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New Brunswick Securities Commission
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Nova Scotia Securities Commission
Superintendent of Securities, Yukon Territory
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December 23, 2009

Dear Sirs/Mesdames:

Proposed National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* and Companion Policy 52-107CP *Acceptable Accounting Principles and Auditing Standards* and other IFRS-Related Amendments to the Continuous Disclosures Rules, the Prospectus Rules and the Certification Rule

This letter is in response to the Request for Comment published at (2009) 32 OSCB 7581 concerning proposed National Instrument 52-107 *Acceptable Accounting Principles and Auditing*

KPMG LLP is a Canadian limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative.

Standards and Companion Policy 52-107CP *Acceptable Accounting Principles and Auditing Standards* (NI 52-107) and the other requests for comment IFRS-Related Amendments to the Continuous Disclosures Rules, the Prospectus Rules and the Certification Rule.

Generally, we support the direction the CSA has taken in proposed materials except for the significant items discussed in Appendix A. However, we do not as a matter of public policy, support having different requirements for acquisition statements among the various CSA jurisdictions. We believe that is in the interest of an efficient securities market to have the harmonized requirements across the country.

In Appendix A we have addressed a number of significant matters:

- Reconciliation to issuer's GAAP
- Use of GAAP for private enterprises in securities documents
- Accounting terms and phrases
- Access to subsidiaries to perform an evaluation of internal control over financial reporting
- Correction of prior period errors identified
- Reporting issues
  - One year interims
  - Three year financial statements with third year not in same GAAP
  - Acquisition operating statements
  - Combined financial statements
  - Carve-out financial statements
  - Registrants
  - Registrants – no comparatives for annual financial statements and interim financial information
  - Foreign registrants

Appendix B includes some other housekeeping matters.

With respect to the matters that the CSA specifically requested comment, please see below:

- Do you agree with the proposal of jurisdictions other than Ontario that acquisition statements should be permitted to be prepared in accordance with Canadian GAAP for private enterprises where the specified conditions are met in accordance with paragraph 3.11(1)(f)? Please give reasons for your response.

  - Generally we support the proposal of jurisdictions other than Ontario with one additional condition. Please see our detailed response in Appendix A under "Reconciliation to Issuer's GAAP" and "Use of GAAP for Private Enterprises in Securities Documents."

- Do you agree with Ontario's proposal that acquisition statements should be permitted to be prepared only in accordance with a set of accounting principles specified in paragraphs 3.11(1)(a) to (e)? Please give reasons for your response.
    - No. Please see our detailed response in Appendix A under “Reconciliation to Issuer’s GAAP” and “Use of GAAP for Private Enterprises in Securities Documents.”
- Do you think that any other options would better balance the cost and time for issuers to provide acquisition statements and the needs of investors to make investment decisions? For example, one option identified by Ontario would be to permit acquisition statements to be prepared in accordance with Canadian GAAP applicable to private enterprises where they are accompanied by an audited reconciliation quantifying and explaining material differences from Canadian GAAP applicable to private enterprises to IFRS and providing material IFRS disclosures. Please give reasons for your response.
    - We have proposed what we believe would be the best acceptable alternative which is accounting standards for private enterprises with additional caveats. However, in Appendix A under “Use of GAAP for Private Enterprises in Securities Documents” we consider the alternative proposed above.

Thank you for the opportunity to comment on NI 52-107 and related amendments. Should you wish to discuss them in more detail, we would be pleased to respond.

Yours truly,

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Appendix A
Significant Matters

Reconciliation to Issuer's GAAP

In recent years we have seen growing acceptance in capital markets of financial statements of issuers prepared in accordance with foreign GAAP without reconciliation to local GAAP. Several years ago the Alternative Investment Market of the London Stock Exchange began to accept financial statements of issuers prepared in accordance with U.S. GAAP and Canadian GAAP without any reconciliation. Last year the SEC began to accept the IFRS financial statements of foreign registrants without reconciliation. More recently, Ireland has introduced legislation permitting Irish public companies to use U.S. GAAP (without any reconciliation). We accept as a fact that the investment community has the capacity to assess the prospects of a reporting issuer regardless of whether the financial statements are expressed in CDN GAAP, U.S. GAAP or IFRSs as issued by the IASB (IASB-IFRS). If securities regulators are accepting financial statements of reporting issuers without reconciliation, it should be even more appropriate that they would accept acquisition financial statements without reconciliation.

When an SEC registrant using U.S. GAAP acquires a foreign entity using IFRS-IASB, the financial statements of the acquired business do not have to be reconciled to U.S. GAAP. Similarly, when a foreign SEC registrant using IFRS-IASB acquires an entity using U.S. GAAP, the financial statements of the acquired business do not have to be reconciled to IFRS-IASB. Nevertheless, the SEC registrant remains obligated to prepare and file pro forma financial statements presented using the same basis of accounting as the registrant. Therefore, the registrant converts the financial information of the acquired business into the registrant's basis of accounting for presentation in its pro forma financial statements. We believe this conversion process is entirely consistent with the registrant's ongoing responsibility to make the adjustments necessary to incorporate the post-acquisition financial position and operating results of the acquired business into the registrant's financial statements for periods subsequent to the acquisition date. The conversion process is not an attempt to reconcile the acquisition statements to the registrant's basis of accounting, but is more in the nature of conforming the accounting policies used in the acquisition statements to those used by the registrant. The adoption of IFRS by Canadian issuers will also result in disclosures in interim and annual financial statements of the combined revenue and combined profit and loss as though the acquisition date for all business combinations effected during the period had occurred at the beginning of the period [see IFRS 3.70 and IAS 34.16(i)]. This disclosure requirement applies to individually material acquisitions (and to individually immaterial acquisitions that are material collectively) and generally will provide pro forma information for periods subsequent to those covered by the pro forma financial statements in a Business Acquisition Report.

