ONTARIO SECURITIES COMMISSION

OSC Staff Notice 51-706

2009

Corporate Finance Branch Report

Corporate Finance Branch Report

ONTARIO SECURITIES COMMISSION

Contents

1. Introduction

This report summarizes the operational activities of the Corporate Finance Branch (the Branch or we) of the Ontario Securities Commission (OSC) during the year ended March 31, 2009 (fiscal 2009 or 2009). It also discusses developing issues and other findings that we believe will be of particular interest to issuers and their advisors.

The Branch is responsible for the regulation of issuers. The Branch's disclosure review programs further the OSC's investor protection mandate. In our reviews, we endeavour to facilitate access to the information investors need to make informed investment decisions without impeding capital flow. We believe this report will assist issuers and their advisors in providing meaningful information to investors.

This year, we focused, in particular, on issues arising from the severe market downturn that began in the fall of 2008. Together with extreme market volatility, the downturn led to a sharp decrease in public offerings in fiscal 2009. Branch resources were redeployed to address the risks arising from market developments. For example, in September 2008, the Canadian Securities Administrators (CSA) announced that their staff were closely monitoring continuous disclosure with a particular emphasis on the banking and financial services sector, along with highly leveraged reporting issuers. During this period, we also communicated with issuers that had defined benefit pension plans to promote robust and timely disclosure of material pension obligations.

In addition to our market conditions reviews, we performed a number of targeted reviews relating to financial instruments and inventory. Overall, we conducted 436 continuous disclosure reviews in fiscal 2009. A full discussion of our review programs and related results is provided in the report.

Another significant priority for the Branch involved preparing for the implementation of International Financial Reporting Standards (IFRS) in 2011. Section 5 contains a detailed discussion of IFRS transition issues.

The Branch is also responsible for monitoring compliance with securities laws in the context of take-over bids and other mergers and acquisitions transactions. Despite a decline in the aggregate level of mergers and acquisitions activities, there has been an increase in Commission hearings as transactions have become more hostile and complex in response to adverse market conditions. Mergers and acquisitions issues are discussed in Section 6.

2. Summary of reviews

The goal of our review program is to facilitate access to the material information investors need to make informed investment decisions.

There are approximately 4,300 reporting issuers (other than investment funds) in Ontario. We focus on the approximately 1,125 reporting issuers with head offices in Ontario. These issuers represented $457 billion or 36% of Canada's $1,286 billion market capitalization as at March 31, 2009.

2.1 Continuous disclosure (CD) review program

We use a risk-based approach to select issuers for continuous disclosure review and to determine the areas of focus for our targeted CD reviews. We incorporate qualitative and quantitative criteria to identify issuers whose disclosure is likely to be materially improved or brought into compliance with securities laws or accounting standards as a result of our intervention.

Types of reviews

We completed 436 CD reviews in fiscal 2009. Ninety-nine were full reviews and 337 were targeted reviews. The table below shows the number of reviews completed in each of the past three fiscal years.

CD reviews completed

	2009	2008	2007
Full	99	123	126
Targeted	337	329	260
Total	436	452	386

Targeted reviews allow us to:

- monitor compliance with new requirements;
- communicate our interpretation of securities requirements and areas of concern;
- quickly address specific areas of risk; and
- assess compliance with new accounting standards.

In 2009, we focused on the following areas in our targeted reviews:

- reporting and disclosure issues associated with market conditions;
- disclosure of pension funding obligations for issuers with defined benefit pension plans;
- valuation and disclosure issues related to non-bank sponsored asset-backed commercial paper (ABCP);
- compliance with new accounting requirements related to financial instruments disclosures; and
- compliance with new accounting requirements for inventory.

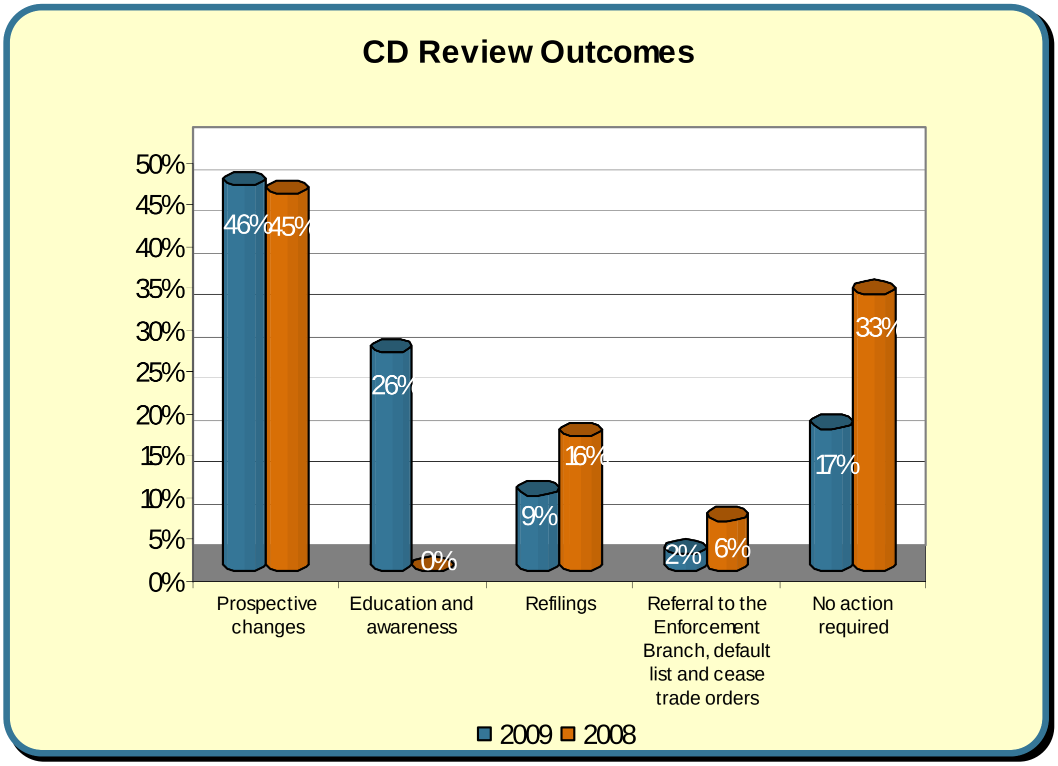
Outcomes of reviews

Continuous disclosure reviews can result in any number of the following outcomes:

- prospective changes;
- education and awareness;
- refilings; and
- referral to the Enforcement Branch, the issuer being added to our default list and/or issuance of a cease trade order.

