TSX venture EXCHANGE

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Re: Proposed National Instrument 51-102 *Continuous Disclosure Obligations (the "Instrument")*, Form 51-102F1, Form 51-102F2, Form 51-102F3, Form 51-102F4, Form 51-102F5, Form 51-102F6 (collectively, the "Forms"), and Companion Policy 51-102CP *Continuous Disclosure Obligations (the "Policy")*

We thank you for the opportunity to comment on the Instrument. As you know, TSX Venture Exchange lists over 2,500 public companies. Almost all of these companies meet the Instrument's definition of a Small Business. As such, we support measures that ensure fair and efficient capital markets. The following comments are meant to advance this objective from the perspective of an operator of a Small Business market and a public shareholder of a Small Business.

Our comments will take two forms. First, we will make our most significant points in the body of this letter. Second, we will respond, in Appendix A, to some of the specific questions you posed in your request for comment.

Major Points

The major points that we will discuss fall into the following general categories:

1. Overview of the continuous disclosure philosophy
2. Business acquisition report
3. 120 days for annual financial statements
4. Reverse takeovers –other matters
5. Implications for Exchange discretion under the Capital Pool Company program and our operating agreement with certain CSA members
6. Implications for Exchange discretion relating to Changes of Business and Reverse Takeovers
7. Conclusion

We believe that once appropriate thresholds for particular disclosures are established, the proposals are very sound. The major comments below go to issues of the types of issuers and transactions should attract increased or more timely disclosure. In addition we have identified areas where there are opportunities for the proposals to give meaningful guidance in relation to certain frequent transactions.

1. Overview of the continuous disclosure philosophy

The proposals follow the structure of past regulation, specifically OSC Rule 41-501 *General Prospectus Requirements* and SEC rules. The proposals implicitly accept the soundness of the existing regulatory regime by stating that the proposals "contain some enhancements to existing requirements". Although some of these enhancements include certain allowances or reductions to regulation for Small Businesses, the proposals do not sufficiently address the fundamental differences between Small Businesses and more senior issuers.

As you are aware, Small Businesses are under intense cost pressure. Shareholders have made it very clear to the Exchange that the benefits of new accountabilities do not justify the incremental costs. This message has become quite overwhelming and it suggests a need for a different philosophy. It is time to consider a different, zero-based approach to Small Business accountability which may differ from the approach to more senior issuers.

We believe that a wholesale reappraisal of reporting requirements and their benefits to shareholders of Small Businesses is necessary. An analysis must be made to determine the impact of changes, particularly the impact of changes on Small Businesses and their shareholders. We believe that an attitude of "one size fits all" is not appropriate.

The starting point should be a blank slate. Each reporting requirement should be justified on its own by its benefit to the shareholder, not by its historical application.

Absent a re-appraisal, we risk losing Small Businesses and increase the likelihood of issuers approaching the proposals as a bare compliance exercise.

This re-appraisal should also differentiate the nature of a Small Business investment from other investments. Small Business investments are much higher risk. Some of this risk is due to the nature of the businesses themselves. As well, some of the risk is due to a Small Issuer's inability to cost-effectively prepare and deliver the same continuous disclosure that a larger issuer can.

Concluding on this issue, we believe our views on Small Businesses are consistent with the published views of some CSA members on the need for harmonized regulation that is mindful of the differences in our capital markets.

2. Business acquisition report

We think the business acquisition report requirements should either:

a. not apply to Small Businesses at all;
b. not apply to Small Business acquisitions below the 50% significance level, in which case one year of financial statements should be required only (except for reverse takeovers); or
c. not apply to any transaction where the issuer has filed an Exchange-prescribed disclosure document in a manner acceptable to us.