The proposed rules retain the requirement to reconcile the acquisition statements to the issuer's GAAP for the most recent financial year and any subsequent interim period ended before the acquisition date. We believe the reconciliation requirement should be dropped for acquisition statements prepared in accordance with:

1. IFRS-IASB (e.g., Canadian SEC issuer using U.S. GAAP acquires a business using IFRS-IASB)
2. CDN GAAP (i.e., Part V of the restructured CICA Handbook)
3. U.S. GAAP
4. GAAP for Private Enterprises, subject to additional conditions discussed below
5. IFRS for Small and Medium-Sized Entities, with a condition preventing the use of the exceptions in paragraph 9.3 from presenting consolidated financial statements (note that IFRS for SMEs requires the use of deferred tax accounting).

The ability to use alternative 2 above may only be needed on a transitional basis (e.g. private business with non-calendar year end that is acquired and has not yet switched to either IFRS or accounting standards for private enterprises).

Use of GAAP for Private Enterprises in Securities Documents

Introduction

Since the introduction of CICA 1300 *Differential* Reporting in 2002 we have refused to be associated with an offering document containing our audit report on financial statements prepared using differential reporting options. These options are intended for a narrow range of users, who typically have direct access to the management and an intimate knowledge of the entity's operations. Such options, in our view, are not appropriate for financial statements to be included in securities documents. To be consistent with our historical policy, we should be equally concerned about the financial statements of a private enterprise that chooses all of the options in the accounting standards for private enterprises corresponding to the existing differential reporting options. As we will explain below, we are prepared to make some compromises if they are necessary to obtain a uniform Canadian approach to the acceptability of the new financial reporting framework for private enterprises ("accounting standards for private enterprises") in acquisition statements without reconciliation to the issuer's GAAP. Ultimately, we believe the capital markets will be best served if a harmonized approach across the country for the treatment of acquisition statements can be achieved.

Acquisition statements

Our experience with the process that reporting issuers are going through in preparation for the adoption of IFRS in 2011 has given us a much deeper appreciation regarding the complexities entailed in changing from one comprehensive financial reporting framework to another. There is little doubt that IFRS 1 *First-Time Adoption of International Financial Reporting Standards* has "raised the bar" when it comes to measuring, presenting and disclosing the nature and financial effects of a change to a new comprehensive financial reporting framework. We believe the benefits of having a single set of high quality global accounting standards for reporting issuers warrant the costs of this arduous conversion process. We are not convinced that these costs are warranted in the case of acquisition statements. If acquisition statements will be required to be prepared in accordance with or reconciled to IFRS, management of the acquirer will be compelled to do in a matter of weeks what Canadian reporting issuers are being given years to accomplish. We believe the complexity of the task was recognized by the CSA in proposing a 30 day delay for filing the first interim report for reporting issuers.

The process of preparing IFRS financial statements by the acquired entity would entail complying with IFRS 1, which raises a number of accounting and reporting complexities. Overall, we believe that the effort and associated costs of requiring acquirees to undertake a one-time reconciliation for purposes of the acquisition statement far outweigh any associated benefits.

It is our impression that historically differential reporting options are not generally used by a private enterprise whose owners who are looking at exit strategies such as a future IPO or a sale of the business to a listed entity. Some of these enterprises tend to "mimic" reporting issuers even to the extent of having audit committees to oversee the interim and annual financial reporting by management. However, our early indications are these same private enterprises are not electing to adopt IFRS but are rather staying planning on adopting.

We strongly support the condition in NI 52-107 sub-clause 3.11(1)(f)(i) that the acquisition statements consolidate any subsidiaries and account for significantly influenced investees and joint ventures using the equity method. It would be nothing short of absurd to permit financial statements carrying a material subsidiary at cost to be included in a securities document. In many circumstances very limited audit procedures would be applied to a very profitable subsidiary carried at a nominal cost amount. The pro forma procedures outlined in the companion policy NI 51-102 section 8.7 were not designed to deal with adjustments to consolidate one or more subsidiaries carried at cost in the underlying acquiree financial statements. Pro forma financial statements are not required to be audited or reviewed, so introducing assets, liabilities, revenues and expenses of non-consolidated entities into the preparation of the pro forma

financial statements may introduce material amounts that cannot be derived from the underlying audited or reviewed historical financial statements included in the securities document.

In the interest of finding some middle ground on the disagreement on this matter between the OSC and the other Canadian securities regulatory authorities we considered whether some of the other accounting choices in the proposed accounting standards for private enterprises corresponding to remaining existing differential options should be prohibited for acquisition statements. We believe the option to use the taxes payable method should be proscribed because the rigour of identifying, understanding and accounting for the differences between book and tax values is important both to the business acquisition due diligence process and the acquirer's purchase price allocation process and subsequent accounting.

For the remaining differential options embedded in the new accounting standards for private enterprises we feel they could be adequately addressed in the pro forma financial statements. For example:

- The acquisition event itself might be an event causing the preparer of the acquisition statements to consider whether any recorded goodwill is impaired. Even if not impaired, any goodwill recorded in the acquisition statements would be eliminated and new goodwill may emerge from the acquirer's purchase price allocation.
- Financial instruments such as equity preferred shares issued in tax planning arrangements or convertible debt generally are retired or settled under the terms of the acquisition agreement and therefore would be addressed in the pro forma financial statements.

We also considered some of the new options being proposed in accounting standards for private enterprises. We have no difficulty with the following, as these options can readily be dealt with in connection with preparing pro forma adjustments to conform accounting policies in the pro forma income statement and /or reflecting the acquired assets and assumed liabilities at fair values in the pro forma balance sheet of the acquirer:

- Pension obligations and costs being accounted for on a basis consistent with the valuation for funding purposes
- Expensing as incurred any qualifying development costs incurred on internally developed intangible assets that meet the criteria in CICA 3460
- Using an easier measurement approach for asset retirement obligations
- Applying a single impairment model to all financial assets
- Limiting the use of hedge accounting.

