

**ONTARIO SECURITIES COMMISSION COMPANION POLICY 41-501CP  
TO ONTARIO SECURITIES COMMISSION RULE 41-501  
GENERAL PROSPECTUS REQUIREMENTS  
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**COMPANION POLICY  
TO RULE 41-501  
GENERAL PROSPECTUS REQUIREMENTS**

**PART 1      GENERAL REQUIREMENTS**

**1.1      Experience of Officers and Directors**

Clause 61(2)(c) of the Act requires the Director to refuse to issue a receipt for a prospectus if it appears that the proceeds received from the sale of securities to be paid to the treasury of the issuer, together with other resources of the issuer, will be insufficient to accomplish the purposes stated in the prospectus. The Commission believes that people are an important resource and that a sufficient number of the directors and officers of the issuer should have relevant knowledge and experience so that the Director will not conclude that the human and other resources are insufficient to accomplish these purposes. If the requisite knowledge and experience are not possessed by the directors and officers, the Director may be satisfied that the human and other resources are sufficient if it is shown that the issuer has contracted to obtain the knowledge and experience from others.

**1.2      Style of Prospectus**

Subsection 3.2(1) of Rule 41-501 General Prospectus Requirements (the "Rule") provides that the information contained in a prospectus shall be in narrative form. The Commission notes that subsection 56(1) of the Act requires that a prospectus contain "full, true and plain" disclosure. To that end, issuers and their advisors are reminded that they should ensure that disclosure documents are easy to read, and are encouraged to adopt the following plain language principles in preparing a prospectus:

- use short sentences
- use definite, concrete, everyday language
- use the active voice
- avoid superfluous words
- organize the document into clear, concise sections, paragraphs and sentences
- avoid legal or business jargon
- use strong verbs
- use personal pronouns to speak directly to the reader
- avoid reliance on glossaries and defined terms unless it facilitates understanding of the disclosure
- avoid vague boilerplate wording
- avoid abstractions by using more concrete terms or examples
- avoid excessive detail

- avoid multiple negatives.

If technical or business terms are required, clear and concise explanations should be used. The Commission is of the view that question and answer and bullet point formats are consistent with the requirements of subsection 3.2(1) of the Rule.

### **1.3 Graphs, Photographs, Maps and Artwork**

Subsection 3.2(5) of the Rule provides that a prospectus may contain graphs, photographs, maps, artwork or other forms of illustration if they are relevant to the business of the issuer or the distribution and are not misleading. There is no longer an obligation to seek prior approval from staff of the Commission for the inclusion of a graph, photograph, map or artwork in a prospectus before the filing of the preliminary prospectus.

### **1.4 Disclosure of Principal Shareholders**

Item 15 of Form 41-501 F1 requires disclosure of the identity and shareholdings of each principal shareholder of the issuer and, if a principal shareholder is a company, of the identity of any individual who controls the company. Issuers are therefore advised that they should institute procedures to obtain and disclose such information.

### **1.5 Disclosure of Selling Security holders**

Item 1.4(7) and Item 15 of Form 41-501F1 require that if any securities are being distributed for the account of an existing security holder who purchased those securities within two years before the date of the prospectus, the name of the security holder and the number or amount of the securities of the class being distributed that are owned by the security holder, shall be included in the prospectus. In some cases, particularly if there are a large number of selling security holders each selling a small number or amount of securities, it may be desirable to disclose the required information on an aggregate, and not an individual security holder, basis. In these cases, application for relief from the requirements in the Form must be made to the Director. The Director will normally require that the issuer undertake to file with the Commission all of the information required under Item 15.1(3) on or before filing the prospectus.

### **1.6 Description of Underlying Securities**

Issuers are reminded that if the securities being distributed are convertible into or exchangeable for other securities, or are a derivative of, or otherwise linked to, other securities, a description

of the material attributes of the underlying securities will generally be necessary to meet the requirements of securities legislation that a prospectus contain full, true and plain disclosure of all material facts concerning the securities being distributed.

## **1.7 Certificate of Underwriter in Prospectus**

Subsection 59(1) of the Act requires that if an underwriter is in a contractual relationship with the issuer or selling securityholder, the prospectus shall contain a certificate signed by the underwriter in the prescribed form. An underwriter participating in the preparation of a prospectus undertakes a due diligence investigation in relation to the business of the issuer that usually results in enhanced quality of disclosure in the prospectus. For that reason, and particularly in the case of an initial public offering, the Commission encourages underwriter participation in the prospectus process. Issuers are reminded that the Director has discretion under subsection 61(1) of the Act to refuse to issue a receipt for a prospectus if it is in the public interest to do so, including in the case of a prospectus that contains disclosure that is considered deficient.

## **PART 2 FINANCIAL MATTERS**

### **A. ISSUERS AND SIGNIFICANT ACQUISITIONS**

#### **2.1 Financial Statement Requirements - Explanation of the 60 and 90 Day References**

- (1) The financial statement disclosure requirements for an issuer and any business acquired or to be acquired are described with reference to 60 or 90 day periods. A company that is or will be a reporting issuer once a final receipt for its prospectus is issued, is required to file interim financial statements 60 days after the last day of an interim period on a continuous disclosure basis. The interim financial statement disclosure requirements in the Rule are based on these continuous disclosure reporting timeframes. Annual audited financial statements are required to be filed 140 days after year end on a continuous disclosure basis. However, if a prospectus is filed more than 90 days after year end, the audited financial statements are required to be included in the prospectus.
  - (a) For example, assume an issuer's current year is year one and its most recently completed years are years two, three, four and five, two being the year immediately preceding one. If the issuer has a calendar year end and files a preliminary prospectus on June 15 of year

one (which is more than 90 days after year end), the following financial statements of the issuer would be required to be included in the prospectus:

**Annual financial statements:** for years two, three and four, in accordance with section 4.1 of the Rule which requires inclusion in the prospectus of the issuer's annual financial statements for the three most recently completed financial years ended more than 90 days before the date of the prospectus.

**Comparative Interim financial statements:** for the first quarter ended March 31 of year one, in accordance with section 4.6 of the Rule which requires comparative interim financial statements for the most recently completed interim period ended more than 60 days before the date of the prospectus.

(b) As another example, if the same issuer filed its preliminary prospectus sometime between January 1 and March 31 of year one, it would not be required to include audited financial statements for year two since that year ended less than 90 days before the date of the prospectus unless those financial statements had been filed with the Commission. In this situation, assuming the year two financial statements had not been filed, the issuer would be required to include audited financial statements for years three, four and five, and unaudited interim financial statements for the nine months ended September 30 in year two. If, however, audited financial statements for year two were included in a prospectus filed less than 90 days from the end of year two, section 4.2 of the Rule would permit the issuer to exclude the audited financial statements for year five. In addition, subsection 4.7(3) of the Rule would permit the interim financial statements for the nine months ended September 30, year 2, to be excluded.

(2) Section 2.8 of the Rule states that unless otherwise stated, a reference to a prospectus in the Rule includes a preliminary prospectus. Consequently, the 60 and 90 day period references discussed in subsection (1) should be considered as at the date the preliminary prospectus is filed and again at the date of the final prospectus is filed for both the issuer and any business acquired or to be acquired. Depending on the period of time between the dates of the preliminary and final prospectuses, an issuer may have to include more recent

financial statements.

For example, if the issuer in subsection (1)(a) filed its final prospectus on September 10, the issuer would be required to include its comparative financial statements for the interim period ended June 30, because by September 10 the last day of the interim period ended June 30 would be more than 60 days before the date of the final prospectus.

The examples in subsections (1) and (2) are not comprehensive. For simplicity, they address only the issuer's requirements and do not take into account exceptions provided for in the Rule.

## **2.2 Additional Financial Statements or Financial Information Filed or Released**

- (1) If annual or interim financial statements, more recent than those that would otherwise be required to be included in a prospectus, have been filed before a prospectus is filed, sections 4.7, 6.7 and 7.3 of the Rule require those financial statements to be included in the prospectus and the prospectus to be updated accordingly. However, if information derived from more recent annual or interim financial statements is released to the public by the issuer before the financial statements are filed, the prospectus should include the information included in the news release or public communication. There is no specific requirement in the Rule to otherwise update the prospectus or *pro forma* financial statements to reflect the more recent information.
- (2) Reporting issuers have an obligation under Part XVIII of the Act to prepare and file financial statements as part of their continuous disclosure obligations. The Commission is of the view that the directors of an issuer should endeavour to consider and approve financial statements in a timely manner and should not delay the approval and filing of the statements for the purpose of avoiding their inclusion in a prospectus.

## **2.3 Auditor's Report for All Financial Statements Included in the Prospectus**

The Rule requires that all financial statements included in a prospectus be accompanied by an auditor's report without a reservation of opinion, except financial statements specifically exempted in the Rule. Issuers are reminded that this requirement extends to financial statements of subsidiaries and other entities

even if the financial statements are not required to be included in the prospectus but have been included at the discretion of the issuer.

#### **2.4 Exemption from Auditor's Report if not Previously Included in a Prospectus**

If an issuer received a receipt for a final prospectus that included financial statements of the issuer for a financial year that were not accompanied by an auditor's report, section 4.10 of the Rule provides that if the issuer includes any of those unaudited financial statements in a subsequent prospectus, the issuer will not be expected to include an auditor's report on those financial statements unless they were audited subsequent to obtaining the final receipt for the previous prospectus. The corresponding exception for a business acquired or to be acquired is in section 6.15 of the Rule. The Commission recognizes that requesting an issuer to obtain an auditor's report that it was permitted to exclude from a previous final prospectus could create undue hardship for the issuer.

#### **2.5 Timing of Requests for Exemptions from the Financial Statement Requirements**

Requests for exemptions from Parts 4, 6 and 7 of the Rule should be made in accordance with Part 15 of the Rule which requires the issuer to make submissions in writing along with the reasons for the request and the proposed alternative disclosure. Written submissions should be filed at, or preferably before, the time the preliminary prospectus is filed, in order to permit the issue to be resolved in a timely manner. Issuers filing a prospectus in more than one jurisdiction are encouraged to consult National Policy 43-201 Mutual Reliance Review System for Prospectuses and Annual Information Forms for more guidance on pre-filing applications.

### **B. ISSUERS**

#### **2.6 Sufficiency of Financial History Included in a Prospectus**

Part 4 of the Rule prescribes the minimum financial statement disclosure requirements for an issuer. The Commission recognizes that an issuer, at the time of filing a prospectus, may have been in existence for less than one year. The Commission expects that in many situations the limited historical financial statement information that is available for such an issuer may be adequately supplemented by other relevant information disclosed in the prospectus. However, if the issuer is unable to provide financial



statements for a period of at least twelve months and the prospectus does not otherwise contain information concerning the business conducted, or to be conducted, by the issuer that is sufficient to enable an investor to make an informed investment decision, the Commission is of the view that the Director may refuse to issue a receipt for the prospectus.

