VERITAS
INVESTMENT
RESEARCH

January 6, 2020

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario
M5H 3S8
comment@osc.gov.on.ca

Me Phillippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cite, tour Cominar
2640 boulevard Laurier, bureau 400,
Quebec (Québec) G1V 5C1
consultation-en-cours@lautorite.qc.ca

Dear Sirs and Madams:

Re: 6.1.1 CSA Notice and Request for Comment — Proposed Amendments to National Instrument 51-102 *Continuous Disclosure Obligations* and Changes to Certain Policies Related to the Business Acquisition Report Requirements - Together "Proposed Amendments".

We are strongly opposed to the Proposed Amendments. In our view, the criteria used to support the amendments are incomplete and the resulting reduction of Business Acquisition Reports (BARs) being filed could significantly reduce the amount of appropriate and relevant information for purposes of making investment decisions following a significant acquisition.

We also understand that the U.S. Securities and Exchange Commission issued a proposed amendment for comment in May 2019 designed to improve disclosures relating to acquisitions and dispositions of businesses. Although a formal conclusion to the SEC proposal has not yet been released, we are concerned that the CSA's Proposed Amendments in their current form may result in laxer requirements for Canadian filers. We would encourage the CSA and associated provincial securities regulators to carefully monitor the SEC's deliberations before concluding.

Based on our review of the Request for Comments, the Staff estimate that over 40% of the BARs published over the last three years would have not been filed (24 of 56), resulting in a total average annual cost savings to issuers of approximately $1.6 million. In our view, however, the cost savings of ~$66K per BAR not filed are likely to be trivial in the context of the total value of the related acquisitions. The total costs should be weighed against the beneficial information provided on each acquisition, by each BAR, which public investors rely on to inform their investment decisions and hold companies to account.

By way of background, Veritas Investment Research Corporation is a Canadian independent equity research firm founded in 2000 that prides itself in using a unique forensic-based approach to analysis. Veritas is an active advocate for investor rights in both securities regulation and accounting standard setting. Its Chief Executive Officer has served as a member of the OSC's Continuous Disclosure Committee since 2006.

History has shown that acquisitions can be a breeding ground for corporate financial reporting problems, ranging from accounting misrepresentations to outright frauds. While it is true that only a small fraction of acquisitions are problematic, BARs give investors insight into the acquired company's historical financial information and accounting policies, allowing users to better analyze adjustments made by the acquiror to integrate the target's accounting with its own. In this way, investors are able to track accounting changes, measure post-acquisition performance and evaluate management's strategy.

At the time of the acquisition, GAAP requires that acquirors fair value the assets and labilities of the acquired entity. Given that calculated fair values are estimates that are based on assumptions regarding the future, such values are inherently subjective. A key benefit of BARs is that they further the investor's ability to evaluate the underlying assumption(s) used by a company in its fair value calculations.

During the consolidation process, the acquiror will assess the acquiree's accounting policies and make any changes the acquiror deems necessary to align the target's reporting with its own. The BAR provides details of: the underlying fair value assumptions; the fair value adjustments recorded; and the accounting policies originally used by the acquiree as well as any changes to those accounting policies made by the acquiror.

Based on Veritas' work over the past twenty years, BARs are a vital input in assessing the quality of company earnings, organic growth rates, and growth-by-acquisition strategies. Measures of organic growth – whether based on revenues, earnings or alternative metrics – are greatly affected by the fair values assigned to the acquiree's assets and liabilities. Equally important and perhaps less well understood, changes by the acquiror in post-acquisition accounting polices can have material effects on reported future earnings and cash flows subsequent to the acquisition.

The aforementioned issues are exacerbated when the acquired entity is private or the subsidiary of a public entity, given that the information contained in the BAR is unlikely to have been public prior to the transaction.

Given the SEC's outstanding proposed amendments to the financial disclosure requirements in Rules 3-05, 3-14, and Article 11 of Regulation S-X related to business acquisition disclosures, we would encourage the CSA to ensure that the final Proposed Amendments are not laxer than those currently in existence and are consistent with those that are ultimately approved by the S.E.C.

Inconsistent securities regulations could be perceived to lessen the quality of Canadian financial reporting. Given that Canada is a market that depends heavily on foreign investment, material weaknesses in our financial reporting and regulatory system are likely to increase the cost of capital for all Canadian issuers, not just those filing BARs.

Even where BARs are not widely read or used by investors, we think there are many intangible benefits to these disclosures. There are numerous studies showing that financial executives are likely to engage in some form of financial accounting management – without the BAR requirement, there would be far less information available for investors to evaluate how acquisitions may have been treated. Public disclosure requirements for acquisitions are likely to act as a deterrent for management teams that might be tempted to manage earnings using an acquiree's financial results.

VERITAS
INVESTMENT
RESEARCH

Paraphrasing, the mission statement of Canadian regulators is:

- To provide protection to investors from fraudulent, manipulative or misleading practices, to foster fair, efficient and transparent capital markets as well as confidence in capital markets, and to contribute to the stability of the financial system and the reduction of systemic risk.

As currently constituted, we think BARs offer a cost-effective means of reducing information asymmetries, deterring negative reporting practices and strengthening confidence in capital markets. These are public goods whose benefits are paid for by public filers but broadly enjoyed by all market participants.

In contrast, the justifications advanced for the Proposed Amendments appear to focus heavily on cost savings to filers, in the form of associated audit and legal fees, as well as management's time. The Staff estimated that the total average cost per BAR is roughly $66,000 and that the resulting reduced number of BARs filed over the last three years would equate to an annual aggregate costs savings of approximately $1.6 million.

In our view, the true "costs" of weak or misleading financial information are borne by investors when a company's earnings management eventually catches up with its underlying fundamentals. These costs to investors tend to occur infrequently and in concentrated cases, but can be dramatic. We are not far removed from high profile growth-by-acquisition scandals, such as Valiant Pharmaceuticals and Concordia Pharmaceuticals, among others. In these cases, Veritas' work has relied extensively on BARs to better inform investors of accounting and disclosure risks in advance of later problems.

In our view, the "costs" of preparing BARs are likely to be miniscule relative to the total dollar value of individual acquisitions, as well as other transactional and due diligence costs borne by the acquiror in completing each purchase. What's more, the independent audits provided in generating BARs are likely to be invaluable to company directors and management teams as they work through differences in accounting between acquiror and acquiree, and make decisions on how to integrate their financial reporting on a go-forward basis.

Any changes to the BAR requirements should be contemplated on a full cost-benefit basis, including an analysis of how information removed by relaxing BAR filings might affect the disclosures available to investors, the effectiveness of overall financial reporting, and whether the aims of the CSA's mandate are likely to be furthered.

In our view, the analysis so far is incomplete. We suspect that, had the BAR rules been relaxed, the BARs that would have remained 'unfiled' offered a significantly higher level of disclosure on individual acquisitions and related accounting than could otherwise be obtained by investors. Combined with the many intangible benefits we have suggested, we think a true cost-benefit analysis of these BARs is likely to be significantly positive for capital market participants and likely to far outweigh the suggested $66K average savings.

We welcome the opportunity to discuss our submission further. Submitted in good faith.

Sincerely,

Anthony Scilipoti
President & CEO

100 Wellington Street West, TD West Tower, Suite 3110, Toronto, Ontario M5K1E7
Telephone: (416) 866-8783 Facsimile: (416) 866-4146
www.veritascorp.com