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**VIA COURIER & EMAIL**

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Dear Sirs/Mesdames:

***Re: CDNX Comments on Canadian Securities Administrators Discussion Paper 52-401  
(the "Paper") - Financial Reporting in Canada's Capital Markets***

I congratulate the CSA on the Paper's content and I thank you for the opportunity to comment. I will comment on questions 1 to 11 and 17 in sequence. I cannot make meaningful comments on questions 12 to 16. The following comments are my own and not necessarily those of CDNX.

The Paper's greatest contribution is its recognition that professional capacity is a constraint to accepting alternative GAAP regimes in Canada. In my opinion, a broad lack of Canadian expertise in GAAP and securities regulatory practice is one of today's biggest barriers to efficient capital formation. If, as the result of the Paper, the CSA and other market participants act to increase skills in this area, we will achieve a significant reduction in the overall cost of raising capital. I will discuss this point further under Question 5 below.

## **Background**

The majority of Canadian public companies are small by world standards. The small size of these companies has deep implications for the course that we take in optimizing financial reporting in our capital markets.

Canada shares a border, one of its official languages, and many business practices and ethics with the United States. The United States is also the world's largest single economy and Canada's largest trading partner. United States GAAP is comprehensive, mature and of high quality. Each of these facts should affect our financial reporting decisions.

## **Question 1**

*Should we relax the current requirements for reporting issuers participating in Canada's capital markets to provide financial information prepared in accordance with Canadian generally accepted accounting principles? By reference to your own experience, please explain why Canadian GAAP as a consistent benchmark does or does not have continuing relevance to Canadian investors in the current environment.*

The question of accepting another GAAP regime in Canada is one of trade-offs between the costs of reduced reliability and initial understanding versus reduced preparation costs and higher international comparability of financial statements.

Canadian GAAP is of high quality and is the most relevant GAAP for a Canadian financial statement user. At least initially, accepting non-Canadian GAAP will reduce the understandability of financial statements to Canadian users. On the other hand, using non-Canadian GAAP may reduce the cost of preparing financial statements for some issuers. Using non-Canadian GAAP may also increase the comparability of the non-Canadian GAAP prepared financial statements with other, non-Canadian entities using the same non-Canadian GAAP regime.

There are non-Canadian GAAP regimes that equal or exceed the quality of Canadian GAAP. While non-Canadian GAAP regimes have less relevance to a Canadian user, certain GAAP regimes, such as U.S. GAAP, are only slightly less relevant. Trade-offs of reliability, reliance, comparability and cost are different for users of small and large issuer financial statements. This different trade-off is less a function of a particular GAAP regime than it is a function of the matters raised in Question 5 of the Paper - ***are issuers capable of preparing financial statements that are in accordance with non-Canadian GAAP and are auditors capable of opining on compliance with non-Canadian GAAP?***

In my opinion, we should relax the requirements and allow the preparation of financial statements on bases other than Canadian GAAP for large issuers only.

## Question 2

*Should any relaxation in current requirements address (a) foreign issuers; or (b) Canadian issuers; or (c) both foreign and Canadian issuers? Please explain the basis for your views, including addressing the basis for any distinction you believe should be made between the requirements for foreign issuers and those for Canadian issuers. If you believe a requirement for foreign issuers to reconcile their financial statements to Canadian GAAP should be retained, please comment on whether that requirement should apply to continuous disclosure as well as offering documents and information circulars.*

*In addressing Question 2, please comment on: (i) your experience with the quality and usefulness of the information included in Canadian GAAP reconciliations provided by foreign issuers; (ii) whether, from your viewpoint as a preparer, user, or auditor of non-Canadian GAAP financial statements, the reconciliation has enhanced the usefulness or reliability of the financial information and how you have used the reconciliation; (iii) any consequences that could result from reducing or eliminating the reconciliation requirement, including your assessment of the magnitude of any decrease or increase in costs or benefits to preparers or users of financial statements.*

Any relaxation should apply equally to foreign and Canadian issuers. A preparer's domicile is relevant only to the whether the preparer is competent in preparing financial statements under the chosen GAAP regime. It is very important to put limiting criteria on issuers so there is reasonable assurance the financial statements are competently prepared under the chosen GAAP regime.

I know of no reason why financial statements prepared in support of a transaction and financial statements prepared for continuous disclosure should have different GAAP reconciliation requirements.