## **2.7 Applications for Exemption from Requirement to Include Financial Statements of the Issuer**

- (1) One of the key changes to the prospectus disclosure requirements introduced by the Rule is the reduction to three years, from five, for historical financial statements of the issuer. In addition, a new category of junior issuer was introduced for which only the financial statements for the most recently completed financial year must be audited. As a result of these changes, the Commission is of the view that relief from the requirement to provide audited historical financial statements should be granted only in unusual circumstances not related to cost or the time involved in preparing or auditing the financial statements. If in unusual circumstances relief from Part 4 of the Rule is granted, conditions will likely be imposed, such as a requirement to include audited divisional statements of income or cash flows, financial statements accompanied by audit reports containing a reservation of opinion or audited statements of net operating income.
- (2) In view of the Director's reluctance to grant exemptions from the requirement to include audited historical financial statements, issuers seeking relief should consult with staff on a pre-filing basis.
- (3) Relief may be granted in appropriate circumstances to permit the auditor's report on financial statements to contain a reservation relating to opening inventory if there is a subsequent audited period of at least six months on which the auditor's report contains no reservation and the business is not seasonal.
- (4) Considerations relevant to granting an exemption from the requirement to include interim financial statements for the comparable period in the immediately preceding financial year may include the fact that the issuer was, before the filing of the prospectus, a private entity and that the issuer is, at the time of making the application, unable to prepare the interim financial statements.

- (5) Considerations relevant to granting an exemption from the requirement to include financial statements, generally for the years immediately preceding the issuer's most recently completed financial year, may include the following:
- (a) The issuer's historical accounting records have been destroyed and cannot be reconstructed. In this case, as a condition of granting the exemption, the issuer may be requested by the Commission to
    - (i) represent in writing to the Commission, no later than the time the preliminary prospectus is filed, that the issuer made every reasonable effort to obtain copies of, or reconstruct, the historical accounting records necessary to prepare and audit the financial statements, but such efforts were unsuccessful; and
    - (ii) disclose in the prospectus the fact that the historical accounting records have been destroyed and cannot be reconstructed.
  - (b) The issuer has emerged from bankruptcy and current management is denied access to the historical accounting records necessary to audit the financial statements. In this case, as a condition of granting the exemption, the issuer may be requested by the Commission to
    - (i) represent in writing to the Commission, no later than the time the preliminary prospectus is filed, that the issuer has made every reasonable effort to obtain access to, or copies of, the historical accounting records necessary to audit the financial statements but that such efforts were unsuccessful; and
    - (ii) disclose in the prospectus the fact that the issuer has emerged from bankruptcy and current management is denied access to the historical accounting records.
  - (c) The issuer has undergone a fundamental change in the nature of its business or operations affecting a majority of its operations and all, or substantially all, of the executive officers and directors of the company have changed. The evolution of a business or progression along a development cycle will not be considered to

be a fundamental change in an issuer's business or operations. Relief from the requirement to include financial statements of the issuer required by the Rule for the year in which the change occurred, or for the most recently completed financial year if the change in operations occurred during the issuer's current financial year, generally will not be granted.

## **2.8 Reverse Take-overs**

When an issuer has been involved in a business combination accounted for as a reverse take-over, section 4.5 of the Rule requires that financial statements referred to in Part 4 of the Rule be provided for the legal subsidiary which is the accounting parent, as those terms are used in the Handbook.

## **2.9 Additional Information**

An issuer may find it necessary, in order to meet the requirement for full, true and plain disclosure in section 56 of the Act, to include certain additional information such as

- (a) separate financial statements of a subsidiary of the issuer in a prospectus, even if the financial statements of the subsidiary are included in the consolidated financial statements of the issuer (for example, separate financial statements of a subsidiary may be necessary to help explain the risk profile and nature of the operations of the subsidiary); and
- (b) selected financial information of the issuer for a period of more than three years if the information would be helpful to an understanding of trends in the business or financial condition of the issuer.

## **PART 3 FINANCIAL STATEMENT DISCLOSURE FOR SIGNIFICANT ACQUISITIONS, SIGNIFICANT DISPOSITIONS AND MULTIPLE ACQUISITIONS**

### **A. GENERAL**

#### **3.1 Financial Statement Disclosure of Significant Acquisitions and Multiple Acquisitions**

Appendix A to this Policy is a chart outlining the key obligations for financial statement disclosure of significant acquisitions and multiple acquisitions. Appendix B includes examples which illustrate the application of certain Parts of the Rule related to financial reporting requirements.

### **3.2 Acquisition of a Business**

Part 6 of the Rule requires an issuer that has made a significant acquisition or is proposing to make a significant probable acquisition to include in its prospectus certain financial statements of each business acquired or to be acquired. Part 7 of the Rule has similar requirements for an issuer that has made or is proposing to make multiple acquisitions that are not related or individually significant. For this purpose, the term "business" should be evaluated in light of the facts and circumstances involved. The Commission generally considers that a separate entity, a subsidiary or a division is a business and that in certain circumstances a lesser component of a person or company may also constitute a business, whether or not the subject of the acquisition previously prepared financial statements. Continuity of business operations is considered in determining whether an acquisition constitutes the acquisition of a business. Other factors that staff will consider include:

- (a) whether the nature of the revenue producing activity or potential revenue producing activity will remain generally the same after the acquisition; and
- (b) whether any of the physical facilities, employees, marketing systems, sales forces, customers, operating rights, production techniques or trade names are acquired by the issuer instead of remaining with the vendor after the acquisition.

### **3.3 Acquisition of an Interest in an Oil and Gas Property**

- (1) The Commission considers the acquisition of an interest in an oil and gas property ("property") to constitute the acquisition of a business as discussed in section 3.2 of the Policy. However, it is recognized that in certain situations, limited availability of, or access to, audited financial statements or financial information of the acquired property makes it difficult to comply with the financial statement disclosure requirements outlined in Parts 6 and 7 of the Rule. The Commission has also considered that, unique to the oil and gas industry, relevant operating information is often publicly available. Accordingly, the Director may consider granting an exemption from certain of the disclosure requirements in Parts 6 and 7 of the Rule if
  - (a) the prospectus was not filed in connection with an issuer's initial public offering;

- (b) the issuer has not accounted for the acquisition as a reverse take-over;
- (c) the property does not constitute a "reportable segment" of the vendor, as defined in section 1701 of the Handbook, at the time of the acquisition; and
- (d) the prospectus includes acceptable alternative disclosure in respect of the property as outlined in subsection (2).

(2) Alternative Disclosure

- (a) The Commission is of the view that alternative disclosure in a prospectus, to be acceptable for the purposes of subsection (1)(d), should include at least an audited operating statement of the property acquired or to be acquired for each of the years required by Parts 6 and 7 of the Rule. The operating statements should each present, at a minimum, the following line items:
  - gross revenue;
  - royalty expenses;
  - production costs; and
  - operating income.

In applying Parts 6 and 7 of the Rule for purposes of this paragraph, the significance of an acquired property or of a probable acquisition of a property shall be determined based on the investment and income tests outlined in section 2.2 of the Rule, except that for purposes of the income test, "operating income" should be substituted for "consolidated income from continuing operations".

- (b) In addition to the information in paragraph (a), the following information may also be required to be included in the prospectus.
  - (i) Information with respect to reserve estimates and estimates of future net revenue and production volumes and other relevant information regarding the property, if material.
  - (ii) Actual production volumes of each of the properties for each of the three most recently completed years.

- (iii) Estimated production volumes of each of the properties for each of the next three years, based on information in the respective reserve reports.

(3) **Relief from the Requirement to Audit Operating Statements** - Despite paragraph (2)(a), the Director may permit an issuer to exclude an audit opinion on the operating statements referred to in subsection (2)(a) if

- (a) the property was acquired prior to December 31, 2000 and the issuer provides written submissions prior to filing the final prospectus which establish to the satisfaction of the Director that, despite making reasonable efforts, the issuer was unable to obtain audited operating statements because the vendor refused to provide such audited statements or to permit access to the information necessary to audit the statements; or
- (b) during the 12 months preceding the date of the acquisition or the proposed date of the probable acquisition, the daily average production of the property on a barrel of oil equivalent basis (with gas converted to oil in the ratio of six thousand cubic feet of gas being the equivalent of one barrel of oil), is less than 20 per cent of the total daily average production of the vendor for the same or similar periods and
  - (i) the issuer provides written submissions prior to filing the final prospectus that establish to the satisfaction of the Director, that despite reasonable efforts during the purchase negotiations, the issuer was prohibited from including in the purchase agreement the rights to obtain an audited operating statement of the property;
  - (ii) the purchase agreement includes representations and warranties by the vendor that the amounts presented in the operating statement agree to the vendor's books and records; and
  - (iii) the issuer discloses in the prospectus its inability to obtain an audited operating statement, the reasons therefore, the fact that the

representations and warranties referred to item (ii) have been obtained, and a statement that the results presented in the operating statements may have been materially different if the statements had been audited.

### 3.4 Probable Acquisitions

- (1) The definitions of "probable acquisition of a business" and "probable acquisition of related businesses" in the Rule both include the phrase "where a reasonable person would believe that the likelihood of the acquisition being completed is high". The Commission interprets this phrase having regard to section 3290 of the Handbook "Contingencies". It is the Commission's view that the following factors may be relevant in determining whether the likelihood of an acquisition being completed is high
  - (a) whether the acquisition has been publicly announced;
  - (b) whether the acquisition is the subject of an executed agreement; and
  - (c) the nature of conditions to the completion of the acquisition including any material third party consents required.
- (2) The test of whether a proposed acquisition is a "probable acquisition of a business" or "probable acquisition of related businesses" is an objective, rather than subjective, test in that the question turns on what a "reasonable person" would believe. It is not sufficient for an officer of an issuer to determine that he or she personally believes that the likelihood of the acquisition being completed is or is not high. The officer must form an opinion as to what a reasonable person would believe in the circumstances. In the event of a dispute as to whether an acquisition is a probable acquisition, an objective test requires an adjudicator to decide whether a reasonable person would believe in the circumstances that the likelihood of an acquisition being completed was high. By contrast, if the definition relied on a subjective test, the adjudicator would assess an individual's credibility and decide whether the personal opinion of the individual as to whether the likelihood of the acquisition being completed was high was an honestly held opinion.