We agree that the information in Form 51-102F4 is useful shareholder information. However, we think that in most cases, the benefit will not justify the cost to shareholders for the following reasons:

a. Small Businesses acquire, more often than not, unaudited businesses. The audit cost for the acquisition will truly be incremental and disproportionately onerous on Small Businesses;
b. The information provided by the financial statements, particularly in respect of exploration issuers with non producing mining properties and oil and gas issuers provides no meaningful disclosure to investors. The critical information for these types of issuers cannot be obtained through an examination of the financial statements. The information that is important to investors is related to the properties held by the issuer. This information is available in the technical reports mandated by the applicable National Instruments and the Exchange. Shareholders also receive important and timely information from ongoing press releases on exploration results and other drilling activity.

   There is a similar limitation to financial statements for all development stage issuers. We agree a balance sheet may be a relevant financial statement, however, statements of operations and cash flows are merely statements of sunk costs. These statements rarely have predictive value. In most cases, the most useful indicator of next year's net income is the amount of money expected to be raised in the following year. Once commercialization occurs, the costs of production are dramatically different from the development costs.

c. Small Businesses often acquire businesses that are components of a much larger business. When negotiating buy / sell agreements, there is often a disparity in bargaining power between a Small Business and a significant seller. Access to records provisions in these cases are transaction barriers. The seller will rarely negotiate support of underlying records for purposes of either an audit or the expression of negative assurance by an auditor.

   We have also been advised that sellers have concerns about being associated with financial statements contained in another issuer's continuous disclosure record. We understand significant sellers may refuse to sell small properties or operations to Small Businesses for this reason alone. We believe such an outcome would be detrimental to the formation of capital in the junior markets, as many Small Businesses get their start exploiting an opportunity that a significant seller has abandoned.

d. Small Businesses find divisional or carve-out financial statements disproportionately costly to prepare. They and many of their service providers do not prepare such financial statements very often.

Exchange policies have a regime that is more appropriate for Small Businesses. We must approve our issuers' significant acquisitions, changes of business and reverse takeovers. Before we approve a transaction we work with the issuer to understand the transaction and to co-develop expectations for an appropriate disclosure document in the circumstances. The Exchange review of the transaction includes a review of: management and insiders; the relative values of the entities; the disclosure of risk factors; the adequacy of the financial resources following the transaction and the public disclosure of critical success factors relating to the transaction. The review often considers technical reports, appraisals and unaudited financial statements. While a disclosure document may not contain the financial statements prescribed by the proposal, the document is more timely and contains other information that is an adequate substitute for financial statements.

Disclosure documents must be filed <u>before</u> we approve the transaction. Shareholders (including potential buyers in the secondary market) therefore have a disclosure document on the acquired business long before 75 days after closing. As a result, shareholders and potential shareholders get a more timely disclosure document which includes technical reports or appraisals and unaudited financial statements. Document particulars are specific to the transaction and mindful of both the cost and benefit of disclosure to the shareholder.

We are of the view that the costs associated with compliance with Form 51-102F4, in particular the financial statement requirements, do not justify the benefits that could accrue to shareholders. The true benefits accruing to shareholders of our listed issuers, particularly from a timing, disclosure and review perspective, are already found in existing Exchange Policies, especially where technical reports, appraisals and unaudited financial information is disclosed.

Therefore we submit that Exchange listed issuers should be exempt from the Instrument as it relates to the business acquisition report, as well as Form 51-102F4, where the transaction is subject to Exchange requirements.

If the proposals are retained in any form, the Policy should be upgraded to give more complete guidance on business acquisition questions. This guidance should reflect the CSA's almost two years of experience on the business acquisition rules in prospectuses. Small Businesses would benefit greatly from examples, based on either experience or belief, of:

a. What constituted a business in cases like non-producing mining properties or development stage endeavours;
b. How related business financial statements were prepared or asked for; and
c. How divisional or carve-out or divisional and carve out financial statements were agreed to in difficult circumstances.

The proposals should also consider specific exemptions where the information provided by the financial statements is not relevant to the investment decision, or does not provide a practical benefit. For instance, an exemption relating to pro-forma income statements should be available where the reporting issuer has no operations.

3. 120 days for annual financial statements

It is unclear whether the evidence in support of this change to the Instrument is applicable to Small Businesses. We question whether shareholders benefit sufficiently from the new requirements to justify the increased costs to file this information and the related MD&A 20 days sooner. It appears the only support for the change is that other jurisdictions have had this requirement for some time. If this is the case, we submit this reason is insufficient support for the change.

