Corporate Finance Disclosure Report

2012 Report

Alberta Securities Commission
December 2012

Alberta Securities Commission

Throughout this report we use the terms reporting issuer (RI) and issuer. Sections 1(cc) and (ccc) of the *Securities Act* (Alberta) provide the definition of issuer and reporting issuer respectively. Although most of this report is geared to Alberta RIs, certain securities legislation addressed in this report apply to both issuers and RIs, such as National Instrument 41-101 *General Prospectus Requirements*. In these instances, issuer has a specific meaning in application and reference. The report refers to RI unless the use of the term issuer is necessary to make the distinction.

INTRODUCTION

The Alberta Securities Commission (ASC) is pleased to share with market participants its observations on the public disclosure provided by Alberta RIs during the past year through our 22nd annual Corporate Finance Disclosure Report (Report).

Our mandate is to provide protection for investors by ensuring those who operate in the Alberta capital market understand and follow the rules and regulations that govern the capital market. As such, our goal with this Report is to provide feedback to RIs that they can use to improve future disclosure.

2012 continued to provide a challenging environment for RIs. Among these challenges were:

- most RIs having to complete their first annual financial statements under IFRS;
- a continued high level of market volatility;
- depressed, yet modestly recovering, natural gas prices for the year and variable spreads on heavy versus light oil;
- uncertainties with respect to both the short-term and long-term picture for oil & natural gas transportation facilities;
- a continued intensity in the need for capital;
- the attracted attention concerning the environmental impact of operations; and
- the apparent influence of more active shareholders.

These issues can and will vary from year to year, but they serve to highlight the critical need for consistent, factual and reliable continuous disclosure (CD) for capital market participants.

Not surprisingly, many would observe a trend to more disclosure by RIs. However, it is not ASC's view that the quality of disclosure and its compliance with applicable requirements should be based on length. The "right" disclosure is always better than simply more disclosure that may miss or obscure a key piece of information. An RI's CD should clearly communicate to an investor what has happened to an issuer and why it has happened, both positive and negatively.

While it appears that the majority of issuers are diligent and understand their reporting obligations, CD reviews will remain a major emphasis for ASC staff given the importance of disclosure to capital market participants.

ASC staff will continue to make themselves available to consult with management of RIs and their advisors. We ask that when seeking our views, RIs carry out an appropriate level of research on the matter prior to contacting us in order to facilitate a useful and complete discussion of the issues.

We welcome comments and feedback on the Report, as well as observations on disclosures that are of concern to market participants.

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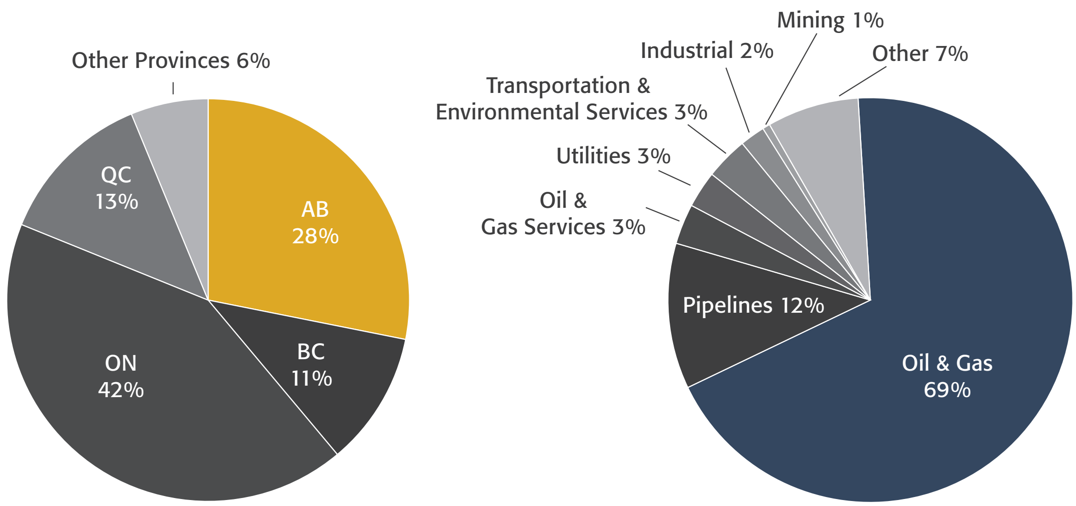
1. THE ALBERTA CAPITAL MARKET

Market Capitalization and Industry Type

Alberta is the second largest capital market in Canada. The market capitalization of Alberta-based[1] RIs constitutes approximately 28 per cent of active Canadian RIs[2]. Alberta-based RIs have the highest average market capitalization per listing.

The ASC regulates 818 Alberta-based RIs, representing a diverse range of industries, with the oil and gas industry making up the majority of RIs at 69 per cent of the total Alberta market capitalization. For further information about Alberta's capital market, refer to *The Alberta Capital Market: A Comparative Overview 2012 Report* available on the ASC's website at www.albertasecurities.com.

MARKET CAPITALIZATION



Active Canadian RIs

Alberta-based RIs by Industry

Corporate Finance

Investors participating in Alberta's and Canada's capital markets rely on information disclosed by RIs when making decisions regarding their current and potential investments. Investors proceed under the assumption that the information they are provided is both:

- relevant – timely and pertinent to the decisions they are making; and
- reliable – representative of the RI's financial condition and operations, and sufficiently comprehensive such that omissions would not result in investors changing their investment decision.

The ASC's Corporate Finance division regulates and monitors public disclosure to ensure that investors can continue to rely on this information. This Report presents our findings from the reviews of CD and offering documents completed during the year, and identifies areas where RIs can improve disclosure. We provide examples, practice tips and reminders to communicate our expectations and provide practical guidance.

[1] Represents RIs whose principal regulator (PR) is Alberta.

[2] Represents RIs based in Canada that are listed on the TSX or TSXV. Source: TMX Group, October 31, 2012.

2. CD REVIEW PROCESS & RESULTS

CD reviews continue to be a critical tool for Corporate Finance to assess RIs' compliance with securities legislation. We perform two types of CD reviews, full CD reviews and issue-oriented reviews (IORs).

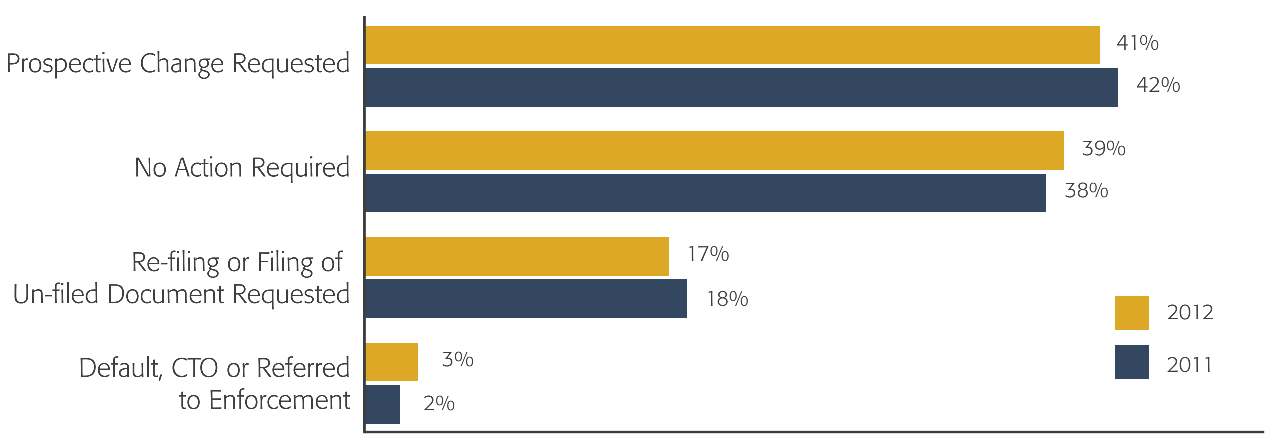
Type of CD Review	Year ended Nov. 30, 2012	Year ended Nov. 30, 2011[3]
Full CD Reviews	113	121
IORs	177	191
Total files reviewed[4]	**290**	**312**

The scope of our full CD reviews is broad and generally includes looking at an RI's CD filings for its most recently completed annual and interim periods, including financial statements, management's discussion and analysis (MD&A), information circulars, news releases, material change reports, websites, and when applicable, annual information forms (AIFs), business acquisition reports (BARs), and any other relevant filings.

We perform IORs when we want to target the scope of our review on a specific area. We conduct some IORs jointly with other Canadian Securities Administrators (CSA) jurisdictions, while other IORs are ASC-specific.

The nature of this year's IORs included specific disclosure issues in news releases, AIFs, MD&As, financial statements, as well as IFRS transition reviews of first interim reports for RIs with non-calendar year ends. A significant IOR we conducted this year included the review of 100 RIs' cash flow disclosures. This IOR focused on the cash flow statement and disclosures with respect to liquidity and capital resources. We discuss some of our observations from this review in the Liquidity and Capital Resources section of this Report.