Formulating the definition using an objective test rather than a subjective test strengthens the basis on which the Director may object to an issuer's application of the definition in particular circumstances.

- (3) A completed acquisition of a business and a proposed acquisition of a business will constitute a probable acquisition of related businesses defined in section 2.1 of the Rule if, among other things, each acquisition is contingent on a single common event. Common financing is one example of a single common event contemplated by the definition.

### **3.5 Significant Acquisitions Completed During the Issuer's Three Most Recently Completed Financial Years**

If an issuer made a significant acquisition during its three most recently completed financial years for which audited financial statements are required to be included in the prospectus under Part 6 of the Rule, the balance sheets of the business as at a date prior to the date of the acquisition will be reflected in the issuer's most recent audited balance sheet included in the prospectus. In addition, the allocation of the purchase price to the assets acquired and liabilities assumed should also be disclosed in the issuer's audited financial statements. Accordingly, there is no requirement under subsection 6.2(1) for the financial statements of the business included in the prospectus to include a balance sheet. The corresponding exception for individually insignificant, unrelated acquisitions is provided in subsection 7.2(4) of the Rule. The Commission recognizes that a balance sheet will normally have been prepared and the Director will not object if the financial statements of a business included in the prospectus include a balance sheet.

### **3.6 Significant Acquisitions Completed During the Issuer's Current Financial Year**

If an issuer has made a significant acquisition during its current financial year, and the acquisition is accounted for using the purchase method, section 6.11 of the Rule requires an issuer to include disclosure about the acquisition, including a purchase price allocation, in a subsequent event note to the issuer's financial statements. At the time the prospectus is filed, the allocation of the purchase price may not yet be finalized so it may be impracticable to provide a detailed purchase equation. However, the issuer will know the assets and liabilities it has acquired and is expected to estimate an allocation of the purchase price to those assets and liabilities, at least on an aggregate basis.



## **B. APPLICATION OF THE SIGNIFICANCE TESTS**

### **3.7 Timing of Significance Tests**

- (1) Section 2.2 of the Rule sets out the significance tests for determining whether an acquisition of a business by an issuer is a "significant acquisition". The first test measures the assets of the acquired business against the assets of the issuer. The second test measures the issuer's investments in and advances to the acquired business against the assets of the issuer. The third test measures the income from continuing operations of the acquired business against the income from continuing operations of the issuer. If any one of these three tests is satisfied at the 20 per cent level, the acquisition is considered "significant" to the issuer. The tests must be applied as at the time of the acquisition using the most recent audited financial statements of the issuer and the business. This is consistent with the requirements of the Securities and Exchange Commission of the United States of America and provides issuers with certainty that if an acquisition is not significant at the time of the acquisition, then no financial statements of the business will be required to be included in the prospectus.
- (2) If an acquisition is determined under subsection 2.2(2) of the Rule to be significant on the date of acquisition, an issuer has the option under subsection 2.2(3) of the Rule of applying the tests using the more recent financial statements for the 12 months ended on the last day of the most recent interim period financial statements included in the prospectus and the financial statements of the business for a coterminous period ending on the same day as the issuer's financial statements. However, for the purposes of applying the investment test under subsection 2.2(3)2 of the Rule, the issuer's investments in and advances to the business should be the amount used to calculate the significance as at the date of the acquisition and not the amount as at the date of the issuer's financial statements used to re-calculate the significance.
- (3) The option under subsection 2.2(3) of the Rule has been included in order to recognize the possible growth of an issuer between the date of acquisition and the date of a prospectus offering and the corresponding potential decline in significance of the acquisition to the issuer. If the significance of an acquisition increases at the second date under subsection 2.2(3), only the financial statements required when the tests are applied at the first stage under

subsection 2.2(2) of the Rule, are required to be included in the prospectus. Applying the significance tests at the second date is not intended to increase the level of significance of an acquisition and thereby the number of years of financial statements.

- (4) The significance tests at the second date are an option available to all issuers. However, depending on how or when an issuer integrates the acquired business into its existing operations and the nature of post-acquisition financial records it maintains for the acquired business, it may not be possible for an issuer to apply the tests at the second date.

### **3.8 Acquisition of a Business when the Financial Statements of the Business are Prepared in Accordance with a Foreign GAAP**

Subsection 2.2(9) of the Rule states that where the financial statements of the business or related businesses are prepared in accordance with foreign GAAP, for purposes of applying the significance tests, the relevant financial statements should be reconciled to Canadian GAAP. It is unnecessary for the reconciliation to be audited for the purpose of the test as the Commission recognizes that this could be onerous, particularly if the business or related businesses are determined not to be a significant acquisition.

### **3.9 Acquisition of a Previously Unaudited Business**

Section 2.2(2) of the Rule requires the significance of an acquisition to be determined using the most recently audited financial statements of the issuer and the business acquired or to be acquired. If the business was a private company prior to the acquisition and it did not engage an auditor to audit its annual financial statements then, for the purpose of applying the significance tests, subsection 2.2(6) of the Rule permits use of the unaudited financial statements of the business prepared in accordance with GAAP. If the acquisition is determined to be significant, then the financial statements for the number of periods required by Parts 6 and 7 of the Rule must be audited.

### **3.10 Application of the Significance Tests when the Financial Year Ends of the Issuer and the Acquired Business are Non-Coterminous**

Subsection 2.2(2) of the Rule requires the significance of an acquired business to be determined using the most recent audited financial statements of both the issuer and the acquired business. For the purpose of applying the tests under this subsection, the year ends of the issuer and the acquired business need not be

coterminous. Accordingly, neither the audited financial statements of the issuer or the business should be adjusted for the purposes of applying the significance tests. However, if an acquired business is determined to be significant and *pro forma* income statements are prepared in accordance with Part 6 or 7 of the Rule and, if the last day of the business' year end is more than 93 days from the last day of the issuer's year end, the business' reporting period required under subsection 6.5(4) of the Rule should be adjusted to reduce the gap to 93 days or less. Reference is made to section 3.17 of this Companion Policy for further guidance.

### **3.11 Application of Investment Test for Significance of an Acquisition**

Subsections 2.2(2) and, if applicable, 2.2(3) of the Rule set out when an acquisition of a business by an issuer is a "significant acquisition". One of the tests is whether the issuer's consolidated investments in and advances to the business or related businesses exceeds 20 per cent of the consolidated assets of the issuer as at the date of the audited financial statements of the issuer for the most recently completed financial year ended prior to the date of the acquisition. In applying this test, the "investments in" the business should be determined using the total cost of the purchase, as determined by generally accepted accounting principles, which includes consideration paid or payable and the costs of the acquisition. If the acquisition agreement includes a provision for contingent consideration, for the purpose of applying the test, the contingent consideration should be included in the total cost of the purchase unless the likelihood of payment is considered remote at the date of the acquisition. In addition, any payments made in connection with the acquisition which would not constitute purchase consideration but which would not have been paid unless the acquisition had occurred, should be considered part of investments in and advances to the business for the purpose of applying the significance tests. Examples of such payments include loans, royalty agreements, lease agreements and agreements to provide a pre-determined amount of future services.

### **3.12 Application of Income Test for Significance of an Acquisition**

- (1) The third significance test set out in subsection 2.2(2)3 of the Rule is whether the issuer's proportionate share of the consolidated income from continuing operations of the business or related businesses exceeds 20 per cent of the consolidated income from continuing operations of the issuer based on the audited financial statements of the issuer and the acquired business for the most recently completed financial year ended before the date of the acquisition. Subsection 2.2(3)3 of the Rule sets out an optional calculation

using more recent financial statements. In applying the income test, the income from continuing operations of the business should be determined using the accounting policies applied by the issuer.

- (2) Subsections 2.3(3), (4) and (5) of the Rule permit the issuer to use the average income of its three most recently completed fiscal years or 12 month periods, respectively, if the income from continuing operations for the most recently completed fiscal year is positive and at least 20 per cent lower than the average for the three most recently completed years. The averaging option is not available if the issuer has incurred a loss from continuing operations during its most recently completed year or more recent 12 month period. If the averaging option is available to the issuer but it incurred a loss from continuing operations in the second and/or third most recently completed fiscal years or 12 month periods, subsection 2.3(6) of the Rule states that for purposes of calculating the average consolidated income from continuing operations for the three fiscal years or 12 month periods, the loss must be treated zero in the numerator and as one in the denominator.

## **C. FINANCIAL STATEMENTS OF ACQUIRED BUSINESSES**

### **3.13 Financial Statements for Interim and Pre-acquisition Periods**

Subsections 6.2(1), 6.3(1) and 6.4(1) of the Rule require that a prospectus include financial statements for the most recently completed interim period of the acquired business that ended prior to the date of acquisition, in the case of a completed acquisition, and in any case, more than 60 days before the date of the prospectus. In some circumstances, the acquired business may not have been a reporting issuer and therefore may not have prepared financial statements for the required interim periods. In connection with its sale, a business may prepare financial statements for the period commencing with the first day of its current year up to the date of the acquisition or a day prior to the date of the acquisition. Subsections 6.2(1)2(a)(ii) and 6.3(1)3(a)(ii) of the Rule permit an issuer to satisfy the requirement for interim financial statements by filing financial statements for a period longer than an interim period provided that period ends no more than 30 days before the date of the acquisition. The period covered by these financial statements is defined in the Rule as the "pre-acquisition period". If the issuer elects to include pre-acquisition period financial statements in the prospectus, it is not also required to include the interim financial statements for the most recently completed interim period ended more than 60 days prior to the date of the prospectus. The pre-

acquisition period financial statements may be used to prepare the *pro forma* financial statements of the issuer required under Part 6 of the Rule.

### **3.14 Acquisition of Related Businesses**

Subsections 6.2(2), 6.3(2) and 6.4(2) of the Rule require that if an issuer is required to include in its prospectus financial statements for more than one business because the significant acquisition involves an acquisition of related businesses or a probable acquisition of related businesses, the financial statements required under these subsections should be presented for each business except for the periods during which the businesses have been under common control or management, in which case the issuer may present the financial statements on a combined basis. Although one or more of the related businesses may be insignificant relative to the others, separate financial statements of each business for the same number of periods required must be presented. Relief from the requirement to include financial statements of the least significant related business or businesses may be granted depending on the facts and circumstances.