A review can also result in no further action.

The chart below shows the outcomes of our CD reviews for the past two fiscal years. In fiscal 2009, 83% of our CD reviews resulted in an outcome compared with 67% in fiscal 2008. The increase in the number of outcomes is largely due to the reviews we conducted in response to market conditions.



Prospective changes

In 46% of our reviews, the issuer agreed to make a change to its disclosure in an upcoming filing. Most of these changes involved correcting deficiencies in the Management's Discussion and Analysis (MD&A) as required by Form 51-102F1 *Management's Discussion and Analysis* (Form 51-102F1) of National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102). A significant number of issuers with defined benefit pension plans committed to improving disclosure of pension obligations. Issuers also committed to enhancing financial instruments and capital disclosures in financial statements.

Education and awareness

In fiscal 2009, 26% of our reviews provided education and promoted awareness. This is a new category we created to capture the outcomes from the market conditions reviews we began conducting in the fall of 2008. We identified issuers at risk of a specific disclosure issue and contacted them about our concern before they made their next CD filing. After the filing, we reviewed their disclosure to assess whether they had addressed the issue appropriately. This new proactive approach helped issuers provide complete, transparent and timely disclosure to their investors about the effects of market conditions on their financial performance.

Refilings

In 9% of our reviews, we identified significant deficiencies that led the issuer to restate and refile documents, make retroactive changes or file documents that had not previously been filed. Most of the refilings related to the following areas:

- non-compliance with the certification obligations under Multilateral Instrument 52-109 or National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (NI 52-109);
- failure to provide comparative financial statements in interim periods;
- incorrect application of Canadian GAAP in several areas including:
  - impairment of mineral properties;
  - revenue recognition; and
  - valuation of investments.

Refilings and retroactive corrections to CD documents are significant events. If an issuer refiles a CD document or makes a retroactive accounting change as a result of our review, the issuer's name, the date of refiling and a description of the deficiency are posted on our Refilings and Errors list on the OSC website for three years.

For more information

- For a description of our approach to refilings, see OSC Staff Notice 51-711 *List of Refilings and Corrections of Errors as a Result of Regulatory Reviews*.
- For guidance on how we generally respond to certain types of continuous disclosure defaults, see National Policy 12-203 *Cease Trade Orders for Continuous Disclosure Defaults* (NP 12-203).

Referral to the Enforcement Branch, default list and cease trade orders

If an issuer's CD documents have serious deficiencies, we may add the issuer to the OSC's default list, issue a cease trade order, or refer the matter to the Enforcement Branch for further action. In fiscal 2009, 2% of our reviews resulted in one or more of these three outcomes.

2.2 Prospectus and rights offerings

In fiscal 2009, we received 462 prospectuses and rights offering circulars, down from 657 in 2008. The decrease in offerings was particularly notable in the third and fourth quarters of the fiscal year and was largely due to market conditions.

Types of offering reviews

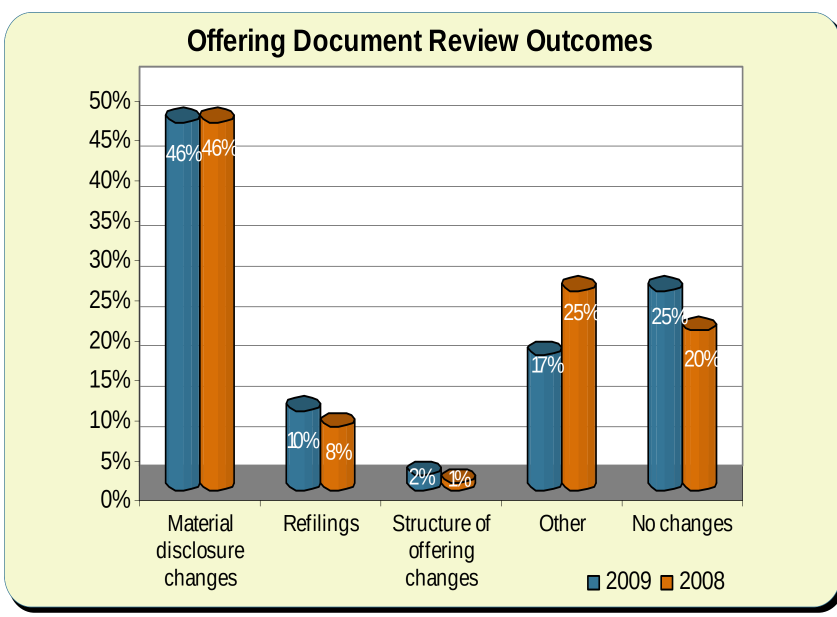
The table below shows the number and types of offering reviews we have conducted over the past three fiscal years.

Offering reviews completed

	2009	2008	2007
Basic	322	450	403
Full	53	94	89
Issue-oriented	52	89	93
Rights offerings	35	24	15
Total	462	657	600

Outcomes of reviews

75% of the prospectus and rights offering reviews resulted in outcomes requiring action. This is consistent with historical results. The table below shows the outcomes for the past two fiscal years.



Material disclosure changes

46% of the reviews resulted in material disclosure changes to comply with an accounting, legal or other regulatory requirement. In both fiscal 2008 and 2009, the primary areas of deficiency included MD&A, use of proceeds and risk factors disclosure.

Refilings

Ten per cent of the reviews resulted in the correction and refiling of significantly deficient documents or the filing of a required document that was not previously filed. Many of the deficiencies related to a failure to file technical reports and related consents.

Structure of offering changes

Two per cent of the reviews resulted in the issuer changing the structure of its offering. This was due either to our review or to changes in market conditions. The most common change was an increase in the minimum offering size to ensure that the issuer had sufficient funds to sustain its operations for a reasonable period of time.

Other

This category includes outcomes that do not result in a change to an offering document but are significant to our mandate in other ways. For example, it includes situations where exemptive relief was granted or procedural enhancements were implemented by the issuer as a result of our review. Seventeen per cent of the reviews resulted in this outcome.

