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Industry Series: Financial Services, Retail and Manufacturing

Corporate Finance Branch

December 4, 2012

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Presentation Outline

Welcome and Introduction to the OSC SME Institute

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OSC SME Institute - Objectives

Our goal is to:

- Help SMEs navigate the regulatory waters
- Demystify disclosure requirements so companies can focus on building their business
- Reduce SMEs' cost of compliance so that this money can be better spent on strategic initiatives
- Provide an opportunity for informal dialogue with OSC staff

Disclosure requirements, including those for financial reporting, are a cornerstone of investor confidence

Securities Regulation 101

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Securities Regulation 101 – Disclosure Requirements

- Periodic Disclosure
  - Financial statements, MD&A, CEO and CFO certifications, annual information form, information circular, executive compensation, corporate governance
- Timely Disclosure
  - Material change news release and report (Securities Act)
  - Material information (Exchanges)
- Event-Based Disclosure
  - Business acquisition reports, material contracts, insider reporting

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Securities Regulation 101 – Periodic Requirements

<table>
<tr><th>Document</th><th>Venture</th><th>Non-venture</th></tr>
<tr><td>Audited annual financial statements accompanied with:
•Annual MD&A
•Annual CEO and CFO Certificates</td><td>120 days after year-end</td><td>90 days after year-end</td></tr>
<tr><td>Interim financial report accompanied with
•Interim MD&A
•Interim CEO and CFO Certificates</td><td>60 days after quarter end</td><td>45 days after quarter end</td></tr>
<tr><td>Annual Information Form (AIF)</td><td>N/A - but may elect to file</td><td>Usually 90 days after year-end</td></tr>
<tr><td>Information Circular</td><td colspan="2">Generally mail 21 days before meeting and file promptly</td></tr>
<tr><td>Executive Compensation</td><td colspan="2" rowspan="2">File with related document (usually with Information Circular or AIF)</td></tr>
<tr><td>Corporate Governance (i.e. Board information)</td></tr>
</table>

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Securities Regulation 101 – Timely Disclosure

Document	Timing
Material change news release and report	▪ Immediately issue and file news release ▪ File material change report within 10 days

Material change – a change in the business, operations or capital of the company that would reasonably be expected to have a significant effect on market price or value of any of the securities of the company (or a decision to implement such a change)

Under stock exchange timely disclosure policies, a listed company is required to disclose material information including any material fact or material change immediately upon the information becoming known to management

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Securities Regulation 101 - Event-Based Disclosure

Document	Timing
Business Acquisition Report	Within 75 days following acquisition
News Release with Financial Information	File news release immediately
Documents Affecting the Rights of Securityholders	Earlier of filing of material change report or AIF or 120 days after year end
Material Contracts	
Initial Insider Report	Within 10 days of becoming a reporting insider
Subsequent Insider Report	Within 5 days of any change in holdings

For more information, see OSC website for presentation slides from OSC SME Institute seminar on "Continuous Disclosure Obligations" held on October 17, 2012