### **3.15 Financial Statement Disclosure for Unrelated Individually Insignificant Acquisitions**

- (1) When an issuer acquires unrelated businesses that are determined by the significance tests to be individually insignificant, section 7.2 of the Rule requires the significance of the acquisitions to be tested again by combining the results of the businesses. The significance tests should be applied using the financial results of the businesses on a combined basis. If the businesses satisfy any of the significance tests at a threshold of 50 per cent or more, then financial statements shall be provided for the businesses that constitute more than 50 per cent of the test satisfied at the highest level of significance. For example, if the acquisitions satisfy the asset, investment and income tests at thresholds of 40 per cent, 80 per cent and 60 per cent respectively, then the investment test is the most significant. Accordingly, financial statements of the individual businesses which comprise 50 per cent of the dollar value of the combined investments in and advances to the businesses must be included in the prospectus. Audited financial statements must be presented for the most recently completed financial year of each business plus interim financial statements. Depending upon the number of acquisitions, there may be several combinations of businesses whose financial statements would satisfy the requirement. Any combination may be included in

the prospectus. For further guidance, refer to example 4 in Appendix B to this Companion Policy.

- (2) Subsection 2.3(2) of the Rule states that if one or more of the unrelated businesses have incurred losses from continuing operations while others have earned income from continuing operations, the losses should not offset the income. Instead, the businesses with losses should be evaluated separately from those with income for the purpose of applying the income test. The absolute value of the aggregate losses should be used to calculate the significance. For further guidance, refer to example 5 in Appendix B to this Companion Policy.

### 3.16 Preparation of Divisional and Carve-out Financial Statements

- (1) As discussed in section 3.2 of this Companion Policy, the Commission generally considers the acquisition of a division of a business and in certain circumstances, a lesser component of a person or company, as constituting a business for purposes of the Rule, whether or not the subject of the acquisition previously prepared financial statements. In order to determine the significance of the acquisition and comply with the requirements in Parts 6 and 7 of the Rule, financial statements must be prepared. This section provides guidance on preparing these financial statements.
- (2) The guidance in this section also applies to the preparation of the financial statements of a completed significant disposition for the purpose of preparing *pro forma* financial statements in accordance with Part 8 of the Rule.
- (3) **Interpretations** - In this section of this Companion Policy, unless otherwise stated, the following interpretations apply:
  - (a) A reference to "a business" means a division or some lesser component of another business acquired by an issuer which constitutes a significant acquisition.
  - (b) The term "parent" refers to the vendor from whom the issuer purchased a business.
- (4) **Divisional and Carve-out Financial Statements** - The terms "divisional" and "carve-out" financial statements are often used interchangeably although a distinction is possible. Some companies maintain separate financial records and prepare financial statements for a business activity or unit which is operated as a division. Financial statements prepared from

these financial records are often referred to as “divisional” financial statements. In certain circumstances, no separate financial records for a business activity are maintained; they are simply consolidated with the parent’s records. In these cases, if the parent’s financial records are sufficiently detailed, it is possible to extract or “carve-out” the information specific to the business activity in order to prepare separate financial statements of that business. Financial statements prepared in this manner are commonly referred to as “carve-out” financial statements. The guidance in this section applies to the preparation of both divisional and carve-out financial statements unless otherwise stated.

(5) **Preparation of Divisional and Carve-out Financial Statements**

(a) When complete financial records of the business acquired or to be acquired have been maintained, those records should be used for preparing and auditing the financial statements of the business. For the purposes of this section, it is presumed that the parent maintains separate financial records for its divisions.

(b) When complete financial records of the business acquired or to be acquired do not exist, carve-out financial statements should generally be prepared in accordance with the following guidelines:

1. **Allocation of Assets and Liabilities** - A balance sheet should include all assets and liabilities directly attributable to the business.
2. **Allocation of Revenues and Expense** - Income statements should include all revenues and expenses directly attributable to the business. Some fundamental expenditures may be shared by the business and its parent in which case the parent’s management must determine a reasonable basis for allocating a share of these common expenses to the business. Examples of such common expenses include salaries, rent, depreciation, professional fees, general and administration.
3. **Allocation of Income and Capital Taxes** - Income and capital taxes should be calculated as if the entity had been a separate legal entity and filed a separate tax return for the period presented.

4. **Disclosure of Basis of Preparation** - The financial statements should include a note describing the basis of preparation. If expenses have been allocated as discussed in paragraph 2, the financial statements should include a note describing the method of allocation for each significant line item, at a minimum.
- (6) **Statements of Assets Acquired, Liabilities Assumed, and Statements of Operations** - When it is impracticable to prepare carve-out financial statements of a business, an issuer may be required to include in its prospectus for the business an audited statement of assets acquired and liabilities assumed and a statement of operations. Such a statement of operations should exclude only those indirect operating costs, such as corporate overhead, not directly attributable to the business. If these costs were previously allocated to the business and there is a reasonable basis of allocation, they should not be excluded. Issuers are encouraged to submit a pre-filing application when this circumstance arises.

### 3.17 **Preparation of *Pro forma* Financial Statements Giving Effect to Significant Acquisitions**

- (1) **Objective and Basis of Preparation** -The objective of *pro forma* financial statements is to illustrate the impact of a transaction on an issuer's financial position and results of operations by adjusting the historical financial statements of the issuer to give effect to the transaction. Accordingly, the *pro forma* financial statements should be prepared on the basis of the issuer's financial statements as they appear elsewhere in the prospectus. No adjustment should be made to eliminate extraordinary items or discontinued items.
- (2) ***Pro forma* Balance Sheets and Income Statements** - Subsection 6.5(1) of the Rule does not require a *pro forma* balance sheet to be prepared to give effect to significant acquisitions which are reflected in the issuer's most recent audited or interim balance sheet included in the prospectus. Similarly, if a significant acquisition was completed during the issuer's most recently completed financial year, subsection 6.5(1)2 of the Rule does not require a *pro forma* income statement to be prepared for the issuer's most recent interim period for which financial statements are included in the prospectus because the results of the acquired business have been consolidated with the issuer's for the entire interim period.



(3) **Non-coterminous year-ends**

- (a) **Reducing the Gap to 93 Days** - For the purpose of preparing a *pro forma* income statement, if the financial year of the business ends on a day which is more than 93 days from the last day of the issuer's financial year, subsection 6.5(4) of the Rule requires the income statement of the business to be adjusted to reduce this gap to less than 93 days. Reducing the gap may be accomplished by adding a subsequent interim period to the results of the most recent fiscal year of the acquired business and deducting the comparable interim results for the immediately preceding year.
- (b) **Consecutive Months** - The adjusted financial period of the business should be comprised of consecutive months. For example, if the adjusted reporting period is 12 months and ends on June 30, the 12 months should commence on July 1 of the immediately preceding year; it should not begin on March 1 of the immediately preceding year with three of the following 15 months omitted, such as the period from October 1 to December 31, since this would not be a consecutive 12 month period.
- (c) **Disclosure of the Adjusted Financial Period** - The adjusted financial period should be clearly disclosed on the face of the *pro forma* financial statements. In addition, there should be disclosure in a note to the *pro forma* financial statements stating that the financial statements of the business used to prepare the *pro forma* financial statements were prepared for this purpose and do not conform with the financial statements included elsewhere in the prospectus.
- (d) **Disclosure of Results Reported in Two *Pro forma* Income Statements** - If the financial statements of the business are adjusted in accordance with paragraph (a), it is possible that the results for one or more months may be included in the twelve month and interim period financial statements of the business which are used by the issuer to prepare *pro forma* income statements for its most recently completed financial year and interim period. In this situation, disclosure should be made of the revenue and income for any periods excluded or included in both *pro forma* income statements.

- (4) **Financial Statements of a Business Prepared for the Purpose of Preparing *Pro Forma* Financial Statements** - If, in accordance with subsection (3), an income statement of an acquired business is constructed for the purpose of preparing a *pro forma* income statement, the constructed income statement need not be audited or otherwise included in the prospectus except as a separate column in the *pro forma* income statement. However, a comfort letter addressed to the Commission must be delivered in accordance with subsection 13.3(2)1 of the Rule.
- (5) **Effective Date of Adjustments**
- (a) ***Pro forma* balance sheet** - Paragraph 1 of subsection 6.5(1) of the Rule requires a *pro forma* balance sheet to be prepared to give effect to significant acquisitions as if they occurred on the date of the issuer's most recent balance sheet included in the prospectus
- (b) ***Pro forma* income statement** - Paragraph 2 of subsection 6.5(1) of the Rule requires a *pro forma* income statement to be prepared to give effect to significant acquisitions as if they had taken place at the beginning of the issuer's current financial year or its most recently completed financial year, depending on when the acquisition occurred. If a prospectus includes *pro forma* income statements for the issuer's most recently completed financial year and a subsequent interim period, the acquisition and most of the adjustments should be computed as if the acquisition had occurred at the beginning of the most recently completed financial year of the issuer only and carried through the most recent interim period presented, if any. However, those adjustments related to the allocation of the purchase price, including the amortization of fair value increments and intangibles, should be based on the purchase price allocation arising from giving effect to the acquisition as if it occurred on the date of the issuer's most recent balance sheet included in the prospectus.
- (6) **Acceptable Adjustments** - *Pro forma* adjustments shall be limited to those which are directly attributable to a specific completed or proposed transaction for which there are firm commitments and for which the complete financial effects are objectively determinable.
- (7) **Multiple Acquisitions** -If the *pro forma* financial statements

give effect to more than one significant acquisition or other event, the *pro forma* adjustments may be grouped by line item on the face of the *pro forma* financial statements provided the details for each transaction are disclosed in the notes.

- (8) **Intervening Periods** - If the issuer prepares a *pro forma* financial statement using a pre-acquisition interim financial statement of the acquired business and that period ends prior to the date of the acquisition, the *pro forma* financial statements should include any significant adjustments necessary to account for the intervening period.

## D. SIGNIFICANT DISPOSITIONS

### 3.18 Significant Dispositions

- (1) Section 2.6 of the Rule states that the term “significant disposition” refers to a disposition of a business, a business segment or a significant portion of a business, either by sale, abandonment or distribution to shareholders. A disposition is determined to be significant in subsection 2.6(2) of the Rule if it satisfies the asset or income test at least the 20 per cent significance level.
- (2) Separate financial statements of a significant disposition are not required to be included in the prospectus. If an issuer decides to include the financial statements, they should be prepared following the guidance in section 3.15 of this Companion Policy and should not be for more periods than the most recently completed financial year and interim period of the issuer for which financial statements are included in the prospectus.

### 3.19 Preparation of *Pro Forma* Financial Statements Giving Effect to Significant Dispositions

- (1) **Businesses and Business Segments** - Part 8 of the Rule requires inclusion in an issuer’s prospectus of *pro forma* financial statements which give effect to significant dispositions completed during an issuer’s most recently completed financial year or current financial year. The disposition of a business segment, as defined by section 3475 of the Handbook, is excluded from the *pro forma* requirements because the financial statement presentation of a discontinued business segment is addressed by the Handbook.