3. Response to Market Conditions

3.1 General

In the fall of fiscal 2009, the CSA took a variety of actions to respond to market conditions. As part of those initiatives, we closely monitored continuous disclosure, with a particular emphasis on the banking and financial services sectors, and on highly leveraged companies. We also:

- published in January 2009 CSA Staff Notice 51-328 *Continuous Disclosure Considerations Related to Current Economic Conditions* to provide guidance on the preparation of financial statements and MD&A in the current market environment;
- conducted a review of disclosure relating to certain defined benefit pension plans; and
- continued monitoring valuation and disclosure issues related to non-bank ABCP holdings.

These initiatives combined elements of our traditional CD reviews with proactive measures to alert issuers to areas of concern. For example, we identified issuers that appeared to be at higher risk of being significantly impacted by market conditions. We contacted 100 of these issuers in advance of their next filing deadline and asked them to provide more focused and transparent disclosure in the following areas:

- liquidity risk and sources of cash or cash equivalents;
- specific exposures related to credit risk;
- the assumptions used to determine fair value for financial instruments;
- the process for assessing impairment of assets including other than temporary impairment of financial instruments; and
- risks and exposures to loss related to off-balance sheet entities.

This proactive approach proved effective because the issuers sufficiently addressed our concerns in the disclosure documents they subsequently filed.

3.2 Pensions

In the fall of fiscal 2009, as market conditions began to significantly affect the pension funding obligations of issuers with defined benefit plans, we conducted a review to assess whether MD&A disclosures properly reflected the status of those obligations and adequately discussed any impact on the issuer's liquidity, capital resources and financial condition.

We reviewed approximately 100 issuers with defined benefit plans. In the majority of cases, we requested prospective commitments to enhance MD&A disclosure relating to:

- the impact of the pension funding obligations on the issuer's capital, liquidity and financial position; and
- the risks associated with the issuer's funding status. This included the assumed rate of return and impact of market conditions on discount rates and other assumptions, and the extent to which measurement uncertainties were incorporated into the actuarial valuation process.

Recent changes to solvency funding requirements at both the federal and provincial level may provide temporary solvency funding relief for sponsors of defined benefit pension plans. In particular, the changes may allow pension plan sponsors to extend their solvency funding amortization period in respect of 2009 deficiencies from five to 10 years. Issuers with defined benefit pension plans should discuss in their MD&A the impact of any solvency relief that is material to their financial statements.

3.3. Non-bank sponsored asset-backed commercial paper

The non-bank sponsored ABCP market was restructured in January 2009 into new notes that track the life of the underlying assets. We reviewed the first and second quarter 2009 filings of holders of significant amounts of the new notes to assess their disclosure of the fair value and the classification of the new notes. We identified the following issues:

- inadequate disclosure of the factors and assumptions used to determine fair market value for illiquid securities;
- improper classification of the new notes as current assets on the balance sheet;
- failure to take into account all observable market data in the valuation methodology; and
- minimal discussion around changes in material assumptions and their impact on fair values from period to period.

For more information

See the *2008 Corporate Finance Branch Report* for a discussion of the reviews we conducted on the valuation and disclosure issues related to non-bank ABCP.

4. Issues arising from reviews

This section is a summary of common issues we identified in our targeted and full CD reviews in fiscal 2009. It also provides guidance to issuers in complying with their CD requirements.

4.1 Disclosures related to financial instruments

We conducted a targeted review to assess compliance with the new accounting standards in Section 3862 *Financial Instruments – Disclosures* and Section 1535 *Capital Disclosures* in the CICA Handbook. The financial instruments standard requires increased disclosures of the risks associated with financial instruments including credit, liquidity and market risks, along with how these risks are managed. The capital disclosures standard requires issuers to disclose financial information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Most of the issuers reviewed did not provide all of the required financial instruments disclosures. The disclosure was often boilerplate and did not appropriately address the issuer's specific situation. In general, issuers did not provide a comprehensive discussion of the credit, liquidity and market risks associated with financial instruments. Many issuers did not include a sensitivity analysis related to their market risks. In these cases, issuers agreed to make prospective disclosure changes in their next financial statements filing.

We also found several instances where issuers did not provide the required capital disclosures. Specifically, they failed to disclose financial information that would enable users of their financial statements to evaluate the issuers' objectives, policies and processes for managing capital. In addition, some issuers did not discuss how economic conditions affected their policies and processes for managing capital.

4.2 Inventory

We conducted a targeted review to assess compliance with the new accounting requirements for inventory in CICA Handbook Section 3031 *Inventories.* This new standard reduces the number of alternatives for the measurement of inventories, permits reversals of prior write-downs, requires impairment testing at each period and has increased disclosure requirements.

In general, while the issuers reviewed were in compliance with the measurement aspects of the standard, most did not provide all of the required new disclosures. The issuers agreed to make these disclosures in their next financial statement filings. Common disclosure deficiencies included a failure to:

- describe the various costs included in inventory;
- disclose the techniques used to measure inventory;
- disclose the carrying amount of inventory by major classification; for example, finished goods, raw materials and work in progress; and
- disclose separately all amounts related to inventory that were expensed during the period; for example, separately identifying the amount of cost of goods sold from write-downs of inventory to net realizable value.

4.3 Management's discussion and analysis (MD&A)

While we have seen improvements in the quality of MD&A in recent years, we continue to find deficiencies in many areas. Clear and informative disclosure is especially important in the current economic environment to help investors understand the risks and circumstances facing the companies in which they invest.

The objective of MD&A is to provide investors with an analysis of the issuer's business "through the eyes of management". To be meaningful, MD&A should be clearly presented and understandable to investors. It should give investors an accurate understanding of the issuer's current and prospective financial position and operating results. This includes the potential effects of known trends, commitments, events and uncertainties.

MD&A should not merely repeat information from the financial statements. It should complement and supplement the financial statements by providing an analysis of an issuer's business and a discussion of its results of operations and financial condition. This analysis must be balanced, with negative information presented as clearly as positive news.

Discussed below are the areas in MD&A where we continue to find deficiencies.

Liquidity and capital resources

We continue to be concerned about the quality of liquidity and capital resources disclosure. Many issuers simply provide boilerplate disclosure or repeat cash flow information readily available from their financial statements. This disclosure should provide sufficient details for investors to understand the company's financial condition and the risks associated with its principal sources of liquidity. For example, MD&A should discuss:

- working capital requirements including fluctuations in operating cash flows;
- deterioration in financial ratios or other measures that could lead to defaults under credit agreements;
- significant risks of default on dividend payments, debt payments, debt covenants or other contractual obligations; and
- how the issuer intends to address any issues with refinancing.