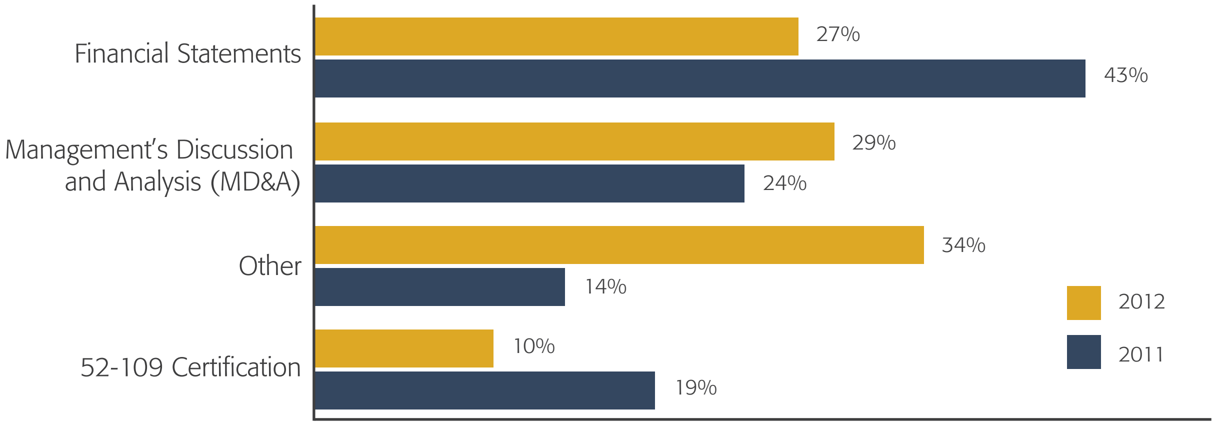
CD Review Outcomes



[3] Previously reported in the 2011 Corporate Finance Disclosure Report, after minor adjustments for current format.

[4] These numbers do not reflect the reviews we carried out on oil and gas disclosures under National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*.

Nature of Re-filings



As seen in the CD Review Outcomes chart, there has been some overall improvement in compliance with securities legislation and disclosures. The nature of the re-filings this year varied compared to the prior year. The percentage of financial statement re-filings this year is more consistent with years prior to 2011. In 2011 there was a significant increase in re-filings due to the first IFRS interim report re-filings. This year we also saw a decrease in the number of 52-109 Certification[5] re-filings, supporting our observations that RIs are generally improving on the certificate filings. The most significant increase this year was in the "Other" category, which is made up of a number of filings: AIFs; BARs; news releases; material contracts; technical reports; executive compensation; and corporate governance. Our Report will highlight key deficiencies that caused some of the re-filings.

[5] National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (NI 52-109)

3. CD REVIEWS

3.1 First Annual IFRS Financial Statements

Last year's Report outlined our expectations with respect to a few areas where we noted disclosure issues or anticipated issues with RIs' first annual IFRS financial statements. While we did observe improvement in disclosures in the first annual IFRS financial statements, some RIs continued to present disclosures that were not satisfactory.

A. Note Presentation - Significant Accounting Policies and Other Explanatory Information

Because of the adoption of IFRS, we observed an expected increase in the volume of note presentation within the financial statements. While some of this volume was a result of the additional IFRS transition presentation and inclusion of future accounting pronouncements, the general trend has been an overall increase within the accounting policy note presentations and the other explanatory notes. The increased volume in note presentation did not always add value to the substance of the information. In some cases, we observed the volume of note presentation increased unnecessarily because the RI included what appeared to be insignificant accounting policies.

The increased volume in note presentation did not always add value to the substance of the information.

Many RIs' note presentation was incomplete or unclear. This is not a new deficiency. Our observations pre-IFRS found this to be an area where RIs needed improvement. As IFRS is more principles-based than Part V Canadian GAAP, it allows more scope in interpretation and judgement, further underscoring the need for greater clarity in note presentation.

In many cases relating to significant accounting policies, the RI provided insufficient additional presentation for the reader to understand the impact of the transactions, events and conditions on the financial position or financial performance of the RI. We also continued to observe that many of the smaller issuers included note presentation that is typical of their industry but not specific to their particular circumstances.

Due to deficient note presentations we often communicated with the RI to determine whether it had applied the appropriate IFRS selection. In most cases the RI had appropriately applied IFRS; however, in a few cases, our inquiry determined the RI had not selected or applied an appropriate policy in accordance with IFRS.

Applicable IFRS standards sometimes do not exist, requiring the RI to refer to IAS 8 *Accounting Policies, Changes and Accounting Estimates and Errors* (IAS 8) and develop and apply a policy that is relevant and reliable. One example where this approach is necessary is accounting for reverse takeovers where the accounting acquiree is a shell company. In these transactions, we observed varying practices. In most cases, the RI had not provided sufficient disclosure of the judgement it made in its policy selection and application.

As policy presentation and other explanatory note presentation is important for understandability and comparability, we will continue to focus our review efforts to this area, particularly when there is either choice or varying interpretations and the applications of those policies are significant to the RI.

We encourage RIs to carefully review their note presentation on an ongoing basis to ensure that they continue to provide relevant and reliable information.

B. Judgements and Estimates

Since many IFRSs allow options for accounting policy, and the principles-based framework allows for interpretation, we expect RIs will apply more judgement. In some instances, the specific judgement that RIs apply can have a significant effect on the resulting financial information and related disclosures. While the most significant judgements and estimates represent critical information for readers, many RIs are failing to provide sufficient disclosure in these areas.

An increasing number of RIs are disclosing the fact that they have made significant judgements in preparing their financial statements; however, this disclosure does not provide the reader with any real insight into the nature of the significant judgements that management made, and why they are significant to the RI. Consistent with our findings regarding accounting policy note presentation, many RIs are identifying significant judgements that may be disclosed by the RI's peers but are not necessarily specific to the RI. This practice not only dilutes the prominence of the judgements that have the most significant effect on the RI's financial statements, it also creates disclosures that lack substance.

It appears that RIs are struggling with determining the depth of disclosure to present for their most significant judgements.

For example, several RIs stated in their accounting policy note presentation that contingencies were an area of significant judgement. However, the RIs did not disclose actual contingencies in the financial statements and they did not provide sufficient information on judgement disclosure to understand what the significant judgement was. It was unclear whether there was a material contingency that these RIs did not disclose because management made the judgement that an inflow or outflow of resources was remote, or if this area was entirely inapplicable to the RI.

It appears that RIs are struggling with determining the depth of disclosure to present for their most significant judgements. Since there are more specific requirements related to judgement disclosures in other IFRSs (such as IAS 27 *Consolidated and Separate Financial Statements* (IAS 27) and IAS 40 *Investment Property*) we would expect that a comparable level of disclosure would be appropriate for judgements in other areas (e.g., the basis for management's determination including criteria/factors/rationale that support the judgement).

Here are a few examples where we have raised comments because an RI's disclosure did not clearly identify the significant judgement made and the basis for management's determination:

- an RI has not consolidated the results of an entity that it would appear to control;
- there are significant factors supporting a functional currency for a material international subsidiary other than the functional currency the RI has disclosed; and
- significant judgement has been applied in determining cash generating units (CGUs).

PRACTICE TIPS

DO:

- focus on the RI's most significant judgements and estimates;
- provide clear distinction between estimates and judgements;
- provide sufficient detail to understand the nature of the judgement, the factors considered and the basis for management's determination; and
- ensure the basis for judgement is well documented.

DO NOT:

- provide a laundry list of all judgements applied by the RI;
- duplicate the same judgement disclosure as peers with no regard to the relevance and significance for the RI;
- simply repeat the accounting standard; or
- duplicate previous year's disclosure without considering if it is still the most significant.

REMINDERS

- Ensure that the judgement applied provides the most relevant and reliable information.
- If an RI is contemplating filing a prospectus that includes a recent or probable transaction where significant judgement has been applied due to the complexity of the transaction (e.g., identifying an acquirer or determining whether the RI has control), we encourage the RI to leave sufficient time for staff to review the basis for the assessment. Alternatively, the RI could consider a pre-filing interpretation.[6]
- IFRS 12 *Disclosure of Interests in Other Entities* becomes effective for RIs for annual periods beginning on or after January 1, 2013. This IFRS specifically requires additional judgement and assumption disclosure. As a result, we would expect this disclosure to be included when there are complex transactions and arrangements.

C. Going Concern

With the inclusion of an emphasis of matter paragraph in auditors' reports, there has been increased attention on the issue of going concern note disclosure. Based on the requirements in IAS 1 *Presentation of Financial Statements* (IAS 1), our expectation is that a reader should be able to clearly identify and understand the material uncertainties related to events or conditions that may cast significant doubt upon an RI's ability to continue as a going concern.

[6] Refer to National Policy 11-202 *Process for Prospectus Reviews* for reference on pre-filing interpretations.

As a result of mixed disclosure practices, some RIs have presented risk disclosure relating to going concern considerations, that does not necessarily represent material uncertainties, which cast significant doubt. This disclosure may be confusing to readers. While we encourage risk disclosure related to these challenges and uncertainties, RIs should consider where this disclosure is being presented, what terminology is being used, and whether the nature and extent of the risks is clear. If the wording or location of the disclosure makes it indistinguishable from the going concern disclosure required by IAS 1, the objective of the requirement may not be met, and the desired emphasis on the material items may become diluted. When RIs present boilerplate risk disclosure, we are likely to raise a comment.

