CSA/ACVM

Canadian Securities Administrators
Autorités canadiennes en valeurs mobilières

Notice of Rule

National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*

Amendments to National Policy No. 27 *Canadian Generally Accepted Accounting Principle*

and

Amendments of National Policy No. 50 *Reservations in an Auditor's Report*

Introduction

National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (the Instrument) is an initiative of the Canadian Securities Administrators (CSA or we). The Instrument establishes a harmonized set of accounting principles and auditing standards that will be acceptable for purposes of preparing and auditing financial statements included in documents filed with securities regulators in Canada. Companion Policy 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (the Policy) provides guidance on how we interpret the Instrument.

The Instrument has been implemented or, subject to ministerial approval in certain jurisdictions is expected to be implemented, by each member of the CSA, as a

- rule in each of Alberta, British Columbia, Manitoba, Ontario and Nova Scotia;
- a regulation in Québec and Saskatchewan; and
- a policy in all other jurisdictions represented by the CSA.

We also expect the Policy will be adopted in all jurisdictions.

The British Columbia Securities Commission (the BCSC) intends to publish the Instrument and the Policy once the BCSC has implemented the Instrument, which is subject to obtaining the requisite ministerial approval.

In Ontario, the Instrument has been made. Also, in Ontario, the Policy and the amendments to National Policies 27 and 50 described below have been adopted. The Instrument and other required materials were delivered to the Minister of Finance on January 14, 2004. The Minister may approve or reject the Instrument or return it for further consideration. If the Minster approves them or does not take any further action they will come into force on March 30, 2004.

In Québec, the Instrument is a regulation made under section 331.1 of the Act and must be approved, with or without amendment, by the Minister of Finance. The Instrument will come into force on the date of its publication in the Gazette officielle du Québec or on any later date specified in the regulation. It must also be published in the Bulletin.

Provided all necessary ministerial approvals are obtained, the Instrument will come into force on March 30, 2004. The Policy and the amendments to National Policies 27 and 50 will come into effect at the same time as the Instrument.

Substance and Purpose
The Instrument sets out the accounting principles that issuers (other than investment funds) and registrants may use to prepare their financial statements and the auditing standards that may be applied to audit those financial statements. These same principles and standards apply to financial statements

- included in a prospectus,
- filed in connection with continuous disclosure obligations, or
- otherwise required to be filed with or, in the case or registrants, delivered to a securities regulatory authority.

The Policy states our views on the interpretation and application of the Instrument.

Background
We first published proposed rules relating to acceptable accounting principles and auditing standards when we first published for comment National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) and National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers* (NI 71-102). We subsequently decided to propose that the rules related to accounting principles and auditing standards be in a separate instrument, which was published for comment on May 16, 2003. The CSA Notice published with the proposed Instrument provides additional background and a summary of comments received when the rules were first published as part of the NI 51-102 and NI 71-102 proposals.

Summary of Written Comments Received by the CSA
After we published the proposed Instrument on May 16, 2003, we received submissions from three commenters. We have considered the comments received and thank all the commenters. The names of all the commenters and a summary of their comments, together with the CSA responses, are contained in Appendix A of this notice.

After considering the comments, and to ensure consistency between the Instrument and other CSA instruments, we have made amendments to the Instrument. However, as these changes are not material, we are not republishing the Instrument for a further comment period.

Summary of Changes to the Instrument
This section describes the noteworthy changes made to the version of the Instrument published for comment on May 16, 2003

The Instrument
Part 1 Definitions

- The definition of *equity security* has been deleted. This term is defined in National Instrument 14-101 *Definitions*.

- The definition of *Canadian GAAP* has been deleted. This term is defined in National Instrument 14-101 *Definitions*. The requirement to apply Canadian GAAP as applicable to public enterprises has been moved into the body of the Instrument.

- We have deleted the definitions of *group scholarship plan, National Instrument 41-102, National Instrument 44-101, National Instrument 44-102 and National Instrument 44-103* as these terms are no longer used in the Instrument.

- We added a definition for *credit support issuer*, *credit supporter* and *public enterprise.*

- We amended the definition of *acquisition statement* to include operating statements for an oil and gas property.

Part 2 Application

- We clarified that the Instrument does not apply to investment funds.

- We have clarified that the Instrument applies to financial statements included in take-over bid circulars filed. These financial statements were already subject to the Instrument as the offeror is required to provide "prospectus-level" disclosure in the circular but the change makes this explicit.

- We have clarified that the Instrument applies to the following: operating statements for an oil and gas property, financial information of an acquired business accounted for by the issuer using the equity method and financial information filed by a credit support issuer.

Part 3 General Rules

- We removed the requirement that an issuer or registrant have a Canadian auditor if their financial statements were prepared using Canadian GAAP and audited using Canadian GAAS.

- We added a section to clarify that when a credit support issuer files or includes in a prospectus financial information derived from its consolidated financial statements the financial statements must:
    - be prepared in accordance with Canadian GAAP,
    - in the case of annual financial statements, be audited in accordance with Canadian GAAS, and
    - disclose the reporting currency,
    - disclose the measurement currency if it differs from the reporting currency.