In circumstances where a potential default referred to above is identified, the issuer should also outline its plans for remedying the deficiency.

Results of operations

We often see only a brief analysis of results of operations in MD&A, and usually that analysis is not quantified. Issuers should provide a detailed, analytical and quantified discussion of the various factors that affect revenue and expenses. This allows investors to assess how a given factor could affect the issuer's operations, readily perform trend or margin analysis, and assess the quality and potential variability of the company's earnings. For example, if an issuer has taken an impairment charge, the discussion in MD&A should not only include the numerical amount of the impairment, but should also explain the reasons why the impairment occurred.

Issuers without significant revenue from operations should provide a comprehensive discussion of their expenses and business objectives. For example, their MD&A should focus on:

- any impact of falling commodity prices on project plans or property values;
- progress updates for project plans, including a discussion of remaining expenditures required to achieve those plans;
- anticipated project timing, along with the additional costs the issuer will need to advance the project to the next commercialization level; and
- detailed reasons for not meeting a project milestone.

Issuers also need to provide an update in their MD&A on the use of proceeds from their most recent financing.

Critical accounting estimates

While non-venture issuers must provide an analysis of critical accounting estimates in their MD&A, many issuers simply repeated the description of accounting policies found in the notes to the financial statements. We expect MD&A to supplement and build on financial statement disclosure. The analysis should include a discussion of the methodology and assumptions used to determine these estimates and their significance to the issuer's financial condition, changes in financial condition and results of operations.

The issuer should also discuss and quantify any changes in the methodology and assumptions used in determining the critical accounting estimates. Issuers generally did not disclose:

- details about the key assumptions used to determine the estimates;
- trends and uncertainties that could affect the estimates;
- sensitivities of the estimates to changes in assumptions; and
- the range of estimates from which the final estimates were selected.

Risks and uncertainties

MD&A must include a discussion of the risk factors and uncertainties the issuer believes will materially affect its future financial performance. We continue to see generic disclosure. Issuers should provide sufficient details to allow investors to understand the significance and impact that risks have on the issuer's financial position, operations and cash flows. In the current market, examples include exposure to market risk, liquidity risk, credit risk and the effects of industry and economic factors on the issuer's performance.

Impairment of goodwill, intangible assets and long-lived assets

MD&A must include an analysis of the effect of any material asset write-downs on the issuer's continuing operations. Current market conditions may increase the likelihood that the carrying values of assets are impaired.

If an impairment charge is taken, issuers should include a quantitative analysis of the write-down and a meaningful discussion of the reasons for the impairment. If significant impairment indicators are present but an impairment charge has not been taken, MD&A should include a discussion explaining why the charge was not taken.

Financial instruments disclosure

Many issuers did not disclose in their MD&A key assumptions and methodologies used to determine the fair value of financial instruments. They also failed to discuss the factors management considered in determining whether financial instruments that were not classified as held for trading were, in fact, impaired.

Non-GAAP financial measures

Issuers who choose to publish non-GAAP financial measures in their MD&A should also provide the disclosure set out in CSA Staff Notice 52-306 *Non-GAAP Financial Measures*. This includes clear disclosure of the calculation of the non-GAAP measure and reconciliation to the most directly comparable measure calculated in accordance with GAAP with equal or greater prominence.

Related party disclosures

Issuers often copy the related party disclosure included in their financial statement notes into MD&A. The related party transactions disclosure in MD&A should not merely repeat the information found in the notes, but expand on the disclosure by including the qualitative and quantitative discussion necessary to understand the transaction's business purpose and economic substance. Specifically, issuers often neglect to discuss the identity of related parties and their relationship. As well, we note that there is minimal discussion around the business purpose of the transaction.

Selected annual information, summary of quarterly results and fourth quarter

Issuers must provide certain summary financial data derived from their financial statements in each MD&A filing. In addition, issuers should explain any significant period-to-period variations. This provides investors with a better understanding of the general trends impacting the issuer. This year, several issuers failed to include the qualitative discussion in their MD&A.

The annual MD&A should also include a discussion and analysis of any fourth quarter events that affected the issuer's financial condition, cash flows or results of operations. Many issuers failed to include this disclosure.

4.4 Deficiencies in financial statements

This section summarizes common disclosure and measurement deficiencies we identified in our reviews of financial statements.

Financial instruments

In addition to disclosure issues, we focused on recognition and measurement issues related to financial instruments. In particular, we looked at the valuation of financial instruments that did not have a quoted market price. It is important that investors receive both quantitative and qualitative disclosure on how fair values of financial instruments are determined in the absence of quoted market prices. This information should be provided in sufficient detail to allow a reader to understand how the issuer arrived at this valuation and the measurement uncertainty associated with the valuation.

The fair value of financial instruments is difficult to determine when markets are inactive and valuation models are used. In these circumstances, it is critical that issuers disclose key assumptions and methodologies used to determine fair value.

Recognition of revenue

We continue to see revenue recognition deficiencies. We will ask issuers to restate their financial statements when they prematurely recognize revenue in situations where transactions fail to materially meet all of the recognition criteria set out in CICA Handbook Section 3400 *Revenue*. If the risks and rewards of ownership of the asset remain with the issuer, the revenue should not be recognized.

We continue to focus on, and encounter, issues relating to the disclosure of revenue recognition policies. Accounting policies that are too high level to be meaningful to investors continue to be a concern to us. In some cases, the policies also failed to address material sources of revenue.

A common issue was inadequate disclosure of revenue recognition policies related to arrangements with multiple deliverables. If sales transactions have multiple elements, such as a product and service, the issuer should clearly state the accounting policy for each element, how multiple elements are determined and valued, and the description and nature of these arrangements. Issuers should regularly assess their disclosed policies to ensure that they provide a complete description of all significant elements of their revenue recognition practices.

Failure to consolidate variable interest entities

An enterprise should consolidate a variable interest entity (VIE) when it has a variable interest, or combination of variable interests, that will absorb a majority of its expected losses, receive a majority of its expected residual returns, or both. The enterprise that consolidates a VIE is called the primary beneficiary of that entity. A reporting issuer should determine whether it is the primary beneficiary of a VIE at the time the issuer becomes involved with the entity. Issuers should apply the guidance set out in CICA Handbook Accounting Guideline 15 *Consolidation of Variable Interest Entities* when assessing whether their variable interests have those characteristics.