In a random sampling of our issuers we found that a significant number do not publicly release their financial results well before the current filing deadlines. Based on our experience with Small Businesses, we believe that these results are representative of Small Businesses in general.

It should be noted that for many Small Businesses, as a result of the proposal, the real change to the reporting deadline would be greater than 20 days for the following reasons:

a. Small Businesses rely more heavily on their auditors to provide financial accounting assistance;
b. A substantial percentage of Small businesses have December 31 financial year ends. Those Small Business would be required to file their financial statements and MD&A by April 30.
c. Most smaller audit practitioners, including those audit practitioners in the small business enclaves of major firms, have significant personal tax practices. A certain percentage of the issuers would, as a practical matter, have to file their financial statements by March 31 or earlier.

The proposed benefit for reduced filing deadlines is stated to be "more timely disclosure that will benefit the marketplace and will facilitate more timely analysis of reporting issuers' financial performance". We think the reference to the phrase 'more timely analysis' is important. If this phrase reflects consultation and feedback from the analyst community, we note that virtually none of our listed companies have analyst following. This feedback would therefore not be relevant to Small Businesses listed on the

Exchange. We have not observed any call by Small Business shareholders for a more prompt filing deadline.

If the 120 day requirement is retained, we ask the CSA to give Small Businesses a longer phase in period to allow them an orderly change of year end from December 31, to some other date. We also ask that this phase in period be accompanied by a reformulated rule replacing National Policy 51 (“NP 51”).

4. Reverse takeovers-other matters

In addition to the concerns expressed at items 2 and 3 above, we also have concerns respecting the treatment of transactions accounted for as reverse takeovers (“GAAP RTOs”) . Going public transactions are often GAAP RTOs. Our issuers execute well over 250 GAAP RTOs each year. Unfortunately, reverse takeover accounting and continuous disclosure following a GAAP RTO are complex. Dealing with these issues is usually a high cost and low value exercise for shareholders. Many of these costs are avoidable.

Appendix B outlines some hypothetical GAAP RTOs at different dates. Applying sections 4.2 and 4.4 of the Instrument to these hypothetical transactions may result in situations where meaningful financial statements are not filed for unacceptably long periods. These situations can be remedied with explanations in the Policy.

Many of these costs can be avoided if:

a. The Instrument included a reformulated NP 51;
b. The reformulation to NP 51 deemed the acquirer by way of GAAP RTO to be a filing issuer for NP 51 purposes; and
c. The Policy provided detailed guidance on the application of sections 4.2 and 4.4 to financial statements prepared in the year of a GAAP RTO. Ideally, this guidance would be in the form of several hypothetical examples.

Appendix C outlines a case where an operating company acquires a listed company in a GAAP RTO where the companies have different year ends. Applying NP 51 to these cases gives an absurd result and imposes avoidable costs on shareholders. The Instrument should be revised to correct this problem.

5. Implications for Exchange discretion under the Capital Pool Company program and operating agreement with certain CSA members

Earlier this year, we entered into an operating agreement with the OSC and certain other commissions and revised our operating agreement with the ASC and BCSC with respect to Capital Pool Companies (“CPCs”). One of the pillars of those agreements was the Exchange’s ability to exercise discretion to waive compliance with several elements of our forms. This discretion existed so long as our forms did not touch on specific securities law requirements.

For example, the CPC Information Circular is an Exchange mandated disclosure document that is used by a CPC in order to obtain shareholder approval for a Qualifying Transaction. A Qualifying Transaction is usually structured as a reverse takeover of the CPC. Although it is an Exchange form, the CPC Information Circular was developed in conjunction with certain CSA members and provides for prospectus level disclosure about the CPC and a Target Company or Significant Assets. The disclosure that is included in the CPC Information Circular is largely based on OSC Rule 41-501, which was adapted so that the disclosure, including financial statement disclosure, would apply specifically to Small Businesses.