Part 6 Requirements for Acquisition Statements

- We added a requirement that Canadian GAAS acquisition statements cannot contain a reservation except for a qualification of opinion on opening inventory balances.

- We clarified that the same options for GAAS, GAAP and reporting currency are available when financial information, as opposed to financial statements, is provided for an investment accounted for using the equity method.

Part 7 Pro Forma Financial Statements

- We added a requirement that, if an issuer or registrant chooses to report under U.S. GAAP and reconciles its financial statements to Canadian GAAP, it will also be required to reconcile its pro forma financial statements reported under U.S. GAAP to Canadian GAAP.

The Policy

Part 1 General

- We reminded issuers and registrants that they may be subject to corporate law or other legal requirements that address matters similar to those addressed by the Instrument and which may impose additional or more onerous requirements.

Part 3 Acceptable Accounting Principles and Auditing Standards

- We indicated that whenever financial information is disclosed to the marketplace, the accounting principles used to prepare the financial information should be disclosed.

- We provided guidance on how to interpret the phrase "same core subject matter".

Part 4 Auditors and Their Reports

- We indicated that we would normally expect issuers and registrants incorporated or organized under the laws of Canada or a jurisdiction of Canada and any other issuer or registrant that is not a foreign issuer nor a foreign registrant, to engage a Canadian auditor to audit the issuer's or registrant's financial statements if those statements are prepared in accordance with Canadian GAAP and will be audited in accordance with Canadian GAAS.

- We provided guidance to non-Canadian auditors auditing financial statements in accordance with Canadian GAAS and prepared by the issuer or registrant in accordance with Canadian GAAP.

Consequential amendments

The requirements in the Instrument conflict with requirements in National Instrument 44-101 *Short Form Prospectus Distributions*, National Instrument 44-102 *Shelf Distributions*, National Instrument 44-103 *Post-Receipt Pricing* and various local rules relating to long-form prospectuses. We intend to amend those instruments and rules to eliminate these conflicts. Until those amendments are implemented, issuers may apply for relief from the conflicting requirements in the instruments and rules when they file their prospectuses so that they can rely on the Instrument, and staff will favourably consider such an application.

We indicated in our notice of May 16, 2003 that National Policy No. 27 *Canadian Generally Accepted Accounting Principles* and National Policy No. 50 *Reservations in an Auditor's Report* would be rescinded. However, these national policies will continue to apply to reporting issuers that are investment funds and therefore we have amended these documents accordingly. CSA Staff Notice 42-301 and 52-302 *Dual Reporting of Financial Information* will be rescinded as planned.

We will consider rescinding National Policy No. 3 *Unacceptable Auditors* or moving its contents into the Policy after considering the new auditor independence standards developed by the Canadian Institute of Chartered Accountants.

Questions
Please refer your questions to any of:

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National Instrument
The text of the Instrument follows.

January 16, 2004

Appendix A
Summary of Comments and CSA Responses

Part I Background
On May 16 2003 the CSA published for comment the Instrument. The comment period expired on August 14, 2003. The CSA received submissions relating to the Instrument from the three commenters identified in Schedule 1.

The CSA have considered the comments received and thank all commenters for providing their comments.

Part II Comments on the Instrument

General

One commenter supported the implementation of NI 52-107, however, noted that implementing the Instrument may negatively affect the establishment and maintenance of accounting standards that reflect the characteristics of smaller issuers due to the potential drain of resources from servicing these smaller issuers.

No response required.

Part 1 – Definitions
One commenter questioned, in the definition of *eligible foreign issuer* and *eligible foreign registrant*,

- what are the assets or business of a holding entity that has subsidiaries or investees
- how one determines the location of securities
- if the 50% asset test is to be based on book or estimated market value.

The commenter also suggested the term *senior officer*, rather than *executive officer*, should be used in the definition, as it is less broad.

Response: The definitions of eligible foreign issuer and eligible foreign registrant *[now* foreign issuer and foreign registrant, respectively*] have been revised to clarify that it is the consolidated assets of the issuer that must be considered when applying the definition. An issuer must consider its specific circumstances in determining the location of its assets. For example, if an issuer holds securities in another company, and the investment is accounted for by the cost method, or is marked to market, the issuer may consider the location of the other company's head office for the purpose of determining the location of that investment.*

We have not replaced the reference to executive officer *in the definition with* senior officer. *The definition is intended to test whether the reporting issuer is carrying on business predominantly outside of Canada. Part of this is ensuring that the issuer's decisions are being made, and operations directed, from outside of Canada. As a result, it is the location of the chair, vice-chair, president, vice-president, and other people performing policy-making functions, that is relevant, not the location of the issuer's five highest paid employees.*

One commenter said the definition of *equity security* should not include securities that have a residual right to participate in earnings. Instead, it should be limited to a security that carries a residual right to participate in the assets of an issuer on the liquidation or winding-up of the reporting issuer.

