(3) of the Policy.

The definition of "income from continuing operations" now specifically addresses amortization and write-offs of goodwill.

The CSA have also responded to public comments on the Instrument by revising interpretative provisions of Part 1 of NI 44-101:

Business Acquisitions: "Significance" Tests: The tests of "significance" have been revised and expanded to provide additional clarity.

To better distinguish between required and optional tests, the required significance tests, to be applied as at the date of an acquisition, are set in subsection 1.2(2) of NI 44-101. Optional significance tests, to be applied as at a date subsequent to the acquisition, are set out in subsection 1.2(3). New subsection 1.2(4) of the Rule makes clear that the optional significance tests can either confirm or reverse the characterization of an acquisition as a

significant acquisition under subsection 1.2(2), but would not render an acquisition significant if it had not been so characterized under subsection 1.2(2).

A number of the changes to section 1.2 concern the financial statements to be used in applying the significance tests:

Subsection 1.2(6) permits the use of unaudited financial statements of an acquired business if those financial statements have not in fact been audited. As section 5.9 of the Policy notes, this provision applies for the purpose of measuring significance, but does not alter the requirements for the inclusion of audited financial statements in a short form prospectus if the acquisition is determined to be significant.

Under subsection 1.2(9), financial statements of an acquired business that are prepared in accordance with foreign GAAP must be reconciled to Canadian GAAP. Subsection 5.8 of the Policy notes that the reconciliation need not be audited for use in the significance tests.

New subsections 1.3(1) and (6) of NI 44-101 specify how to apply the income test when losses have been incurred.

B. Financial Statement Disclosure for Significant Acquisitions

A number of provisions in Part 4 of NI 44-101 have been amended and Part 4 as a whole has been reformatted to make its provisions more understandable, in response to public comments.

Separate sections now set out the financial statement disclosure requirements for (i) significant acquisitions completed within the three most recently completed financial years of the issuer, (ii) significant acquisitions completed during the issuer's current financial year and (iii) significant probable acquisitions.

The following is a summary of other changes in Part 4:

Interim financial statement requirements: In response to public comments, Part 4 makes clear that interim financial statements for periods subsequent to the date of an acquisition are not required.

Balance sheet requirement: Part 4 been amended to make clear that a balance sheet of an acquired business is not required if the acquisition was completed prior to the date of the most recent balance sheet of the issuer included in the short form prospectus.

Pre-acquisition financial statements: In response to public comments, sections 4.2 and 4.3 of NI 44-101 have been modified to permit the inclusion of financial statements for a pre-acquisition period rather than for the most recently completed interim period.

Purchase price equation: In response to public comments, the proposed requirement to provide an audited purchase price equation for probable acquisitions has been removed.

Non-coterminous year-ends: In response to commenters' calls for more guidance on how to deal with non-coterminous year-ends, subsection 4.5(4) has been added to NI 44-101 and further guidance is provided in section 5.10 and subsection 5.17(3) of the Policy. This guidance is very similar to that provided in the "90-day" rule of the US Securities and Exchange Commission (the "SEC").

Additional financial statements or financial information filed or released: In response to public comments, the requirements under sections 4.7 and 5.3 for financial statement disclosure relating to acquired businesses, have been modified:

The proposed requirement to include, in a short form prospectus, financial statements in support of recent news releases has been removed. Instead, only the contents of the news release need be included in the prospectus. NI 44-101 does not require either auditor's "comfort" for the financial information in the news release nor updates to the MD&A or pro forma financial statements included in the short form prospectus.

If, however, interim or annual financial statements for an acquired business are filed for a period more recent than the periods for which financial statements are otherwise required to be included in a short form prospectus, then subsections 4.7(1) and 5.3(1) require that the more recent financial statements be included in the short form prospectus. These financial statements, like other unaudited financial statements included in a short form prospectus, must be accompanied by a comfort letter from the auditor and the MD&A and pro forma financial statements contained in the prospectus must be updated.

Change of year-end: In response to comments, a definition of "transition year" has been added to Part 1 and section 4.9 has been modified to clarify that, if an acquired business has undergone a change of financial year-end, a transition year of at least nine months may be used for one of the years of historical financial statements required to be included in a short form prospectus.

Relief: New section 4.15 of NI 44-101 provides that if annual financial statements for an acquired business were previously included in a prospectus without an auditor's report and an audit has not been subsequently performed, those unaudited financial statements may be included in subsequent short form prospectuses.

C. Significant Dispositions

Pro forma financial statements: New Part 6 of NI 44-101 requires certain pro forma financial statements for significant dispositions, consistent with SEC requirements.

D. Review and Approval of Financial Statements

Audit Committee Review and Board Approval: Section 8.1 (formerly section 6.4) of NI 44-101 now supplements the requirement for audit committee (if any) review with a requirement for board of directors approval of all financial statements included in a short form prospectus.

E. GAAP, GAAS, Auditors Reports and Board Role

Reconciliation of financial statements of foreign acquired businesses: If an issuer is required to include in a short form prospectus three years of financial statements for an acquired business and those financial statements are prepared in accordance with foreign GAAP, section 7.2 provides relief from the requirement to reconcile to Canadian GAAP the earliest of the three years of financial statements.

Application of US GAAS: In response to a comment, clause 10.2(b)7(ii) has been modified so as to exempt only US auditors who apply US GAAS including in their comfort letter the discussion specified in that clause.

F. Short Form Prospectus Filing Requirements

Auditors comfort letters: In addition to the change referred to immediately above, new clauses 10.3(b)1(ii), (iii) and (iv) of NI 44-101 require that a comfort letter be delivered to the regulator in respect of: financial information related to equity investees; financial statements constructed to comply with the "93-day" rule; and financial statements reflecting a significant disposition as required under Part 6.

(ii) Form Requirements

MD&A: A new requirement for supplemental disclosure relating to MD&A, if a Canadian issuer prepares its MD&A on the basis of financial statements prepared other than in accordance with Canadian GAAP, has been added as Item 6.12 of Form 1.

Asset-backed securities: In response to informal comments received and experience gained by regulatory staff from their review of recent asset-backed security offerings, refinements have been made to AIF disclosure requirements in section 4.2 of Form 1 and to short form prospectus disclosure requirements in section 8.3 of Form 3.

(iii) The Policy

Significant Acquisitions: In response to comments from the public, considerably more guidance is now provided in the Policy in areas including:

the interpretation of references to 60 and 90 days in connection with the age of financial statements (section 4.1 of the Policy);

guidance with respect to when exemptions from financial statement requirements may be available in situations where records have been destroyed, an issuer or business is emerging from bankruptcy and a fundamental change in the business has occurred (subsections 4.7(4) and 5.20(6));

the required and optional significance tests and their application (section 5.7);

non-coterminous year-ends and the "93-day" rule (section 5.10 and subsection 5.17(3));

acquisitions of related businesses (section 5.14);

unrelated individually insignificant acquisitions (section 5.15); and

pro forma financial statements (expanded section 5.17).

Exemptions relating to financial statement disclosure: The Policy now sets out the views of the CSA on the circumstances and conditions under which exemptions may be granted:

from financial statement requirements for an issuer or for an acquired business in situations involving destroyed records, emergence from bankruptcy or a fundamental change in business (subsections 4.6(4) and 5.20(6)).

from requirements for audited financial statements in respect of an acquisition of an interest in an oil and gas property, as discussed in paragraph (a) above (section 5.3).

Significant dispositions: Sections 5.18 and 5.19 of the Policy provide additional guidance concerning financial statements disclosure requirements relating to significant dispositions.