Landscape of the Industries

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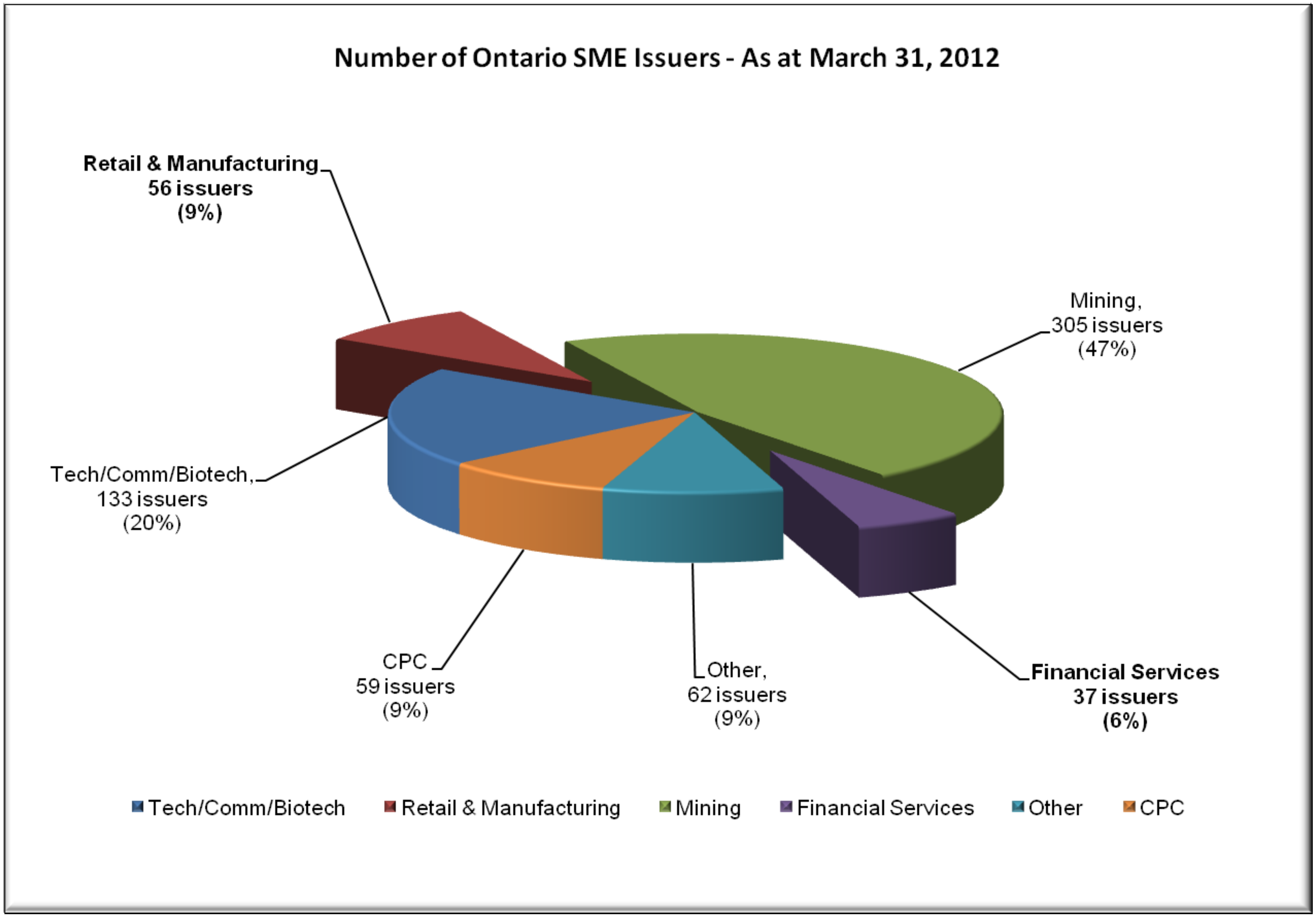
Ontario's Public SMEs by Industry



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Economic Outlook and Industry Trends

- Canadian economic growth forecasted to be around 2% for the next few years
- Robust growth in emerging markets
- Increased debt levels across developed countries
- Canadian firms are losing competitiveness
- Borrowing costs at exceptionally low levels
- Canadian debt levels rising to those of US and UK
- Increased austerity in the euro zone prompting businesses to be more cautious in terms of lending

Industry Specific Observations

Observations at a Glance

Financial Statements	MD&A	Other Key Obligations
• Financial Instruments • Classification • Measurement • Disclosure • Financial Instruments – Convertible Debt • Revenue Recognition • Impairment of Assets • Going Concern • Heads Up	• Discussion of Operations • Liquidity and Capital Resources • Transactions Between Related Parties • Critical Accounting Estimates • Risks and Uncertainties • Forward-Looking Information	• Material Contracts • Non-GAAP Financial Measures

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Financial Statement Observations

Financial Statements	MD&A	Other Key Obligations

• Financial Instruments
  • Classification
  • Measurement
  • Disclosure
• Financial Instruments – Convertible Debt
• Revenue Recognition
• Impairment of Assets
• Going Concern
• Heads Up
	• Discussion of Operations
	• Liquidity and Capital Resources
	• Transactions Between Related Parties
	• Critical Accounting Estimates
	• Risks and Uncertainties
	• Forward-Looking Information
		• Material Contracts
		• Non-GAAP Financial Measures