Under the terms of the CPC Operating Agreement, the Exchange has general discretion to waive CPC Information Circular requirements provided that such waiver is not contrary to securities legislation.

Where securities legislation does not specify the nature of the disclosure to be included in an Information Circular, the Exchange is permitted to exercise discretion in regard to that disclosure. For example, Item 11 of Form 30 under the Alberta Securities Rules states that "where a reorganization or similar restructuring is involved, references should be made to the prospectus form . . . for guidance as to what is material." Since the form is an Exchange form, the Exchange has the discretion to waive the CPC Information Circular disclosure requirements insofar as prospectus level disclosure is concerned.

Another example of this Exchange discretion is found in the CPC Operating Agreement, wherein the Exchange has the discretion to waive "financial statement disclosure requirements in connection with a Qualifying Transaction". Any such waiver must be reported to the Commissions on a semi-annual basis pursuant to the terms of the CPC Operating Agreement.

With the changes in the proposed Instrument, and in particular Item 13.2 of proposed Form 51-102F5, an issuer proposing to effect a restructuring will no longer be "guided" by the prospectus form as to material disclosure. Rather, the Form will mandate the specific nature of the prospectus level disclosure, including financial statement disclosure. In order to obtain any relief from these requirements a Small Business issuer will be required to obtain an exemption from the applicable commissions.

These mandatory disclosure requirements will, in essence, eliminate the Exchange's discretion in respect of CPC Information Circulars, as contemplated by the CPC Operating Agreement. This will have the effect of removing not only a source of flexibility currently available to Small Businesses using the CPC program, but will also deny CPCs the benefit of the Exchange's expertise respecting the CPC program, accumulated over the past 16 years.

We believe that this source of flexibility and experience should be maintained so that the CPC program will continue to operate as efficiently as possible pursuant to the terms of the CPC Operating Agreement.

Accordingly we request that CPCs proposing to effect a Qualifying Transaction be exempted under the Instrument from complying with Item 13.2 of Form 51-102F5 provided that they comply with the requirements of the CPC Policy and the prospectus level disclosure under the Exchange's Form 3B. As this is largely an Exchange form, the Exchange would continue to retain the discretion that it has under the CPC Operating Agreement to grant Significant Waivers and provide the necessary flexibility needed for Small Businesses, particularly as to the prospectus level disclosure to be included in that document.

6. Implication for Exchange Discretion for Changes of Businesses and Reverse Takeovers

The same concerns that apply in respect of the efficient operation of the CPC program also apply to Exchange issuers effecting changes of businesses ("COBs") and reverse takeovers ("RTOs") in accordance with Exchange requirements. Currently, the Exchange regulates COBs and RTOs pursuant to Policy 5.2-*Changes of Business and Reverse Take Overs* ("Policy 5.2"). The policies and processes governing these transactions are similar to that of CPCs, as discussed above, although there is no operating agreement specifically governing COBs and RTOs.

As is the case for a CPC, an Exchange listed issuer proposing to effect a COB, may or, in the case of an RTO, will be, required to prepare an Information Circular in order to obtain requisite shareholder approval for the transaction. As is the case for CPCs, since the Exchange Information Circular is largely an Exchange mandated document, the Exchange is able to exercise discretion to grant relief from the specific disclosure requirements of that form, except for those items that are specifically prescribed by securities legislation (i.e., Form 30).

As with the CPC situation, the proposed Instrument will eliminate this discretion and the flexibility that is currently available to Exchange listed Small Businesses contemplating a COB or RTO.

Accordingly, we would request that Small Business Exchange issuers that are proposing to effect a COB or RTO be exempted under the Instrument from complying with Item 13.2 of Form 51-102F5 provided that they comply with the requirements of Exchange Policy.

7. Conclusion

We trust that this gives you a perspective on the effect of the proposals on Exchange listed issuers and their shareholders.

Although overall, we support the proposals, we are of the general view that the proposals are too reliant, without direct research, on following existing regulatory regimes and in particular the regulatory regime in the United States, at the expense of Small Businesses. The proposals appear to be based on a "one size fits all" concept which is inapplicable to the capital markets of this country which are made up of both junior issuers (i.e., Small Businesses) and more senior issuers.