Transitional provision: Section 5.20 sets out the CSA's view as to the circumstances and conditions under which relief may be granted from requirements to provide audited financial statements for a business acquisition completed prior to December 31, 2000, the Effective Date of the Instrument.

Appendix B: Appendix B to the Policy provides examples intended to assist in understanding how certain provisions of the Instrument are to be applied.

6. International Disclosure Standards for Cross-Border Offerings

In September 1998 the International Organization of Securities Commissions (IOSCO") proposed new international disclosure standards for use by issuers in connection with cross-border public offerings and listings of equity securities (International Disclosure Standards"). The proposed standards would not govern financial statement disclosure and do not specify the bodies of accounting or auditing principles to be followed by an issuer in preparing its financial statements. On September 28, 1999 the SEC revised its requirements for disclosure, outside financial statements, by "foreign private issuers" to conform more closely to the International Disclosure Standards. The Commission and the CSA are monitoring developments in this area, which may result in post-implementation changes to the Instrument.

7. Transition

Under the Instrument, the existence of a "current AIF" is a condition of qualification to file a short form prospectus. Part 1 of NI 44-101 defines the term to include an AIF, filed before the Effective Date, that would constitute a "Current AIF" under NP 47 if that instrument were applicable at the time the condition is being considered.

The Instrument makes no transitional provision for a short form prospectus itself. Accordingly, if a preliminary short form prospectus is filed in accordance with NP 47 but no receipt is issued for the final short form prospectus before the Effective Date, the final short form prospectus must comply with the requirements of the Instrument.

8. Expiry of NP 47

NP 47 will expire on the Effective Date, as will Commission Order No's 56 and 57 dated March 1, 1993.

10. Text of Rule, Forms and Companion Policy

The texts of NI 44-101, the Forms and the Policy follow.

January 26, 2001

**APPENDIX A
TO
NOTICE**

**NATIONAL INSTRUMENT 44-101,
FORMS 44-101F1, 44-101F2 AND 44-101F3 AND COMPANION POLICY 44-101CP
SHORT FORM PROSPECTUS DISTRIBUTIONS**

**List of Commenters
on the December 1999 Proposal**

The CSA received comments on the December 1999 Proposal from the following commenters:

1. Borden & Elliot by letter dated February 25, 2000
2. Burnet, Duckworth & Palmer by letter dated February 14, 2000
3. CICA Task Force on Prospectuses and Other Offering Documents by letter dated February 14, 2000
4. KPMG LLP by letter dated February 17, 2000
5. Numac Energy Inc. by letter dated April 28, 2000
6. PricewaterhouseCoopers LLP by letter dated February 15, 2000
7. Talisman Energy Inc. by letter dated February 14, 2000

**APPENDIX B
TO
NOTICE**

**NATIONAL INSTRUMENT 44-101,
FORMS 44-101F1, 44-101F2 AND 44-101F3 AND COMPANION POLICY 44-101CP
SHORT FORM PROSPECTUS DISTRIBUTIONS**

**Summary of Public Comments
on the December 1999 Proposal
and CSA Responses**

The CSA received comment letters on the version of the Instrument published in December 1999 from the seven commenters identified in Appendix A. The CSA thank all of them for their valuable comments. Their comments, and the CSA's responses, are summarized below.

In addition to the comments specific to the Instrument that are summarized in this Appendix B, refer also to Appendices C and D, which identify commenters on the proposed OSC Rule and summarize their comments and the OSC's responses.

I. Deadline for Issuers Annual Financial Statements

Comment:

One commenter expressed concern that an additional qualification criterion has been introduced which requires an issuer that files a short form prospectus more than 90 days after its year-end to file its annual financial statements and incorporate them into the prospectus despite the fact that under continuous disclosure requirements, the annual financial statements are not required to be filed until 140 days after the year end. The commenter believed that this was inconsistent with the move towards increasing reliance upon an issuer's continuous disclosure system. The commenter suggested that, if there is a concern that the short form prospectus offering system does not provide for sufficiently current information, regulators should review the entire system rather than merely accelerate deadlines when an offering is contemplated. The commenter suggested that if there is concern that the continuous disclosure requirements are not timely enough, then those deadlines should be reviewed.

CSA Response:

The CSA considered this issue at length. The CSA believe that in the context of a prospectus offering, it is appropriate to require the issuer's annual financial statements for its most recently completed year to be incorporated by reference if the prospectus is filed more than 90 days after the issuer's most recently completed year. The CSA are indeed considering whether continuous

disclosure requirements should be amended to reduce the 140 day deadline for annual financial statements to 90 days. Whether or not that change is made, the CSA believe that the context of an offering demands more current information and that the revised requirement is appropriate for a short form prospectus. A similar change will be reflected in the requirements applicable to long form prospectuses under the OSC Rule. The CSA also note that many issuers who file prospectuses under NP 47 already file their annual financial statements within 90 days, and that the new requirement is consistent with existing requirements that apply to issuers conducting cross-border offerings in the US. For these reasons the CSA do not believe that the new requirements will impose undue hardship on issuers.

II. Fourth Quarter Reports

Comment:

One commenter noted that some issuers release, soon after year-end, fourth quarter results which typically provide separate disclosure of the results of the last three months of the year and the issuer's 12 months results. The commenter raised the following two issues and recommended that they be addressed in the Companion Policy:

1. Even if the 12 month results are omitted from such a fourth quarter report, the report could reasonably be interpreted as a "back-door" release of the annual results and would trigger the requirements of 12.1(1)4 of Form 44-101F2.
2. In some cases, the 12 month results, prepared in the same format and detail as interim financial statements, have been incorporated by reference into the preliminary short form prospectus with the understanding that the annual financial statements will be included in the final prospectus. In the commenter's view, such 12 month financial statements are not prepared in accordance with GAAP. The commenter suggested that if others believe that they are in accordance with GAAP, then it would in the commenter's view be possible that issuers could satisfy their annual reporting requirements under securities legislation by providing annual financial statements prepared in accordance with CICA Handbook section 1750.

CSA Response:

1. In response to other comments received on the Instrument and the OSC Rule, the CSA have amended the requirements of Item 12.1 of Form 44-101 F2 (now Form 44-101F3). Release of fourth quarter results in a press release or other public communication would not, by itself, trigger the requirements in paragraphs 3 and 4 of Item 12.1(1) of Form 44-101F3. However, if the annual financial statements included in the fourth quarter or any other set of financial statements report were filed with the regulator, the requirements in paragraphs 3 and 4 of Item 12.1(1) of Form 44-101 F3 would be triggered.

2. The CSA do not agree with the commenter's view that where such 12 month financial statements are prepared in accordance with GAAP, an issuer has satisfied its annual reporting requirements under securities legislation since the relevant requirement under securities legislation is for annual *audited* historical information. Since the 12 month financial statements would be unaudited, they would not satisfy the requirement for one of the three years of audited historical financial statements required to be included in the prospectus.

III. Significant Acquisition Disclosure

Comment (i)

One commenter applauded the CSA's efforts to improve prospectus disclosure in the proposed Instruments. The commenter particularly agreed with the direction of disclosure for significant acquisitions in that it will improve the consistency of this disclosure. The commenter was also pleased that the requirements were harmonized with those in the US.

CSA Response

The comment was noted. For additional comments related to business acquisition disclosure please refer to Appendix D.

Comment (ii)

One commenter expressed concern with the definition of "acquisition of related businesses" as it relates to the oil and gas industry. The commenter was concerned that the definition may describe oil and gas acquisitions that have common operators but are otherwise unrelated. This would imply that a combined set of financial statements would be required, which the commenter suggested would be too onerous to prepare and would be potentially misleading. The commenter recommended that the definition be clarified to exclude such situations.