Issuers will need to look through the “structure” of an arrangement. They should consider the existence of call or put options when determining whether an entity retains the majority of risks or rewards. If an issuer does not consider all possible VIEs, it may not be applying consolidation principles appropriately.

Impairment of goodwill

We raised comments where goodwill impairment indicators were present and the issuer had not taken an impairment charge. After reviewing the impairment analysis prepared by management, we found that some issuers did not fully consider the impact of the economic environment. For example, some issuers were using incomplete or unrealistic cash flow forecasts in testing goodwill for impairment. Other issuers were overly optimistic in establishing assumptions used to determine the fair value of their reporting units.

Going concern

In light of current economic conditions, issuers also need to consider the amendments to CICA Handbook Section 1400 *General Standards of Financial Statement Presentation*. The amendments apply to interim and annual financial statements for fiscal years beginning on or after January 1, 2008. They require issuers to carefully assess and disclose in the financial statements the material uncertainties that may put into question their ability to continue as a going concern.

We focused on issuers’ disclosure of material uncertainties, including continued and expected operating losses, negative operating cash flows, a failure to obtain or renew financing, a significant decline in the demand for a company’s products, declining prices, substantial refinancing requirements and an inability to make scheduled payments on debt. Issuers committed to enhance disclosure in this area going forward.

Material uncertainties will continue to be an area of focus in our reviews.

5. Transition to International Financial Reporting Standards (IFRS)

Converting from Canadian GAAP to IFRS represents a fundamental change to reporting standards. It is one of the most significant changes that issuers will have to deal with over the next few years. The process will require a significant commitment of resources by issuers and regulators, and sufficient advance planning to ensure a smooth transition.

5.1 MD&A disclosures relating to IFRS transition

Changing to IFRS may materially affect an issuer's reported financial position, results of operations and other business functions. To assist investors and other market participants with the transition, we issued CSA Staff Notice 52-320 *Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards*.

This notice describes our expectations for an issuer's disclosures of the expected changes in accounting policies related to the changeover. The detailed guidance provided in the notice also provides for an incremental approach to disclosure in annual and interim periods leading up to the changeover date.

Fiscal 2008

For fiscal 2008, our disclosure expectations focused on the key elements and timing of an issuer's IFRS conversion plan. Reporting issuers should have been aware that developing and implementing an IFRS conversion plan is not just an accounting exercise, since it will affect a wide variety of an issuer's business activities. We expected issuers to consider how the transition to IFRS would affect all business functions that rely on financial information and to communicate this to investors. Examples of critical business functions are information technology systems, executive compensation plans, treasury activities and investor relations.

If an issuer did not have a conversion plan, we generally believe this to be material information that should have been disclosed in MD&A. Given that there is less than approximately 13 months until the changeover date, we are concerned that issuers without a plan may be at greater risk of not meeting their future regulatory obligations.

Fiscal 2009

We expect issuers to generally be able to provide more detailed information about the expected effects of IFRS as we move closer to the changeover date. Specifically, an issuer's fiscal 2009 MD&A disclosures should provide a progress update on their conversion plan, along with describing the major identified differences between the issuer's current accounting policies and those the issuer requires or expects to apply when preparing its IFRS financial statements.

Fiscal 2010

In 2010, we expect issuers to provide significant details of their conversion plan and information about key decisions on policy choices under IFRS 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1). As well, if an issuer has quantified information about the impact of IFRS accounting policy choices on its financial statements, this information should be disclosed.

Review of IFRS transition disclosures

We are completing a targeted review of the IFRS disclosures in issuers' fiscal 2008 and 2009 MD&As. Our preliminary results indicate that many issuers are providing boilerplate IFRS transition disclosure, which makes it difficult to assess the status of an issuer's changeover plan.

We believe that this disclosure is important for investors to assess the readiness of an issuer's transition to IFRS and the possible impact the adoption of IFRS will have on the issuer's financial statements. We plan to issue a staff notice that will summarize the final results of our review and provide additional guidance for issuers in filing future MD&A.

5.2 Regulatory impacts of IFRS transition

The CSA has been actively reviewing securities legislation to consider the extent of changes necessary to accommodate the transition to IFRS. On September 25, 2009, we published proposed National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* and proposed IFRS-related amendments to our continuous disclosure, prospectus and certification rules. These proposed amendments include a list of changes to accounting terms and phrases, and transition changes that should assist with the conversion to IFRS.

Our goal is to facilitate a smooth regulatory transition to IFRS. We welcome public comment on the proposals. Some of the more significant transitional amendments are highlighted below.

First IFRS interim financial report

IFRS 1 requires the preparation of an opening IFRS statement of financial position as at an issuer's date of transition to IFRS. For a calendar year-end company, the date of transition to IFRS is January 1, 2010. This opening statement of financial position is the starting point for an issuer's accounting under IFRS and provides meaningful information to investors. Given its importance, we are proposing to require that it be presented in an issuer's first IFRS interim financial report. For a calendar year-end issuer, the first IFRS interim financial report will be for the quarter ending March 31, 2011.

We are also proposing to provide issuers with a 30-day extension to the filing deadline for the first IFRS interim financial report. This is because the first IFRS interim financial report will be due shortly after the filing of the Canadian GAAP annual financial statements for fiscal 2010. The extension is intended to assist management with their CEO and CFO certification process in the first quarter and to provide boards of directors and audit committees more time to review and approve the first IFRS interim filing.

Presentation of statement of cash flows

For consistency with IFRS, we are proposing to require issuers to present a cash flow statement in their interim financial statements only for the year-to-date period and the corresponding comparative period. NI 51-102 and existing Canadian GAAP require issuers to present a cash flow statement in their interim financial statements for a three-month and year-to-date period, along with corresponding comparative periods.

5.3 Early adoption of IFRS

A few issuers have elected to adopt IFRS prior to January 1, 2011. An issuer may adopt IFRS early if it meets key conditions for readiness, including readiness of staff, board of directors, audit committee and auditors. Issuers that elect to adopt early will have to address IFRS changeover and disclosure requirements in a more compressed timeframe. Orders that have been granted to allow early adoption are available on the OSC website.

5.4 Canadian GAAP and IFRS differences

This section highlights some of the current differences between Canadian GAAP and IFRS. It is intended to assist issuers in developing and implementing their IFRS conversion plans. However, it is not a complete discussion. Issuers should carefully read all of the IFRS standards to ensure they identify all accounting differences and how they will impact their business.