Response: We have deleted the definition of equity security *in the Instrument as the term is already defined in National Instrument 14-101* Definitions. *That definition refers back to the definition of equity security in securities legislation. It would not be appropriate to change that definition, which has been used for many purposes in many different national and multilateral instruments, in this Rule.*

One commenter noted the definition of *exchange-traded security*

- excludes all foreign-listed or quoted securities,
- in provinces other than Ontario, appears to exclude TSX listed securities, and,
- in Ontario, excludes TSX Venture listed securities.

Response: The term is only used in the definition of marketplace. As the definition of marketplace also encompasses exchanges and quotation systems, regardless of where they are located, the limitations to the definition of exchange-traded security suggested by the commenter are irrelevant.

One commenter suggested paragraphs (e) or (f) of the definition of *executive officer* may be over-broad, as there could be a large number of policy-making personnel (for example, in respect of the privacy policy, or the environmental policy) that should not be considered "executive officers". The terms *senior officer* or *officer* would be more appropriate.

Response: We disagree. The definition of executive officer is designed to capture persons that are directing the operations of the reporting issuer and making its significant decisions. This includes the people responsible for approving a policy direction and ensuring the policy is implemented and followed (that is, the making of the policy for the issuer). This group is distinct from those personnel that simply develop the policies for consideration. Given this distinction, we do not agree that the definition is too broad.

Part 2 – Application

One commenter indicated it was not clear whether prospectuses of non-redeemable investment funds were to be exempted or not from the instrument.

Response: *We have modified the wording to clarify that prospectuses of non-redeemable investment funds are exempted from the instrument.*

One commenter indicated it was unclear why financial statements would be required of foreign registrants given the place of incorporation limits imposed by the IDA and the OSC.

Response: The Instrument was written to allow future changes to incorporation limits without the instrument being amended.

Part 3– General Rules
One commenter suggested that the instrument might preclude changes in principles under a specific form of GAAP.

Response: The instrument requires consistent principles (Canadian GAAP, U.S. GAAP, etc). Changes in accounting policies within the specific accounting principles are acceptable.

One commenter suggested that it was inappropriate to require issuers and registrants that prepare their financial statements in accordance with Canadian GAAP and have them audited in accordance with Canadian GAAS to use auditors licensed by the laws and professional standards of a jurisdiction of Canada. The commenter indicated licensing issues might preclude a Canadian auditor from conducting the audit in certain states in the United States. The commenter noted that the SEC does not preclude Canadian auditors from opining in accordance with U.S. GAAS on financial statements prepared in U.S. GAAP.

Response: We have eliminated the requirement that a Canadian auditor must report on financial statement prepared in accordance with Canadian GAAP and audited in accordance with Canadian GAAS. We have expanded the Policy to indicate that, if a foreign auditor is reporting on financial statements prepared in accordance with Canadian GAAP and audited in accordance with Canadian GAAS, that the foreign auditor should consult or involve an auditor that is knowledgeable about Canadian GAAP and Canadian GAAS.

Part 4 – Exemptions for SEC Issuers
One commenter indicated it was not clear whether an issuer that prepares its financial statements for continuous disclosure purposes in accordance with U.S. GAAP and has them audited in accordance with U.S. GAAS, and previously had been granted relief from the current rules to do so, would still be required to comply with the two year reconciliation requirement.

Response: If an SEC issuer or registrant had been granted relief more than two years ago from the current rules to file in accordance with U.S. GAAP and audit in accordance with U.S. GAAS, it would not be required to comply with the two year reconciliation requirement.

Part 5 – Exemptions for Eligible Foreign Issuers
One commenter suggested that foreign issuers should not be required to provide any more detail than is required today as the additional requirements may discourage foreign issuers from coming to Canada.

Response: Foreign issuers are given extensive flexibility in determining how to meet their reporting obligations to the public. We felt it was important to have consistency between reporting in prospectuses and on a continuous basis for foreign issuers.

Part 6 – Requirements for Acquisitions Statements
One commenter suggested that the requirement to prepare an audited balance sheet as at a date other than a financial year-end might be too onerous for venture issuers. The commenter

indicated it was unclear whether Ontario issuers will be able to take advantage of the mutual reliance system to obtain exemptions.

Response: Exemptions will be considered on a case-by-case basis based on the facts and circumstances. Issuers can take full advantage of the mutual reliance system as detailed in National Policy 12-201 Mutual Reliance Review System for Exemptive Relief Applications.

One commenter suggested that it should be clear that the qualification relating to inventory in a business acquisition report cannot be a denial of opinion under generally accepted auditing standards.

Response: We modified the wording to clarify that an opinion is required.

Part 7 – Pro Forma Financial Statements

One commenter indicated it was not clear whether a Canadian issuer who chose to report under U.S. GAAP and was reconciling its financial statements to Canadian GAAP as required by subsection 4.1(2) (now 4.1(1)) would be required to reconcile pro forma financial statements under U.S. GAAP to Canadian GAAP.

Response: The CSA has amended the wording to clarify that the issuer would be required to provide a reconciliation with the pro forma financial statements.

Schedule 1
List of Commenters

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