CSA Response

The CSA considered the commenter's recommendation but concluded that such an issue would need to be considered on a case-by-case basis. Accordingly, no change was made to the Instruments. However, it should be noted (and the Policy provides clarity in this regard) that there is no requirement to prepare one set of financial statements for related businesses. The instrument does provide that combined statements may be prepared if, during the period, the businesses were under common control or management.

IV. Securities Exchange Take-over Bids and Issuer Bids

Comment:

One commenter expressed its view that the requirements of the instruments as they relate to securities exchange take-over bids and issuer bids are too extensive in that they appear to require the target's financial statements be included in a take-over bid circular. In the commenter's view, the recipients of the take-over bid circular are security holders of the target and can be presumed to have already received financial statements of the target in the normal course. The target security holders require historical financial information about the offeror and pro forma financial information on a post-acquisition basis. Any other financial information on the target should come from the target itself, through the directors' circular. The commenter recommended amending the proposals to require only pro forma financial statements as at end of each of the offeror's most recently completed year and the most recent quarter for which financial statements of the target are available.

CSA Response:

The CSA agree with the comment. Changes have been made to the Instrument and the Form to address the commenter's concern. The requirement to include target financial statements in a take-over bid circular has been deleted.

V. Historical Oil and Gas Production

Comment:

One commenter criticized the proposed requirement for disclosure in the AIF, under Item 4.4, paragraph 8(a) of Form 44-101F1, of oil and gas production after deduction of royalties payable in kind, on the grounds that (i) differentiation between royalties payable in cash or in kind is not justified and would impair comparability between issuers, and between wells, that are subject to different royalty provisions, and (ii) royalties being more akin to a "cost of goods sold", a deduction for royalties would not be an appropriate adjustment for this disclosure item.

CSA Response:

The CSA generally concur with the comments. Item 4.4, paragraph 8(a) of Form 44-101F1 has been revised to provide that production is to be disclosed without deduction for royalties.

**APPENDIX C
TO
NOTICE
NATIONAL INSTRUMENT 44-101,
FORMS 44-101F1, 44-101F2 AND 44-101F3 AND
COMPANION POLICY 44-101CP
SHORT FORM PROSPECTUS DISTRIBUTIONS**

**List of Commenters on
Proposed Ontario Securities Commission Rule 41-501
General Prospectus Requirements**

The OSC received comments on the December 1999 Proposal from the following commenters:

1. Bennett Jones by letter dated February 15, 2000.
2. Burnet, Duckworth & Palmer by letter dated February 14, 2000.
3. CICA Task Force on Prospectuses and Other Offering Documents by letter dated February 14, 2000.
4. Ernst & Young LLP by letter dated February 16, 2000.
5. KPMG LLP by letter dated February 21, 2000.
6. McCarthy Tétrault by letter dated February 14, 2000.

**APPENDIX D
TO
NOTICE**

**NATIONAL INSTRUMENT 44-101,
FORMS 44-101F1, 44-101F2 AND 44-101F3 AND
COMPANION POLICY 44-101CP
SHORT FORM PROSPECTUS DISTRIBUTIONS**

**Summary of Public Comments
on
Proposed Ontario Securities Commission Rule 41-501
General Prospectus Requirements
and Ontario Securities Commission Responses**

The OSC received submissions on the December 1999 proposed instruments from the six commenters identified in Appendix C. Many of those comments are relevant to the Instrument and were taken into consideration by the CSA in finalizing the Instrument.

The following is a summary of the comments received, together with the Commission's responses, organized by topic. In the summary, references to proposed Rule, proposed Policy and proposed Forms (collectively, the "proposed instruments") are references to the December 1999 version of these documents. References to the Rule, Policy and Forms (collectively, the "instruments") are references to the final version of these documents.

PART A - OVERALL COMMENTS

I. Drafting Style

(i) Comment

Three commenters, all commenting on behalf of accountants, expressed views on the drafting style of the proposed Rule, Policy and Prospectus Form. One commenter stated that the wording of the instruments was unnecessarily obscure; the text was not user friendly; and as a result, the instruments will be difficult for issuers and their advisers to understand and apply, and for Commission staff to administer. The commenter noted that the proposals should embody the plain language principles set out in section 1.2 of the Policy.

Another commenter found the language difficult to work through and overly legalistic and recommended that every effort should be given to simplifying the language.

The third commenter also noted that it continued to find the proposed Rule very difficult to understand and interpret.

Response

In finalizing the instruments the Commission was keenly aware of these concerns and made every effort to address them. Given that many of the key provisions of the instruments relate to financial reporting and that accountants would be called upon to assist issuers in applying them, it was very important to the Commission that the issues raised by the commenters were satisfactorily addressed.

Consequently, staff of the Commission, on behalf of the CSA, invited the commenters who raised these issues to a meeting to discuss them with staff in greater detail. The meeting between these commenters and the staff was very helpful in identifying ways in which their comments could be addressed. Though the general style of drafting is dictated by legislative requirements in Ontario, and other jurisdictions, a number of changes were made to the proposed Rule in an attempt to simplify it, and extensive additional guidance, including examples, was added to the proposed Policy to assist issuers and their advisors. Some sections of the proposed Rule have been re-organized and reworded in an effort to make it easier to read and understand. The Commission very much hopes that the re-drafting of the proposed instruments is responsive to these comments.

II. National Harmonization

(i) Comment

One commenter applauded the Commission's undertaking to work with the CSA and the stated intention of Commission staff in Alberta, British Columbia and Quebec, to recommend that their respective Commissions provide accommodation to facilitate filings prepared in accordance with the proposed Rule and Prospectus Form.

Another commenter strongly encouraged the Commission to work with the CSA to adopt a national general prospectus instrument. In fact, the commenter recommended that the Commission delay implementing the proposed Rule in Ontario until a national instrument is developed and continuous disclosure standards are in place which address significant business acquisitions.

Response

The Commission understands the commenters' concerns and has worked diligently with the CSA to address this point. The CSA Chairs have approved using the Rule as the basis for developing a national instrument and work has begun on that front. However, given the statutory time periods required to make a rule and the time available to the Commission before the rule entitled National Policy Statement No. 47 *Prompt Offering Qualification System* is to expire, it would not have been possible to prepare a national general prospectus rule.

The Commission also understands that in the interim, staff of the securities commission in each of British Columbia, Alberta and Quebec will recommend to their respective commission that relief be provided to permit the filings of prospectuses prepared in compliance with the requirements of the Ontario instruments.

Regarding the comment that implementing the instruments should be delayed until continuous disclosure requirements are in place for business acquisition disclosure, the Commission has decided to proceed with finalizing the Rule. The Rule not only brings together in one place the prospectus requirements that have been scattered throughout the Act, Regulation, policy statements, notices and the Corporate Finance Accountant's Practice Manual, it also considerably updates these requirements. The existing requirements in securities regulation have included business acquisition disclosure requirements for prospectuses for many years. When the Commission requested comment in May 1997 on its proposal to either maintain its materiality approach to business acquisition disclosure or adopt an SEC approach, the public comments received overwhelmingly supported an SEC approach. This approach is now reflected in the instruments.

(ii) Comment

One commenter again encouraged the Commission to develop national instruments consolidating various requirements such as those for the financial statements of issuers and acquired entities, MD&A, and AIF's.