Revenue recognition

Revenue is typically the single largest item reported in a company's financial statements. In addition to the direct impact that it has on an issuer's bottom line, investors also place great importance on revenue when making investment decisions. Issuers will need to focus on the IFRS accounting standards governing revenue recognition. In particular, they should note the absence of detailed guidance that these standards provide compared to Canadian GAAP.

The principal revenue recognition standards in IFRS include IAS 18 *Revenue* (IAS 18) and IAS 11 *Construction Contracts* (IAS 11). Some of the key differences between these standards and Canadian GAAP are in the following areas:

- where transactions consist of multiple elements that require separate accounting for each element, IFRS does not provide as detailed and prescriptive guidance on how to account for these various elements;

- the criteria for recognizing revenue for bill-and-hold arrangements under IFRS differs and may result in revenue being recognized earlier; and

- revenue recognition for long-term construction contracts is more restrictive in that revenue may only be recognized under the percentage of completion method as the completed contract method is not specifically addressed under IFRS.

The IASB and the Financial Accounting Standards Board (FASB) are currently working on a joint project with plans to publish a standard outlining a comprehensive set of principles for revenue recognition that will replace IAS 18 and IAS 11. Issuers must take into account any changes to these revenue recognition standards prior to the IFRS changeover date.

Business combinations

The objective of IFRS 3 *Business Combinations* is to improve the relevance, reliability and comparability of the information that a reporting issuer provides in its financial statements about the effects of a business combination. While there are currently several differences in accounting for business combinations between IFRS and Canadian GAAP, the AcSB has converged the accounting for business combinations with that prescribed by IFRS, which will be effective on Canada's changeover date. In the meantime, the following differences, while not exhaustive, will continue to exist:

- the methodologies for valuing the purchase consideration are different under IFRS and Canadian GAAP. Under IFRS, the consideration is based on the fair value of equity securities issued by the acquirer at the acquisition date. In contrast, Canadian GAAP determines the fair value of equity securities in reference to their market price for a reasonable period of time before and after the terms of the business combination are agreed to and announced;

- under Canadian GAAP, the cost of the business acquisition can include direct and incremental acquisition costs, while under IFRS these costs are generally expensed;

- IFRS has a broader concept of what constitutes a business, which may include those entities in the development stage. Under Canadian GAAP, development stage entities generally do not meet the definition of a business; and

- contingent consideration is recognized differently under both standards. IFRS requires that contingent consideration be recognized initially at fair value as part of the consideration transferred. Canadian GAAP, however, requires that contingent consideration be generally recognized as part of the cost of the acquisition only when the contingency is resolved and the consideration has been transferred.

Related party disclosures

Information about related parties and the extent to which related party transactions may affect reported results of an issuer is particularly important to investors because these transactions lack the independence that is inherent in other financial transactions. In light of this, one of the major differences for issuers is that Canadian GAAP addresses both the measurement and disclosure of related party transactions, while IAS 24 *Related Party Disclosures* only addresses disclosure requirements. Other differences include the following areas:

- the definition of related parties is broader under IFRS than under Canadian GAAP; and

- compensation for key management personnel is a related party disclosure under IFRS, whereas executive compensation arrangements are generally not considered related party transactions under Canadian GAAP but are governed by securities legislation.

While Canadian GAAP specifically excludes management compensation arrangements from the scope of related party transactions, executive compensation disclosure is required under Canadian securities legislation. The requirements can be found in *Form 51-102F6 Statement of Executive Compensation*. Issuers should be aware that the pool of individuals and the types of compensation disclosed under IFRS and Form 51-102F6 could vary significantly. The context of these differences should be explained to investors so that the disclosure is meaningful in both instances.

Property, plant and equipment

IAS 16 *Property, Plant and Equipment* prescribes the required accounting treatment for property, plant and equipment, including the recognition of assets, the determination of their carrying amounts and the related depreciation charges and impaired amounts. Some of the more substantive differences are highlighted below:

- IFRS requires separate accounting for the different components of an asset when different depreciation methods or rates are appropriate for a component. In contrast, Canadian GAAP requires component accounting only when practicable;

- subsequent to the initial measurement of an asset, IFRS allows property, plant and equipment to be revalued to fair value if fair value can be measured reliably. There is no revaluation model under Canadian GAAP, therefore, property, plant and equipment assets must be carried at amortized cost;

- in certain circumstances, IFRS requires that borrowing costs be capitalized as part of the cost of property, plant and equipment, while Canadian GAAP allows borrowing costs to be expensed or capitalized; and

- the disclosure requirements are more extensive under IFRS in that a continuity schedule of the carrying amount of each class of property is required.

Impairment of assets

IAS 36 *Impairment of Assets* is the standard that describes the procedures that a reporting issuer applies to ensure that its assets are carried at no more than their recoverable amount. If the carrying amount of an asset exceeds its recoverable amount, as determined through use or sale of the asset, the asset is considered impaired and an impairment loss must be recognized.

While the concept of impairment is similar under IFRS and Canadian GAAP, the following are some significant differences that issuers need to be aware of:

- more frequent impairment testing may be required under IFRS since all assets (except for financial instruments) must be reviewed for indications of impairment at the end of each reporting period, whereas Canadian GAAP only requires a review of indications of impairment when events or changes in circumstances occur;

- under IFRS, the methods for recognizing and measuring impairment losses vary from Canadian GAAP. IFRS requires a one-step impairment process only, which may cause impairment losses to be recognized earlier;

- unlike Canadian GAAP, IFRS permits the reversal of impairment losses (except for goodwill) if there has been a change in the estimate used to determine the asset's previous recoverable amount; and

- IFRS requires more detailed disclosure than under Canadian GAAP.

Provisions

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37) is the standard that establishes the recognition and measurement of provisions under IFRS. Significant differences between Canadian GAAP and IAS 37 include:

- the definition of a provision under IFRS is broader as it includes both legal and constructive obligations. A constructive obligation arises when an entity creates a valid expectation that it will discharge certain responsibilities based on past or published practices amongst other conditions;

- the threshold for recognizing provisions under IFRS is interpreted to be lower. Under IFRS, provisions are recognized when they are "probable", while provisions are only recognized under Canadian GAAP when they are "likely to occur";

- when there is a range of outcomes available and no outcome is more likely than the others, IFRS requires the provision be measured at the mid-point of the range as compared to the low end of the range as required under Canadian GAAP;

- IFRS requires provisions to be discounted if the effects of the discounting are material, while under Canadian GAAP provisions are generally not discounted; and

- there are increased note disclosure requirements under IFRS, including a provision continuity schedule for each class of provision.