With the addition of a condition requiring the use of tax allocation accounting, we would strongly support the acceptance by all Canadian securities regulatory authorities of the use of accounting standards for private enterprises in acquisition statements.

We would also recommend that the language in the companion policy to NI 51-102 sub-section 8.7(9) be strengthened from "the issuer *should consider* disclosing the adjustments necessary to achieve consistency with the issuer's GAAP" to requiring the issuer to separately disclose the adjustments necessary to achieve consistency with the issuer's GAAP from the other pro forma adjustments. We believe such a requirement would help compensate for the absence of a GAAP reconciliation in the business acquisition statement and would provide more transparent disclosure of the nature and effects of the GAAP differences from the acquirer's perspective.

Acquisition statements accompanied by a reconciliation to IFRS

We recognize that another alternative being considered is to require any acquisition statement prepared in accordance with accounting standards for private enterprises to be accompanied by an audited reconciliation quantifying and explaining material differences from accounting standards for private enterprises to IFRS. While this is not our preferred approach, as we believe that the effort and associated costs of requiring acquirees to undertake a one-time reconciliation note for purposes of the acquisition statement far outweigh any associated benefits, we have considered this approach as requested in the Request for Comment.

To facilitate the preparation of any reconciliation, we believe clear and explicit guidance will be required regarding the form and content of the reconciliation. The form and content of the requirements will significantly impact the cost to prepare the reconciliation and will also impact whether the basis of presentation will be IFRS or a described basis of presentation which is in accordance with regulations.

For example, if a full reconciliation to IFRS is required, including all note disclosures under IFRS for all periods presented and an opening statement of financial position and reconciliations per IFRS 1, then this could be described as IFRS. However, this would likely be as costly and time consuming as preparing IFRS financial statements for the acquiree.

If a less rigorous form of reconciliation to IFRS is accepted then what is disclosed in the reconciliation would not be IFRS, in which case, we believe the basis of presentation for the reconciliation note could not be described as being in compliance with IFRS but rather should be described as being prepared in accordance with regulatory requirements. Since the basis of presentation would not be IFRS, then the exemptions and exceptions in IFRS 1 would not be available to the preparer unless the CSA specifically allows their use. We would recommend that these exemptions and exceptions in IFRS 1 be specifically allowed.

We believe the guidance on the form and content of the reconciliation should address:

- which statements require reconciliation and the preferred format for presentation
- which periods require reconciliation and what is the transition date
- whether IFRS note disclosures are required
- which, if any, exemptions and exceptions to IFRS 1 may be applied when the basis of presentation is in accordance with regulations
- explicit disclosure that the basis of presentation is not IFRS when there is less than full compliance with IFRS.

We believe reporting under a fair presentation framework is possible provided the basis of presentation of the reconciliation note is sufficiently clear. We believe it would be inappropriate in most circumstances to describe the basis of presentation of the reconciliation note as IFRS given that the reconciliation does not represent compliance with IFRS. We believe a detailed basis of presentation note will be required. We also believe that the addition of an emphasis of matter paragraph in the auditor's report highlighting the basis of presentation of the GAAP reconciliation note and the fact that it is not IFRS should be considered.

IPO as exit strategy

When a private enterprise "goes public" we support the continued requirement for the financial statements of the entity to be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises (i.e., IFRS).

We also believe that three years of audited annual financial statements should continue to be required in a long form prospectus filed during and after the changeover to IFRS. We are aware that the SEC made a concession in this area, but we don't believe Canadian circumstances are comparable.

During the transition period most Canadian-based IPO candidates are likely to be able to provide audited Canadian GAAP financial statements to supplement the IFRS financial statements included in the document. For example, in the case of a long form prospectus filed in May 2012, the audited annual financial statements included in the long form prospectus could include either:

1. Audited annual IFRS financial statements for the years ended December 31, 2011 and 2010 and audited annual Canadian GAAP financial statements for the years ended December 31, 2010 and 2009; or
2. Audited annual IFRS financial statements for the years ended December 31, 2011 and 2010 and audited annual Canadian GAAP financial statements for the years ended December 31, 2009 and 2008.

In most cases we believe the Canadian GAAP financial statements for the earliest of the three years will: (i) provide material information; (ii) be readily available; and (iii) will be understood by Canadian prospective investors and financial analysts.

Accounting terms and phrases

The Notice and Request for Comment indicates that the proposed amendments are not intended to substantively alter securities law requirements; however, in a number of instances we believe the proposed wording changes may result in a difference in disclosure or outcome.

In particular, when non-controlling interests exist, the amounts that would be disclosed under existing Canadian GAAP and under IFRS would differ. For example, in NI 51-102 clause 13.4(1)(b) "income from continuing operations" was replaced with "profit or loss from continuing operations" resulting in different disclosures ($540 versus $600 based on the example below) and clause 13.4(1)(c) "net earnings" was replaced with "profit or loss" resulting in different disclosures ($594 versus $660 based on example below).

For "net earnings" we recommend replacing "profit or loss" with "profit or loss attributable to equity holders" to achieve the same disclosure if this is desired.

For "profit or loss from continuing operations" we recommend continued use of the proposed language recognizing that different disclosures may result since the concept of non-controlling interest under IFRS is different than minority interest under existing Canadian GAAP.