D. Decommissioning Liability Disclosures

We continue to note weaknesses in the disclosure around decommissioning liabilities, most commonly with respect to the material assumptions used in the measurement of the provision.

Clear disclosure of the material assumptions (for both the current and comparative periods) not only helps readers gain an understanding of the factors involved in calculating the provision, but also adds to the understanding of changes that have occurred in the period. With the IFRS requirement to re-measure the provision at each reporting period, we have noted increased variances from period to period (often identified as revisions or changes in estimates in the note disclosure). To the extent these variances are material, we would expect sufficient disclosure to understand the nature of the changes (which estimates or assumptions changed, and why).

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI had disclosed a significant increase in the present value of its decommissioning liability in its continuity schedule and provided the following qualitative note disclosure to explain the increase:

The Company recorded a significant revision to estimated decommissioning obligations in the period. The increase in the present value of future decommissioning obligations is due to a combination of discounting future cost estimates at a lower rate than in prior periods, and increasing the underlying cost estimates. In prior periods, the Company estimated abandonment and reclamation costs using publicly available industry data as a benchmark. In the current year, an external party was engaged to perform an independent review of the Company's operating locations and provided new information with respect to the estimated costs of future site restoration.

The change in estimate has been recognized prospectively by increasing the carrying amount of the decommissioning obligation, with a corresponding addition to the carrying amount of the development and production assets to which the obligations relate.

Although the RI had disclosed the discount rates, it could improve disclosure by expanding the discussion to include the quantitative breakdown of the amount impacted by the change in discount rate and the amount of change in cost estimates. It is also unclear if the cost estimates changed because the third party consultant assessed new costs or because there are unique attributes to the RI's decommissioning liabilities that were not typical to the industry.

When decommissioning provisions relate to operations outside of Canada, there may be additional factors, considerations and judgements that affect the measurement and disclosure of the provision. For example:

- judgement in determining whether a constructive obligation exists if there is no legal obligation; and
- factors in selecting appropriate discount and inflation rates (e.g., source/location of cash flows to settle the obligation, basis/source for the rate).

Other issues we have noted are the timing of the recognition of a decommissioning provision and the omission of an expected provision. If RIs presented disclosure suggesting that development has progressed to a point where it would be reasonable to assume a liability exists, we would question the RI if there was no provision disclosed. This is especially relevant if the RI had never recognized a decommissioning liability in the past due to its overall stage of development, and also for material projects/properties within an RI's operations that progress to a point where a provision would be expected. For instance, if the RI did not recognize changes to its decommissioning liability despite a lot of development activity, we would question the appropriateness of the provision through our CD review process.

E. Segment Disclosures

Another area we focus on is segment disclosures. Any inconsistencies between an RI's financial statements and other disclosure documents may suggest that the RI is not appropriately identifying reportable segments results in accordance with IFRS 8 *Operating Segments* (IFRS 8).

For example:

- MD&A, AIF, investor presentations, etc. discussed the results of distinct operating segments, but there was no comparable disclosure in the financial statements; or
- the RI completed a significant acquisition that would appear to constitute a new reportable segment for the RI, but this was not reflected in the financial statements.

When we have inquired as to the basis for not presenting segment information, we often receive boilerplate responses from RIs referencing the scope of IFRS 8 and the definition of an operating segment, without providing sufficient detail to assess why these do not apply to the RI. We may request further clarification as to:

- who or what group is the chief operating decision maker (CODM)?
- what does the CODM regularly review (what level of operations)?

F. Additional GAAP Measures

Since last year's Report, the CSA published CSA Staff Notice 52-306 (revised) *Non-GAAP Financial Measures and Additional GAAP Measures* (SN 52-306), which provides further guidance on disclosure of additional GAAP measures presented under IFRS.

The disclosure requirements and Staff expectations with respect to non-GAAP measures remain unchanged. As such, it is still inappropriate to present non-GAAP measures in the financial statements and the additional disclosure requirements when presenting non-GAAP measures in the MD&A are still applicable.

The introduction of additional GAAP measures appears to have caused some confusion. One reason is that the identification of additional GAAP measures can differ from one RI to another (i.e., an additional GAAP measure to one RI may be a non-GAAP measure or entirely not applicable to another). As set out in IAS 1, the presentation of additional line items, headings or subtotals (to the minimum line items) in the financial statements or financial statement notes is required when it is relevant to an understanding of the RI's financial position or financial performance. Frequently, we see additional GAAP measures as additional subtotals in the financial statements.

The most common issues related to additional GAAP measures are blank lines/subtotals or inappropriate names.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

($ millions)	2011	2010
Cash provided by (used in) Operating Activities:		
Comprehensive loss	(6,543)	(7,432)
Items not involving cash:		
Depletion, depreciation and amortization	7,111	3,222
Impairment of property, plant and equipment	891	1,234
Stock-based compensation	789	987
Accretion expense on decommissioning obligations	45	34
	2,293	(1,955)
Changes in non-cash working capital (Note 7)	678	(333)
	2,971	(2,288)

Here, the RI presented an unnamed subtotal in its Statement of Cash Flows above the line item 'Changes in non-cash working capital'. The unnamed subtotal corresponds to a measure called "Funds from operations" in the RI's MD&A.

If the RI has determined the additional subtotal is relevant to an understanding of its financial position or financial performance, then the subtotal should be presented. The RI would then be expected to name the subtotal, as set out in SN 52-306. If the additional subtotal is not relevant, it should be removed.

The fact that this unnamed subtotal was presented as an additional GAAP measure in the financial statements, but has been named and identified as a non-GAAP measure in the MD&A can pose additional issues as the disclosure requirements for additional GAAP measures differ from those for non-GAAP measures. The inconsistent identification can cause confusion for readers.

PRACTICE TIPS

Considerations to address when presenting an additional GAAP measure:

- Is the line item/subtotal unnamed?
- Is the name inappropriate (look for generic identifiers such as "before the undernoted" or "other items")?
- Does the presentation of the additional GAAP measure confuse, obscure or exceed the prominence of minimum disclosure items?
- Is additional disclosure required to clearly explain the measure?
- Is the discussion and analysis of the measure in the MD&A missing?

We continue to note issues with the presentation of certain non-GAAP measures with more prominence than the closest GAAP measure. Some RIs presented an analysis of the non-GAAP measure in the MD&A (identifying and analyzing variances from prior periods, etc.); however, the discussion of the closest GAAP measure was either far less comprehensive or not presented at all. This was most commonly noted when a measure that represents Cash Flow from Operating Activities before changes in non-cash working capital (often referred to as Funds from Operations) was presented and discussed in the MD&A while the RI omitted any discussion of the closest GAAP measure, Cash Flow from Operating Activities.

3.2 Other Notable Areas

We have noted several other areas where RI disclosures could be improved. While many of our expectations for improvement consider the need for additional disclosure, our intent is not necessarily to add to the volume of disclosures. We encourage RIs to consider the substance of their overall disclosure record, and focus on what is relevant, material and meaningful to readers. Depending on the current financial condition and operations, RIs should consider how their disclosures can evolve accordingly.

We encourage RIs to consider the substance of their overall disclosure record, and focus on what is relevant, material and meaningful to readers.

A. Liquidity and Capital Resources

With continued market and commodity price volatility, many RIs have faced liquidity and capital challenges. In order to assess RIs' disclosure of cash flow information and the depth of disclosure for those RIs that face certain risks in light of their business condition, we carried out an IOR of cash flow disclosure. Our review focused on cash flow presentation, liquidity and capital disclosure as presented in the RI's disclosure documents.

Material terms of debt including financial covenants

We noted an increased incidence of RIs that breached their debt covenants, that were in risk of breaching covenants, or that had reductions to their facility limits. In a few cases, the RI entered into discussions with its creditors to negotiate a waiver in anticipation of a possible breach.

Our review indicated that seven per cent of RIs with debt did not disclose the existence of debt covenants. Of those RIs that did identify debt covenants, only 46 per cent provided clear details of those covenants. All but one RI that breached its covenant had disclosed this fact; however, those RIs nearing or anticipating a covenant breach did not provide sufficient disclosure for readers to appreciate the associated liquidity risks.

Financial Statements

IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) requires disclosure of summary quantitative data and qualitative discussion about an RI's exposure to liquidity risks arising from financial instruments, such as short and long-term borrowings. The application guidance further explains that if the outflows of cash in this summary data could occur significantly earlier than indicated (e.g., covenant breach that causes the lender to call the loan) the RI needs to state that fact and provide quantitative information that enables users to evaluate the extent of the risks (e.g., how far the RI is from a potential breach).

MD&A

The MD&A is meant to complement and supplement an RI's financial statements, and discuss important risks that have, or are reasonably likely to have, an effect on the financial statements. To the extent that RIs have included disclosure related to the liquidity risk in the financial statements, these disclosures should be discussed further in the MD&A.

The MD&A should provide an analysis of the statement of financial position conditions, profit or loss, or cash flow items that may affect the RI's liquidity. For instance, if conditions have deteriorated to a point where there is a default or a material risk of default, this should be discussed. In addition, RIs should disclose how they intend to remedy the default or address the risk.