Response

The Commission recognizes the merits of consolidating certain requirements, such as the financial statement requirements for issuers and acquired companies, into one or more separate national instruments. Given the statutory time periods required to make a rule and the time available to the Commission before the rule replacing National Policy Statement No. 47 is to expire, it would not have been possible to prepare a new national instrument, publish it for comment and finalize it.

III. Harmonization with the SEC

(i) Comment

A commenter again requested that the Commission formally adopt the SEC's rules regarding historical financial statements and *pro forma* financial statements relating to businesses that have been acquired as the commenter continued to find the proposed Rule difficult to understand and interpret. The commenter acknowledged that the SEC rules are also complex but stated that practitioners are experienced in applying the rules, and that most anomalies in the SEC rules have been fixed over time. Concern was expressed that there will be a significant "break-in" period for the proposed rules.

Another commenter expressed concern about the significant differences between the proposed requirements and the SEC regime and hopes that they can be minimized in time.

Response

As noted in the December 1999 Notice, the Commission recognizes the value in harmonization with the requirements of the SEC where those requirements are appropriate for Canadian capital markets and consequently made harmonizing changes to the proposed Rule. However, the Commission disagrees with the proposition that the SEC's regulatory regime, in its entirety, is appropriate for the Canadian markets. Instead, the Commission has moved towards greater harmonization in the formulation of the significance tests and in other areas. In many instances, the differences between the Rule and the SEC's requirements result in requirements that the Commission believes are better suited to the Canadian market.

In several instances, additional conforming changes have been made to the Rule. For example, the revised instruments include guidance very similar to the SEC's "93 day rule" for situations where the issuer and the business do not have coterminous year-ends. As another example, the guidance for applying the significance tests has been brought more in line with the SEC's approach. The Commission believes that, in the few areas where there are differences from the SEC regime (i.e., where an option has been provided to perform the significance tests at a more recent date and to present pro-forma income statements using "pre-acquisition" stub period financial statements), there are good reasons for these differences. The Commission also believes that the instruments will, after an initial break-in period, be easier to apply than the SEC's requirements since all the requirements have been included in one set of instruments rather than scattered throughout many different reference sources.

(ii) Comment

A commenter expressed concerns about the acquisition disclosure requirements as they apply to cross-border financings that are also subject to SEC jurisdiction. The commenter stated that it would be a disservice to investors if the differing requirements in Canada and the U.S. were permitted to create alternative or conflicting accounting presentations. The commenter recommended that the Commission accept the requirements for an SEC Form-1 filing incorporating financial statements prepared in accordance with Canadian GAAP with a reconciliation to U.S. GAAP.

Response

The Commission agrees generally with the concern and, as noted in the previous response, has tried to achieve a substantially similar regime. There should be no significant differences between the requirements given that the SEC's significance tests, financial statement and *pro forma* financial statement requirements are the same. The Commission is not, however, prepared to permit a Canadian company doing a cross-border offering to file in Canada documents prepared in accordance

with the SEC's Form F-1. The onus is on issuers who are reporting issuers in both jurisdictions to ensure that they comply with the regulatory requirements in both Canada and the U.S.

IV. Continuous Disclosure Regime

(i) Comment

One commenter thought that the provisions concerning significant acquisition disclosure have been included in the prospectus proposals to address shortcomings in the continuous disclosure system.

The commenter does not support this approach and believes that the timely disclosure of business combinations should be addressed through the continuous disclosure system.

Another commenter noted that the continuous disclosure regime should remain a priority.

Response

The Commission emphasizes that the provisions concerning significant acquisition disclosures were included in response to comments received on the December 1999 version of the Rule as noted above. The requirements were not introduced to address shortcomings in the continuous disclosure system.

However, the Commission recognizes the interaction between the requirements for prospectus and continuous disclosure and the Commission also recognizes that the market would benefit from more timely disclosure of significant business acquisitions. The continuous disclosure regime is a priority of the Commission. The issue of continuous disclosure for business acquisitions is discussed in the Integrated Disclosure System ("IDS") Concept Paper, which was published for comment in January, 2000. Comments on the IDS Concept Paper are currently being analyzed. The prospectus requirements will be revisited if changes are made to the continuous disclosure regime to address business acquisition disclosure as a result of the IDS proposals.

V. Special Warrant Prospectuses

(i) Comment

One commenter expressed the view that the preparation of a prospectus for the issuance of securities under special warrants, while providing documentation for the public record, is largely irrelevant to the investors that the prospectus is designed to inform and protect. In the commenter's view, the result is an unnecessary cost for issuers without a corresponding benefit for investors. The commenter thought that the utility of a prospectus in this situation will be reduced further if the IDS proposals are adopted.

Response

As noted in the December 1999 Notice, the Commission has resolved not to provide special treatment for special warrant transactions in the context of the instruments. The Commission is of the view that the differences between special warrant offerings and other offerings are mainly with respect to timing. The significance of the prospectus to an issuer's continuous disclosure record is a key factor in the decision to make no distinction between, and therefore not establish a separate system for, special warrant and other offering documents.

It is very possible that when proposed Multilateral Instrument 45-201 Resale of Securities, published for comment in September, 2000, and the IDS proposals become effective, special warrant offerings will no longer be made. In the meantime, special warrants transactions will continue to be done and certain disclosure standards must be met in order for the underlying securities to become freely tradeable.

PART B - SPECIFIC COMMENTS

I. Definitions and Interpretations

1. Junior Issuer - Market Capitalization" Test

(i) Comment

One commenter requested clarification of when the market capitalization calculation, for purposes of defining a junior issuer, should be made.

Response

Clarification has been added to the definition of junior issuer and to the interpretation in section 2.7 of the Rule. The test now refers to a 20 day average calculation within 5 days prior to the date of the preliminary prospectus.

2. Probable Acquisition of a Business

(i) Comment

One commenter agreed with the guidance provided in section 3.4(2) (section 3.3(2) in the 1999 proposed Policy) of the Policy. The commenter believed that the test of whether a proposed acquisition is a "probable acquisition of a business" should be an objective, rather than a subjective, test. However, the commenter believed that the Commission should provide additional guidance on the standard of probability as in its view, the guidance provided in the Policy is unworkable. The commenter noted that applying the objective standard of the "reasonable person" test is different

from assessing the range of probabilities contained in Handbook s. 3290, *Contingencies*. Furthermore, within Handbook s. 3290, the ranges of probabilities are provided as a basis for establishing the appropriate accounting treatment only. A business combination is never recorded prior to closing irrespective of how "likely" it is to occur.

Response

The Commission believes that although the Rule and the wording in the Handbook s. 3290 are not identical, they are not substantially different. The "reasonable person" concept is well known in the field of law. Applying the reasonable person test is not meant to complicate the decision making process, it should simplify it by requiring the use of common sense. Reference to Handbook s.3290 was meant to assist accountants by directing them to a concept better known by them, but one which should not result in a substantially different result than the reasonable person concept. If in doubt, the issuer's accounting advisor should consult the issuer's legal counsel.

3. Definition of Income from Continuing Operations

(i) Comment

One commenter suggested removing the word "net" from the definition of "income from continuing operations" because "net income" implies income *after* the deduction of discontinued operations, extraordinary items, and income taxes.

Response

The Commission agrees with the comment and has made the change to the definition.

II. Comparative Figures

(i) Comment

One commenter disagreed with comment N.1(ii) in Appendix B to the December 1999 Notice which stated that "...failure to provide comparative figures, as contemplated by subsection 2.2(5) of the 1999 proposed Policy represents a departure from GAAP, unless the information is not reasonably determinable." The commenter objected to the rationale provided and the original commenters view that it is contrary to GAAP to omit comparative financial statements. The commenter also stated that if securities regulators have concluded that depending on the significance of an acquisition, only a single year of financial statements of an acquired business is necessary for users of a prospectus, then it is not meaningful to require comparative financial statements in these circumstances. In such circumstances, presenting a single year of financial statements would be in accordance with GAAP.