Illustrative example

	Income before tax	Tax @ 40%	Net Income	MI/NCI (10%)	Equity Holders
Income from continuing	$1,000	$400	$600	$60	$540
Income from discontinued	100	40	60	6	54
	$1,100	$440	$660	$66	$594

Canadian GAAP		**IFRS**	
Income before tax, minority interest & discontinued operations	$1,000	Profit before tax & discontinued operations	$1,000
Income tax	$400	Income tax	$400
Income before MI and disc. operations	$600		
Minority interest (10%)	$60		
Income from continuing operations	$540	Profit from continuing operations	$600
Income from discontinued operations	$54	Profit from discontinued operations	$60
Net income	$594	Profit	$660
		Profit attributable to:	
		Non-controlling interest	$66
		Equity holders	$594

We also observed that the profit or loss test in the required significance tests in NI 51-102 clause 8.3(2)(c) is similarly impacted when non-controlling interests exist and may result in a different outcome when performing a significance test. Acquisition test profit or loss was defined to be profit or loss adjusted to exclude discontinued operations and income taxes (or more directly stated profit from continuing operations). If an entity was acquired with profit from continuing operations of $115 under the prior test it would be considered significant ($115/$540 income from continuing operations = 21.3%) but under the new test the acquisition would be insignificant ($115/$600 profit from continuing operations = 19.1%). We

recommend continued use of the proposed language recognizing that different outcomes may result when determining the significance of acquisitions because we believe this is consistent with the conceptual change that treats non-controlling interest as part of equity. We observe that a search of the term "minority interest" on disclosure net during the last 12 months contained in annual financial statements produced 358 documents which suggests that this terminology matter may impact a significant number of issuers.

We also recommend that the CSA review all other replacements of terminology made in this area to determine whether they are satisfied with the appropriateness of any possible changes in disclosure or other outcome (e.g. selected annual information and summary of quarterly results in NI 51-102F1, summary financial information about scoped out entities under NI 52-109, summary financial information for certain issues of guaranteed securities in Form 41-101F1 and Form 44-101F1, etc.).

Access to subsidiaries to perform an evaluation of internal control over financial reporting

The Companion Policy to NI 52-109 sub-section 13.3(1) recognized that in certain circumstances certifying offices may not have sufficient access to a proportionately consolidated entity or a VIE to design and evaluate the effectiveness of the controls, policies and procedures carried out by the underlying entity. The Companion Policy states that "In the case of an issuer with an interest in a subsidiary, as the issuer controls the subsidiary, certifying officers will have sufficient access to the subsidiary…". We believe that under IFRS, situations may arise where a reporting issuer is required to consolidate an entity because of consideration of the existence and effect of potential voting rights that currently are exercisable or convertible (IAS 27.14) but that reporting issuer may not have access to evaluate the effectiveness of the controls, policies and procedures carried out by the underlying entity.

We recommend that section 3.3 of the Rule, the certificates and sub-section 13.3(1) of Companion Policy be amended to reflect the fact that situations could arise under IFRS where the reporting issuer may need to report a limitation on evaluation of the scope of design of internal control over financial reporting related to a consolidated subsidiary.

Correction of prior period errors identified

The Companion Policy to NI 41-101 in sub-section 5.5(3) states that if as part of the reconciliation process to IFRS, "the issuer becomes aware of errors made under previous GAAP, the reconciliations summarized above must distinguish the correction of those errors from changes in accounting policies."

We believe the guidance as drafted is not sufficiently robust and that further discussion of the matters noted below could occur in this section and additionally in the Companion Policy to NI 52-107 part 2. We also believe the requirement to distinguish only exists when the error is material.

For existing reporting issuers, if the difference in financial information is material, we recommend referring to discussions in NI 51-102 on material change reports (part 7) and re-filing documents (section 11.5). We believe the guidance should explicitly indicate that section 11.5 would apply in these circumstances.

We are concerned that situations may arise after following the above guidance where Canadian GAAP financial statements that are not corrected for a material error could be included in a long form prospectus or incorporated by reference into a short form prospectus.

For example, in the case of an existing reporting issuer filing a long form prospectus containing interim financial statements prepared in accordance with IFRS (.e.g. quarter ended March 31, 2011) and annual financial statements prepared in accordance with existing Canadian GAAP (e.g. years ended December 31, 2010 and 2009), if a material error is discovered prior to the filing of the preliminary long form prospectus, we believe the reporting issuer is obliged to consider its disclosure obligations under part 7 and section 11.5 of NI 51-102 on material change reports and re-filing documents, respectively. Section 11.5 of NI 51-102 requires an immediate press release disclosing the nature and substance of the change or proposed changes to the previously filed documents. Unless the error was discovered just before the preliminary prospectus filing, we believe withholding disclosure until the filing of the preliminary prospectus with the amended

audited financial statements would not likely satisfy the requirements under Section 11.5. In most cases we would expect the issuer to issue an immediate press release and to subsequently re-file on SEDAR its 2010 comparative annual financial statements reflecting the correction of the material error. We are concerned that the limited discussion in the Companion Policy might give the impression that merely disclosing the error in the reconciliation note to the 2011 interim financial statements was a sufficient response.

Similar situations could arise with short form prospectuses. For example, in the first IFRS interim financial report an error may be identified relating to the Canadian GAAP annual financial statements for 2010 and 2009 incorporated by reference in a short form prospectus. The current guidance could be interpreted to conclude it would be appropriate to only disclose the error in the Canadian GAAP financial statements in the reconciliation note (which will be unaudited). We believe in this situation that the guidance should require the Canadian GAAP financial statements to be corrected for the material error and re-filed.

Overall, to achieve transparency, we believe if the financial statements are to be contained in or incorporated by reference into a prospectus those financial statements should be corrected directly in respect of material prior period errors, rather than relying on disclosure through a reconciliation note. We remind the CSA that because of CICA 7110.52, we would not be able to provide consent to the inclusion of incorporation by reference of our audit report if such correction was not made.