In disclosing trends or expected fluctuations in liquidity and related risks, RIs should discuss provisions in debt, lease or other arrangements that could trigger a material additional funding requirement or early repayment. This discussion would likely relate back to the disclosure provided with respect to covenants in the financial statements.

PRACTICE TIPS

To provide sufficient disclosure, the RI should consider discussion of:

- the status of debt facilities (e.g., if the facility is up for review/renewal);
- the amount of facility drawn and remaining; and
- the details of covenants.

The extent of disclosures necessary for users to understand the liquidity risks of an issuer will vary depending on the facts and circumstances of the RI.

EXAMPLE THAT MET OUR EXPECTATIONS

The Company's indebtedness is subject to a number of financial covenants. Under the terms of the Company's credit facility, the following ratios are monitored: current ratio, funded debt to EBITDA, and fixed coverage ratio.

Current ratio

Current ratio is the ratio of current assets to the current liabilities.

Funded debt to EBITDA ratio

Funded debt is all of the Company's obligations, liabilities and indebtedness which would, in accordance with GAAP, be classified on a consolidated balance sheet of the Company as indebtedness for borrowed money of the Company, but excludes subordinated debt, deferred taxes and accounts payable incurred in the ordinary course of the Company's business.

Fixed charge coverage ratio

Fixed charge coverage ratio is the ratio of EBITDA less the aggregate amount of unfunded capital expenditures and cash taxes divided by the sum of all interest expense and scheduled repayment of debt for the relevant period, cash dividends and rent.

As at December 31, 2011, the Company was in compliance with all credit agreement financial covenants, as follows:

Ratio	Covenant (March 1, 2012 Agreement)	Covenant (March 1, 2011 Agreement)	RI at Dec. 31, 2011
Current	> or = 1.20:1.00	> or = 1.00:1.00	1.90:1.00
Funded debt to EBITDA	< 2.50:1.00	< 2.80:1.00	1.65:1.00
Fixed charge coverage	> or = 1.00:1.00	> or = 1.00:1.00	1.36:1.00

The funded debt to EBITDA and fixed charge coverage ratios are calculated quarterly based on the latest rolling four quarter period completed.

In this example the RI described each of the relevant covenants and disclosed its actual results for each covenant. In this case, there was also a recent amendment to the covenant thresholds in its credit facility agreement (subsequent to the year-end), so the RI disclosed the thresholds that were in place at the balance sheet date, as well as the updated covenants. This provides meaningful information to readers to assess the RI's risk of default under both agreements.

PRACTICE TIP

In order to avoid unnecessary duplication of disclosure, RIs may want to consider that, as permitted under IFRS 7, certain disclosures pertaining to the nature and extent of risks arising from financial instruments under paragraphs 31 – 42 may be presented either in the financial statements or incorporated by reference to some other disclosure document, such as the corresponding MD&A.

Liquidity and Capital

We continue to see boilerplate liquidity disclosure in RIs' MD&As, particularly in the areas of anticipated funding and working capital deficiencies. Some RIs simply repeated disclosure from the financial statements related to the Statement of Cash Flows or capital disclosures.

Often the disclosures with respect to anticipated funding requirements and how the RI expects to generate sufficient amounts of cash and cash equivalents, both in the short term and long term were vague and insufficient.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI that had not yet established significant revenues, had generated a net loss of $4 million in 2011, and did not complete any successful debt or equity financings in the year, provided the following disclosure:

<u>Liquidity and Capital Resources:</u>

At December 31, 2011, the Company had bank indebtedness of $0.1 million and a working capital deficiency of $1.6 million. The Company does not have sufficient working capital at this time to meet its ongoing financial obligations for the next twelve months and fund its business plan. It will require additional funds either from revenues or financing to continue its operations. While management of the Company believes that it will be able to generate funding through sales or equity financing there can be no guarantee that the Company will be successful in obtaining sufficient revenues or financing to continue operations beyond this date.

In this example, the RI provided a boilerplate description of potential sources of funding and a general disclaimer that the anticipated sources of funding may not actually be available. As a result, this disclosure does not offer readers any insight into the RI's ability to generate sufficient amounts of cash and cash equivalents. Rather than generic disclaimers, we would expect RIs to describe the entity-specific, material circumstances that could affect the sources of cash and cash equivalents that are reasonably likely to occur.

In addition, the RI was ambiguous in disclosing that the anticipated sources of funding may not be available. This ambiguity may result in readers questioning the implications of the RI not obtaining the needed funding – such as, whether this lack of funding could impair the RI's ability to undertake essential transactions, meet planned growth or development activities, and discharge its working capital requirements.

PRACTICE TIPS

Reassess MD&A disclosure on an ongoing basis to avoid simply carrying-forward disclosure that is no longer applicable. Also consider if there is disclosure required now, which may not have been applicable in the past.

The nature of MD&A disclosures should evolve as the financial condition and results of operations of an RI change.

Working Capital

While RIs generally identified when they had a working capital deficiency, we noted weak disclosures related to how RIs could meet their working capital obligations as they came due, and how they expected to remedy the deficiency. We often saw boilerplate disclosures or a repeat of the going concern note disclosure from the financial statements as an attempt to address this disclosure requirement. In addition, we noted that few RIs provided appropriate analysis when they had positive working capital, but expected to have a working capital deficiency.

RIs are reminded that the disclosures of potential funding sources to remedy a working capital deficiency should be reasonably based on the RI's specific circumstances. For instance, if the RI encountered difficulty raising equity financing or the share price deteriorated significantly, future equity financings may not represent a viable potential funding source. This is one area where we found that providing updated information (i.e., as at or close to the date of the MD&A) related to any financings, or other sources of funding that the RI was able to realize since the end of the relevant reporting period, offers meaningful information to the reader.

EXAMPLE THAT MET OUR EXPECTATIONS

The Company's consolidated working capital deficiency (current assets less current liabilities) as at March 31, 2012 is $2.5 million. The Company received $5.5 million (before costs) from an issue of convertible debentures which closed on May 5th, 2012 which covered the working capital deficiency. In addition to these funds, the Company expects to be able to access further capital through farmouts and selected asset sales, although none have been completed to date and there is no certainty we will find buyers on acceptable terms. The latter are likely only to be partial sales or reductions in working interest for the Company's exploration assets. Funds received from farmouts and asset sales will provide the Company with a different risk profile on those particular projects farmed out and reduce the requirements on the Company's cash balances while at the same time ensuring exploration activities continue.

Cash Flow Statement

A majority of RIs we reviewed cited either a cash flow measure or a measure derived from the statement of cash flows as a key metric that the RI or the analysts following the RI used.

It is important that the presentation of the line items in the statement of cash flows is appropriate. Given the prevalence of the discussion and analysis of cash flows from operating activities in RIs' disclosures, RIs should carefully consider the classification of cash flow items between operating, investing and financing activities. We noted a few cases where line items appeared to be inappropriately included or excluded from cash from operating activities, typically when this adjustment was favourable to the results of the RI. In these cases we raised comments that questioned the RI's classification.

For example, an RI presented exploration and evaluation costs that had been expensed as incurred (i.e., had not been capitalized) as an adjustment for non-operating transactions in determining the cash flow from operating activities. The RI then presented these costs as a cash outflow for investing activities. Since paragraph 16 of IAS 7 *Statement of Cash Flows* states that only expenditures that result in a recognized asset in the statement of financial position are eligible for classification as investing activities, the RI's classification was inappropriate. By including the exploration costs expensed as an adjustment to cash flows from operating activities this cash flow measure was inappropriately overstated and cash flows from investing activities were understated.

B. Results of Operations

A continued area of weakness in MD&A disclosures related to the discussion of overall performance (section 1.2 of Form 51-102F1 *Management's Discussion & Analysis* (51-102F1)) and operations (section 1.4 of 51-102F1). We noted that many RIs provided superficial discussions of performance and operations – often repeating information that they already provided in the financial statements, or identifying changes, without analyzing the underlying reasons for the changes. Disclosure should enhance a reader's understanding of the RI's financial condition and financial performance and highlight trends.

REMINDERS

- A discussion of financial condition should include important trends and risks that have affected the financial statements, and **trends and risks that are reasonably likely to affect them in the future**.
- When explaining changes in an RIs financial condition and results, include an analysis of the **effect on continuing operations** of any material acquisition, disposition, write-off, abandonment or other similar transaction.

EXAMPLES OF CHANGE AND POSSIBLE "WHY"

Disclosing that revenues decreased due to a decrease in the volume of oil and natural gas sales does not provide readers with meaningful insight into the **underlying reason for the decrease** in volume of the sales. As a result, the reader is unable to determine the effect on the financial statements in future periods. Disclosing WHY a measure changed (rather than simply identifying the change) can provide readers with information to assess the potential impact on the RI, and assess whether past performance is indicative of the future.

Disclosing the reason for the decrease in oil and gas sales volumes can lead a reader to very different expectations regarding future performance:

Potential cause for current decrease in sales		Potential impact on future operations
Disposition of a production facility	→	Sales are expected to stay at the decreased level
Production stoppage for maintenance	→	Sales are expected to return to normal levels when maintenance complete
Production stoppage for material expansion	→	Sales are expected to exceed previous levels when expansion complete
Plan to gradually sell off all production assets	→	Sales are expected to continue to decline

PRACTICE TIP

In considering what and how much to disclose, step back and ask yourself, "Have I clearly provided the underlying reasons for the change in operations?"