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Financial Instruments – Classification/Measurement

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Classification of Financial Instruments

Observations

Companies can categorize financial instruments into one of five categories. Classification depends on the business purpose of the financial instrument. Companies often do not discuss the reason behind the classification choice made

Why important

Appropriate classification of financial instruments will drive the accounting methodology used. Classification will either impact the statement of operations or the statement of comprehensive income (OCI)

Proper classification of financial instruments when initially acquired is important as transfers between categories is limited

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Classification of Financial Instruments – Example

Company holds an equity security that on initial recognition had a fair value of $160. At the end of the year, the FV had increased to $200. The impact to the company based on classification is as follows:

Available for Sale Security	Fair Value through Profit and Loss (FVTPL)
▪ Company has classified the security as AFS as the security has not been classified as FVTPL, HTM or loans and receivables.	▪ Company has classified the security as FVTPL as the principal purpose is to sell or repurchase the security in the near term.
▪ Impact at end of year→ Unrealized gain of $40 recognized in OCI ***No impact to earnings***	▪ Impact→ Unrealized gain of $40 recognized in P&L ***Impacts volatility of earnings***

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Classification of Financial Instruments – Example

A year later, entity disposes of security for $300:

Available for Sale Security	Fair Value through Profit and Loss (FVTPL)
▪ Cumulative gain in OCI is $40 for the security	▪ Profit/loss for the year would be $300-200 = $100
▪ Profit/loss for year will include: ▪ Gain on sale of $100 (300-200 [160+40]) ▪ Reclassification from OCI to P&L of $40 ***Total impact to P&L $140***	▪ Profit/loss includes: ▪ Year 1 $40 ▪ Year 2 $100 ***Total impact to P&L $140***

Regardless of classification, the impact on disposal will be the same

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Measurement of Financial Instruments

Observations

Companies often do not provide adequate disclosure of the methods and assumptions used to determine fair value when assets are categorized as level 2 or level 3

Why important

Investors need clear information on the methods and assumptions applied in determining fair value to assess the reasonableness of the amount recorded in the financial statements

All financial instruments, regardless of classification, are initially measured at fair value