- (2) **Objective and Basis of preparation** - The basis for preparing *pro forma* financial statements which give effect to a significant disposition is very similar to the guidance outlined in section 3.17 of this Companion Policy which discusses the preparation of *pro forma* financial statements which give effect to significant acquisitions. The *pro forma* financial statements should be prepared using the issuer's financial statements as if the significant disposition occurred at the beginning of an issuer's current or most recently completed financial year, as appropriate.
- (3) **Pro Forma Balance Sheet** - Section 8.2(1) of the Rule does not require a *pro forma* balance sheet if the significant disposition is reflected in the issuer's most recent balance sheet included in the prospectus.
- (4) **Pro Forma Income Statements**
- (a) If a significant disposition was completed during the issuer's most recently completed financial year, subsection 8.2(2)(a) of the Rule does not require inclusion of a *pro forma* income statement for the most recent interim period for which financial statements are included in the prospectus because the results of the disposed business have been excluded from the issuer's results for the entire interim period.
- (b) A *pro forma* income statement prepared to give effect to significant dispositions should not present results below the level of income from continuing operations.
- (5) **Constructed Financial Statements of the Business for the Purpose of Preparing Pro Forma Financial Statements** - If an income statement of the disposed business is constructed or otherwise carved out from the issuer's financial statements in accordance with the guidance in section 3.16 of this Companion Policy, for the purpose of preparing a *pro forma* income statement, the constructed income statement need not be audited or otherwise included in the prospectus except as a separate column in the *pro forma* income statement. However, a comfort letter addressed to the Commission must be delivered in accordance with subsection 13.3(2)1 of the Rule with respect to the separate column.
- (6) **Effective Date of Adjustments** - *Pro forma* balance sheets should be prepared as if the disposition had occurred on the date of each balance sheet presented. If a prospectus includes *pro forma* income statements for the issuer's most

recently completed financial year and a subsequent interim period, the acquisition and adjustments should be computed as if the disposition had occurred at the beginning of the most recently completed financial year of the issuer only and carried through the most recent interim period presented, if any.

- (7) **Acceptable Adjustments** - *Pro forma* adjustments should be limited to those which are directly attributable to a specific completed or proposed transaction for which there are firm commitments and for which the complete financial effects are objectively determinable.
- (8) **Multiple Dispositions** -If the *pro forma* financial statements give effect to more than one significant disposition, the *pro forma* adjustments may be grouped by line item on the face of the *pro forma* financial statements provided the details for each transaction are disclosed in the notes.

## E. EXEMPTIONS

### 3.20 Exemptions from Parts 6 and 7 of the Rule

- (1) Despite Parts 6 and 7 of the Rule, an issuer may be permitted by the Director to exclude an audit opinion on the financial statements of an acquired business for any of the years for which financial statements are required other than the most recently completed year of the acquired business if
  - (a) the business was acquired prior to December 31, 2000;
  - (b) the issuer provides written submissions prior to filing the final prospectus which establish to the satisfaction of the Director that, despite making reasonable efforts, the issuer was unable to obtain audited financial statements because the vendor refused to provide such audited financial statements or to permit access to the information necessary to audit the financial statements; and
  - (c) The issuer discloses in the prospectus that despite making reasonable efforts, the issuer was unable to obtain audited financial statements because the vendor refused to provide such audited financial statements or to permit access to the information necessary to audit the financial statements.
- (2) The Commission is of the view that relief from the financial

statement requirements of Parts 6 and 7 of the Rule should be granted only in unusual circumstances not related to cost or the time involved in preparing and auditing the financial statements.

- (3) If relief is granted from the requirements of Parts 6 and 7 of the Rule to include in a prospectus audited financial statements of an acquired business, conditions will likely be imposed, such as a requirement to include audited divisional or partial income statements or divisional statements of cash flow, financial statements accompanied by an auditor's report containing a reservation of opinion such as an inventory qualification or an audited statement of net operating income for a business.
- (4) Relief may be granted in appropriate circumstances to permit the auditor's report on financial statements of a business acquisition to contain a reservation relating to opening inventory. In certain situations, such as when any of the significance tests are satisfied at 40 per cent or higher, the issuer may be requested to include in the prospectus audited financial statements of the business for a subsequent period of at least six months on which the auditor's report contains no reservation of opinion and the business is not seasonal.
- (5) Considerations relevant to granting an exemption from the requirement to include interim financial statements for the comparable period in the immediately preceding financial year may include the fact that an acquired business was, before the filing of the prospectus, a private entity that did not prepare interim financial statements.
- (6) If an issuer acquired a business or is proposing to acquire a business, considerations relevant to granting an exemption from the requirement to include financial statements of the business for one or more years required to be included in the prospectus may include the following:
  - (a) The business's historical accounting records have been destroyed and cannot be reconstructed. In this case, as a condition of granting the exemption, the issuer may be requested by the Commission to
    - (i) represent in writing to the Commission, no later than the time the preliminary prospectus is filed, that the issuer made

every reasonable effort to obtain copies of, or reconstruct, the historical accounting records necessary to prepare and audit the financial statements, but such efforts were unsuccessful; and

- (ii) Disclose in the prospectus the fact that the historical accounting records have been destroyed and cannot be reconstructed.
- (b) The business has recently emerged from bankruptcy and current management of the business and the issuer is denied access to the historical accounting records necessary to audit the financial statements. In this case, as a condition of granting the exemption, the issuer may be requested by the Director to
- (i) represent in writing to the Commission, no later than the time the preliminary prospectus is filed, that the issuer has made every reasonable effort to obtain access to, or copies of, the historical accounting records necessary to audit the financial statements but that such efforts were unsuccessful;
  - (ii) Disclose in the prospectus the fact that the business has recently emerged from bankruptcy and current management of the business and the issuer are denied access to the historical accounting records.
- (c) The business has undergone a fundamental change in the nature of its business or operations affecting a majority of its operations and all, or substantially all, of the executive officers and directors of the company have changed. The evolution of a business or progression along a development cycle will not be considered to be a fundamental change in an issuer's business or operations. Relief from the requirement to include audited financial statements of the business for the year in which the change in operations occurred, or for the most recently completed financial year if the change in operations occurred during the business's current financial year, generally will not be granted.

## **PART 4 GAAP, GAAS AND AUDITOR'S REPORTS**

### **4.1 Foreign GAAP**

- (1) Subsection 9.1(2) of the Rule provides that if a person or company is incorporated or organized in a foreign jurisdiction, the financial statements of the person or company included in the prospectus shall be prepared in accordance with either Canadian GAAP or foreign GAAP. Foreign GAAP is defined in the Rule to mean a body of generally accepted accounting principles, other than Canadian GAAP, that are as comprehensive as Canadian GAAP.
- (2) The Commission is of the view that foreign GAAP are as comprehensive as Canadian GAAP if the foreign GAAP cover substantially the same core subject matter as Canadian GAAP, including recognition and measurement principles and disclosure requirements.
- (3) The Rule permits foreign GAAP to be used only if the notes to the financial statements explain and quantify the effect of material differences between the foreign GAAP and Canadian GAAP that relate to measurements and provide disclosure consistent with Canadian GAAP requirements. The Commission expects that in most cases the reconciliation will be adequate to ensure clear and understandable disclosure for investors in Canada, unless the differences are so pervasive as to render the financial statements misleading.

### **4.2 Foreign Auditors and Foreign GAAS**

- (1) The Rule requires financial statements in a prospectus to be accompanied by an auditor's report which by definition is prepared in accordance with generally accepted auditing standards. The Rule permits the financial statements of foreign issuers to be audited in accordance with generally accepted auditing standards other than those applied in Canada, if those auditing standards are substantially equivalent to Canadian auditing standards.
- (2) Issuers should recognize that subsection 61(2) of the Act requires the Director not to issue a receipt for a prospectus if it appears to the Director that a person or company who has prepared any part of the prospectus or is named as having prepared or certified a report used in connection with a prospectus is not acceptable. Therefore, under section 9.4 of



the Rule, the foreign auditor's report must be accompanied by a statement confirming that the auditing standards applied are substantially equivalent to Canadian GAAS. The statement must also disclose any material differences in the form and content of the foreign auditor's report.

- (3) The Commission is of the view that in order for auditing standards to be substantially equivalent to Canadian GAAS, they must require underlying audit work that is comparable in scope, nature and timing to the work required in connection with an audit in accordance with Canadian GAAS. For example, auditing standards of foreign jurisdictions such as the United States are known to the Commission to be substantially equivalent to the standards of the CICA. Foreign issuers using auditors from foreign jurisdictions, with auditing standards and supervision that are less well known to the Commission, are encouraged to consult with staff of the Commission in advance of filing a preliminary prospectus to resolve uncertainty as to whether the Commission will consider a particular auditor or auditing standards to be acceptable.
- (4) In making a determination of whether the foreign auditing standards applied are substantially equivalent to Canadian GAAS, auditors are referred, in particular, to the general standard of Canadian GAAS as set out in section 5100 of the Handbook and its reference to an auditor's "objective state of mind". This standard, when read together with the objectivity standard for auditors contained in the standards of professional conduct applicable to Canadian auditors in each jurisdiction, emphasizes the importance of the independence of the auditor. In the view of the Commission, auditor independence is an essential element of Canadian GAAS which should be reflected, among other things, in the foreign GAAS applied in order for the foreign GAAS applied and Canadian GAAS to be considered substantially equivalent.
- (5) Subsection 13.2(2)7 of the Rule requires an issuer, if a financial statement included in a prospectus has been prepared in accordance with foreign GAAP or includes a foreign auditor's report, to deliver a letter from the auditor that discusses the auditor's expertise to audit the reconciliation of foreign GAAP to Canadian GAAP and, in the case of foreign GAAS other than U.S. GAAS applied by a U.S. auditor, to make the determination that foreign GAAS applied are substantially equivalent to Canadian GAAS. This provision requires that this comfort letter be delivered with the preliminary prospectus to

better facilitate timely resolution of any issues.

#### **4.3 Auditor's Comfort Letters**

Subparagraph 1(l) of subsection 13.3(2) of the Rule requires a comfort letter to be delivered to the Commission from the auditor of the issuer or the business, as applicable, if an unedited financial statement of an issuer or a business is included in a final prospectus. If unedited financial statements of the issuer or the business for more than one interim period are included in the prospectus, a comfort letter with respect to each unedited financial statement must be delivered. If an unedited financial statement presents the results of the issuer or the business for the most recently completed interim period and the cumulative results for the current financial year up to the last day of the most recently completed interim period, a comfort letter with respect to both the interim and cumulative periods, including any comparative periods presented, must be delivered.