The proposals must be more clearly refined in terms of Small Business issuers so as to ensure that continuous disclosure obligations will, in fact benefit not just senior issuers, but the shareholders of Small Business issuers. Some of these benefits should enable Small Business issuers listed on the Exchange to take advantage not only of the expertise of the Exchange, but also the flexibility currently available to them pursuant to the exercise of Exchange discretion when structuring and disclosing a transaction to shareholders. Under the current proposals, this expertise and flexibility will be largely, if not totally, eliminated in favour of commission exercise of discretion, particularly as to disclosure requirements. Historically, the exercise of commission discretion, as opposed to Exchange discretion, has been subject to various formalities, timing issues and costs, which generally has not resulted in great efficiencies for Small Businesses.

In addition, Small Business Exchange issuers should not be required to take the time and expend the funds required to prepare and file reports such as the business acquisition report at a time when they are subject to review, timing and disclosure provisions under Exchange requirements. Such duplication of effort will result in a needless expense for Small Business issuers, particularly where they are already subject to what we believe to be a more appropriate regulatory regime.

We appreciate the opportunity to comment on the proposals. If you have any questions, please do not hesitate to contact the undersigned.

Yours truly,

Matt Bootle
Director, Accounting Standards

Appendix A
Responses to Specific Questions

1. *Criteria for Determining Financial Statement Filing Deadlines*

No comments

2. *Elimination of Requirement to Deliver Financial Statements*

No comments.

3. *SEC Developments* - Under the heading "Recent SEC Developments" above, we identify SEC Releases that propose changes to corporate disclosure requirements for SEC registrants. Should we change the Rule to reflect the proposed SEC requirements?

We have no specific comment on the requirement itself, but we are concerned about the CSA's perspective. Although SEC developments are relevant to our markets, they should not be viewed as a guide to all aspects of the Canadian market, particularly the Small Business market. We believe that the CSA may place too much importance on SEC developments in CSA's priority setting and actions. We are concerned that the proposals are reactive to recent SEC developments and this may result in sub optimal and possibly harmful initiatives.

As the SEC appears pre-occupied with several financial reporting and governance debacles, especially with the most major of corporations, we recommend that the CSA examine carefully Canadian developments related to the financial statements of Canadian companies at a senior and Small Business level as it monitors SEC developments.

4. *Combination of Financial Statement and MD&A Filings* - We are considering amending the Rule so that financial statements and MD&A would have to be filed at the same time, as one filing. MD&A contains important discussion of financial statement disclosure, and is already subject to the same filing deadlines as financial statements. Should we combine financial statement and MD&A filing requirements?

Provided the filing deadlines are appropriate, we support this action.

5. *Disclosure of Restructuring Transactions in Information Circulars* - Item 13.2 of Form 51-102F5 *Information Circular* requires an issuer to provide disclosure regarding restructuring transactions.

(a) Does the definition of "restructuring transaction" in item 13.2 require disclosure about the appropriate classes of transactions? If not, what kinds of transactions should be added or excluded, and why?
(b) Should item 13.2 be expanded so that it applies to significant acquisitions of assets in exchange for securities?
(c) Does item 13.2 require disclosure about the appropriate entities for any transaction that is subject to this item? If not, which entities should be added or excluded, and why?

(d) The requirement in item 13.2 to include disclosure prescribed by the prospectus form is qualified by the words "to the extent necessary to allow a reasonable securityholder to form a reasoned investment decision". Is this clear enough? If not, how could we make the requirement clearer?

(e) Would it be preferable to prescribe a separate form of information circular for certain restructuring transactions (such as reverse takeovers) similar to new TSX VN Form 3B Information Required in an Information Circular for a Qualifying Transaction?

(f) Should item 13.2 specify which disclosure items in the relevant prospectus forms must be given for certain transactions (such as reverse takeovers or issuances of exchangeable shares)?