An exposure draft has been issued for proposed amendments to IAS 37, which may result in significant changes from the existing IFRS standard prior to changeover.

Financial instruments

IAS 39 *Financial Instruments: Recognition and Measurement* is the standard that establishes the principles for recognizing and measuring financial assets and liabilities. In addition, IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures* describe the requirements for presenting and disclosing financial instruments respectively. While these standards are for the most part converged with Canadian GAAP, a close reading of the standards is warranted.

The IASB and the FASB are currently working on the accounting requirements for financial instruments in light of the suggestions made by the G20 and the Financial Stability Forum. Issuers should closely monitor accounting developments in this area and factor them into their IFRS conversion plans.

Investment properties

IAS 40 *Investment Property* (IAS 40) prescribes the recognition, measurement and related disclosure requirements for investment property. Investment property is property held to earn rental income, for capital appreciation, or both.

IAS 40 is an industry-specific standard that addresses investment property. Under Canadian GAAP, investment property is accounted for under the requirements for property, plant and equipment. The differences between the IFRS standard represents a significant difference from Canadian GAAP as follows:

- while under both IFRS and Canadian GAAP investment property is initially measured at cost, IFRS will allow an issuer to subsequently measure all investment property under the fair value model;

- under the fair value model, all changes in fair value are recognized in the income statement. Canadian GAAP requires the use of the historical cost model where these assets are subject to depreciation and impairment testing; and

- if the cost model is chosen under IFRS, disclosure of the fair value of all investment properties is required. The historical cost method under Canadian GAAP does not require disclosure of such fair value information.

Specific industry standards

This section highlights certain IFRS issues that may impact issuers in specific industries.

- IFRS 4 *Insurance Contracts.* This standard provides less guidance than Canadian GAAP, however issuers should closely monitor the IASB's work plan on Phase II. As part of Phase II, an exposure draft is expected to be issued in the fourth quarter of 2009 and as a final standard in 2011;

- IFRS 6 *Exploration for and Evaluation of Mineral Resources*. This standard provides industry-specific guidance related to exploration and evaluation expenditures. The IASB has an extractive activities project that is working to develop an acceptable approach to resolving accounting issues that are unique to upstream extractive activities. The ultimate objective of this project is to develop an IFRS on accounting for extractive activities that will supersede IFRS 6.

- Proposed IFRS standard for entities that operate in rate-regulated activities. In July 2009, the IASB issued a proposed IFRS standard to be followed by entities that operate in rate-regulated activities. While current Canadian accounting standards recognize rate-regulated activities, until the proposed standard is released, there will be no equivalent guidance under IFRS.

6. Mergers and Acquisitions

This section summarizes the following three areas of recent development involving mergers and acquisitions transactions:

- Staff's views on negative bid variations and the ability of bidders to unilaterally withdraw a bid;
- significant Commission decisions resulting from a hearing process; and
- the relevance of the Toronto Stock Exchange (TSX) staff notice on financial hardship to the financial hardship exemptions under Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* (MI 61-101).

6.1 Varying bid terms or withdrawing a bid

Some market participants have taken the view that a bidder can, at its discretion and at any time, amend a bid to make it less favourable to target security holders or unilaterally withdraw the bid prior to its expiry. We regard such actions as generally being inconsistent with the take-over bid regime and its underlying purpose to provide a transparent and predictable framework for take-over bids. Staff intend to closely monitor and review any actions taken by a bidder that would result in a negative bid variation or unilateral withdrawal to determine whether the bidder has failed to comply with applicable securities legislation or otherwise acted in a manner contrary to the public interest. We will, in particular, focus on whether the bidder's actions were based on a reasonable interpretation of bona fide conditions in its offer.

6.2 Significant Commission decisions

The Commission recently released decisions that provide guidance on its approach to key mergers and acquisitions issues. These decisions relate to the:

- review of TSX decisions;
- interaction between take-over bids and second step business combinations; and
- application of the Commission's public interest jurisdiction in determining whether to cease trade a shareholder rights plan.

Hearing and review of TSX decisions

The Commission considered two applications, each of which asked the Commission to review a TSX decision that approved the issuance of shares without imposing shareholder approval.

These decisions gave the Commission an opportunity to comment on the appropriate standard of review for a TSX listing committee decision and, in one of the decisions, discuss what factors are relevant to the TSX in exercising its discretion under section 603 of the TSX Company Manual (the Manual) to impose shareholder approval where a share issuance affects the quality of the marketplace.

HudBay Minerals Inc.

The Commission in *Re HudBay Minerals Inc.* held that shares issued by HudBay Minerals Inc. (HudBay) as consideration for the acquisition of all the common shares of Lundin Mining Corporation could not be listed by the TSX unless prior shareholder approval from HudBay shareholders was obtained.

The Commission deferred to the TSX's determination under section 604 of the Manual that the issuance of the shares would not affect control of HudBay within the meaning of that provision. The Commission concluded that the TSX's analysis with respect to section 604 was reasonable under the circumstances.

The Commission did not defer to the TSX's determination under section 603 because the TSX had not provided sufficient analysis to support its decision not to exercise its discretion to require shareholder approval under that section. As a result, the Commission proceeded to make its own determination under section 603 of the effect of the share issuance on the quality of the marketplace.

The Commission considered the following factors in its analysis and concluded that permitting the share issuance to proceed without the approval of HudBay shareholders would adversely affect the quality of the market place and be contrary to the public interest:

- the level of dilution;
- the transaction was a merger of equals;
- impact on the HudBay share price;
- HudBay's corporate governance practices in relation to the transaction;
- the transformational impact of the transaction on HudBay; and
- fair treatment of HudBay shareholders.

InterRent Real Estate Investment Trust

The Commission applied the standard of review for a TSX decision set out in HudBay to its review of the decision by the TSX to approve the listing of units in a private placement by InterRent Real Estate Investment Trust without requiring shareholder approval under section 603.

The Commission dismissed the application and upheld the TSX decision on the following grounds:

- the Commission had a sufficient basis upon which to defer to the TSX and the TSX decision was reasonable under the circumstances;
- TSX had made its decision after taking into account all relevant information and assessing all relevant regulatory considerations;
- TSX had followed an appropriate process in reviewing the concerns raised by the applicant;
- TSX had carefully articulated its rationale for its decision; and
- the applicant had failed to establish any of the grounds that would entitle the Commission to intervene.