### **PART 5 GENERAL REQUIREMENTS AS TO FILING AND AMENDMENTS**

#### **5.1 Certificate by Issuer**

Subsection 58(1) of the Act provides that a prospectus must contain a certificate in the prescribed form signed by the chief executive officer, the chief financial officer and, on behalf of the board of directors, any two directors of the issuer (other than the chief executive officer and the chief financial officer) duly authorized to sign. Where an issuer has only three directors, two of whom is the chief executive officer and the chief financial officer, subsection 58(3) provides that the certificate may be signed by all the directors. The Commission is of the view that section 58 requires that the positions of the chief executive and chief financial officers must be held by two individuals.

#### **5.2 Consents of Lawyers**

The names of lawyers or legal firms frequently appear in prospectuses in two ways. First, the underwriters, the issuer and selling security holders may name the lawyers upon whose advice they are relying. Second, the opinions of counsel that the securities may be eligible for investment under certain statutes may be expressed or opinions on the tax consequences of the investment may be given. In the first case, the Commission is of the view that the lawyer is not, in the words of subsection 13.4(1) of the Rule, named as having prepared or certified a part of the prospectus and is not named as having prepared or certified a report or

valuation referred to in the prospectus. Accordingly, the written consent of the lawyer contemplated by subsection 13.4(1) of the Rule is not required. In the second case, because the opinions or similar reports are prepared for the purpose of inclusion in the prospectus, the Commission is of the view that subsection 13.4(1) applies and the consent is required.

### **5.3 Material Contracts**

Section 13.6 of the Rule requires an issuer to make available all material contracts referred to in a prospectus. The Commission recognizes that certain material contracts or portions thereof may contain sensitive operational or financial information, disclosure of which would be competitively disadvantageous or otherwise detrimental to the issuer. The Director will consider granting relief from the Requirement to make these contracts available for public inspection if disclosure would be unduly detrimental to the issuer and the disclosure would not be necessary in the public interest.

### **5.4 Filed or Delivered**

The Act makes a distinction between material that is required to be "filed" with the Commission and material that is required to be "delivered" to the Commission. Section 140 of the Act requires that material filed pursuant to Ontario securities law be made available by the Commission for public inspection, unless the Commission decides to hold the material in confidence because the material "discloses intimate financial, personal or other information"; and the desirability of avoiding disclosure in the interests of any person or company affected outweighs the desirability of adhering to the principle that material filed with the Commission be available to the public for inspection. Material that is delivered to the Commission is not required under the Act to be made available for public inspection, but the Commission may choose to make such material available for public inspection. Ontario Securities Commission Policy 2.2, Public Availability of Material Filed Under the Securities Act, discusses the views of the commission regarding this matter. This policy is under review and may be subject to change.

Subsection 13.2(2)4 of the Rule requires that an issuer "deliver" to the Commission concurrently with the filing of the preliminary prospectus copies of all material contracts to which the issuer is a party and a copy of each report or valuation referred to in the preliminary prospectus for which a consent is required to be filed under the Rule (other than technical reports dealing with a mineral project or oil and gas operations of an issuer which are required to be filed with the preliminary prospectus). Subject to requests for confidentiality, each of these documents will be made public at

the end of the filing process when a receipt is issued for a final prospectus

## **5.5 Response Letters and Marked-up Copies**

The Commission recommends that a response to a comment letter for a preliminary prospectus include draft wording for the proposed changes to be reflected in the prospectus. When the comments of the various securities regulators have been resolved, a draft of the prospectus with all proposed changes from the preliminary prospectus should be clearly marked and submitted as far as possible in advance of the filing of final material. These procedures may prevent delay in the issuing of a receipt for the prospectus, particularly if the number or extent of changes is substantial.

## **5.6 Disclosure of Investigations or Proceedings**

- (1) Subsection 61(1) of the Act provides that, subject to subsections 61(2) and 63(4), the Director shall issue a receipt for a prospectus unless it appears that it would not be in the public interest to do so. The existence of an ongoing or recently concluded investigation or proceeding relating to an issuer, a promoter, a controlling shareholder, director or officer of the issuer or an underwriter or other person or company involved in a proposed distribution will be considered by the Director in determining if the Director should refuse to issue a receipt for the prospectus. That decision will be made on a case by case basis and will depend upon the facts known at the time.
- (2) If the facts and circumstances do not warrant the denial of a receipt for a prospectus, the Act nonetheless imposes a statutory obligation to provide full, true and plain disclosure of all material facts relating to the securities issued or proposed to be issued by the prospectus. Disclosure of an ongoing or recently concluded investigation or proceeding relating to a person or company involved in a proposed distribution may be necessary to meet this standard. The circumstances in which disclosure will be required and the nature and extent of the disclosure will also be determined on a case by case basis. In making this determination, all relevant facts, including the allegations that gave rise to the investigation or proceeding, the status of the investigation or proceeding, the seriousness of the alleged breaches that are

the subject of the investigation or proceeding and the degree of involvement in the proposed distribution by the person or company under investigation will be considered.

## **5.7 Filing of Advertising and Sales Literature**

The Director may request that an issuer file a copy of all advertising and sales literature that will be used in connection with the distribution in Ontario of the securities distributed under the prospectus.

## **5.8 Amendments to a Preliminary Prospectus**

- (1) Subsection 57(1) of the Act provides that if a material adverse change occurs after a receipt for a preliminary prospectus is obtained, an amendment to the preliminary prospectus shall be filed as soon as practicable and in any event within 10 days after the change occurs. Section 13.7 of the Rule contains additional provisions concerning amendments. In the Commission's view, if a preliminary prospectus indicates the number or value of the securities to be distributed under the prospectus, an increase in the number or value is, absent unusual circumstances, unlikely to constitute a material adverse change requiring an amendment to the preliminary prospectus.
- (2) In the Commission's view, if, after filing a preliminary prospectus, an issuer decides to attach or add to the securities offered under a prospectus a right to convert into, or a warrant to acquire, the security of the issuer being offered under the preliminary prospectus, the attachment or addition of the conversion feature or warrant is, absent unusual circumstances, unlikely to constitute a material adverse change requiring an amendment to the preliminary prospectus.
- (3) Subsection 53(1) provides that no person or company shall trade in a security where such a trade would be a distribution of such security, unless a preliminary prospectus and a prospectus have been filed and receipts therefore obtained from the Director. The Commission is of the view that if an issuer intends to add a new class of securities to the distribution being effected by the prospectus after the preliminary prospectus has been filed and receipted, an issuer must file an amended and restated preliminary prospectus.

## **5.9 Changes to the Offering**

Issuers are reminded that any changes to the terms or conditions of the security being distributed, such as the deletion of a conversion feature, may constitute a material adverse change requiring an amendment to the preliminary prospectus.

## **5.10 Confidential Material Change Reports**

In the view of the Commission, if an issuer has a confidential material change report on file with any Canadian securities regulatory authority at the time that it is contemplating a distribution, or if circumstances arise that cause an issuer to file a confidential material change report during the distribution period of securities under a prospectus, the issuer should cease all activities related to the distribution until

- (a) the material change is generally disclosed in the prospectus, or if the prospectus has been filed, a prospectus amendment is filed, if required; or
- (b) the circumstances that gave rise to the confidential material change have changed or the proposed transaction constituting the material change has been rejected and the issuer has so notified the Commission.

If the Director is aware that a distribution is taking place while the issuer has a confidential material change report on file, the Director may take steps to cease trade the distribution if it considers it appropriate.

## **5.11 Registration Requirement**

Issuers filing a preliminary prospectus or prospectus and other market participants are reminded to ensure that members of underwriting syndicates are in compliance with registration requirements under Canadian securities legislation in each jurisdiction in which syndicate members are participating in the distribution of securities under the prospectus.

# **PART 6 PROCEDURES FOR GRANTING OF RECEIPTS**

## **6.1 Extension of 90 Day Period for Issuance of Final Receipt**

- (1) The effect of subsection 14.1(2) of the Rule is to make it possible for the Director to close inactive files, and more importantly, to ensure that issues are not being marketed by

means of preliminary prospectuses containing outdated information. It should be noted that Part 15 of the Rule gives the Director discretion to exempt the issuer from compliance with any provision of section 14.1 of the Rule if the Director is satisfied that there is sufficient justification for so doing.

- (2) If the period between the issuance of the receipt for the preliminary prospectus and the prospectus exceeds 90 days by more than a few days, the Director will normally consider it to be in the public interest that either an amended preliminary prospectus containing updated information or a new preliminary prospectus be filed with the Commission.
- (3) The Commission is of the view that the Director should not permit an amended preliminary prospectus to be used to extend the 90 day period unless the issuer is continuing to use its best efforts to finalize and file the prospectus and obtain a receipt.