As outlined in our main comments under items 5 and 6 of our letter, we are very much concerned that Item 13.2 of Form 51-102F5 essentially eliminates the current flexibility that exists for Small Business issuers listed on the Exchange, by removing Exchange discretion in respect of the disclosure to be included in information circulars, particularly in the context of CPCs effecting Qualifying Transactions as well as Exchange issuers effecting COBs or RTOs. Accordingly, as previously stated, we are of the view that CPCs, subject to the CPC Policy, and issuers subject to Policy 5.2, should be exempted from the requirements of Item 13.2 of Form 51-102F5 provided that they comply with applicable Exchange Policies and the requisite forms (i.e. Exchange Form 3B or Form 3D, as applicable) in accordance with Exchange requirements.

6. *Significant acquisitions disclosure* - The proposed significance tests for business acquisitions in the Rule were the subject of extensive comments when the prospectus rules were being reformulated. The CSA analyzed the comments and finalized the tests in the prospectus rules. Several commenters said that significant acquisition disclosure should be required in CD, not just in prospectuses. Many commenters expressed the view that Canadian acquisition disclosure rules should parallel the SEC Rules. The significance tests proposed in the Rule are very similar to the SEC Rules and are consistent with the significance tests in the prospectus rules.

The proposed Rule requires one, two or three years of financial statements depending on whether an acquisition is significant at a 20%, 40% or 50% threshold. Would it be better or worse to have only one threshold for determining significance with a requirement for two years of financial statements when the threshold is met? If you support this approach, what would you suggest as an appropriate threshold and why?

The threshold tests are unduly complex and should be simplified. As noted, we believe that the Instrument should defer to TSX Venture Exchange requirements for acquisitions. Failing that, for Small Businesses, the appropriate threshold level should be 50%, whereupon one year of financial statements would be required.

7. *Requirement to File Material Documents* - The Rule requires issuers to file constating documents and other instruments that materially affect the rights of securityholders or create a security.

Would an acceptable alternative to filing be to require issuers to describe these documents in their AIFs or information circulars, rather than file them?

An acceptable alternative to filing would be for an issuer to describe these documents in its AIF or information circular. As shareholders frequently do not read extensive disclosure documents, it is highly unlikely that they would read these additional documents, particularly if they are segregated from an information circular or AIF.

8. *Criteria for Identifying Small Issuers*

The rules for Small Businesses need to be more focussed before any identifying criteria will be relevant.

9. Approach to Regulation of Small Issuers - The Rule includes some exemptions or alternative means of satisfying certain CD requirements for small businesses, as summarized immediately above. The anticipated costs and benefits of the Rule were discussed above. We invite comment on whether the cost-benefit analysis might differ for issuers of different sizes. We invite commenters to identify any provisions for which this might be the case, and to provide suggestions for disclosure alternatives that might be more appropriate for specific categories of issuer.

As stated in our letter, we are of the view that Small Business issuers listed on the Exchange should be exempt from Item 13.2 of Form 51-102F5 as well as the Instrument relating to the business acquisition report and Form 51-102F4, provided that they comply with the applicable Exchange Policies and any other Exchange requirements.

10. *Cost Benefit Analysis* - We believe that the costs and other restrictions on the activities of reporting issuers that will result from the Rule are proportionate to the goal of timely, accurate and efficient disclosure of information about reporting issuers. For more discussion of this, see the section above entitled Summary of Rule and Anticipated Costs and Benefits. We are interested in hearing the views of various market participants on any aspect of the costs and benefits of the Rule and we invite your comments specifically on this matter.

We believe the proposals would be stronger and have more acceptance were they to be based on detailed knowledge and research of Small Business shareholder needs. This knowledge and research would also provide meaningful and essential information about the cost and benefit of the proposals.