Response

The Commission is of the view that in certain circumstances, such as the one provided for in section 2.7(4) of the Policy, lack of comparatives is appropriate and would be in accordance with GAAP.

III. Change in Year End

(i) Comment

Two commenters found it difficult to understand the wording regarding financial statement requirements where there has been a change in a year-end. In particular, the use of the words "...may omit the financial statements for the year in which the financial year end changed", which suggests that a gap in the continuity of the financial statements is acceptable, was confusing to the commenters.

One commenter hoped that it was the Commission's intention that a financial year of less than 9 months resulting from a change in year end will not count as one of the three most recently completed financial years in the case of s. 4.3 of the proposed Rule or one of the most recently completed financial years under s. 6.3 of the proposed Rule. The commenter noted that this would be consistent with its understanding of the SEC's rules and with s.7.2(1) of National Policy Statement No. 51, Changes in the Ending Date of a Financial Year and in Reporting Status, (NP 51"), which does not consider a Transition Year of less than nine months to count as a comparative to the new financial year.

The commenter suggested defining "Transition Year" using the definition in NP 51 and then using this defined term in the Rule. The commenter also suggested adding an example.

Response

The Commission agrees. Section 2.1 of the Rule has been amended to include a definition of "transition year" identical to that in NP 51. In addition, sections 4.3 and 6.9 of the Rule have been modified to clarify that only a transition year of at least nine months may be used for one of the years of historical financial statements required to be included in a prospectus.

IV. Significant Acquisitions - Reporting Requirements

1. Annual Financial Statements

(i) Comment

A commenter expressed the view that the requirement in s.6.3(2) of the proposed Rule is unduly onerous in the absence of a continuous disclosure rule. It was noted that at the time of a transaction,

an issuer may not necessarily know that the transaction will have to be revisited three years later if the issuer files a prospectus.

Response

In the vast majority of cases, the issuer will know at the time of an acquisition whether the acquisition will be a significant acquisition for purposes of prospectus disclosure. For some acquisitions, such as individually insignificant acquisitions and acquisitions of major significance (ie. at the 100% significance level), this may not be the case. To partially offset this, the Rule, unlike the requirements in the U.S., permits the significance tests to be recalculated at a date closer to the date of the prospectus to recognize the potential growth of the issuer and thus the potential decline in significance of the acquisition.

As noted above, the Commission has substantially adopted the SEC's rules for business acquisition disclosure, notwithstanding the absence of continuous disclosure rules. This approach was advocated by commenters several years ago. The Commission believes that business acquisition disclosure is material and should be included in a prospectus. As noted in previous Notices, the Commission supports extending these requirements to continuous disclosure filings. Progress is being made on that front through the IDS proposal.

2. Interim Financial Statements

(i) Comment

Two commenters noted that although the proposed Rule was revised to clarify that separate financial statements of the acquired business would be required only for the years before the acquisition, no similar clarification was made for interim financial statements.

Response

The Commission agrees with this comment. The Rule has been amended to clarify that interim financial statements for periods subsequent to the date of an acquisition are not required.

3. Pre-acquisition Financial Statements

(i) Comment

One commenter previously commented on the July 1999 version of the proposed Rule and recommended that when interim financial statements of an acquired business are required to be included in a prospectus, the Rule should permit the filing of financial statements covering a stub period from the *beginning* of the acquired business's last financial year to *the date of the acquisition*, with comparatives for a period of approximately the same length. The Commission's response, as noted in the December 1999 Notice, was that an issuer may, at its option, include

additional financial statements for a stub period but that the issuer was nonetheless required to include the interim financial statements for the acquired business's most recently completed interim period.

The commenter, in response to the December 1999 Notice, acknowledged that there was some merit in the Commission's approach in situations where the acquired business itself is a reporting issuer subject to quarterly reporting on a continuous disclosure basis. However, the commenter noted that even in these situations (i.e. the acquisitions of one public company by another), certain Canadian stock exchanges require the acquired company to file financial statements up to the date of the acquisition.

Two commenters noted that the Commission's position may be unduly onerous when the acquired company was a private entity which did not prepare interim financial statements. Such an entity would be required to prepare financial statements for the most recent interim period and as at the date of the acquisition.

Response

The Commission reconsidered its approach and decided that the Rule should include an option that would permit issuers to include financial statements of an acquired business covering such a pre-acquisition period in lieu of interim financial statements. Sections 6.2, 6.3 and 7.2 of the Rule have been modified to this effect. Explanatory wording has also been included in the Policy. A new definition, "pre-acquisition period" has been introduced in section 2 of the Rule to effect this change. The Rule also provides that a limited gap, between the end of the pre-acquisition period and the date of acquisition, of up to 30 days may exist.

Although the SEC does not permit this approach, the Commission believes that this approach is a practical solution that provides appropriate disclosure to the marketplace.

V. Pro Forma Financial Statements

(i) Comment

One commenter stated that in certain circumstances, the historical and *pro forma* financial statement requirements of the proposed Rule will be too extensive. In the absence of continuous disclosure requirements, the commenter questioned the usefulness of some information, on the basis of its age at the time of the prospectus.

Response

No changes have been made to these basic provisions of the Rule in order to maintain an approach to business acquisition disclosure requirements that is consistent with that of the SEC. The

Commission recognizes that the prospectus regime would be clearly relevant to an integrated continuous disclosure regime. As noted above, staff of the Commission are addressing this issue in the context of the IDS proposals.

(ii) Comment

One commenter expressed its view that problems will arise in determining the interim periods for which *pro forma* financial statements are to be provided. By way of example, the commenter indicated that it is unclear how the stub period *pro forma* income statement is to be constructed and suggested that it would be helpful to issuers if some guidance was provided.

The commenter also suggested that guidance be provided as to how *pro forma* financial statements should be prepared when the issuer and significant acquired businesses have different financial year ends.

Response

To address these concerns, the Commission has amended the Rule by adding a new subsection 6.5(4) which prescribes how *pro forma* financial statements are to be prepared when the year ends are not coterminous. Guidance is provided in subsection 3.17(3) of the Policy. This guidance is very similar to the SEC's "93-day" rule.

(iii) Comment

One commenter believes there is a discrepancy in the *pro forma* income statement requirements for significant acquisitions that occurred in the issuer's current and most recently completed financial years. Footnote 34 to the proposed Rule stated that for acquisitions which occurred during the issuer's most recently completed year, a *pro forma* income statement is required for that year only and not for the subsequent period, if any. However, for significant acquisitions that occurred during the issuer's current fiscal period or significant probable acquisitions, section 6.2(1)7(b)(ii) of the proposed Rule required a *pro forma* income statement to be prepared to give effect to those acquisitions as at the beginning of each of the issuer's current financial year and most recently completed financial year.

The commenter recommended that the accounting treatment for acquisitions during the issuer's current financial year be conformed to that for the most recently completed financial year. This would make the requirement consistent with the SEC's.

The commenter stated that notwithstanding the SEC requirements, the commenter consulted U.S. accountants and understands that despite the SEC written guidance, alternative practices have developed. Specifically, the SEC has not objected to preparing *pro forma* income statements on the basis that the acquisition occurred at the beginning of each period presented. Accordingly, the commenter recommended that the proposed Rule omit the detailed description of the method to be

used in constructing the *pro forma* financial statements in order to minimize unnecessary conflicts with existing practice.