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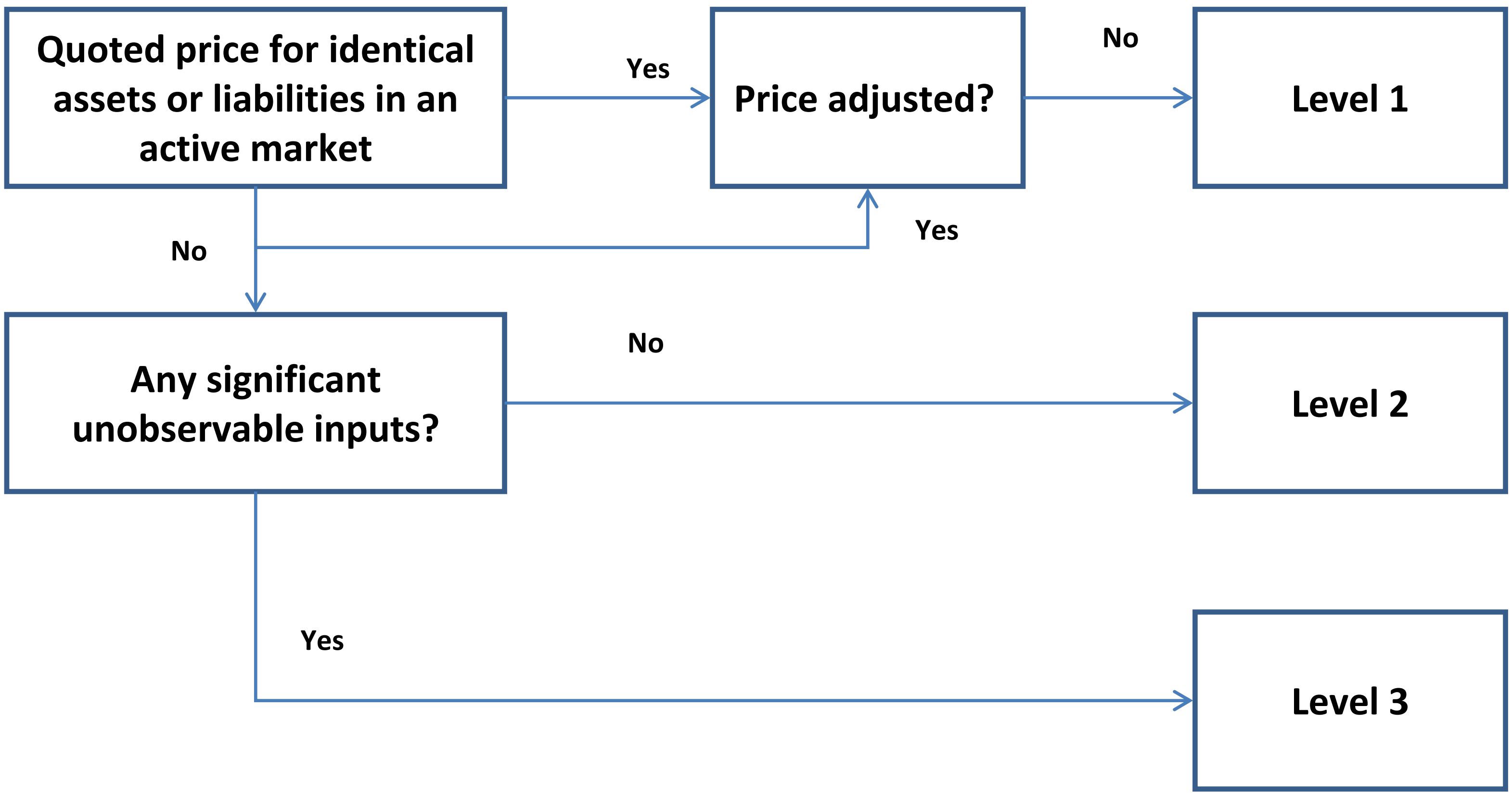
Fair value Hierarchy



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Financial Instruments – Classification/Measurement Hot Buttons

Areas	Considerations
Classification	▪ How is the financial instrument categorized? ▪ Available for sale ▪ Fair value through profit and loss ▪ Loans and receivables ▪ Held to maturity ▪ Other financial liabilities
Measurement	▪ All financial instruments are measured at fair value on initial recognition ▪ How is fair value determined in the hierarchy? ▪ Level 1, Level 2 or Level 3 ▪ Does the instrument have a quoted market price? ▪ Are there any unobservable inputs? ▪ What valuation technique is used to value level 2 and level 3 financial instruments? ▪ How have private investments been valued?

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Financial Instruments – Classification/Measurement Hot Buttons

Areas	Considerations
Disclosure	▪ If financial instruments have been transferred from one level to another, have all the appropriate disclosures been made? ▪ Has company disclosed the methods when a valuation technique is used and the assumptions applied in determining fair value?

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Fair Value Hierarchy Examples

Hierarchy	Examples of Financial Instruments
Level 1	▪ Cash and cash equivalents ▪ Equity/Debt securities traded in active markets
Level 2	▪ Options and warrants (Black Scholes) ▪ Debentures ▪ Credit facilities
Level 3	▪ Private Company investments ▪ ABCP during credit crisis

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Fair Value Hierarchy Example

Government of Canada bonds are generally not exchange traded and therefore have no quoted prices

Large Financial Institution	Corporate Entity
▪ Large financial institutions trade these securities with regularity and significant volume. They are considered "market makers"	▪ Corporate entities do not trade at the same level as large financial institutions and therefore do not have the same level of price transparency
Level 1 valuation	***Level 2 valuation (likely)***

Valuation of same security will not always result in same hierarchy level as it depends on volume of trades and price transparency. Fair value measurement requires judgement.