We anticipate that the costs accruing to Exchange issuers in complying with the filing of the business acquisition report, and in particular, the costs of preparing financial statements in accordance with Part 8 of the proposed Instrument, will not justify the benefits that could accrue to shareholders. This is particularly the case for Exchange issuers which are already required, by reason of the CPC Policy and Policies 5.2 and 5.3, to provide detailed disclosure to shareholders in the form of comprehensive news releases and information circulars prior to the closing of a transaction, as opposed to 75 days after closing. These new rules do not appear to provide any added benefit to shareholders of Small Business issuers who are already subject to Exchange rules on a pre-transaction basis. In addition, if the

Exchange decides to exercise its discretion pursuant to an applicable Policy and waives a specific disclosure requirement, the issuer will be required to expend the additional time and money in order to obtain a similar waiver from the applicable commission(s) in accordance with Part 13 of the Instrument.

11. *Credit Supporters and Exchangeable Shares*

No comments

Appendix B
Reverse Takeover Hypothetical
Possible Continuous Disclosure Gap

Facts

X Ltd., a private company with a December 31 financial year-end, has had operations since 1995. Y Ltd., a small public company with a December 31 financial year-end, became a reporting issuer in 1998. Y and X are at arm's length. In 2002, Y acquires all of X's shares in exchange for Y shares from treasury. Following the transaction, X's former shareholders own 71% of Y's shares, i.e., the transaction is a GAAP RTO.

For accounting purposes, the transaction occurred as at the closing date.

The information circular (the "Circular") describing the transaction was mailed to Y shareholders on August 15, 2002. The Circular contains X balance sheets as at March 31, 2002 and December 31, 2001 and 2000, and statements of income, retained earnings and cash flows for the three month period ended March 31, 2002, and the years ended December 31, 2001 and 2000 and 1999.

Y prepares and files interim financial statements on November 18, 2002 for the interim period ended September 30, 2002.

Issue

What primary accounting entity comprises Y's financial statements, assuming the closing date is

a) September 28, 2002
b) November 15, 2002
c) November 21, 2002

Discussion

a) X is the accounting entity. As at September 30, the reverse takeover is complete. Following Emerging Issues Committee Abstract 10 ("EIC 10"), issue 2, the company's financial statements will be a continuation of X.
b) Unknown. As at September 30, the reverse takeover is not complete. Y is the accounting entity at the interim period end, but as at the date the financial statements, X is the accounting entity. EIC 10, issue 2 is not clear in this. Issue 2 says, "The comparative financial statements presented in the consolidated financial statements prepared after a reverse takeover should be those of the legal subsidiary." If issue 2 is interpreted widely, the September 30, 2002 financial statements are now "comparatives" in a set of financial statements prepared November 15. This interpretation is questionable.
c) Y is the accounting entity. As at the date financial statements are filed, the reverse takeover is not complete.

There is a problem underlying the responses to (b) and (c). If the analyses are correct, then there is a troublesome gap in the substance of the continuous disclosure. Sometime in the third quarter of 2002, X becomes the real public entity.

Under (b) and (c), the public record comprises X through March 31, 2001 until, assuming the CD proposals go through, 90 days after December 31, 2002, or March 31, 2003. The continuous disclosure record should have June 30, 2001 and September 30, 2001 X financial information well before this time.

Appendix C
Reverse Takeover Hypothetical
Different financial year ends

Facts

- A Ltd. became a reporting issuer in 1997.
- A's financial year-end is December 31.
- A is now a dormant shell.
- B Ltd. is a private company.
- B has had an active business since 1995.
- B's financial year-end is March 31.
- In early 2000, A prepares and files an information circular (the "Circular") describing the acquisition of B.
- The Circular contains B's audited financial statements for the years ended March 31, 1999, 1998 and 1997.
- B has significant inventories.
- On April 15, 2000 A acquires all of B's shares.
- The transaction is a GAAP RTO
- It is now April 30, 2000 and A is now thinking about its financial year end in connection with filing its notice under Part 8 of NP 51.

Summary- Effects of NP51 and EIC-10

- In all cases, qualified audit opinions would result on A's post RTO financial statements.
- In all cases, additional costs to perform audit procedures at new cut off dates would be incurred.