Reporting Issues

One year interims

NI 52-107 clause 3.2(2)(b) contemplates situations where the regulator will accept an interim financial report without comparative interim financial information provided certain disclosures are made in the interim financial report. The disclosures will indicate that the interim financial report for the current interim period does not comply with IAS 34 *Interim Financial Reporting* because it does not include comparative financial information.

We also note NI 51-102 section 8.9 contemplates an exemption from providing comparative financial information. The circumstances described in section 8.9 mirror those in CICA 1751.35. However, there is no corresponding provision in IAS 34. We recommend the deletion of section 8.9 because in our experience such circumstances are rare and are worthy of a regulatory review of the issuer's application for exemption.

IAS 34 *Interim Financial Reporting* explicitly requires in paragraph 20 the presentation of comparative information, so the lack of comparative financial statements will represent a departure from generally accepted accounting principles.

CICA 7050.57 requires that when the entity's auditor believes that the interim financial statements probably contain a material departure from Canadian generally accepted accounting principles, he or she should express a qualification in his or her communication, unless the departure is such that, in the auditor's opinion, the departure renders the financial statements misleading or virtually useless even when considered in conjunction with the auditor's communication. In the latter case, the auditor should render an adverse communication. In either case, the communication should describe the nature of the departure(s) and, if readily determinable, should state the effects on the interim financial statements.

We believe that the absence of comparative information would result in an adverse communication.

As a result, in those situations where the interim financial statements are required to be reviewed, when comparatives are not provided because it is impracticable to do so as contemplated in securities regulations (NI 51-102 4.7(4), 4.10(3) and 8.9), then as required by NI 52-102 4.3(3)(c) and HB 7050.54 auditors will be required to issue a written review report to accompany the interim report indicating the adverse communication.

We recommend that the CSA reconsider the policy of accepting non-comparative interim financial statements and the policy of accepting prior period information that has not been prepared on a basis consistent with the most recent period (as this also creates the same reporting challenges). We believe these accommodations should be removed and issuers should be required to apply for an exemption.

We also recommend that this reporting matter be considered by the Task Force on Assurance Implications of Changeover to IFRSs or the Securities Regulatory Advisory Group to determine if another acceptable approach may be taken.

Three year financial statements with third year not in same GAAP

NI 52-107 sub-section 3.2(6) suggests that financial information may be presented in a format which would contain a mixed presentation of generally accepted accounting principles (e.g. for years ended December 31, 2011 and 2010 IFRS and for the year ended 2009 Canadian GAAP). We believe such presentation may be confusing to investors since presentation of such amounts in columnar format would create an impression that the amounts are comparable. Also the notes to such financial statements to explain the presentation would likely be confusing.

We recommend a more direct approach which would clearly differentiate the presentation and avoid the risk of investor confusion. An issuer could present for the years ended December 31, 2011 and 2010 financial statements prepared in accordance with IFRS and then separately for the years ended December 31, 2010 and 2009 financial statements prepared in accordance with Canadian GAAP. We recommend that guidance be included in the Companion Policy regarding how to apply NI 52-107 sub-section 3.2(6) in practice.

Acquisition Operating Statements

Basis of preparation:

When an oil and gas property is acquired the acquisition statements may not consist of a complete set of financial statements per IAS 1.10 but may be an acquisition operating statement which presents at least gross revenue, royalty expenses, production costs and operating income. However, we observe that such minimal disclosure does not comply with all the disclosure requirements of an income statement in IAS1.12 and thus, may not fairly present the financial performance in accordance with a financial reporting framework such as IFRS. It is our firm's view that that to fairly present the financial performance of an entity in accordance with IFRS, both a statement of financial position and cash flow statement are required as well as applying all recognition, measurement and disclosure requirements of IFRS. Accordingly, the basis of preparation of acquisition operating statements would not be IFRS.

Furthermore, we believe that those preparing acquisition operating statements cannot apply IFRS 1 as the application of IFRS 1 is only appropriate in the first IFRS financial statements which contain an explicit and unreserved statement of compliance to IFRS. As a result of not having the optional exemptions and exceptions in IFRS 1 the conversion to IFRS must be done by retrospective restatement.

If the CSA accepts a compliance reporting framework, the CSA could also allow certain exemptions and exceptions relevant to the oil and gas industry.

Auditors report – general purpose or specified purpose

NI 52-107 sub-clause 3.12(2)(f)(i) indicates the auditor's report must refer to the requirements in IFRS for the recognition, measurement and disclosure of information in the statements as the applicable fair presentation framework. The Companion Policy to NI 52-107 in section 3.4 contemplates that such audit reports would be prepared in accordance with CAS 805 *Special considerations – audits of single financial statements and specific elements, accounts or items of a financial statement.*

Its important to note that CAS 805 is expected to be applied in conjunction with either CAS 700, *Forming an opinion and reporting on financial statements* (“general purpose financial statements) or CAS 800, *Special considerations – audits of financial statements prepared in accordance with special purpose frameworks* (special purpose financial statements). As such, we believe that that the Companion Policy should be clear that CAS 805 should be applied as though these acquisition operating statements are general purpose financial statements. A general purpose financial statement is designed to meet the common financial needs of a wide range of users. A special purpose financial statement is designed to meet the financial information needs of <u>specific users</u>. As acquisition operating statements are broadly distributed through prospectuses we believe that these are general purpose financial statements.

Auditors report – fair presentation or compliance

We believe that is unlikely that a “fair presentation” report as required under NI 52-107 3.3 is achievable, even if the pieces of the operating statement are audited individually - i.e., gross revenue, royalty expenses, production costs were audited individually. Generally, we believe that an understanding of other elements contained within the statement of financial position may be required to achieve fair presentation. For example, to fairly present revenue, an understanding of deferred revenue in the statement of financial position may be necessary.