Financial Instruments – Disclosure

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Financial Instruments – Disclosure

Observations

Companies often do not provide adequate entity-specific and meaningful qualitative and quantitative disclosure of the nature and extent of risks arising from financial instruments including credit risk, liquidity risk and market risk

Why important

Investors need to be able to evaluate the company's exposure to risks arising from financial instruments and the impact it may have on the company's operations and financial performance

Provide quantitative data about entity's exposure to risks based on information provided internally to key management personnel

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Financial Instruments – Disclosures Hot Buttons

Areas	Considerations
Disclosure	▪ Both qualitative and quantitative disclosures ▪ Concentration of risks (ie. geographic, counterparty, currency)
Credit Risk	▪ Maximum exposure to credit risk without collateral ▪ Description of collateral held as security ▪ Information on credit quality of financial assets that are neither past due nor impaired, and either past due or impaired
Liquidity Risk	▪ Maturity analysis showing remaining contractual maturities to understand timing of cash flows ▪ Description of how company manages liquidity risk
Market Risk	▪ Sensitivity analysis (impact on P&L and equity) for each market risk including exposure to equity markets, interest rate, foreign exchange ▪ Disclose methods and assumptions

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Financial Instruments – Disclosure
Example of Boilerplate Disclosure

Does not adequately explain how liquidity is managed and does not provide quantitative analysis

Liquidity Risk

Liquidity risk is managed by the company by reviewing the amount of cash and cash equivalents available, on a daily basis, to ensure that it can meet its short term obligations

Financial Instruments – Disclosure Example of Entity-Specific Disclosure

Description of how company manages liquidity risk

Liquidity Risk

Liquidity risk is the risk that arises from the company's inability to meet its financial obligations as they come due. The company generates its cash flow from its return on investments and commissions earned on transactions.

The Company manages its liquidity by monitoring cash flows, on a daily basis, to ensure that it has sufficient liquidity generated by operations as well as funds available under its credit facilities. The company holds a number of liquid investments that can be readily convertible into cash.

It also monitors its cash flows against established internal limits. Management meets on a regular basis to discuss and analyze the cash flows related to contractual maturities to ensure that the company has the ability to meet ongoing obligations.

Under its credit facility agreements, the Company is subject to certain financial covenants and as at December 31, 20xx has met all of these conditions.

The following shows the contractual maturities of the company's material financial liabilities as at December 31, 20xx on an undiscounted basis.

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Financial Instruments – Disclosure
Example of Entity-Specific Disclosure

Maturity analysis

Contractual Obligations	6 months to 1 year	1 to 3 years	After 3 years	Total
Accounts payable	$1,200	$2,500	$1,000	$4,700
Long-term debt	$2,250	$3,000	$1,200	$6,450
Litigation liability	$800	$1,000	$2,500	$4,300
Operating leases	$950	$1,900	$1,500	$4,350
Total	$5,200	$8,400	$6,200	$19,800

Financial Instruments – Convertible Debt

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Financial Instruments – Convertible Debt

Observations

Companies often issue convertible debt and disclosure is not always clear on whether the compound instrument has been separated between its debt and equity components

Why important

Investors need to understand the substance of the instrument, as conversion of the debt into common shares could dilute investors' shareholdings and could impact the Company's debt/equity ratios

Classification of liability/equity component is not revised after initial recognition

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Financial Instruments – Convertible Debt Hot Buttons

Areas	Considerations
Classification	▪ Has the company evaluated the instrument's terms to determine whether it contains both a liability and equity component? ▪ Has the company presented the liability and equity components separately on the Statement of Financial Position?
Measurement	▪ Has company disclosed how the debt will be valued? ▪ Has fair value of liability component been measured using a similar instrument without an equity conversion option? ▪ Has the equity component been assigned the residual amount after deducting the liability amount from the fair value as a whole?