I find reconciliations of non-U.S. GAAP to Canadian GAAP and reconciliations of Canadian GAAP to U.S. GAAP useful. However, I do not find reconciliations of U.S. GAAP to Canadian GAAP very useful. On reflection, I have the following views:

- I am comfortable with my knowledge of U.S. GAAP
- U.S. GAAP results in reliable financial statements
- I prefer to see how U.S. GAAP would have treated something accounted for some way under Canadian GAAP (but not vice versa)
- I am less comfortable with my knowledge of non-Canadian and non-U.S. GAAP regimes, including IAS (“Other Foreign GAAP”)

You have asked for views on the magnitude of the cost reduction associated with eliminating a GAAP reconciliation requirement. Paragraph 52 of the Paper says the process of reconciling foreign GAAP financial statements to Canadian GAAP entails a significant cost burden. The Paper does not say what significant is in this respect and I believe that information is important to the discussion. I am skeptical that the actual cost of a GAAP reconciliation is that significant in absolute terms or significant at all in relative terms to an international issuer. Absent empirical research results, I cannot say the process of reconciling foreign GAAP financial statements to Canadian GAAP entails a significant cost burden.

### Question 3

*In your view, how should the CSA implement any relaxation in the requirement for reconciliation from foreign GAAP to Canadian GAAP? Please consider at least the following possibilities: (i) elimination of all reconciliation requirements, regardless of the basis on which a foreign issuer prepares its financial statements; (ii) elimination of the requirement for a full reconciliation and its replacement with a requirement to reconcile only specified financial statement items. If you believe such an approach is appropriate, please describe how you believe it could be implemented; (iii) elimination of all quantitative reconciliation requirements, regardless of the basis on which a foreign issuer prepares its financial statements, and introduction of a narrative discussion of qualitative differences between the basis of accounting used in preparing the financial statements and Canadian GAAP; (iv) elimination of the reconciliation requirement for only those foreign issuers that prepare financial statements in accordance with specified bases of accounting, e.g., IAS and U.S. GAAP. If you recommend this approach, please set out the criteria you believe should be applied in making this determination and indicate which bases you believe would meet these criteria; (v) identification of specific reconciliation requirements depending on the type of transaction, type of security or proportionate interest of Canadian investors. If you believe such an approach is appropriate, please describe how you believe it could be implemented.*

All Canadian issuers eligible to file a short form prospectus (“POP Issuers”) and all foreign issuers with attributes similar to POP issuers should be permitted to use U.S. GAAP without reconciliation to Canadian GAAP in all financial statements filed. Other Canadian reporting issuers should not be permitted to use U.S. GAAP without reconciliation to Canadian GAAP until we resolve the competency issues discussed under Question 5.

U.S. GAAP should be interpreted to include the complete body of SEC interpretations, guidance and precedent, both formal and informal.

All Other Foreign GAAP should be reconciled to Canadian GAAP for all financial statements filed. The reconciliation should be presented in a manner similar to Item 17 of SEC Form 20-F. Reconciliation requirements should be reconsidered over time as a particular non-Canadian GAAP regime is determined to be sufficiently comprehensive, conceptually sound, and familiar and relevant to a Canadian user.

#### Question 4

*If you believe Canadian companies should no longer be required to prepare financial statements in accordance with Canadian GAAP, what alternatives do you believe should be available and why are they an appropriate basis for a Canadian company to participate in Canadian capital markets? Please comment on the impact of the concessions you propose on the comparability of financial information available about Canadian companies in the Canadian capital markets. Is it important that Canadian investors have access to financial information prepared on a comparable basis? If not, why not?*

I recommended U.S. GAAP as an alternative to Canadian GAAP in my response to Question 3 above. U.S. GAAP is an appropriate basis for an issuer to participate in Canadian capital markets for several reasons:

- despite the differences set out in paragraphs 32 to 34 of the Paper, U.S. GAAP has much in common with Canadian GAAP
- many Canadian users know enough about U.S. GAAP to make meaningful use of the U.S. GAAP financial statements (users need to know less about GAAP than do preparers and auditors)
- U.S. GAAP is mature, comprehensive and of high quality
- U.S. GAAP more likely of being more well known anywhere in the world than other non-domestic GAAP regimes, including IAS

## Question 5

*On the basis of your own knowledge and experience, what is your assessment of the ability of Canadian issuers, auditors and users to prepare, audit and make use of financial statements prepared on bases other than Canadian GAAP?*

In my opinion, this is the most important question the Paper asks. The Paper's Executive Summary identifies professional capacity as a complicating question on accepting alternative GAAP in Canada.