Rather, we believe that reporting in accordance with CAS 805 and CAS 700 on an a general purpose operating statement prepared in accordance with a compliance framework with an additional emphasis of matter relating to differences between the compliance framework used and IFRS is the appropriate reporting framework. The compliance framework would be that described by CSA as the basis of preparation of the acquisition operating statement. The use of a compliance framework would also allow the CSA to specifically allow the application of the optional exemptions and exceptions in IFRS 1 as part of the basis of presentation. A sample report under this scenario is contained for your consideration.

Summary

As a result we recommend the following changes to NI 52-107:

- delete sub-clause 3.12(2)(f)(i) and replace with “in the case of acquisitions statements that are operating statements refer to the requirements of the Regulator” thus indicating that the basis of presentation is a financial reporting compliance framework specifically requested by the CSA
- add a sub-clause 3.3(1)(a)(iv) notwithstanding 3.3(1)(a)(iii)(A), operating statements may be prepared in accordance with a compliance framework
- require the issuer to include in a basis of presentation note the describing the regulation which the financial statements are prepared in compliance with and including a statement referring to following the requirements in IFRS for the recognition, measurement and disclosure of information
- provide guidance indicating that the optional exemptions and exceptions in IFRS 1 can be applied despite the fact that the entity is not making an explicit and unreserved statement of compliance with IFRS in its first IFRS financial statements.

We also recommend that the Companion Policy to NI 52-107 section 3.4 explicitly state that CAS805 should be applied as though these acquisition operating statements are general purpose financial statements.

Finally, we are concerned that the required statement in 3.11(1)(f)(iii) is inappropriate. This requires a statement that the operating statement was prepared in accordance with Canadian GAAP applicable to private enterprises. However, Canadian GAAP applicable to private enterprises, does not address the creation of such operating statements. We recommend that the financial statements indicate that they were prepared in accordance with regulatory requirements.

Sample Report

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the operating statement of ABC Company for the year ended December 31, 20X1 and a summary of significant accounting policies and other explanatory notes (together "the financial statement").

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and presentation of this financial statement in accordance with the accounting requirements prescribed by the Regulator (see Note X Basis of Presentation).and for such internal control as management determines is necessary to enable the preparation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statement of ABC Company for the year ended December 31, 20X1 is prepared, in all material respects, in accordance with the accounting requirements prescribed by the Regulator.

Other Matter – Financial Reporting Framework

We draw attention to Note X to the financial statement, which describes the basis of accounting used in the preparation and presentation of these financial statements, which are not, and are not intended to be, prepared and presented in accordance with Canadian generally accepted accounting principles for publicly accountable enterprises. Note X also describes the differences between the financial reporting framework used in these financial statements and Canadian generally accepted accounting principles for publicly accountable enterprises being principally that this financial statement does not contain all statements required under IFRS and that certain elements required in an operating statement purported to meet the recognition, measurement and disclosure requirements of IFRS are omitted. Our opinion is not qualified in respect of this matter.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

Combined financial statements

NI 51-102 sub-section 8.4(8) requires that if a reporting issuer includes in its business acquisition report financial statements for more than one related business, separate financial statements must be presented for each business except for the periods during which the businesses were under common control or management, in which case the reporting issuer may present the audited financial statements on a combined basis.

NI 41-101F1 Item 32.1 also references a requirement for combined financial statements.

IFRS does not specifically contain guidance on the preparation of combined financial statements; however, it is our firm's view that this is possible.

This may be a reporting matter which should be considered by the Accounting Standards Board.

Carve-out Financial Statements

The Companion Policy to NI 51-102 sub-section 8.6(4) discusses carve-out financial statements and provides guidelines on creating carve-out financial statements. In addition, the companion policy to NI 51-102 sub-section 8.6(5) contemplates situations when it may be impracticable to prepare carve-out financial statements and that reporting issuer may be required to audit statements of assets acquired and liabilities assumed and a statement of operations.

Basis of presentation:

We believe that the first determination is whether carve out financial statements may be prepared in accordance with IFRS. For example, when a component of a larger entity is organized as a separate legal entity with separate management, books and records and accounting systems from which a complete set of financial statements for the component are prepared, then we believe that such carve out financial statements may be prepared in accordance with IFRS. However, when the component does not have separate management, books and records and accounting systems, and the financial statements for the component are extracted from the larger entity's records (carve-out financial statements), then we believe that the carve out financial statements are prepared in accordance with a described basis of presentation and can not be IFRS.

As previously stated, without an explicit and unreserved statement of compliance to IFRS then the optional exemptions and exceptions in IFRS1 cannot be applied.

Auditors report – general purpose or specified purpose:

NI 52-107 clause 3.12(2)(f) indicates that the auditor's report in the case of acquisition statements that are financial statements for a business division refer to the requirements in IFRS for the recognition, measurement and disclosure of information and refer to IFRS as the applicable fair presentation framework.

The companion policy to NI 52-107 in section 3.4 contemplates that the audit of such reports business division reports are done in compliance with CAS 805 *Special considerations – audits of single financial statements and specific elements, accounts or items of a financial statement.*

As stated previously, it is important to note that CAS 805 is expected to be applied in conjunction with either CAS 700, *Forming an opinion and reporting on financial statements* (general purpose financial statements) or CAS 800, *Special considerations – audits of financial statements prepared in accordance with special purpose frameworks* (special purpose financial statements). As such, we believe that that the Companion Policy should be clear that CAS 805, when applicable, should be applied as though these carve out financial statements are general purpose financial statements. A general purpose financial statement is designed to meet the common financial needs of a wide range of users. A special purpose financial

statement is designed to meet the financial information needs of specific users. As carve out financial statements are broadly distributed through prospectuses we believe that these are general purpose financial statements.