Since the sum of the carrying amounts of the liability and equity components is equal to fair value of the instrument as a whole, no gain or loss arises on Day 1

Convertible Debt Example

Liability component

Company issued a $3 million, 7% convertible note maturing on January 31, 2015. The note was issued at par and pays interest at 7% per annum

Equity component

The principal amount can be converted, at the option of the holder, into 350,000 common shares of the company at any time up to the maturity date

Company should account for the compound instrument by determining fair value of liability component first and then allocating the residual to equity

Revenue Recognition

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Revenue Recognition

Observations	Revenue recognition policies are generally boilerplate and it is difficult to know how revenue is recognized for each major product or service
Why important	Revenue is generally a key consideration for investors to assess the company's future prospects and stock value

Revenue must be earned, measurable and collectible to be recognized

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Revenue Recognition Hot Buttons

Areas	Considerations
Amount	▪ Can returns be reasonably estimated based on past experience?
Timing	▪ Have delivery obligations been fulfilled? ▪ Which period should revenue be recognized?
Disclosure	▪ Is the revenue recognition policy understandable to a reader? ▪ Does it describe all products and services? ▪ Are all unique terms of the sales arrangements described?

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Revenue Recognition
Example of Boilerplate Disclosure

Unclear what products are sold

Unclear how key criteria is met

Revenue is recognized upon delivery when the selling price is fixed, costs can be measured reliably and collection is reasonably assured.

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Revenue Recognition
Example of Entity-Specific Disclosure

Revenue streams

The company generates revenue from the sale of:

I. Product merchandise to retail customers; and
II. Manufacture of widgets to third party distributors

First product policy

Earned

Collectible

Measurable

Product Merchandise

The company generates revenue from the sale of product merchandise to retail customers. The company has a 30-day return policy for merchandise. Sales revenue and related cost of sales is recognized by the retail stores at the point of sale net of expected returns when the merchandise is paid for by the customer. At the point of sale, the company has transferred the significant risks and rewards of ownership to the customer, retains no effective control over the product merchandise and it is probable that the economic benefits associated with the transaction will flow to the company as the customer has taken possession and paid for the product merchandise. The amount of revenue can be measured reliably at the point of sale as the sales price of the product merchandise is fixed and

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Revenue Recognition
Example of Entity-Specific Disclosure (cont'd)

Second product policy

Earned

Measurable

Collectible

Widgets

The company also generates revenue from the manufacture of widgets which are sold to third party distributors. The distributors then process the widget for final sale to retail consumers. Sales revenue from the sale of widgets is recognized when the products are delivered to the distributors, which occurs upon shipment and receipt at the distributors' locations. Upon receipt by the distributor, the company has transferred the significant risks and rewards of ownership of the widgets as legal title of the widgets has transferred and the company retains no continuing managerial involvement nor effective control over the widgets. The amount of revenue can be measured reliably as the price at which the widgets are sold is fixed per the contract. Widgets are paid in full and sales terms do not provide for a right of return.

Impairment of Assets

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Impairment of Assets

Observations

Companies are not writing down assets to reflect a decline in value even though indicators of impairment are present

Why important

Assessing for indicators of impairment and performing impairment tests ensures that assets are not overstated

Companies must assess for indicators of impairment at the end of each quarter

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Impairment of Assets Hot Buttons

Areas	Considerations
Indicators	▪ Has the intended future use of an asset changed? ▪ How will a competitor's announcement impact the company? ▪ Has consumer demand changed? ▪ Has share price dropped significantly so that net book value of assets exceeds market capitalization?
Value	▪ Are the assumptions used in the impairment assessment consistent with overall operations?
Disclosure	▪ Will an investor be able to understand the events leading to the impairment? ▪ Are the key assumptions used in the impairment assessment disclosed?

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Impairment of Assets
Examples of Potential Indicators

- Scenarios that would likely be an indicator of impairment:
  - Company decision to no longer market a product due to the company's release of an upgraded product
  - Slower than anticipated consumer demand for product offered by the company or shifting consumer preferences
  - Introduction of competing product in the market
  - Declining sales per square footage
  - Net book value exceeds total company market capitalization

Going Concern

Going Concern

Observations

Financial fundamentals, such as a working capital deficiency and negative operating cash flows, suggest liquidity concerns that may cast doubt on the company's ability to continue operations, however a going concern note is absent

Why important

A going concern note provides warnings about the significant risks being faced by the company and identifies concerns regarding its future viability, both of which will ultimately impact investment decisions

Management needs to assess the company's ability to continue as a going concern for at least 12 months from the end of the reporting period