C. Updating Information

The requirement to update information is another area we have identified for improvement. Specifically:

- updating previously disclosed forward-looking information (FLI) or outlooks; and
- providing updates of progress on significant projects.

The requirement to provide updates applies to all disclosures made by an RI, including MD&As, news releases, websites and corporate presentations.

Updating FLI

When events or circumstances occur where there is a significant risk that actual results will differ materially from a previously presented FLI or outlook, the expectation is that an RI will discuss in its MD&A the events or circumstances and the expected differences.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

This is an example where an RI presented its outlook related to an exit rate of production for the next financial year.

2010 Annual MD&A: Excerpt from the "Outlook" section – filed in March 2011:

"Increase production facilities to handle our target exit production rate of 28,000 bbl/d."

Staff noted that this rate would represent a material increase in the Company's production rates – more than double the RI's current rates.

The RI presented the identical outlook disclosure in each of its interim MD&As, filed throughout 2011.

In its 2011 annual MD&A, filed in March 2012, the RI disclosed the actual exit production rate (15,000 bbl/d), which was significantly lower than what it presented in the previous MD&As as outlook.

The RI provided no discussion of the variance from the target presented to actual results. The RI disclosed the fact that production increased from the prior year, but it provided no discussion of the fact that the increase was far less than what it presented as outlook at December 31, 2010 and throughout fiscal 2011.

The first instance where the RI addressed the significant difference between the outlook and the actual results was in a Corporate Presentation filed in June of 2012.

June 2012 Corporate Presentation:

Disclosed that the Company had missed production targets due to operational issues due to water intrusions and liner issues.

In this case, when management became aware of the operational issues that were materially affecting the production growth of the RI such that the actual results were likely to differ materially from the target that it previously presented as a 2011 exit production rate, the RI should have disclosed this information in a timely news release and discussed in the applicable 2011 interim MD&As.

REMINDER

As set out in Part 7 of National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102), if a material change occurs in the affairs of an RI, the RI must:

- immediately issue and file a news release authorized by an executive officer disclosing the nature and substance of the change; and
- as soon as practicable, and in any event within 10 days of the date on which the change occurs, file a Form 51-102F3 *Material Change Report* with respect to the material change.

EXAMPLE THAT MET OUR EXPECTATIONS

2011 Annual MD&A "Outlook" excerpt:

Assuming drilling success based on expected outcomes and applied risk parameters, the Corporation anticipates exiting 2012 with approximately 9,750 to 10,000 boe/d with about 60% to 75% oil and liquids. Average 2012 production is expected to be approximately 7,200 boe/d, with about 50% oil and liquids.

Q1 Interim MD&A "Outlook" excerpt:

Due to low natural gas prices, the Company shut-in approximately 480 boe/d of sour gas production in the DEF area subsequent to the quarter-end. The shut-in production will reduce the expected average production rate from 7,200 boe/d in 2012 to about 6,850 boe/d with about 55% representing crude oil and NGLs. Assuming drilling success based on expected outcomes and applied risk parameters, the Company anticipates exiting 2012 with approximately 9,325 to 9,575 boe/d with about 63% to 68% representing crude oil and NGLs. Given that the shut-in production was cash flow negative at the time, the impact is negligible and cash flow is still expected to be about $40.0 to $42.0 million in 2012.

Q2 Interim MD&A "Outlook" excerpt:

The Company still anticipates exiting 2012 with approximately 9,325 to 9,575 boe/d with about 63% to 68% oil and liquids. [...] However, due to a 45-day delay in starting production from the Corporation's first three HIJ Formation oil wells in the second quarter, the subsequent four-week shut-in period of the higher producing DEF area oil well early in the third quarter to comply with energy regulations and other future production timing adjustments, the Company is reducing its expected 2012 average production rate from 6,850 boe/d to 6,100 boe/d with about 52% oil and liquids and its expected 2012 cash flow to about $38.0 to $39.5 million. As a result of the reduced cash flow and an increase in capital expenditures, the Company's year end net debt level is expected to increase to between $39.0 and $41.0 million. The above cash flow guidance is based on an annual average oil price of US$94 WTI per barrel and an annual average AECO natural gas price of $2.00 per mcf. It also anticipates an average annual corporate operating netback of $32 per boe over 2012 and an average 2012 general and administrative cost of $5.10 per boe.

In this case, management provided updates when it expected material differences from what was originally presented as the production outlook. The RI also discussed a possible material effect on other previously disclosed FLI or outlook, such as the expected 2012 cash flows.

REMINDER

In addition to the requirement to update material FLI in section 5.8 of NI 51-102, an RI should also identify and **discuss material expected changes that did not occur** in the RI's financial condition and results of operations in the discussion of overall performance (section 1.2 of 51-102F1).

For example, if an RI discloses that it expects to commence production on a material property in the next interim period, and this does not end up occurring, our expectation is that to the extent that such a delay would be material to the financial condition or operations of the RI, it would be discussed in the MD&A.

Updating Significant Projects

We noted cases where RIs disclosed significant development projects, but did not update their disclosures to discuss the status of these projects. It is important for readers to understand the significant projects an RI has and how the RI is progressing towards completing significant milestones. We would expect disclosure of material changes (e.g., in timing, expected costs) to the development plan, and the expected impact of such changes on the project and the RI.

RIs should focus on material updates when presenting subsequent MD&As. We noted that some RIs simply added on to the description of their projects at each reporting period, creating a growing timeline of status updates. While this may be appropriate in cases where RIs have made significant progress in a period and this disclosure is meaningful to readers, in many cases, this presentation could create an overload of information. An up-to-date summary may be more reader-friendly.

REMINDER

RIs with significant projects that have not yet generated revenue are required to provide the following disclosures:

- a description of each project, including the RI's plan for the project and the status of the project relative to that plan; and
- the expenditures made and how these relate to anticipated timing and costs to take the project to the next stage of the project plan.

This discussion should include:

- whether or not the RI plans to expend additional funds on the project;
- any factors that have affected the value of the project(s) such as change in commodity prices, land use or political or environmental issues; and
- the progress in achieving previously announced milestones.

D. Understanding the Business

When presenting a description of the RI (in an AIF, MD&A, etc.), RIs should ensure that the discussion presents the material information in a clear manner to enable an understanding of the business. We noted that some RIs, especially those in a period of development and/or growth, presented an excessively long and complex discussion of the development of their business. What may start as a meaningful discussion of updates of material milestones, objectives, and growth can evolve into a lengthy discussion where it is difficult to distinguish material facts and current status.

RIs should also keep in mind the form in which they present such discussions. They can use tables effectively to facilitate efficient disclosure, especially when identifying or comparing a number of properties, assets, segments, etc.

PRACTICE TIP

Keep the reader in mind when preparing the description of the business. Would someone who is not already familiar with the company be able to gain a good understanding of the nature of operations from the description provided?

E. Unbalanced and Promotional Disclosures

One of the key concepts underlying appropriate CD practices is maintaining balanced disclosures. Events, results and conditions that are potentially unfavourable for an RI should be disclosed just as promptly, prominently and completely as those which are favourable. As noted in National Policy 51-201 *Disclosure Standards*, RIs that disclose positive news but withhold negative news could find their disclosure practices subject to regulator scrutiny.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI consistently provided disclosures about two of its main oil & gas properties (Site A and Site B). Based on the relative capital expenditures and comparable prominence in historical CD filings, both appeared to be material to its operations. At year end, the RI disclosed an impairment loss, the majority of which related to Site B. The RI's MD&A disclosures focused on the positive results, including significant growth in reserves in Site A, and omitted what was considered to be material information regarding the impairment on Site B. As a result of this unbalanced and incomplete disclosure, we required the RI to re-file its MD&A.

We also noted some RIs provided promotional and unsupportable statements. These statements were more prevalent in filings such as MD&As, news releases and corporate presentations, as well as on RIs' websites.

EXAMPLES OF PROMOTIONAL STATEMENTS NOTED

- "the future looks very bright";
- the RI is in "a great position financially and strategically"; and
- "the Company will have low cost structures and high corporate netbacks generating strong cash flow and capital."

Due to the subjective nature of statements such as these, and the lack of measurable goals, milestones and assumptions to support these comments, the use of this type of promotional wording can be misleading and should be avoided.

Some RIs presented promotional disclosures that were contradictory to risk disclosures contained in the same disclosure document (e.g., with respect to certainty and immediacy of anticipated returns for investors). Including the risk disclosure does not serve to provide balance to the disclosure (i.e., it does not mitigate the fact that the RI provided the promotional disclosure), but simply leads to reader confusion and detracts from the clarity of the disclosures.

REMINDER

The concept of providing balanced, consistent and supportable disclosure should be applied to all forms of information disseminated by an RI including news releases, documents, presentations and disclosures that are presented on RI websites.

Well-flow test results

The CSA published an update to CSA Staff Notice 51-327 *Guidance on Oil and Gas Disclosure* (SN 51-327)[7] that included new guidance with respect to disclosure of well-flow test results. The main concern is that RIs may disclose the results of extremely short-term test rates or peak rates without identifying them as such. Without providing the additional disclosures outlined in SN 51-327 this disclosure may be misleading or considered to be promotional.