*Professional capacity -- Canadian accounting professionals have limited knowledge of U.S. GAAP and virtually no experience with IAS. A significant effort would be required for issuers, auditors and regulators to build sufficient expertise to handle increased use of these other sets of standards while maintaining high standards of compliance.*

I welcome the Paper's recognition of this matter as a significant complicating question. I believe lack of competency is a fundamental and pervasive problem.

The Paper is considering accepting alternative GAAP regimes despite what are, in my opinion, significant shortcomings in Canadian practitioners' level of knowledge of **Canadian** GAAP and **Canadian** securities regulatory practice. This is evidenced by the following:

- The Ontario Securities Commission's Initial Report on staff's Review of Revenue Recognition, Notice 52-701. This Notice highlighted the most basic of failures to properly identify and document alternative revenue generating activities in the accounting policy notes to financial statements.
- The nature of the deficiencies raised in the BC Securities Commission's Notice and Interpretation Note 2000-15.
- Reports in the past several years of both the BC and Alberta Securities Commissions on financial statement reviews.
- The extensive involvement CDNX observes of an entity's auditors for carriage of basic financial reporting matters, despite any theoretical independence concerns. This involvement indicates that issuers lack internal accounting expertise.
- CDNX' own deficiency comments on financial statements it reviews.

This is not a complete list of evidence of this problem. My opinion is also based on my experiences in practice and formerly as a regulator. Further, my opinion is not restricted to junior issuers.

In my opinion, these shortcomings are long-standing features of the Canadian accounting landscape. I suggest there are two structural things that permit the continuance of some of these problems.

- Canadian Accounting Professional Bodies (“Accounting Bodies”) and Canadian Securities Administrators (“CSA”) members have set competency thresholds too low for public company auditors. The CSA is permitting undue self-regulation in this area.
- Accounting Bodies have not recognized that public company financial accounting and regulatory practice is a specialty area requiring a specialized program of study or possibly a specialist designation.

Two market factors also permit the continuance of some of these problems.

- There is a shortage of supply of competent practitioners- many small Canadian issuers cannot afford to retain competent accounting help.
- Canadian companies have been accustomed to significantly lower accounting and auditing fees than U.S. companies. A supply shortage usually results in higher costs. What has in fact occurred is significantly lower quality compliance.

These shortages in professional capacity limit Canada’s ability to accept the use of other GAAP regimes

#### **Question 6**

*If you believe alternatives to Canadian GAAP should be permitted, what specific steps should the CSA, the accounting profession or others take to facilitate implementation in a way that overcomes the issues identified in section 5 of the paper and ensures Canadians are provided with high quality, relevant, reliable and understandable financial information? Please comment on: (i) the steps you believe the CSA should take to ensure their ability to provide appropriate regulatory oversight over the financial statements provided to participants in Canada's capital markets; and (ii) changes to incorporating statutes that would be required to facilitate the financial reporting environment you envisage.*

Accounting Bodies and the CSA should immediately establish and enforce higher competency and experience standards that auditors must meet before being allowed to opine on either Canadian or U.S. GAAP public company financial statements. Similar criteria should be established for preparers of public company financial statements. Accounting Bodies need to

establish a formal training program in the specialty area of public company accounting and regulatory practice. Ideally, there should be a specialty designation for this practice area. One alternative may be to set up something similar to the CICA's "in-depth" tax course, but for public company accounting and regulatory matters.

In my opinion, the supplemental attainment of a CPA designation is not sufficient specialist training in U.S. GAAP.

The CSA needs to be more active in sanctioning preparers (Chief Financial Officers) and auditors for non-compliance with GAAP and GAAS. In this respect, the CSA should consider mechanisms like the SEC's auditing and accounting enforcement practices.

As a minimum, the Canada Business Corporations Act, all provincial corporations acts, and all provincial securities acts need amendment to allow for the use of U.S. GAAP. The Income Tax Act may need to be amended to accept a GAAP reconciliation.

#### **Question 7**

*If you believe the accounting standards of certain foreign countries, e.g., U.S. GAAP, should be acceptable for use by Canadian companies while other foreign GAAP should not, what is your basis for this distinction?*

My favouring U.S. GAAP over Other Foreign GAAP is due to my own comfort level with U.S. GAAP and my lack of comfort with Other Foreign GAAP. I speculate that others have similar comfort levels with U.S. GAAP and Other Foreign GAAP. As said in answer to previous questions, Canada and the U.S. have much in common, including GAAP. I also believe that IAS is less mature than U.S. GAAP is and is therefore not yet a suitable candidate for acceptance in Canada without reconciliation to Canadian GAAP.