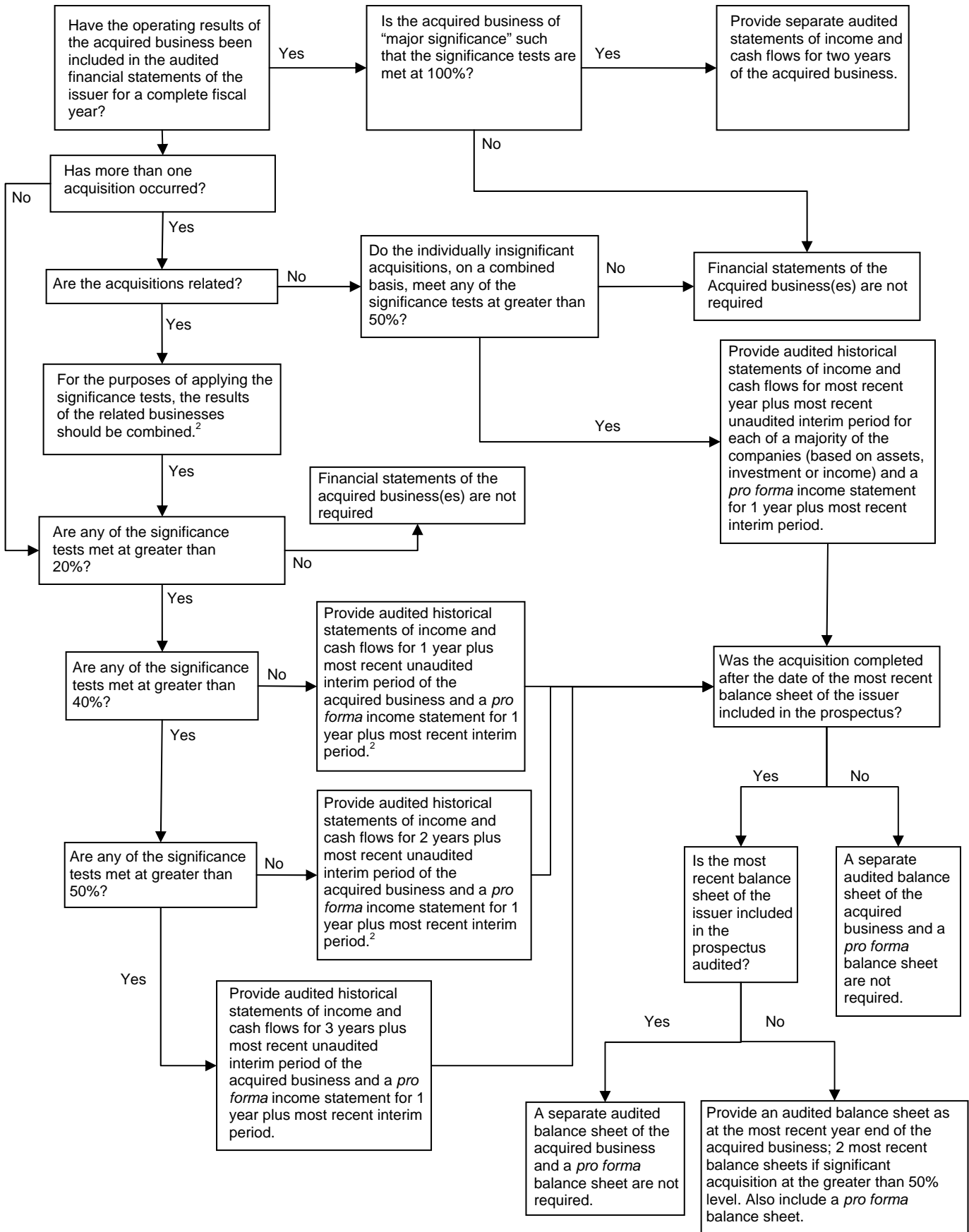
## **6.2 Project Financings**

Certain project financings are made by issuers that are unincorporated associations or co-tenancies comprised of security holders. In the view of the Commission, it is not appropriate for an unincorporated association or co-tenancy comprised of security holders to be responsible for compliance with the continuous disclosure obligations under the Act, including financial reporting requirements, given the passive nature of the investment and the absence of directors and officers who might appropriately assume this responsibility. The Commission would not normally consider it to be in the public interest to issue a receipt for a prospectus unless the constating documents of the issuer designate the person to be responsible for the day to day operations of the issuer including fulfilling continuous disclosure obligations.

## **6.3 Minimum Amount of Funds**

Item 19.5 of Form 41-501 F1 requires a prospectus to state that if a minimum amount of funds specified in a prospectus is not raised within 90 days from the date of the prospectus, and if each of the persons or companies who subscribed during that period have not consented to an extension of that period, the funds actually received from subscribers shall be returned to the subscribers unless the subscribers have otherwise instructed the depository. The 90 day period does not restart if an amendment to the prospectus is filed.

## APPENDIX A - OVERVIEW OF BUSINESS ACQUISITIONS DECISION CHART<sup>1</sup>





### Notes

1. This decision chart provides general guidance and should be read in conjunction with Rule 41-501 and Companion Policy 41-501CP. No reference is made to pre-acquisition periods for the sake of simplicity.
2. If an acquisition of related businesses constitutes a significant acquisition when the results of the related businesses are combined, the required financial statements shall be provided for each of the related businesses.

## APPENDIX B - ILLUSTRATIVE EXAMPLES

The following examples illustrate the application of certain parts of the Rule in determining the financial statements which should be included in a prospectus based on the specific facts and circumstances of the example. Selected explanations are provided to clarify the outcome or results in some cases. The subheading "variations" describes how the requirements would change given a change in certain facts.

Unless otherwise stated, the Issuer is assumed to have a December 31 year end. Unless otherwise stated, neither the Issuer nor a business is a junior issuer.

Terms and references used throughout the examples are defined as follows:

- Year 1 - refers to the current year.
- Year 2 - refers to the year immediately preceding Year 1.
- Year 3 - refers to the year immediately preceding Year 2.
- Year 4 - refers to the year immediately preceding Year 3.

- Q1 - refers to the first quarter or 3-month period of a year.
- Q2 - refers to the second quarter or 3-month period of a year.
- Q3 - refer to the third quarter or 3-month period of a year.

Company A or B or C, etc - refers to a completed or probable acquisition of a business.

### EXAMPLE 1 - SIGNIFICANT ACQUISITION OF A COMPANY IN YEAR 1

#### *Assumptions:*

- The Issuer files a prospectus on June 15, Year 1.
- The Issuer acquired Company A on April 15, Year 1.
- Company A has a December 31 year end.
- Company A's financial statements for the year ended December 31, Year 2 have been audited.
- Company A's financial statements for Q1-Year 1 were filed before the preliminary prospectus is filed.
- The significance tests under subsection 2.2(2) of the Rule are applied using the audited financial statements of the Issuer and Company A for the year ended December 31, Year 2. Company A is determined to be significant at 65%, 55% and 35% based on the income test, the investment test, and the asset test, respectively.

### *Financial Statement Requirements:*

The preliminary prospectus filed on June 15 should include the following financial statements:

#### *Issuer:*

- Audited statements of income, retained earnings and cashflows for years 2, 3 and 4.
- Audited balance sheets for years 2 and 3.
- Unaudited statements of income, retained earnings and cashflows for Q1 of years 1 and 2.
- Unaudited balance sheet as at March 30, Year 1.
- *Pro forma* income statements for Year 2 and Q1- Year 1. Each *pro forma* income statement is prepared to give effect to the acquisition of Company A as if it had occurred on January 1, Year 2.
- *Pro forma* balance sheet to give effect to the acquisition of Company A as if it had occurred on March 30 – Year 1.

#### *Company A*

- Audited financial statements for Years 2, 3 and 4.
- Unaudited statements of income, retained earnings and cash flows for Q1 - Years 1 and 2.
- Unaudited balance sheet as at March 30, Year 1.

#### *Explanations:*

1. Financial statements would be required for three years which corresponds to the level of significance, as outlined in section 6.6 of the Rule.
2. A *pro forma* balance sheet is required because the March 30, Year 1 balance sheet of the Issuer does not reflect the acquisition.

#### *Variations:*

1. If the Issuer filed its prospectus on April 15, it would be unnecessary to include the Q1 financial statements of the Issuer, including the *pro forma* financial statements, unless those financial statements had been filed, because April 15 is not more than 60 days from March 30, the last day of Q1.
2. If the Issuer filed its final prospectus on September 10th, the Rule would require it to include in the prospectus its unaudited financial statements for Q2-Year1 because the interim period ended more than 60 days from the date of the prospectus. The Issuer would be required to

update all disclosure in the prospectus, including the *pro forma* financial statements for the interim period, to reflect the Q2 results.

3. Junior Issuer - If Company A was a junior issuer and its financial statements for Years 3 and 4 had not been audited, then the financial statements for those years could be included in the prospectus without an auditor's report. If, however, an auditor had been engaged to audit Year 3 or 4, then the Issuer must include in its prospectus the auditor's report issued on those financial statements, regardless of the fact that Company A is a junior issuer.

**EXAMPLE 2 - RE-CALCULATING THE SIGNIFICANCE OF AN ACQUISITION AND PREPARING *PRO FORMA* FINANCIAL STATEMENTS WHEN THE YEAR END OF THE ISSUER AND THE BUSINESS DIFFER BY MORE THAN 93 DAYS.**

*Assumptions:*

- The Issuer files a prospectus on April 15, Year 1.
- The Issuer acquired Company A on November 15, Year 2.
- Company A is a public company.
- Company A's year end is June 30.
- Company A's financial statements for the year ended June 30, Year 2 have been audited.
- Company A filed its Q1-Year 2 financial statements on October 31.

*Note: Company A's fiscal Year 1 begins on July 1 of the Issuer's fiscal Year 2 which is also the calendar year. For simplicity, reference is made to calendar years only. For example, Company A's Q1 financial statements for its fiscal Year 1 are referred to as its Q1-Year 2 financial statements.*

- The significance tests are applied using the Issuer's audited financial statements for the year ended December 31, Year 3 and Company A's audited financial statements for the year ended June 30, Year 2. Company A is determined to be significant at 55% based on the Income test.
- Company A became the Issuer's Subsidiary A following the acquisition.
- Subsidiary A operates much as it did prior to the acquisition and has not been restructured by the Issuer. Separate financial records are maintained.
- The Issuer recalculated the significance of Subsidiary A based on the Issuer's financial statements for the year ended December 31, Year 2 after deconsolidating the results of Subsidiary A from the date of acquisition. For the purpose of applying the significance tests at this second date, December 31, Year 2, the financial results of Subsidiary A for the period January 1 to December 31, Year 2 were used. As a result of the calculations, Subsidiary A is significant at 46% based on the

income test.

*Financial Statement Requirements:*

The prospectus filed on April 15 should include the following financial statements:

*Issuer:*

- Audited statements of income, retained earnings and cash flows for the years ended Years 2, 3 and 4.
- Audited balance sheets as at December 31, Years 2 and 3.

*Company A:*

- Audited statements of income, retained earnings and cash flows for the years ended June 30, Years 2 and 3.
- Audited balance sheets as at June 30, Years 2 and 3.
- Unaudited statements of income, retained earnings and cash flows for Q1- Years 2 and 3.
- Unaudited balance sheet as at June 30, Year 2.

Pro forma Income Statement

In addition to the financial statements listed above, a *pro forma* income statement of the Issuer must be included in the prospectus. A *pro forma* balance sheet is not required because the acquisition occurred prior to December 31, Year 2, the most recent balance sheet of the Issuer included in the prospectus. The December 31 year end of the Issuer and the June 30 year end of Company A (prior to the acquisition) differ by more than 93 days. The following alternatives are some of those available to the Issuer for the purpose of preparing a *pro forma* income statement:

(1) Prepare an income statement for Company A for the period January 1, Year 2 to November 14 and compile these results with the Issuer's audited consolidated income statement for the year ended December 31, Year 2. A comfort letter would be filed with the Securities Regulator(s) in connection with Company A's income statement

(2) Prepare an income statement for Company A for the period October 1, Year 3 to September 30, Year 2 which period ends not more than 93 days from December 31. This may be accomplished by starting with Company A's income statement for the year ended June 30, Year 2, deducting Q1 of that year (July 1 to September 30, Year 2) and adding Q1 of fiscal year 1 (July 1 to September 30, Year 1). Deduct the post-acquisition results of Subsidiary A from the Issuer's consolidated income statement for the year ended December 31, Year 2. Compile the two income statements. A

comfort letter would be filed with the securities regulators with respect to both the Issuer's deconsolidated income statement and Company A's constructed income statement.