[7] Published December 29, 2011

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

Excerpt from January 2012 Material Change Report:

"The well was placed on production January 14, 2011 at 660 barrels of oil per day ("bopd") (330 bopd net) and 1,400 thousand cubic feet per day ("mcf/d") of gas (700 mcf/d net) for a total of 893 BOE/d (447 BOE/d net)."

Excerpt from Q1 2012 MD&A:

"Although this well's initial production was approximately 450 BOE per day net to the Company, it has since declined to 80 BOE per day net to the Company.

Initial production from the first Property LMN well was at a rate of 225 BOE per day but has since stabilized at a rate of approximately 45 BOE per day bringing the Company's current total production level for all wells to approximately 165 BOE per day."

In this example, the RI disclosed the results from its well-flow test but did not include the additional disclosures per SN 51-327. As a result, we considered the disclosure to be misleading.

We have noted investors and analysts are sensitive to the disclosure of flow testing results, and share price can fluctuate significantly as a result of the initial disclosure of the very positive flow testing results and the potentially material decrease to sustainable production levels. Appropriate disclosure can enable RIs to manage expectations regarding anticipated production.

EXAMPLE THAT INCLUDED THE ADDITIONAL DISCLOSURE

July 16, 2012 News Release

Production test results and additional data from the first four OPQ Formation wells drilled by the Company are provided in the following table. The production test results from the recently completed third and fourth wells exceeded expectations averaging 846 bbls/d and 864 bbls/d of oil after a 9 day and 4 day test respectively.

Well ID Location	Avg test rate (bbl/d oil)(1)	End of Test Rate (bbl/d oil)(1)	IP30 (bbl/d oil)(1)	IP60 (bbl/d oil)	Current Rate (bbl/d oil)	Cumulative oil (bbls)
#1	799 (5 day)	510	420	330	240	22,500
#2	820 (7 day)	736	535	-	-	17,500
#3	846 (9 day)	643	-	-	-	9,000
#4	864 (4 day)	550	-	-	-	7,700

(1) Test rates are not necessarily indicative of long-term performance or of ultimate recovery.

When presenting its operational updates and drilling updates, the RI added the disclosures required to accompany the disclosure of well-flow test results including:

- *the relevant geological formation (OPQ formation);*
- *the type of test (production test);*
- *the duration of the test (specified for each location),*
- *average rate during the test; and*
- *a cautionary statement that the test results are not necessarily indicative of long-term performance or of ultimate recovery.*

The production declines during the test are disclosed through the presentation of both the average rate during the test and the end of test rate to show the decline. The RI also includes updated rates at 30 and 60 days into production, as well as the current rate so that readers are able to see the decline in the rate.

F. Interim Reporting

IAS 34 *Interim Financial Reporting* (IAS 34) prescribes the minimum content for an interim financial report, and the principles for recognition and measurement in complete and condensed financial statements for an interim period. The disclosure requirements of IAS 34 are based on the assumption that anyone reading the interim financial report will have access to the most recent annual financial statements. Therefore, not all of the supplementary notes in the annual financial statements are required for interim reporting purposes, as this would result in repetition. Explanation of events and transactions in an RI's interim financial report is required if these events are significant to an understanding of the changes in financial position and performance of the RI[8].

We noted that some RIs did not provide disclosures for significant events and transactions that occurred since their last reporting period. One RI issued a press release prior to the end of its second quarter disclosing that it had entered into a farm-out arrangement. The RI later supplemented this news release disclosure with a general description of the farm-out transaction in the RI's corresponding interim MD&A. The interim financial report did not contain accounting policy note presentation about how the RI accounted for the farm-out arrangement. In addition, as this was the RI's first farm-out transaction, the prior annual financial statements did not include accounting policy note presentation for a farm-out transaction. In this case we did not feel the disclosure in the interim report was sufficient for an understanding of the changes in the RI's financial condition and performance.

REMINDER

Explanatory notes included within the interim financial report should be useful in understanding the events and transactions that have resulted in changes in the RI's financial position or performance since the end of the last annual reporting period.

G. Impairment

A number of RIs recognized impairment losses in one or more periods presented in their first annual IFRS financial statements. However, fewer RIs recognized impairments in subsequent interim periods, despite what appeared to be indicators of impairment. If we observe signs of indicators of impairment such as decreases in market capitalization or commodity prices, and it is unclear how the RI took those indicators into consideration, we will likely raise comments if the RI did not take an impairment.

We will continue to review CD filings to assess whether the measurement and timing of impairments taken were appropriate (i.e., whether the impairment should have been recognized in an earlier period).

RIs must provide the disclosures required by IAS 36 *Impairment of Assets*, including the identification of the CGUs affected by the impairment. We noted that it is not always evident which CGU an impairment relates to. This can result in potentially misleading disclosure when the results of operations of some CGUs are positive, while others are experiencing material impairment losses.

[8] As required by paragraphs 15 -15C of IAS 34.

H. NI 52-109

We noted some RIs continued to struggle with certain requirements of NI 52-109 compliance. One of the most common issues we observed relates to non-venture RIs not disclosing or not fully disclosing the certifying officers' conclusions about the effectiveness of Disclosure Controls and Procedures (DC&P) and Internal Control over Financial Reporting (ICFR) in the annual MD&A. Form 52-109F1 *Certification of Annual Filings Full Certificate*[9] requires the CEO and CFO to certify that the annual MD&A discloses the certifying officers' conclusions about the effectiveness of DC&P and ICFR. When the MD&A disclosure was unclear, incomplete, or omitted, we asked RIs to re-file the annual MD&A and certificates.

Other common issues we identified during our review include the following:

- amendments to wording on forms – RIs and certifying officers may not make any amendments to the wording prescribed by the required form even if they considered those amendments to be minor. If RIs made significant amendments to the wording of the form, they were asked to re-file the certificates; and
- RIs using old 52-109 forms – the amendments to NI 52-109 came into force on January 1, 2011.

We encourage RIs to review the Companion Policy to NI 52-109, CSA Staff Notice 52-325 – *Certification Compliance Review* and CSA Staff Notice 52-327 *Certification Compliance Update* for additional guidance on NI 52-109 requirements.

I. Reverse Take-over Transactions

The transition to IFRS has introduced new considerations with respect to reverse-takeover transactions (RTOs). In cases where the accounting acquiree does not meet the definition of a business, these transactions do not fall within the scope of IFRS 3 *Business Combinations* (IFRS 3). This is a common arrangement, especially for RIs completing a Qualifying Transaction.

We noted the following two views in practice:

1. These transactions are within the scope of IFRS 2 *Share-based Payment* (IFRS 2); or
2. There is absence of an IFRS that specifically applies, so issuers use judgement in developing and applying an accounting policy in accordance with IAS 8.

In developing an accounting policy, issuers have used IFRS 2 by analogy, IFRS 3 by analogy or the capital transaction approach.

Our expectation, as set out in section 3.1(A) of this Report is that RIs present clear disclosure about the accounting policy that they have applied, including significant judgements made. In the absence of clear disclosure, we may raise comments to clarify the approach taken and related disclosures.

[9] Subsections 6(a) and (b)(i).

J. Non-Core and Core Terminology - Oil and Gas RIs

RIs in the oil and gas industry commonly make reference to the terms "core" and "non-core". We observed that this reference was used in conjunction with terminology such as properties, plays and assets and was often used interchangeably within and among RIs disclosure documents. It was often unclear what distinguished one from the other. This terminology was frequently used by RIs in the context of their discussion of activities, outlook, CGUs, dispositions, and impairments.

For purposes of discussing our observations we use the term "properties".

We noted many RIs did not clearly disclose what they define as core and non-core properties. In some cases the RI identified its core properties in its annual disclosure documents but then, in its subsequent annual reporting, the core properties changed without clear disclosure between the periods as to how the core properties previously reported became non-core.

The observed disclosure practices become particularly problematic when discussing CGUs, impairment and dispositions. For example, one RI made disclosure of five CGUs in its IFRS transition interim financial report. It clearly identified and described four CGUs as core CGUs and described the fifth as a non-core CGU. In its 2011 annual financial statements, the RI took an impairment. The financial statements disclosed the impairment related to "certain assets" with no further disclosure, while the annual MD&A provided disclosure that the impairment related to two non-core CGUs. Based on our inquiry, we were satisfied with the rationale for one core property becoming non-core by the next annual period. However, we found the disclosure in respect to the change was unclear and confusing.

We noted several RIs, when disclosing dispositions, would refer to those dispositions as non-core properties. Without clear disclosure we were unable to determine if those properties were recently considered core properties and changed to non-core on disposition, or were consistently considered non-core in the RI's financial year.

While we recognize that an RI's core and non-core properties will change over time due to many circumstances, it is important that the disclosure be clear so that users can understand and assess those changes. We are also of the view that if an RI is using the term core it is conveying that property is material to the RI.

We encourage RIs to explain their terminology, use it consistently, and disclose changes between core and non-core in a clear and timely manner.