#### **Question 8**

*If you believe U.S. GAAP should be permitted as an alternative basis for preparation of a Canadian company's financial statements, should that alternative be available to all Canadian companies or to only a limited group such as those that are SEC registrants and are therefore required to provide either U.S. GAAP financial statements or a reconciliation to U.S. GAAP? Similarly, if you believe Canadian companies should be permitted to use other bases of accounting such as IAS or UK GAAP, should those alternatives be available to all or to a limited group only? If you believe the alternatives should be available to a limited group only, what criteria should be applied to determine eligibility?*



See response to Question 3. The threshold for permitting use of U.S. GAAP should be the competency of the preparer and auditor. I have suggested a size test (POP Issuer) as a surrogate for competency. I believe reasonable and diligent Canadian financial statement users can understand U.S. GAAP statements. The fundamental point (raised in Question 5 above) is ensuring there is a reasonable prospect that financial statements are in fact in accordance with U.S. GAAP.

#### **Question 9**

*Regardless of which bases of accounting you consider acceptable as alternatives to Canadian GAAP, should a Canadian company using one of those alternatives be required to present a reconciliation to Canadian GAAP in some or all cases? If so, in what form should the reconciliation be presented, e.g., a full quantified reconciliation or something less, such as a reconciliation of only specified financial statement items or a qualitative discussion of differences?*

See response to Question 3. All reconciliations of Other Foreign GAAP to Canadian GAAP should be presented in a way similar to Item 17 of Form 20-F.

#### **Question 10**

*If the CSA permits alternatives to Canadian GAAP, what transitional issues would need to be addressed to facilitate implementation of the change? For example, in the first period in which a Canadian company presents financial statements prepared in accordance with a basis of accounting other than Canadian GAAP should comparative information for all prior years presented be required on a consistent basis?*

A change from one GAAP regime to another is something more than a change in an accounting policy- it is likely a change in several accounting policies. In the period of change, each significant change in accounting policy inherent in the change in GAAP regime should be treated as an accounting policy change and recorded both in accordance with U.S. GAAP and, by way of supplemental disclosure, in accordance with CICA Handbook section 1506 "Accounting Changes". In some cases, U.S. GAAP requires the effect of certain accounting policy changes to be recorded in the income of the period of change. Canadian users should receive, in the period of the change, disclosure that allows them to retroactively restate prior periods for comparative purposes. This disclosure may be supplemental information where CICA 1506 conflicts with U.S. GAAP. A change in GAAP regime should not be permitted if the effects of each change cannot be quantified and allocated to specific prior periods.

A second change in GAAP regime within five years of a change would require an application to the primary CSA jurisdiction before making the change. Such applications would be rare and would be granted only in exceptional circumstances.

### Question 11

*Do the core standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues encountered in a broad range of industries and a variety of transactions without the need to look to other accounting regimes? Please explain the basis for your view and, if you believe there are additional topics that need to be addressed in order to create a comprehensive set of standards, identify those topics.*

The following is based on limited IAS knowledge. The comments are made from my inferences of IAS contents based on the titles reproduced in the Paper's appendix. The following areas are significant to CDNX issuers.

- Measurement of Related Party Transactions
- Enterprises in the Development Stage
- Oil and Gas Activities (An extractive industries research paper has been done)
- Stock Based Compensation

### Questions 12 to 16

No comments due to lack of broad experience in these areas.

### Question 17

*Are there mechanisms or structures in place within public accounting firms and the business community that will promote consistent interpretations of IAS where those standards do not provide explicit implementation guidance? Please provide specific examples.*

My comments are more from experiences with U.S. and Canadian GAAP. As well, my concerns about professional capacity generally (see Question 5 above) should be considered here. I worry that IAS knowledge will be concentrated in 'pockets' within public accounting firms and companies. As adoption is in its early years, firms will also have to take care that individual practitioners have a sufficient practice base to competently do their job. Firms will be challenged to ensure that there are not 'regional' IAS interpretations. The Standing Interpretations Committee will have a significant role to play in minimizing these occurrences. I foresee the Standing Interpretations Committee having a significantly longer task list than resources for some time and this may be a barrier to consistent application of IAS.

Thank you again for the opportunity to comment. If you have questions about any of my comments, please call me at 403-974-7444.

Yours truly,  
Canadian Venture Exchange Inc.

*Signed "Matt Bootle"*

Matt Bootle

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