Response

The Commission has restructured Part 6 of the Rule to provide greater clarity. Paragraph 2 of subsection 6.5(1) of the Rule requires that a *pro forma* income statement give effect to an acquisition as if it had taken place at the beginning of the earliest *pro forma* period presented whether the acquisition occurred in the issuer's current, or most recently completed, year. Staff of the Commission confirmed with senior SEC staff that this approach is consistent with the SEC's approach.

(iv) Comment

The commenter noted that in some cases, *pro forma* financial statements would be required for a period for which accounts of the acquired entity are consolidated in the accounts of the issuer. Such anomalous requirements should be eliminated.

Response

The Rule has been amended to clarify that a *pro forma* balance sheet will not be required where the most recent audited balance sheet of the issuer presented in the prospectus reflects the acquisition. A *pro forma* income statement will be required if the acquisition has not been consolidated into the issuer's income statement for a full year. This is consistent with the SEC's approach.

VI. Acquired Businesses - Additional Financial Statements Filed or Released

(i) Comment

One commenter expressed support for the provisions of s. 4.7 of the proposed Rule but felt that it was too punitive to compel the issuer to completely overhaul the historical and *pro forma* financial disclosures in the prospectus (not to mention the MD&A, financial summaries etc).

The commenter suggested that except for the rare instance where the release of the annual results is tantamount to reporting a material adverse change, the changes to the prospectus be limited to requiring the inclusion of the most recent financial statements along with a supplement to the MD&A to cover any significant 4th quarter developments.

The commenter then went on to suggest expanding s. 6.4(2) of the proposed Rule to outline alternatives the issuer may choose, i.e., the minimum disclosure standard or the complete overhaul of the financial statements and related disclosures.

Another commenter expressed distress by the requirements for full financial statements to be included in a prospectus when selected information from the statements has been released. The commenter stated that frequently, the information needed to complete the statements (e.g., note disclosures) will not be readily available, and in the case of annual statements, the auditors will have to complete their work after the necessary information has been assembled. This will result in issuers postponing publication of relevant information in order to avoid delay in filing the prospectus.

Response

The Commission is sympathetic to the concerns raised and has modified the Rule as a result. The Commission decided that the bright-line test for inclusion of financial statements, comfort on them and updating of MD&A and *pro formas* would be the actual filing of the financial statements, rather than a press release disclosing results. A summary of the changes follows.

If an issuer *press releases* financial information pertaining to interim or annual financial periods prior to filing its final prospectus, the final prospectus should include the contents of the press release in the prospectus (perhaps under a caption entitled "Significant Developments" or something similar). No comfort on the numbers disclosed in the narrative will be required (which is the same treatment afforded other non-financial statements numerical information included in a prospectus) and neither updating of *pro forma* financial statements nor MD&A is specifically required. (See subsection 4.7(2) of the Rule)

If, however, an issuer *files* its interim or annual financial statements prior to filing its final prospectus, the final prospectus should include the contents of the press release as above and in addition, include the financial statements that have been filed. These financial statements will need to be comforted. In addition, *pro forma* financial statements must be updated and MD&A must be updated or supplemented. (See subsection 4.7(1) of the Rule)

The specific requirement to include financial statements which have been approved by the board of directors for a more recent period but which have not been filed has been deleted.

(ii) Comment

A commenter was of the view that the current drafting suggested that s. 6.4 of the proposed Rule would require more recent financial statements of significant acquired businesses for periods after the date of the acquisition.

The commenter suggested that the section makes sense only for probable acquisitions and for recently completed acquisitions where an interim period or financial year ended shortly before the acquisition and the prospectus is filed before the expiry of the applicable period of 60 or 90 days, respectively.

Response

The Commission agrees with the comment. As a result, changes have been made to subsections 6.7(1) and 7.3(1) of the Rule.

VII. Significant Acquisitions Accounted For Using the Equity Method

(i) Comment

Two commenters recommended that issuers be permitted to derive summary interim information from unaudited information. In their view, if this is not permitted, then the apparent benefit of the exemption is lost by requiring a special audit for such interim information.

Response

The Commission agrees with the comment. Section 6.10 of the Rule has been clarified so that although summary annual financial information should be derived from audited financial statements, there is no requirement that summary interim financial information be derived from audited financial statements or otherwise subjected to audit procedures.

(ii) Comment

One commenter questioned whether there was any intention that interim periods required under this section be derived from financial statements which have been subjected to Handbook Section 7100 auditor review procedures.

Response

The Commission believes that selected financial information derived from interim financial statements should be comforted. Only the selected information needs to be comforted, however, not the complete financial statements from which that information is derived. Requirements for auditor's comfort on unaudited financial statements are set out in paragraph 1 of subsection 13.3(2)1.

(iii) Comment

The same commenter also wondered if the Commission contemplated receiving consent under Part 11.7 from the "associated" auditor?

Response

The Commission believes that an auditor reporting on the equity investee's financial statements should be required to provide consent. A new paragraph (b) has been added to subsection 13.4(1) of the Rule.

VIII. Significant Acquisition of Joint Venture Interests

(i) Comment

One commenter questioned why the proposals do not provide an exemption from the disclosure requirements, similar to that for acquisitions accounted for by the equity method, for the acquisition of joint venture interests accounted for by the proportionate consolidation method.

Response

The Commission is of the view that the concept of joint control differs from the concept of significant influence and the prescribed accounting treatment reflects this. The relief requested would be inconsistent with the accounting for a joint venture going forward. Such relief would also exempt the issuer from preparing *pro forma* financial statements which seems inappropriate. Therefore, no change has been made to the Rule.

IX. Significant Acquisitions Made After Year End Accounted For Using the Purchase Method

(i) Comment

Three commenters were concerned about the requirement to include details of a purchase equation for significant acquisitions made after the issuer's year end.

One commenter expressed the view that the requirements extended the thinking of EIC-14 beyond reasonable limits. In the commenter's view, the required disclosure, particularly in the case of a probable acquisition, was equivalent to either FOFI or a *pro forma*. The commenter reasoned that if the disclosure was FOFI, it had no place in audited financial statements and, if the disclosure was *pro forma* in nature, it capsulized information already contained in the *pro forma* financial statements but ignored the explanatory notes which accompanied the *pro forma* financial statements and, imposed an auditor's report on information already covered by a compilation report. The commenter stated that the requirement is problematic for completed acquisitions and completely unreasonable for proposed acquisitions.

Another commenter stated that the requirement for an audited purchase equation for significant acquisitions after the year-end is unworkable. The commenter stated that many of the procedures performed to audit a purchase price equation are time-consuming and so it won't be possible for an auditor to complete the work necessary to give a clean opinion in the short time frame for preparing and filing the financial statements.

A third commenter did not believe that the purchase equation for a significant acquisition occurring subsequent to an issuer's year end should be subject to audit. In its view, there are many important transactions which may occur subsequent to an issuer's year end and which are first recorded in interim financial statements, without audit.

Response

The Commission acknowledges that the requirement for an audited purchase price equation has been and continues to be controversial. Based on the comments received and further conversations with the commenters and other professionals, the Commission reconsidered its requirements in this area.

The requirement to disclose a purchase equation when the transaction has not been completed and in all likelihood, the purchase price has not been finalized, has been deleted from section 6.11 of the Rule.

With respect to completed acquisitions, the Commission recognizes that in the majority of cases, it is likely that only a basic allocation will be made and it will be qualified by a statement that the estimate is preliminary and is subject to change. Such a statement is permitted by section 6.11(2)(a)(ii) of the Rule and will not be challenged by staff.

