

CANADIAN SECURITIES ADMINISTRATORS
STAFF NOTICE 41-301 and 51-302¹

The Year 2000 Challenge
Disclosure Issues

Purpose

The purpose of this Notice is to set out the views of the staff of each of the Canadian Securities Administrators ("staff") with respect to matters that a reporting issuer would be expected to consider in assessing the nature and extent of its disclosure obligations concerning the implications of the "Year 2000 issue". The Notice does not address any specific financial statement disclosures that may be required to comply with generally accepted accounting principles in the particular circumstances of an individual reporting issuer.

Background

The "Year 2000 issue" is a general term used to refer to certain business implications of the arrival of the new millennium. In simple terms, these implications arise largely because it has been normal practice for computer hardware and software to use only two digits rather than four to record the year in date fields. On January 1, 2000, when the year is designated as "00", many computer systems could either fail completely or create erroneous data as a result of misinterpretation of the year. In some cases, date sensitive systems may begin to fail prior to January 1, 2000. The results of failures may range from relatively minor processing inaccuracies to catastrophic system malfunctions. Failures may affect not only hardware and software used to process everyday business information but also the embedded computers that control plant machinery, robotics, office equipment, elevators and building climate and security systems.

On November 21, 1997, the Canadian Securities Administrators ("CSA") published a notice entitled, *The Year 2000 Challenge* (CSA Notice 31-301). This Notice included a statement on Year 2000 computer problems issued by the Technical Committee of the International Organization of Securities Commissions. The CSA expressed concern that many securities market participants may not be addressing adequately the risks associated with the Year 2000. They noted that, because of the interconnection of the securities markets, it is essential that all market participants identify and address the issues to ensure they are Year 2000 compliant. In this regard, the CSA focused its comments on the technological, business and regulatory problems faced by financial markets and financial intermediaries.

Many of the types of problems faced by financial markets and financial intermediaries can be expected to arise in virtually all entities since most use computer technology in some aspect of their business. It is essential that these entities identify and address the problems in an organized and timely manner if potentially

¹ This Notice deals with two subject matters (prospectus and continuous disclosure requirements). Accordingly, since the new numbering system categorizes instruments by subject matter, we have assigned two numbers to the Notice in order to assist parties who rely on the numbering categories for locating relevant requirements. The first number, 41-301, categorizes the Notice under the 41 category which applies to Distribution Requirements (Prospectus Contents – Non-Financial Matters). The second number, 51-302, categorizes the Notice under the 51 category which applies to Ongoing Requirements for Issuers and Insiders (Disclosure – General)

significant adverse consequences are to be avoided. Despite the importance of the issue and its pervasive nature, a recent Statistics Canada survey of 2,000 Canadian companies indicates that less than half of all Canadian firms have taken action to prepare for computer problems when the calendar hits January 1, 2000. Staff are therefore reminding reporting issuers to consider their disclosure obligations relating to the implications of the Year 2000 issue. These obligations arise in the context of both continuous disclosure and offerings of securities by way of prospectus.

Continuous Disclosure Obligations

Reporting issuers that are required to provide Management's Discussion & Analysis ("MD&A") as a supplement to their financial statements are required to disclose in the MD&A information on risks and uncertainties facing the issuer. These disclosures, which should emphasize risks and uncertainties likely to be factors within the next two financial years, are required to the extent they are necessary for an understanding of the issuer's financial condition, changes in financial condition and results of operations. In addition, reporting issuers are required to discuss and analyze in their MD&A risks, events and uncertainties that would cause reported financial information not necessarily to be indicative of future operating results or future financial condition.

Staff believe the Year 2000 issue gives rise to uncertainties that are potentially significant for virtually all reporting issuers. Further, in some circumstances, the uncertainties may be considered to cause reported financial information not to be indicative of future operating results or of future financial condition. Accordingly, all reporting issuers should assess carefully the nature and extent of information about the Year 2000 issue that needs to be disclosed to meet the requirements of securities legislation.

In making this assessment, staff expect that senior management and the Board of Directors of a reporting issuer would consider matters such as the following:

the scope of activities undertaken to date to evaluate the extent of potential problems by identifying operating and information systems and equipment used by the reporting issuer that may require remedial action;

the scope of activities undertaken to date to assess the reporting issuer's vulnerability to the state of readiness for the Year 2000 of third parties, including suppliers, customers, lenders and borrowers;

- the scope of the reporting issuer's action plan defining the steps necessary to minimize its exposure to risk as a result of the Year 2000 issue, including identification of those systems that will be replaced and those systems that will be modified;
- the availability of sufficient appropriate resources, both internal and external, to carry out the necessary remedial actions within a time frame that allows for completion and testing prior to January 1, 2000;
- the progress made in relation to each phase of the reporting issuer's action plan, including whether activities are proceeding on schedule and the status of testing of remedial actions taken;
- the extent of risks and uncertainties that may prevent successful completion of any aspect of the reporting issuer's action plan, including an assessment of the potential consequences of failure and whether contingency plans exist to provide for this eventuality.

In staff's view, narrative disclosure explaining the risks and uncertainties arising from the Year 2000 issue and how those risks and uncertainties are being managed should include, at a minimum:

- a discussion of the reporting issuer's vulnerability to the Year 2000 issue, taking into account its dependence on information technology, the complexity of its systems and the extent of its interaction with third parties;
- a description of the reporting issuer's evaluation of its situation and the plans made to deal with critical systems within the remaining time available;
- a discussion of the status of implementation of the reporting issuer's remediation plans and the expected timing of completion, including testing and implementation; and
- information about associated costs, both incurred to date and expected to be incurred in the future, including a description of the accounting treatment afforded such costs.

Staff believe reporting issuers that are not required to provide MD&A should consider providing information about the Year 2000 issue as part of other information that accompanies annual financial statements.

The nature of the Year 2000 issue and the short time frame within which it must be addressed are such that staff believe reporting issuers should consider updating annual MD&A disclosure in subsequent interim financial reports. This will contribute to ensuring that participants in capital markets are made aware of significant information on a more timely basis than would otherwise be the case.

Prospectus Offerings

Reporting issuers that make an offering of securities by way of prospectus are required under securities legislation to provide full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed. A "material fact" is a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of the securities issued or proposed to be distributed.

Staff believe the Year 2000 issue is potentially significant to virtually all reporting issuers contemplating the issuance of securities by way of prospectus. Accordingly, reporting issuers should give careful consideration to the Year 2000 issue when assessing the nature and extent of information that needs to be disclosed in a prospectus to meet the requirements of securities legislation. Staff expect that, in making this assessment, a reporting issuer would consider matters such as those discussed above under "Continuous Disclosure Obligations".

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