Identical treatment in take-over bids and second step business combinations

In *Re JLL Patheon Holding LLC,* the Commission considered an application by the special committee of Patheon Inc. (Patheon) for compliance and public interest orders in respect of an insider bid for Patheon shares made by JLL Patheon Holding LLC (JLL).

The basis of the application was that the insider bid by JLL violated both the identical treatment requirement and the prohibition against collateral agreements because of arrangements JLL had entered into with a group of Patheon shareholders (the MOVA Group). The MOVA Group was offered the opportunity to exchange its shares for shares of the acquisition vehicle as well as the ability to tender to the offer for cash. If the MOVA Group chose to exchange its shares for shares of the acquisition vehicle, it had the benefit of a voting agreement (the Voting Agreement) with JLL.

That agreement protected the MOVA Group from having their Patheon shares acquired without their consent in a second step acquisition transaction and, if the MOVA Group decided to avail themselves of this protection, granted them certain “tag-along”, “drag-along” and board representation rights. These terms were not offered to other Patheon shareholders. The Commission suggested, but did not conclusively determine, that the choice provided to the MOVA Group to obtain a continuing interest in JLL if the bid succeeded (and the benefit of the Voting Agreement), or to tender into the offer, violated the identical consideration requirement and the prohibition against collateral benefits.

At the hearing, JLL and the MOVA Group offered to terminate the Voting Agreement as a condition of the Commission’s dismissal of the application. The special committee of Patheon and OSC staff recommended to the Commission that it impose additional conditions in dismissing the application to ensure that JLL and the MOVA Group could not enter into arrangements similar to the Voting Agreement during the period of the bid and prior to completing any related subsequent acquisition transaction.

The Commission dismissed the application on the condition that JLL and the MOVA Group not enter into any collateral agreement or understanding for 120-days (that is the period after expiry of a bid during which tendered shares can be counted as part of the minority approval for a second step business combination). As a result of this condition, Patheon shareholders would know, at the time when making their decision to tender to the bid and effectively voting for a second step business combination, that the MOVA Group and JLL would not be entering into any collateral agreements or understandings as part of the bid or a second step business combination.

Shareholder rights plans

The Commission dismissed an application by Pala Investment Holdings Limited (Pala) for an order cease trading the shareholder rights plans of Neo Material Technologies Inc. (Neo).

In addition to its standard shareholder rights plan, the Neo board implemented an additional rights plan during the course of Pala's bid. This rights plan was different from the existing rights plan in that it prohibited partial bids. Neo shareholders had an opportunity to vote on this second rights plan at a shareholders' meeting held during the course of Pala's bid.

The issue before the Commission was whether it was in the public interest to cease trade the second rights plan where there was no evidence that it was being used by Neo to solicit other offers or otherwise conduct or sustain an auction for Neo. The Commission held that, under the circumstances, it was not yet time for the rights plan to be cease traded.

In its detailed reasons dated September 1, 2009, the Commission explained the basis for its decision. In staff's view, the determining factor for the Commission was that an overwhelming majority of Neo shareholders had made an informed decision to approve the second rights plan in the face of the Pala bid. This was, in effect, an informed rejection of the Pala bid. The Commission considered whether there were any considerations that would undermine reliance on the shareholder vote as the basis for permitting the rights plan to remain in effect. The Commission concluded that there was no evidence that the process undertaken by the Neo board in implementing the second rights plan and deciding not to solicit competing offers was not in the best interest of Neo and its shareholders. The Commission also held that there was no evidence that Neo shareholders were coerced into approving the second rights plan or that there were any procedural irregularities relating to the meeting at which the second rights plan was approved.

6.3 Financial hardship exemption under MI 61-101

Issuers may be exempt from the minority approval and valuation requirements applicable to related party transactions under MI 61-101 if they satisfy the grounds for financial hardship set out in paragraphs 5.5(g) and 5.7(e) of MI 61-101. The TSX may also exempt a transaction involving the issuance of securities from shareholder approval requirements if the issuer is able to demonstrate financial hardship in circumstances similar to those set out in MI 61-101. This exemption is set out in subsection 604(e) of the Manual.

The TSX published a notice dated April 27, 2009 (the TSX Staff Notice) that provides guidance on the types of procedural and informational considerations it would expect from issuers seeking to establish financial hardship as a basis for reliance upon the exemption in subsection 604(e). As the TSX financial hardship considerations are similar to, and based on, the financial hardship exemption in MI 61-101, the considerations set out in the TSX Staff Notice may be relevant to an issuer proposing to rely upon the financial hardship exemption in MI 61-101.

7. Contact Information

General inquiries	Inquiries and Contact Centre Telephone: (416) 593-8314 Toll-Free (North America): 1-877-785-1555
Branch report inquiries	Margo Paul, Director Telephone: (416) 593-8136 Email: mpaul@osc.gov.on.ca Naizam Kanji, Deputy Director Telephone: (416) 593-8060 Email: nkanji@osc.gov.on.ca Lisa Enright, Manager Telephone: (416) 593-3686 Email: lenright@osc.gov.on.ca Kelly Gorman, Manager Telephone: (416) 593-8251 Email: kgorman@osc.gov.on.ca Sonny Randhawa, Assistant Manager Telephone: (416) 204-4959 Email: srandhawa@osc.gov.on.ca Carmen Tang, Legal Counsel Telephone: (416) 593-8215 Email: ctang@osc.gov.on.ca
Cease trade orders and filing CD documents	Ann Mankikar, Supervisor, Financial Examiners Telephone: (416) 593-8281 Email: amankikar@osc.gov.on.ca
Preliminary receipts	Merle Shiwbhajan, Review Officer Telephone: (416) 593-8239 Email: mshiwbhajan@osc.gov.on.ca Moses Seer, Administrative Support Clerk Telephone: (416) 593-3684 Email: mseer@osc.gov.on.ca
Final receipts	Fareeza Baksh, Selective Review Officer Telephone: (416) 593-8062 Email: fbaksh@osc.gov.on.ca
Applications for exemptive relief	David Mattacott, Applications Administrator Telephone: (416) 593-8325 Email: dmattacott@osc.gov.on.ca

ONTARIO
SECURITIES
COMMISSION

OSC Staff Notice 51-706
2009 Corporate Finance Branch Report

Ontario