4. OFFERING DOCUMENTS

During the year ended November 30, 2012, there was a total of 179 offering documents filed by RIs and issuers where Alberta is the principle regulator, a 21 per cent decrease from the prior year. A large part of the overall decline in short form prospectuses resulted from the continued uncertainty in the capital markets.

Type of Filing	12 months ended November 30, 2012	12 months ended November 30, 2011	% Change
Initial Public Offering (IPO) Prospectus	15	32	(53%)
Long Form Prospectus	6	5	20%
Short Form Prospectus	140	159	(12%)
Rights Offering Circular	4	6	(33%)
CPC Prospectus	14	25	(44%)
Total	**179**	**227**	**(21%)**

During the year we noted deficiencies for prospectus filings related to:

- use of proceeds disclosure;
- disclosure regarding financial condition;
- minimum subscription considerations;
- earnings coverage; and
- combined financial statements.

A. Use of Proceeds Disclosure

A prospectus should contain clear disclosure on how the RI intends to use the proceeds raised in an offering. The prospectus form requirements set-out various disclosure requirements depending on the RI's stated use of proceeds[10].

[10] As set out in section 6 of Form 41-101F1 *Information Required in a Prospectus* (41-101F1) and section 4 of Form 44-101F1 *Short Form Prospectus* (44-101F1).

EXAMPLE OF USE OF PROCEEDS DISCLOSURE THAT DID NOT MEET OUR EXPECTATIONS

(Italicized notes added)

The Corporation intends to use the net proceeds from the offering to temporarily reduce its indebtedness under the credit facility. The Corporation's current indebtedness under its credit facility has been incurred in the ordinary course of business and the principal purpose for the indebtedness is to fund the exploration and development of the Corporation's assets (***see (1) below***). The Corporation funded its capital program for the past two financial years through the use of the credit facilities and cash flows from operating activities (***see (2) below***). The balance of expenditures required for the Corporation's 2012 capital program (***see (3) below***) are expected to be funded through the credit facility and cash flows from operating activities (***see (2) below***).

We did not consider the use of proceeds disclosure in the above example to be sufficient and we requested additional disclosure for the following items:

(1) There was insufficient disclosure around the principal purposes for which the proceeds of the indebtedness were used within the two preceding years as required by section 4.3 of 44-101F1[11].

(2) The financial condition of the RI did not support the use of, 'cash flows from operating activities', as the RI's statements of cash flows presented negative cash flows from operating activities of $3.3 million and $12.9 million for the three months ended March 31, 2012 and the financial year ended December 31, 2011 respectively.

Given the lack of clarity as to how the RI's 2012 capital program was to be funded and how its capital program was funded in the past, we requested details, in the form of additional disclosure in the prospectus, for the following items:

- the amount of indebtedness under the credit facility outstanding as at the most recent month-end before the date of the prospectus;
- the amount of the undrawn borrowing facilities, after giving effect to the offering, that may be available for future operating activities of the RI; and
- disclosure of the negative cash flow from operating activities and whether the net proceeds from the offering would be used to fund any anticipated negative cash flow from operating activities in future periods.

(3) The RI did not provide disclosure on the business objectives the RI intended to achieve with the proceeds as required by section 4.7 of 44-101[12]. Given that the successful execution of the 2012 capital program would accomplish the RI's short-term business objectives, we requested

[11] There is a comparable requirement in section 6.4 of 41-101F1.

[12] There is a comparable requirement in section 6.8 of 41-101F1.

additional disclosure on the RI's planned 2012 capital program. This RI did not have any specific or significant milestones[13].

In consideration of the above, the RI made changes to the disclosures as follows:

SAME EXAMPLE AS ABOVE WITH CHANGES MADE TO MEET OUR EXPECTATIONS

The Corporation intends to use the net proceeds from the offering to temporarily reduce its indebtedness under the credit facility, thereby freeing up borrowing capacity which is intended to be redrawn and applied as needed to fund the Corporation's 2012 capital program and for additional working capital purposes. Approximately $45.9 million of indebtedness was outstanding under the credit facility as at May 31, 2012. The bulk of the Corporation's current indebtedness under its credit facility was incurred in 2011 when the Corporation drilled 24 gross oil wells in the Area UVW and completed upgrades to its pipelines and facilities to further enhance its production capabilities. After applying the net proceeds from the offering to the credit facility, the Corporation will have approximately $83.1 million in available debt funding which will be used to fund the Corporation's 2012 capital program.

The Corporation has planned a capital expenditures budget of $76.2 million for 2012, focusing on its capital program for the development of Project XYZ. The net proceeds from the offering are being utilized, along with the credit facility and working capital to fund those planned expenditures. The Corporation sees the 2012 planned capital program as part of its ongoing strategy to drill and expend its production capabilities in this area. A breakdown of the planned expenditures for 2012 is as follows:

Estimated 2012 Capital Program

Drilling & completions – 26 wells	$ 48.6 million
Facilities & equipping	$ 13.2 million
Land & seismic	$ 14.4 million
Total	$ 76.2 million

During the three months ended March 31, 2012 and the fiscal year ended December 31, 2011, the Corporation had negative cash flows from operating activities. The Corporation does not intend on using the net proceeds from the offering to fund its negative cash flow. If the Corporation does not have sufficient working capital, it may be necessary for the Corporation to reduce their planned capital expenditures or raise additional equity or debt (***see note below***). There is no assurance that additional equity or debt will be available on terms acceptable to the Corporation. See "Risk Factors – Negative Cash Flows from Operating Activities".

Note: The statement made by the RI that they would 'raise additional equity or debt' seemed realistic given the RI's recent successful financings.

[13] Section 4.7 of 44-101F1 requires the disclosure of each significant event, the specific time period and the costs related to each event. There is a comparable requirement in section 6.8 of 41-101F1.

B. Disclosure Regarding Financial Condition

We continued to note deficiencies in prospectuses related to the description of a RI's financial condition. Many of these issues related to missing information regarding an RI's liquidity disclosure, which is discussed in further detail in section 3.2(A) of this Report. Some RIs failed to update a prospectus for information relating to new events and circumstances that occurred since the date of the RI's most recently filed financial statements. A prospectus must contain full, true and plain disclosure of all material facts, including any new information or updates to previously disclosed information up to the date of the filed prospectus.

EXAMPLE OF A DEBT COVENANT DEFAULT - MODIFIED TO MEET OUR EXPECTATIONS

In this example, we noted the RI disclosed a debt covenant violation in the March 31, 2012 interim financial report incorporated by reference in the prospectus. The RI did not include disclosure of this default in the prospectus. Although the RI received a waiver from its financial institution for this debt covenant default, we considered the debt covenant violation to be material information to readers and we required prominent disclosure in the prospectus given:

- *the RI intended to use a combination of funds from its credit facility and the net proceeds from the offering to acquire assets; and*
- *with the default there was a risk that the RI's ability to draw from the credit facility in future periods may be impacted.*

To address this issue, the RI included the following disclosure in the prospectus filed:

The terms of the Credit Facility require the Corporation to maintain a working capital ratio of 1.00:1. [...] Compliance with the working capital ratio covenant is a condition precedent to each advance under the Credit Facility. The Corporation's working capital ratio was 0.95:1 as at March 31, 2012 and 1.15:1 as at May 31, 2012. Pursuant to a waiver dated June 6, 2012, the Corporation's financial institution agreed to waive the Corporation's March 31, 2012 breach of the working capital ratio covenant, provided that the Corporation was in compliance with all of its covenants under the Credit Facility as at June 30, 2012. If the Corporation breaches this covenant again, there can be no assurance that an additional waiver will be granted by the Corporation's financial institution or, if granted, will be on terms acceptable to the Corporation.

EXAMPLE OF SIGNIFICANT RISK OF DEFAULT - MODIFIED TO MEET OUR EXPECTATIONS

In this example, the RI was in risk of breaching its debt covenants. Through our review of the documents incorporated by reference we noted there was a significant receivable balance that was outstanding for two annual periods. In addition to insufficient credit risk disclosure, it was also unclear what risk, if any, this receivable might have on the covenants. Upon inquiry we discovered that the RI had recently reached settlement on the receivable for a lesser amount.

In order to provide full, true and plain disclosure, we required the following additional disclosure in the prospectus:

- *the quantitative and qualitative details of settlement agreements entered into;*
- *the anticipated impact of the settlement agreement on the RI's debt covenants; and*
- *the anticipated impact, if any, on the RI's operating and capital expenditures.*

REMINDER

New material information or material updates to previously disclosed information up to the date of the filed prospectus that are available about a RI's financial condition should be prominently disclosed in a prospectus and the RI should consider disclosure of any related and relevant risk factors.

C. Minimum Subscription Considerations

During a prospectus review we may raise comments where the RI appears to have short-term liquidity concerns and/or the proceeds from the prospectus offering, and other resources appear to be insufficient to accomplish the purpose of the net proceeds as stated in the prospectus.

EXAMPLE WHERE AN RI NEEDED TO PROVIDE A MINIMUM SUBSCRIPTION AMOUNT[14]

An RI's preliminary prospectus was subject to minimum net subscription proceeds in the amount of $0 and maximum net subscription proceeds in the amount of $56.3 million. The closing of this best efforts offering was conditional on the RI receiving final approval for a proposed $75 million credit facility prior to the date of the closing of the offering. The $56.3 million maximum net subscription proceeds of the best efforts offering and the proposed $75 million credit facility were slated to fund the RI's planned business activities stated at $60 million.