We do believe when a complete financial records of the business acquired exist then a complete set of general purpose financial statements may be created following CAS 700, without considering the guidance in CAS 805.

Auditors report – fair presentation or compliance

Although NI 52-107 clause 3.12(2)(f) indicates that the auditor's report on carve out financial statements refer to a fair presentation framework, this may not be possible based on the matters discussed in "basis of presentation" above. Accordingly, if the carve out financial statements are prepared in accordance with IFRS, then the auditor's report will refer to a "fair presentation framework". However, if the carve out financial statements are prepared in accordance with a described basis of presentation and not IFRS, then the auditor's report will refer to a "compliance framework". Accordingly, reference to a "fair presentation framework" should be removed as the auditor may not be in a position to issue such a report.

Summary

As a result of our belief that the basis of presentation may differ among entities, we recommend:

- delete clause 3.12(2)(f)(i) and replace with "in the case of financial statements for a business division when sufficient information is available to allow separation of the component's financial performance and results from the rest of the entity, refer to IFRS as the fair presentation framework"
- add clause 3.12(2)(f)(ii) "in the case of financial statements for a business division when sufficient information is not available to allow separation of the component's financial performance and results from the rest of the entity, refer to the requirements of the Regulator as the compliance framework"
- provide guidance indicating that the optional exemptions and exceptions in IFRS 1 can be applied despite the fact when the entity is not making an explicit and unreserved statement of compliance with IFRS in its first IFRS financial statements.

We believe the financial statement notes should disclose specifically what regulation the statement of financial position and statement of comprehensive income (or statement of assets acquired and liabilities assumed and statement of operations) are prepared in compliance with if in situation (ii) above and include a statement describing the basis of presentation (e.g. as required by Regulation X the financial statements were prepared following the requirements in IFRS for the recognition, measurement and disclosure of information).

We also recommend that the Companion Policy to NI 52-107 section 3.4 explicitly state that CAS805, when applicable, should be applied as though these carve out financial statements are general purpose financial statements.

We would recommend that business division financial statements should disclose in the basis of presentation note that the business division is part of a larger entity and the criteria used to define the business division. In the case of carve-out financial statements we further recommend disclosure that the financial statements:

- have been prepared from the books and records maintained by the larger entity;
- include allocations of certain material expenses and the allocation methods used; and
- may not be indicative of the results that would have been obtained if the component had operated as an independent entity.

In those situations, when it is impracticable to prepare carve-out financial statements and a statement of assets acquired and liabilities assumed and a statement of operations is being audited, we also believe that the same guidance as for situation (ii) above would apply (e.g. when sufficient information is not available to allow separation of the component's financial performance and results from the rest of the entity).

Registrants

Basis of preparation:

NI 31-102 *Registration Requirements and Exemptions* section 12.10 requires that the annual financial statements be audited. NI 31-102 section 12.11 also requires the preparation of interim financial information. The interim financial information is not required to be reviewed. NI 52-107 clause 3.2(3)(a) sets out the basis of presentation. It requires that these financial statements be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises, except that the financial statements must account for investments in subsidiaries, jointly controlled entities and associates as specified for separate financial statements in Canadian GAAP applicable to publicly accountable enterprises. NI 52-107 clause 3.2(3)(b) requires that the issuer disclose that the annual financial statements comply with IFRS except that the financial statements account for investments in subsidiaries, jointly controlled entities and associates as specified for separate financial statements in IFRS.

IAS 1.16 states that "An entity shall not describe financial statements as complying with IFRSs unless they comply will all the requirements of IFRSs." Further, as the registrant may not be complying with IFRS as the conditions in IAS 27.10 may not met it does not appear to be appropriate to then say they are applying rules specified for separate financial statements in IFRS. For registrants preparing interim financial information the absence of a cash flow statement would also mean that the statements are not compliant with IAS 34.20. In addition, as this is not an explicit and unreserved statement of compliance, we believe the exemptions and exceptions available in IFRS 1 cannot be applied by such registrants when converting to IFRS. In these situations, where the conditions in IAS 27.10 are not met or a cash flow statement is missing, we believe the basis of presentation should be described as following regulatory requirements and then describing such requirements.

As previously stated, without an explicit and unreserved statement of compliance to IFRS then the optional exemptions and exceptions in IFRS1 cannot be applied.

In situations where the registrant does not have entities to consolidate or meets all the conditions in paragraph IAS 27.10, they would be compliance with IFRS for annual financial statements and thus, it would be inappropriate to make the disclosure required in clause 3.2(3)(b) as the financial statements would comply with IFRS.

Auditors report – general purpose or specified purpose

Since the annual financial statements are delivered to the regulator and not publicly available we believe the audit reports of any such statements should follow CAS 800 *Special Considerations – Audits of financial statements prepared in accordance with special purpose frameworks* as contemplated in the section 3.4 of the companion policy to NI 52-107.

Auditors report – fair presentation or compliance

In situations where the registrant does not have entities to consolidate or meets all the conditions in paragraph IAS 27.10, a fair presentation framework would be appropriate.

The CSA has directed registrants to describe the basis of presentation as complying with IFRS "except that …" in certain situations. We believe that this represents a compliance framework. We are concerned that the required disclosure in NI 52-107 clause 3.2(3)(b) as currently drafted implies presentation under a fair presentation framework versus a compliance framework because of use of the "except that" language.

We recommend that the language in clause 3.2(3)(b) be replaced to indicate that the basis of presentation is that which complies with the financial reporting framework established by regulation. We also believe it would be beneficial to clearly state in the Companion Policy that a compliance framework is acceptable.