X. Financial Statement Disclosure For Multiple Insignificant Acquisitions

(i) Comment

The commenter found section 7.2 of the proposed Rule confusing. The wording in subsections (1) and (2) suggested that subsection (2) required individual financial statements for more than one business to be included. In addition, it was unclear to the commenter that the provision in subsection 2.2(1) for the asset and income tests to be applied using only the issuer's proportionate share of the acquirees, carried through to the application of the tests under section 7.2.

Response

The requirement is that the issuer's proportionate share of the acquiree's financial results should be used for the significance test. Clarification has been added in new section 3.15 of the Policy in this regard.

(ii) Comment

One commenter noted that the test in subsection 7.2(2) of the proposed Rule which requires the inclusion of financial statements with respect to those businesses which "represent a majority" of the various tests is unclear. The commenter also expressed its view that since financial statements

are required in respect of any business that exceeded the 20% thresholds, the multiple acquisition requirements are unnecessary.

Response

Revisions have been made to the wording in section 7.2 of the Rule and additional clarification has been provided in new section 3.15 of the Policy on how these tests work and how the "represent a majority" test should be applied. The approach to multiple acquisitions is consistent with the SEC's business acquisition disclosure regime and, as such, has been retained.

XI. Application of Significance Tests

1. Different year ends

(i) Comment

The commenter noted that no guidance was included regarding how the significance test would be performed at the date of the acquisition if the acquired company's fiscal year end is different from the issuer's. The commenter recommended that in this scenario, it should not be necessary to conform the fiscal periods for purposes of the tests.

Response

Guidance has been added to the Policy in new section 3.10 in this respect.

2. Losses in the current period

(i) Comment

One commenter noted that no guidance was provided regarding how the income test would be applied if the issuer incurred a loss in the current year or if the acquired company incurred a loss. Section 2.3(3) addresses the situation where the issuer had a loss only in the context of calculating the average amount of income.

Response

Staff of the Commission discussed the issue with staff of the SEC. Consequently, it was decided to add a requirement in the Rule (see subsection 2.3(1)) that if either the issuer and/or the acquired business has incurred a loss in the year, the income test should be applied using the absolute value of the loss.

3. Applying the tests at the second date

(i) Comment

One commenter expressed its view that the second stage of the significance tests should be deleted. The commenter noted that if an issuer fully integrated the acquired business with its own operations, it may be unable to determine the income of the acquired entity post-acquisition. The commenter argued that the disclosure requirements for an issuer who chose to integrate the acquired business operations with its own, should not be subjected to more onerous reporting requirements than the issuer who left the acquired business intact. The commenter recommended that the tests not be permitted to be performed at the second point in time given the complexities and subjectivities involved.

Another commenter discussed the potential difficulties of applying the tests at the second date and recommended that the application of the test at the second date be optional. The commenter also recommended that the Rule be clarified to provide that the application of the significance tests at the second date does not operate so as to increase the level of significance of an acquisition, thereby requiring additional financial statements to be provided.

Response

The Commission realizes that it may not be possible for all issuers to take advantage of applying the tests at the second point in time. However, the option to perform the tests at a more recent date has been retained. Applying the test at the second stage has been included to provide relief from the financial statements requirements required under Parts 6 and 7 and not to increase the requirements. If an acquisition was not significant at the first, mandatory, stage, then the second stage of the tests need not be applied. If an acquisition was significant at the first stage and becomes more significant at the second stage only the financial statements, determined under the first stage, are required.

Subsection 2.2(5) has been added to the Rule to reflect the Commission's expectation that in order for the tests to be applied at the second stage, the acquired entity must have remained substantially intact and not undergone a significant reorganization or transfer of its assets and liabilities to other entities. Subsection 3.7(4) of the Policy also addresses this issue.

XII. Application of Significance Tests

1. Income Test for Multiple Acquisitions

(i) Comment

One commenter noted that the use of the combined basis in the income test for multiple acquisitions would appear to result in the netting of any losses from continuing operations of certain businesses against the income from continuing operations of others. The commenter noted that the computational note to SEC Rule 1-02(w) states: "Where the test involves combined entities, ...entities reporting losses *shall not* be aggregated with entities reporting income."

The commenter did not object to the more lenient approach but wanted to ensure that it represented an intentional departure from the SEC approach.

Response

The Commission appreciates the comment and has added a new subsection 2.3(2) to the Rule to adopt the SEC's wording in 210.1-02(w)(3)3. Guidance has also been added to the Policy in this respect. (See subsection 3.15(2))

2. Investment Test

(i) Comment

In connection with the application of the Investment test, one commenter was puzzled by the intent of the last sentence in s. 3.5 of the proposed Policy which read, "For the purpose of this test, any new debt incurred by the issuer in the acquisition should also be included as an investment by the issuer in the business."

Response

The Commission agrees that the sentence in section 3.5 of the proposed Policy was confusing. No change has been made to the description of the test in the Rule; however, the problematic sentence in the Policy has been deleted and replaced with guidance (see section 3.11 of the Policy) to the effect that in applying the investment test, the issuer should measure its investment by using the purchase consideration paid.

XIII. Auditor's Letter Filed in Connection with Financial Statements Prepared Using Foreign GAAP or Accompanied by a Foreign Auditor's Report

(i) Comment

One commenter applauded the recognition of and exemption provided for U.S. GAAS. The commenter was concerned, however, that this exemption will be interpreted more broadly and that non-U.S. auditors conducting audits in accordance with U.S. GAAS will rely on the exemption.

The commenter assumes that the Commission is equally concerned with non-U.S. auditors' expertise to conduct an audit in accordance with U.S. GAAS as it is with a foreign auditor's expertise to conduct an audit substantially in accordance with Canadian GAAS.

Response

The Commission agrees with the commenter's concern and has amended paragraph 7 of subsection 13.2(2)7(ii) of the Rule to read as follows: "In the case of foreign GAAS other than U.S. GAAS applied by a U.S. auditor...."

(ii) Comment

The same commenter requested that the exemption given to U.S. auditors from having to explain how they made the determination that U.S. GAAS was substantially equivalent to Canadian GAAS, be extended to auditors in the U.K., Australia and New Zealand who conduct audits in accordance with their domestic GAAS. The commenter noted that the SEC accepts audits conducted in accordance with U.S. GAAS by these auditors. The commenter suggested that if the SEC was satisfied with the capacity of auditors from these countries to conduct U.S. GAAS audits, then the Commission should also be satisfied with the capacity of those auditors to conduct Canadian GAAS audits. The commenter also suggested that if the Commission decides not to expand the list of acceptable foreign GAAS, the Commission should consider amending section 4.2 of the proposed Policy to include a statement along the following lines: "Relief from the requirement in s. 11.9(3)(b) of the Rule to discuss the auditor's expertise may be granted in appropriate circumstances such as when the auditor's report is issued by firms familiar to staff from the U.K., Australia, and New Zealand."

Response

Consistent with the response in the December 1999 Notice, the Commission agrees that a list of foreign jurisdictions recognized as having standards that are substantially equivalent to Canadian standards is a worthy objective. However, such a list does not exist at present and is beyond the scope of the Rule. In the meantime, the responsibility for making a determination as to substantial equivalence and comprehensiveness appropriately lies with auditors with expertise in both of the jurisdictions in question. As the commenter is likely aware, the Commission along with its international counterparts through IOSCO, is looking at the acceptability of international auditing standards. To the extent IOSCO endorses their use at some point in the future, the Commission will consider revisiting this aspect of the Rule. Given this, the Commission does not think it is appropriate to provide the relief requested by the commenters. Since the Commission has not determined whether the identified foreign GAAS are substantially similar to Canadian GAAS, it would be inappropriate to suggest that relief might be granted. No change has been made to the proposed instruments.