Discussion- Effect of NP 51 and EIC-10

- B is not a "Filing Issuer" (NP 51, Part 1).
- Under EIC–10, issue 2, A's comparative figures in any financial statement following a GAAP RTO are B's.

If A continues to have a December 31st year end, it must file, by May 20, 2001, audited balance sheets as at and for the years ended December 31, 2000 and 1999.

- The audit reports cannot contain a reservation of opinion.
- A's post RTO December 31, 1999 balance sheet, now comprised of B's figures, has not been audited before.
- A's December 31, 1998 post RTO balance sheet needs to be audited to as an opening position to provide an opinion on A's post RTO December 31, 1999 statements of income, retained earnings and cash flow.
- A will incur costs to perform these audits.
- There is a strong possibility A's auditors cannot verify material components of A's post -RTO December 31, 1999 and 1998 balance sheets, such that it will be impossible to provide clean audit opinions on the following A post RTO financial statements:

    - balance sheet as at December 31, 1999.

- income, retained earnings and cash flows for the years ended December 31, 2000 and 1999.

If A changes its year end to March 31, 2001:

- A's Transition Year (NP 51 Part 1) is the fifteen month period from January 1, 2000 to March 31, 2001.
- A's Old Financial Year (NP 51 Part 1) is the twelve month period from January 1, 1999 to December 31, 1999.
- A's post RTO December 31, 1999 balance sheet, now comprised of B's figures, has not been audited before.
- A's December 31, 1998 post RTO balance sheet needs to be audited to as an opening position to provide an opinion on A's post RTO December 31, 1999 statements of income, retained earnings and cash flow.
- A will incur costs to perform these audits.
- There is a strong possibility A's auditors cannot verify material components of A's post RTO December 31, 1999 and 1998 balance sheets, such that it will be impossible to provide clean audit opinions on the following A post RTO financial statements:

  - balance sheet as at December 31, 1999.
  - income, retained earnings and cash flows for the fifteen month period ended March 31, 2001 and the year ended December 31, 1999.

If A changes its year end to March 31, 2000:

- A likely cannot do this because March 31, 2000 has passed (assume A can do this).
- A's Transition Year (NP51 Part 1) is the three month period from January 1, 2000 to March 31, 2001.
- A's Old Financial Year (NP51 Part 1) is the twelve month period from January 1, 1999 to December 31, 1999.
- A's New Financial Year (NP51 Part 1) is the year ended March 31, 2001.
- A's post RTO December 31, 1999 balance sheet, now comprised of B's figures, has not been audited before.
- A's December 31, 1998 post RTO balance sheet needs to be audited to as an opening position to provide an opinion on A's post RTO December 31, 1999 statements of income, retained earnings and cash flow.
- A will incur costs to perform these audits.
- There is a strong possibility A's auditors cannot verify material components of A's post RTO December 31, 1999 and 1998 balance sheets, such that it will be impossible to provide clean audit opinions on the following A post RTO financial statements:

  - balance sheet as at December 31, 1999.
  - income, retained earnings and cash flows for the year period ended March 31, 2001, the three month period ended March 31, 2000 and the year ended December 31, 1999.

Alternatives

1. Accept qualified audit opinions. – Reject. This alternative is contrary to existing and proposed continuous disclosure rules . Qualified opinions rarely serve the public interest, and additional costs are incurred. In some cases, where both opening and closing balance sheet accounts cannot be audited, an opinion on flow statements might be denied.

2. Cease trade A for failing to file in accordance with continuous disclosure rules. – Absurd.

3. Allow the A to adopt March 31, 2000 or 2001 as its new year end without causing NP 51 to apply. – Accept.

   Qualifications and costs are avoided. The public is not prejudiced because B's audited March 31, 1999, 1998 and 1997 financial statements are in the public domain. In effect, B has already disclosed financial statements as if it were doing an IPO prospectus. With this disclosure base, B is in effect a filing issuer and the public does not need the protection built into NP 51.

   This could be done by amending NP 51 to say that where there is an RTO and the acquirer has filed its financial statements to a prospectus level, the acquirer will be deemed to be a filing issuer under NP 51 Part 8.