Summary

We recommend the following:

- replace clause 3.2(3)(a) to say "be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises and in the case of annual financial statements, disclose that the financial statements comply with IFRS"
- replace clause 3.2(3)(b) to say "when the financial statements do not comply with IFRS, be prepared in accordance with Canadian GAAP applicable to publicly accountable enterprises except that the financial statements or interim financial information must account for investments in subsidiaries, jointly controlled entities and associates either at cost or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement"*
- add clause 3.2(3)(c) to say "when the financial statements do not comply with IFRS, in the case of annual financial statements, disclose the financial statements were prepared in compliance with NI 52-107 3.2(3)(b) and as such the financial statements comply with IFRS except that the investments in subsidiaries, jointly controlled entities and associates were accounted for at cost or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement"*
- modify 3.3(a)(a)(iii) such that it is clear that a registrant that does comply with IFRS can deliver a financial statement prepared in accordance with a fair presentation framework
- provide guidance indicating that the optional exemptions and exceptions in IFRS 1 can be applied despite the fact when the entity is not making an explicit and unreserved statement of compliance with IFRS in its first IFRS financial statements.

Registrants – no comparatives for annual financial statements and interim financial information

NI 52-107 sub-section 3.2(4) contemplates that for periods relating to a financial year beginning in 2011 registrants complying with NI 31-102 *Registration Requirements and Exemptions* may present financial statements that exclude comparative information for the preceding financial year or interim period provided certain disclosures are made as set out in clause 3.2(4)(b) and the financial statements or interim financial information are prepared using a date of transition to IFRS that is the first day of the financial year to which the financial statements or interim financial information relate (e.g. January 1, 2011 for a calendar year company). Such financial statement (without comparatives and using a transition date of January 1, 2011) could not be described as being in compliance with IFRS but rather should be described as being prepared in accordance with regulatory requirements.

We believe the required disclosures for registrants to include in financial statements set out in clause 3.2(4)(b) are misleading and as the disclosures imply compliance with IFRS by stating that the financial statements comply with IFRS "except for" certain matters. We recommend that the language in clause 3.2(4)(b) be replaced to more clearly indicate the compliance basis on which it is prepared. We recommend the following:

- replace 3.2.(4)(b) with "in the case of annual financial statements, disclose that the financial statements have been prepared in accordance with the requirements of NI 52-107 clauses 3.2(3)(a)(b)(c), as revised and applicable and 3.2(4)(a). We believe the basis of presentation note should then fully describe the regulations that were complied with.

We believe that such changes will allow appropriate reporting under CAS 800 *Special Considerations – Audits of financial statements prepared in accordance with special purpose frameworks* following a compliance framework.

Foreign Registrants - Basis of Presentation

NI 52-107 section 3.15 allows foreign registrants to deliver annual financial statements and interim financial information that are prepared in accordance with IFRS or U.S. GAAP, except that the financial statements must account for investments in subsidiaries, jointly controlled entities and associates as specified for separate financial statements in IFRS. Generally, we believe it would be more appropriate to refer to the specific requirements as noted under "registrants" above.

For foreign registrants applying U.S. GAAP, the requirement to apply IFRSs to account for investments in subsidiaries, jointly controlled entities and associates as specified for separate financial statements in IFRS seems inappropriate as these registrants generally lack familiarity with IFRS and mixing accounting frameworks is not recommended.

Our understanding is that the intent of obtaining non-consolidated financial statements is to evaluate the adequacy of capital. In this regard, U.S. GAAP allows for parent-only financial statements through one-line consolidation via the equity method and we understand that these foreign registrants are already typically creating such financial statements to meet US regulatory requirements.

Overall, we recommend:

- replacing NI 52-107 clause 3.16 (a) with "IFRS, except that the financial statements or interim financial information must account for investments in subsidiaries, jointly controlled entities and associates at either cost or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement"*
- replacing NI 52-107 clause 3.16(b) with "US GAAP, except that the financial statements or interim financial information must account for investments in subsidiaries, jointly controlled entities and associates following the cost method, equity method or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement"*.

Appendix B
Housekeeping Matters

NI 52-107

- 3.6(1)(c)(d) and 3.6(2)(a)(i)(ii)

  Why is this needed? Section 3.5 already required display of presentation currency and functional currency. As an observation, we also note that many issuers have multiple functional currencies (i.e., they have multiple foreign operations each with a different functional currency).

3.11(1)(f)(iii)

- Suggest delete the following:

  "which are International Financial Reporting Standards incorporated into the Handbook". The relevant point is that private GAAP differs from GAAP applicable to publicly accountable enterprises. As well, in future years IFRS for SMEs may exist.

NI 51-102

4.11(1)
- We believe the word annual should be inserted before financial statements in the definition of "disagreement".

8.3(7)
- We believe the word "loss" in this paragraph should be replaced with "loss, adjusted to exclude discontinued operations and income taxes" to be consistent with the definition of acquisition test profit or loss.

9.4(9)(a)
- We believe the words "has been filed" should follow "under paragraph 9.2(6)(a)".

NI 41-101F1

5.1(1)
- Since reporting segment is not a defined term within the instrument, we recommend changing the first sentence of 5.1(1) to say "Describe the business of the issuer and its operating segments that are reportable segments as determined by reference to the issuer's GAAP".

8.7
- We recommend changing the final sentence of 8.7 to say "In determining cash flow from operating activities, the issuer must include cash payments related to dividends and borrowing costs".
- Similar changes are also recommended for 41-101CP 4.3(1) and 44-101CP 4.4(1).

Item 9 – Instructions (3) (Also 44-101 Item 6 – instruction 3)
- Not sure borrowing costs will get to same spot as saying interest expense in accordance with GAAP. We are concerned that issuers may fail to include interest on capital lease obligations, interest on preferred shares classified as debt and capitalized interest. Additional guidance may be required.

NI 52-109 Companion Policy

13.1
- We recommend substituting "not accounted for by consolidation, proportionate consolidation or the equity method" rather than "not accounted for by consolidation or the equity method".