We noted a sufficiency of proceeds concern when new information was made available about the RI's other resources where it was determined that only 20 per cent, or $15 million, of the $75 million credit facility was available to the RI on the close of the offering with the remaining $60 million to be made available subject to certain reviews and approvals by the RI's lenders over the course of a two-year period. Based on this new information, and assuming the RI raised only a nominal amount in the best efforts offering, there would be a shortfall of just under $45 million where the net proceeds from the offering combined with the RI's other resources would be insufficient to accomplish the stated purpose of the offering.

Given the RI would not achieve the stated purpose of the offering and the use of proceeds absent a minimum subscription, the RI arranged for a minimum subscription of $45 million net proceeds. The RI included the following disclosure in the use of proceeds section of the prospectus filed about how the proceeds would be used with reference to the minimum and maximum subscriptions raised:

The estimated net proceeds will be used to fund the Corporation's exploration programs in the ZZZ Area and for general working capital purposes, as follows:

Nature of the expenses	Minimum Offering	Maximum Offering
Development of the ZZZ assets	$28.3 million	$37.6 million
Development Engineering of the YYY Field	$4.9 million	$4.9 million
Acquisition of the TTT Assets	$3.5 million	$3.5 million
General and Administrative Expenses	$0.8 million	$0.8 million
Unallocated Working Capital	$7.5 million	$9.5 million
Total	**$45.0 million**	**$56.3 million**

The RI also expanded on the disclosure of the particulars of the proposed credit facility agreement in the prospectus, by providing information on the timing and amounts of the debt available under the credit facility, covenants, renewal dates, repayment terms and assets assigned for the securitization of the credit facility.

[14] The Executive Director shall not issue a receipt for a prospectus if the aggregate of the proceeds from the sales of securities under the prospectus that are to be paid into the treasury of the issuer, and the other resources of the issuer are insufficient to accomplish the purpose of the issue stated in the prospectus - s. 120 of the *Securities Act* (Alberta). In certain cases we may require an issuer to have a minimum subscription to satisfy the requirements under s. 120.

EXAMPLE OF SUFFICIENCY OF PROCEEDS WHEN PROCEEDS FROM THE OFFERING DO NOT ADDRESS THE RI'S SHORT-TERM LIQUIDITY REQUIREMENTS

An RI with a working capital deficit, and a history of negative cash flows from operating activities and a history of net losses was raising proceeds in a best efforts offering with a minimum subscription that appeared to be insufficient to meet the RI's short-term liquidity requirements. The RI's working capital deficit exceeded $15 million as of its most recent period end and the RI's stated use of proceeds for the $10 million minimum subscription allocated only $2 million to cover working capital requirements. The RI allocated the remaining $8 million to fund the RI's exploration activities of the RI's oil and gas assets. The RI arranged to increase its minimum subscription as it lacked sufficient funds to continue operations as well as the funds necessary to reach completion of the next phase of its exploration activities. The RI increased its minimum subscription to $20 million, an amount that covered its working capital deficiency as well as a portion of the funding of its exploration activities.

For further information on concerns regarding the financial condition of an issuer and/or the sufficiency of proceeds in the context of a prospectus offering, issuers can refer to the CSA Staff Notice 41-307 *Concerns Regarding An Issuer's Financial Condition and the Sufficiency of Proceeds from a Prospectus Offering*.

D. Earnings Coverage Ratios

In prospectus reviews we continue to raise comments on earnings coverage ratios. The most common deficiencies we noted relate to the actual calculation of the ratio. Specifically, we observed inappropriate inclusions and exclusions in the determination of the numerator and denominator.

PRACTICE TIP

Recurring errors to look out for in the calculation and disclosure of the earnings coverage ratios (not an exhaustive list)

Calculation of the numerator:

- the inclusion of an adjustment for depreciation and amortization (i.e., using EBITDA rather than EBIT)[15];
- the inclusion of an adjustment for accretion on decommissioning liabilities;
- adjustments for material foreign currency gains or losses;
- the inclusion of profit or loss attributable to a non-controlling interest;
- borrowing costs do not include the total costs incurred in connection with the borrowing of funds, for example:
    - includes adjustments for the interest expense only on long-term debt; and
    - excludes servicing costs (i.e., other costs that an issuer incurs in connection with the borrowing of funds).

Calculation of the denominator:

- incorrect borrowing cost adjustments (see above);
- the exclusion of dividends declared during the period, together with undeclared dividends on cumulative preferred shares; and
- the inclusion of dividend payments on common shares.

Common error noted in disclosure:

- omission of cover page disclosure if the ratio is less than 1:1.

E. Combined Financial Statements

We recently observed an example of combined financial statements, where the financial statements included "combined" financial information about two or more entities or businesses that did not constitute a single group. Section 1601 of Part V Canadian GAAP provides specific guidance on the preparation of combined financial statements, while IFRS is silent on the combined financial statement concept. We caution RIs that combined financial statements are not appropriate when a specific IFRS applies and the preparation of combined financial statements would override the required accounting treatment for a transaction or arrangement (e.g., when an RI accounts for an entity under the equity method in accordance with IAS 28 *Investments in Associates* or is consolidated in accordance with IAS 27).

[15] EBITDA is defined as earnings before interest, taxes, depreciation and amortization. EBIT is defined as earnings before interest and taxes.

Given the possible complexity of each RI's particular case facts and circumstances, as well as ongoing discussions on this topic at the IFRS Discussion Group, we encourage RIs to consult staff early on in the process. This consultation will allow sufficient time for review and time for the preparation of the RI's financial statements by the RI's filing deadline. Prior to consultation with staff, RIs should consider if combined financial statements lead to full, true and plain disclosure of all material facts.

REMINDER

If RIs prepare combined financial statements we remind RIs to consider the inclusion of relevant segment disclosure as required by IFRS 8.

5. 2012 CSA INITIATIVES

Throughout the year, the CSA publishes staff notices and amendments to securities legislation. Some of these notices communicate securities regulators' expectations or provide guidance to improve disclosure. Other notices summarize results from recent reviews conducted across the CSA and identify areas where RIs did not comply with requirements. We identified and discussed some of these CSA staff notices in this Report. Copies of all CSA staff notices are available on the ASC website (www.albertasecurities.com). RIs and their advisors should review these publications in advance of their 2012 year-end reporting and future filings.

CSA staff notices referenced in this Report	**Reference in the Report**
CSA Staff Notice 41-307 *Concerns Regarding An Issuer's Financial Condition And The Sufficiency Of Proceeds From A Prospectus Offering* (published March 2, 2012)	Sections 4(B) and 4(C)
CSA SaffNotice 51-327 *Guidance on Oil and Gas Disclosure* (revised December 29, 2011)	Section 3.2(E)
CSA Staff Notice 52-306 (Revised) *Non-GAAP Financial Measures and Additional GAAP Measures* (published February 16, 2012)	Section 3.1(F)

Other CSA Staff Notices published in recent months:

- CSA Staff Notice 43-307 *Mining Technical Reports – Preliminary Economic Assessments* (published August 16, 2012)
- CSA Staff Notice 43-308 *Professional Associations under NI 43-101 Standards of Disclosure for Mineral Projects* (published August 16, 2012)
- CSA Staff Notice 45-308 *Guidance for Preparing and Filing Reports of Exempt Distribution under National Instrument 45-106 Prospectus and Registration Exemptions* (published April 26, 2012)
- Multilateral CSA Staff Notice 45-309 *Guidance for Preparing and Filing an Offering Memorandum under National Instrument 45-106 Prospectus and Registration Exemptions* (published April 26, 2012)
- CSA Staff Notice 45-310 *Update on CSA Staff Consultation Note 45-401 Review of Minimum Amount and Accredited Investor Exemptions* (published June 7, 2012)
- CSA Staff Notice 46-306 *Third Update on Principal Protected Notes* (published August 30, 2012)
- Multilateral Instrument 51-105 *Issuers Quoted in the U.S. Over-the-Counter Markets* (effective July 31, 2012)
- Blanket Order 51-513 *Relief from Multilateral Instrument 51-105 Issuers Quoted in the U.S. Over-the-Counter Markets* (effective July 31, 2012)

6. CONTACT PERSONNEL AND OTHER INFORMATION

Feedback on the Report and other Corporate Finance Matters

We welcome comments on this Report and other Corporate Finance matters directed to any of the individuals listed below:

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Upcoming Presentations

From time to time, the ASC will host webinars and breakfast seminars on various topics related to securities requirements including CD matters. Breakfast seminars related to this Report and other topics are scheduled for Calgary on January 8, 2013 at the Westin Calgary and for Edmonton on January 9, 2013 at the Sutton Place Hotel. A related webinar is scheduled for January 11, 2013. If anyone planning on attending one of the above seminars or webinars has a specific topic or question that they would like us to address, we would be pleased to consider your request. Please submit your topic or question to cf-report@asc.ca by January 3, 2013. We will consider submissions after this date for potential future presentations. Information about future seminars and webinars can be found on the ASC website at www.albertasecurities.com. Archived presentation slides and related reference materials from past seminars are also available on the ASC website.