(3) Prepare an income statement for Company A for the period January 1, Year 2 to September 30, Year 2 and add this to the Issuer's consolidated income statement for the year ended December 31, Year 2. The results of Company A for the period October 1 to October 31 would have to be included as a separate column in the *pro forma* income statement. A comfort letter would be filed with the Securities Regulator(s) in connection with Company's A income statement for the period January 1 to September 30 and with respect to the results for the stub period October 1 to November 14, either separately or on a combined basis.

(4) Prepare an income statement for Company A for the period April 1, Year 2 to March 30, Year 2 and add this to the Issuer's consolidated income statement for the year ended December 31, Year 3. A comfort letter would be filed with the securities regulator(s) in connection with Company's A income statement for the 12 months ended March 30, Year 2.

*Variations:*

1. *Historical Financial Statements of Company A to be included in the Prospectus* - If Company A's year end was December 31 and pre-acquisition financial statements for the period January 1 to November 14, Year 2 were prepared and audited, assuming Company A is significant at the 46% threshold, the audited financial statements for the 10.5 month period ended November 14 would have satisfied the requirement for one of the two years of audited financial statements otherwise required because they are audited and for a period greater than 9 months. The prospectus would also include audited financial statements of Company A for the year ended December 31, Year 3 however, no interim financial statements would be required.

2. *Pro forma Income Statement* - If Company A's year end was December 31, a pre-acquisition income statement for the period January 1 to November 14 could have been prepared and compiled with the Issuer's audited consolidated income statement for the year ended December 31, Year 2. No other interim financial statements would be required, other than the Year 3 comparative financial statements.

**EXAMPLE 3 - PREPARING *PRO FORMA* FINANCIAL STATEMENTS TO GIVE EFFECT TO**

**A BUSINESS ACQUIRED DURING THE ISSUER'S CURRENT YEAR WHEN THE YEAR ENDS OF THE ISSUER AND THE BUSINESS DIFFER BY MORE THAN 93 DAYS.**

*Assumptions:*

- The Issuer files a prospectus June 10, Year 1.
- The Issuer acquired Company A on April 5, Year 1.
- The Issuer filed its Q1-Year 1 interim financial statements on May 30.
- Company A is a public company.
- Company A's year end is May 30.
- Company A's financial statements for the year ended April 30, Year 1 are not audited as at the time the prospectus is filed.
- Company A filed its Q3-Year 1 interim financial statements on April 29, Year 1.
- Company A is determined to be significant at 44%.

*Financial Statement Requirements:*

The preliminary prospectus filed on June 10 should include the following financial statements:

*Issuer:*

- Audited statements of income, retained earnings and cash flows for the years ended December 31, Years 2, 3 and 4.
- Audited balance sheets as at December 31, Years 2 and 3.
- Unaudited statements of income, retained earnings and cash flows for Q1- Years 1 and 2.
- Unaudited balance sheet as at March 31, Year 1.

*Company A:*

- Audited statements of income, retained earnings and cash flows for the years ended April 30, Years 2 and 3.
- Audited balance sheets as at April, Years 2 and 3.
- Unaudited statements of income, retained earnings and cash flows for Q3-Years 1 and 2.
- Unaudited balance sheet as at February 28, Year 1.

***Pro forma Financial Statements***

In addition to the financial statements listed above, the following *pro forma* financial statements of the Issuer are required to be included in the prospectus because the acquisition occurred subsequent to the date of the most recent financial statements of the Issuer included in the prospectus:

- A *pro forma* balance sheet as at March 31, Year 1.

- A *pro forma* income statement for the year ended December 31, Year 2.
- A *pro forma* income statement for the 3 months ended March 31, Year 1.

The December 31 year end of the Issuer and the April 30 year end of Company A (prior to the acquisition) differ by more than 93 days. The *pro forma* balance sheet should be prepared as follows:

***Pro forma balance sheet***

Combine the Issuer's balance sheet as at March 30, Year 1 with Company A's balance sheet as at February 28, Year 1.

The following is one alternative available to the Issuer for preparing the *pro forma* income statements:

***Pro forma income statement for the year ended December 31, Year 2***

Combine the Issuer's audited income statement for the year ended December 31, Year 2 with the 12 month income statement of Company A for the period March 1, Year 2 to February 28, Year 1.

***Pro forma income statement for the 3 months ended March 31, Year 1***

Combine the Issuer's Q1- Year 1 income statement with the income statement of the Issuer for the three month period ended February 28, Year 1.

The 12 month and 3 month *pro forma* income statements should be prepared to give effect to the acquisition of Company A as if it occurred on January 1, Year 2. Each *pro forma* income statement includes results of Company A for the period December 1, Year 2 to February 28, Year 1. The notes to the *pro forma* financial statements should disclose the fact that the results of Company A for the 3 months ended February 28, Year 1, which were used to prepare the 3 month *pro forma* income statement, are also included in the 12 month *pro forma* income statement. The overlapping period is Company A's third quarter, the results of which are fully disclosed in the 3 month *pro forma* income statement therefore, it is unnecessary to provide additional disclosure about the revenue, expenses, gross profit or income from continuing operations.

**EXAMPLE 4 - APPLICATION OF THE SIGNIFICANCE TESTS FOR INDIVIDUALLY INSIGNIFICANT ACQUISITIONS - ALL COMPANIES HAVE INCOME FROM CONTINUING OPERATIONS**

*Assumptions*



- The Issuer acquired five companies, A, B, C, D and E, during Year 2, its most recently completed financial year.
- The Issuer files a prospectus on April 15, Year 1.
- Each company reported net income from continuing operations during its most recently completed year ended before the date of the acquisition.

### Discussion

Section A of the following table presents the consolidated assets and consolidated net income from continuing operations of each company as reported on the audited financial statements of each company for its most recently completed financial year ended prior to the date of its acquisition by the Issuer. The "investment" column presents the Issuer's consolidated investments in and advances to each company as at the date of its acquisition by the Issuer. Section B presents the individual significance of each acquisition as a result of applying the significance tests. Each company acquired is individually insignificant. However, on a combined basis, the acquisitions are significant, satisfying the asset, income and investment tests at 40%, 50% and 75%, respectively.

Company	Section A \$ Millions			Section B % of Issuer's Results		
	Assets	Income	Investment	Assets	Income	Investment
A	300	30	550	8%	8%	14%
B	200	20	500	5%	5%	13%
C	400	35	700	10%	9%	17%
D	500	55	600	13%	14%	15%
E	200	60	650	5%	15%	16%
	<u>1,600</u>	<u>200</u>	<u>3,000</u>	<u>40%</u>	<u>50%</u>	<u>75%</u>

Company	Section A \$ Millions			Section B % of Issuer's Results		
	Assets	Income	Investment	Assets	Income	Investment
Issuer's Dec. 31	\$4,000	\$400				
Aggregate Significance of Companies' Combined Results	40%	50%	75%			
Highest Significance			75%			

The investment test is satisfied at the highest percentage. As a result, the Issuer should include in its prospectus audited financial statements of those companies which comprise at least 50% of the total investment in all five companies acquired - i.e. 50% of \$3,000 or \$1,500.

The following table shows some of the combinations of the companies' financial statements which the Issuer may include in its prospectus. Column B shows the Issuer's combined investments in and advances to the companies identified in column A. Column C shows that the combined investments in and advances to each combination of companies represents more than 50% of the Issuer's investments in and advances to all five companies acquired. The Issuer should include in its prospectus audited financial statements for each of the companies in the selected combination for the most recently completed financial year and the most recently completed interim period of the company, which ended more than 90 and 60 days before the date of the prospectus, respectively, and before the date of the acquisition.

A	B	C
Companies	Combined Investments in and Advances to the Companies \$ Greater than \$1,500	Combined Purchase Price of Selected Companies as a % of \$3,000
A+B+C	1,750	58%
A+B+D	1,650	55%
A+D+E	1,800	60%
B+C+D	1,800	60%
C+D+E	1,950	65%

**EXAMPLE 5 - APPLICATION OF THE SIGNIFICANCE TESTS FOR INDIVIDUALLY INSIGNIFICANT ACQUISITIONS WHEN SOME OF THE COMPANIES HAVE LOSSES FROM CONTINUING OPERATIONS**

*Assumptions*

- The Issuer acquired seven companies, A, B, C, D, E, F and G during Year 2, its most recently completed financial year.
- The Issuer files a prospectus on May 20, Year 1.
- Companies A, C, E, and G reported net income from continuing operations during its most recently completed year ended before the date of the acquisition while companies B, D and F reported net losses from continuing operations.

*Discussion*

Section A of the following table shows the consolidated net income or net loss reported by each company acquired by the Issuer during the most recently completed financial year of the company ended before the date of the acquisition. For the purposes of calculating the significance of each company, the companies have been segregated. Section B includes the companies which reported consolidated net income while section C includes those companies which reported net losses. The second column of sections B and C illustrate that each company is individually insignificant based on the income test. However, in aggregate, the companies reporting net income are significant at 65% while those reporting net losses are significant at 46%, based on the absolute value of the aggregate net losses. As a result, companies A through G inclusive, are significant at 65% and financial statements should be provided for any combination of companies whose aggregate net income is at least \$485 (ie. 50% of \$970). The combination of companies should be selected using the absolute value of any net losses.

The Issuer should include in its prospectus audited financial statements for each of the companies in the selected combination for the most recently completed financial year and the most recently completed interim period of the company, which ended more than 90 and 60 days before the date of the prospectus, respectively, and before the date of the acquisition.

Note that if the aggregate significance under both sections B and C was less than 50%, then no financial statements of any of the companies would be required.

Company	Section A	Section B		Section C	
	Net Income (Loss) From Continuing Operations	Net Income	Significance	Net Loss	Significance
A	\$235	\$235	16%		
B	(200)			(\$200)	-16%
C	210	210	14%		
D	(245)			(245)	-18%
E	250	250	17%		
F	(250)			(250)	-18%
G	275	275	18%		
	<u>\$275</u>	<u>\$970</u>		<u>(\$695)</u>	
Absolute Value		\$970		\$695	
Issuers Net Income	<u>\$1,500</u>				

Aggregate Significance based on the absolute value of the companies net income (loss) as a % of issuers net income

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65%

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46%