(iii) Comment

Another commenter expressed views similar to those summarized above, but in addition suggested including International Auditing Standards. The commenter also suggested that the list be periodically reviewed and updated so that it is not rigid and unresponsive to changing circumstances. In the commenter's view, the practical difficulty with the proposed Rule is that most foreign auditors are unfamiliar with Canadian GAAS and do not know whether the foreign GAAS are

substantially equivalent to Canadian GAAS; while Canadian auditors, being unfamiliar with foreign GAAS, will be unable to help them.

Response

As noted above, the Commission believes that auditors are in the best position to make these assessments.

(iv) Comment

One commenter recommended that relief from the requirement in s. 11.9(3)(b) of the Rule should be provided in circumstances where the foreign auditor is an affiliate of an international firm of auditors and applies the international firm's worldwide auditing standards, provided those standards comply with, or are based on, a body of GAAS recognized by staff, such as U.S. GAAS or International Auditing Standards.

Response

The Commission respectfully disagrees. The Commission has concerns that worldwide firm auditing standards may be tailored, depending upon the country and/or business environment in which the foreign issuer operates. Such modifications may lead to significant departures from what the Commission would consider to be acceptable Canadian GAAS. If the foreign auditor is satisfied in a particular situation that the international standards applied are substantially equivalent to Canadian GAAS, then there should be little difficulty complying with the requirement.

(v) Comment

One commenter noted that in Canada, objectivity is an element of GAAS, and the standards and guidance for this concept (including the independence requirements) are included in provincial institute rules of professional conduct and related interpretations. Independence, however, is not regarded as an element of GAAS in some other countries so the commenter queried whether a reference to independence should be included in the proposed Rule.

Response

The Commission agrees that objectivity is an important element of Canadian GAAS but believes that the issue is adequately addressed by subsection 4.2(4) of the Policy.

(vi) Comment

Part 8.3 of the proposed Rule (Part 9.4 of the Rule) requires a foreign auditor's report to disclose material differences in the form and content of the report as compared to a Canadian auditor's

report. One commenter was in doubt as to the meaning of the reference to differences in form and content.

Response

The Commission expects that a foreign auditor's report would address the form and content requirements set out in section 5400 of the Handbook.

XIV. Application of the Significant Acquisition Rules to the Oil, Gas & Extractive Industries

Three commenters expressed concerns about the application of the business acquisition disclosure requirements to the natural resource industry and in particular to acquisitions of oil and gas properties. The following issues were raised.

Comments

(a) Specific Oil & Gas Properties do not Constitute a Business

One commenter objected to the characterization of discrete oil and gas properties as a "business," particularly when the issuer has purchased non-core resource properties from another entity, because, in the commenter's view, virtually all of the *indicia* of a stand-alone business are absent insofar as the acquired properties are concerned. In the commenter's view, the mere existence of assets alone is not conclusive evidence of the existence of a business. If there is insufficient continuity of operations before and after the acquisition, then historical financial information is not material to understanding the value of future operations.

(b) Availability and Usefulness of Historical Financial Statements

The three commenters expressed their view that in many instances, financial statements for the acquired oil and gas assets are not available. They stated that larger organizations in particular, do not keep separate sets of financial statements in respect of each oil and gas property owned by them nor is the underlying data maintained for the purpose of creating financial statements if and when necessary. In addition, the commenters stated that it may be impossible to create financial statements since the allocation of many expenses, such as general and administrative, income taxes and interest, cannot be made. Even if the information is available, the cost of preparing the financial statements will exceed the benefits. In the commenters' view, the Commission has ascribed an importance to historical financial statements that is not perceived by purchasers, underwriters or agents. In the commenters' experience, independent engineering reports were generally considered by industry participants to be a compelling valuation tool and the starting point for an analysis of the appropriate price of the asset in question.

One of the commenters suggested that when separate financial statements respecting the acquired properties are unavailable, it is of greater value to an investor to require a prospectus to contain a reserve report only, than it is to: (i) preclude an issuer from accessing the public capital market on a timely basis; or (ii) cause the purchaser and vendor to incur excessive expense and delay in preparing financial statements which do not provide meaningful information to an investor.

Alternatively, the commenter suggested that, in addition to the required reserve report disclosure, the purchaser should be required to disclose the production income of the acquired properties to the gross margin level.

One of the commenters submitted that the following information would be more meaningful than historical financial statements:

- an engineering report,
- cash flow and operating cost estimates derived from engineering reports, and
- historical production information for approximately 3 years.

(c) Financial statements requirements and Junior and mid-sized corporations

It was noted by two of the three commenters that property dispositions are frequently handled by third party agents and a potential acquirer must conform to the bid procedures established by a third party agent in order to participate in the process. The commenters expressed their view that in many of these situations, the third party firms principally responsible for conducting disposition transactions do not make historical financial statements available in respect of discrete packages of oil and gas assets. The commenters stated that junior to mid-sized entities would be unable to participate in a competitive bidding process because a bid coupled with a request for historical financial information would not likely conform with the bid procedures or would otherwise be discounted by the third party responsible for the disposition process.

(d) Relevance of Asset and Investment Tests

One of the commenters expressed the view that the asset and investment tests were flawed for the purpose of applying them to the oil and gas industry because they ignore the current value of the issuer's assets at the time an acquisition was made. The commenter submitted that a market price test based on the issuer's market capitalization would be more meaningful, provided that there is an active market for the securities.

Response

The Commission, with its CSA colleagues, carefully considered the comments raised. As stated in the December 1999 Notice, a CSA committee was in the process of reviewing these very issues. The Commission, in consultation with the CSA, has developed an approach that it believes will address the concerns expressed by the commenters and others. Though the Commission takes the view that the acquisition of an oil and gas property will generally constitute the acquisition of a business, potential relief is outlined in section 3.3 of the Policy from the requirement for audited historical financial statements, if certain disclosure related conditions are met. These relief provisions were developed to address the issues outlined in the comment letters described above. The Commission has not extended similar relief provisions to acquisitions of other than oil and gas properties. The Commission believes that given the unique nature of the oil and gas industry, the requirements and

the potential relief described in the Policy strikes the right balance between investor protection and fair and efficient capital markets.

XV. Form Requirements

(i) Comment

One commenter noted that Item 8.2 of the proposed Prospectus Form requires separate quarterly financial information for each of the eight quarters of the two most recently completed financial years, whereas interim financial information for the current year will be provided only on a cumulative basis for the 3, 6 or 9 months, depending on the circumstances.

Response

No change has been made to the requirement, which incidentally is not a new requirement. It is assumed that issuers have prepared quarterly information and that it is available, although it is typically reported on a cumulative basis. Ontario reporting issuers may need to begin reporting their quarters separately in addition to on a cumulative basis on a continuous disclosure basis once proposed Rule 52-501, Financial Statements, is finalized.

(ii) Comment

A commenter noted that Item 8.5 of the proposed Prospectus Form requires the issuer to reproduce the MD&A disclosure to be included in the issuer's Annual Information Form. The commenter was concerned that in the case of an initial public offering, a private entity will not have an AIF from which to reproduce the disclosure.

Response

The Commission believes it has addressed this problem by cross-referencing the MD&A requirements in the Prospectus Form directly to new Form 44-101 F2 MD&A, so that it will be clear that the requirement applies to all issuers.