Going Concern Hot Buttons

Areas	Considerations
Management's assessment	▪ Have the following factors been considered? ▪ Current and expected profitability ▪ Debt repayment schedules ▪ Availability of potential sources of financing ▪ Working capital position ▪ Negative operating cash flows (cash burn rate) ▪ Economic conditions ▪ Adequacy of capital resources
Disclosure	▪ Does management's assessment of the company's financial fundamentals indicate that a going concern note is warranted? ▪ If so, has the company disclosed the **material uncertainties** that cast significant doubt upon the ability to continue as a going concern? *Note: In order for this disclosure to be useful, explicitly state that these uncertainties cast **significant doubt** upon the company's ability to continue as a going concern*

Going Concern
Example of Boilerplate Disclosure

Unclear if this is meant to highlight a material uncertainty

Missing clear disclosures of material uncertainties that cast significant doubt

At year-end the company had cash of $1M and a working capital deficiency of $2M. The company's ability to continue operations and fund its expenditures is dependent on management's ability to secure additional financing. Management is actively pursuing such additional sources of financing, and while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future.

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Going Concern
Example of Entity-Specific Disclosure

Specific disclosure of the material uncertainties that cast significant doubt

The company has incurred significant operating losses ($5M in 2012 and $6M in 2011) and negative cash flows from operations ($2M in 2012 and $2M in 2011). At year-end the company had cash of $1M and a working capital deficiency of $2M. The company's ability to continue operations and fund its expenditures is dependent on management's ability to secure additional financing.

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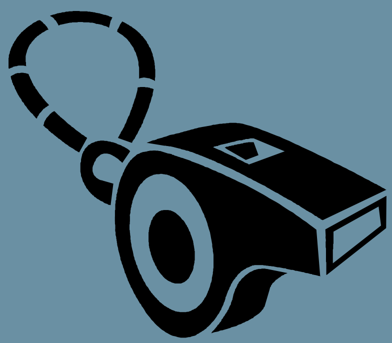
Going Concern
Example of Entity-Specific Disclosure (cont'd)

Explicit link between disclosed uncertainties and ability to continue as going concern

Whether and when the company can attain profitability and positive cash flows is uncertain. These uncertainties cast significant doubt upon the company's ability to continue as a going concern. The company will need to raise capital in order to fund its operations. The company will seek financing through debt and equity financings, asset sales, and rights offerings to existing shareholders. The success of these plans may be adversely impacted by: a lack of normally available financing, the ongoing lawsuit, an accelerating loss of customers, and declining sales per customer. The outcome of these matters cannot be predicted at this time

Heads Up!



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Heads Up!
Inventory

Market Condition	In unfavourable economic conditions inventory can be slow moving and become obsolete or over-valued.
Impact	Inventory must be valued at lower of cost and Net Realizable Value (NRV)
Action	Monitor movement and inventory turnover

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Heads Up!
Accounts Receivable

Market Condition	Declining economic conditions can impact collectability of receivables. Receivables generally represent a material balance for both retail and manufacturing issuers
Impact	If customers are not able to pay outstanding balances on time, valuation of receivables may become an issue. Important to disclose past due or impaired receivables.
Action	Monitor movement and A/R turnover

MD&A Observations

Financial Statements	MD&A	Other Key Obligations

• Financial Instruments
  • Classification
  • Measurement
  • Disclosure
• Financial Instruments – Convertible Debt
• Revenue Recognition
• Impairment of Assets
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• Heads Up
	• Discussion of Operations
	• Liquidity and Capital Resources
	• Transactions Between Related Parties
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	• Risks and Uncertainties
	• Forward-Looking Information
		• Material Contracts
		• Non-GAAP Financial Measures

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MD&A Background

- MD&A is a narrative explanation “through the eyes of management” which:
  - Provides a balanced discussion of company’s results, financial condition and future prospects – openly reporting bad news as well as good news
  - Helps current and prospective investors understand what the financial statements show and do not show
  - Discusses trends and risks that have affected or are reasonably likely to affect the financial statements in the future
  - Provides information about the quality and potential variability of company’s earnings and cash flow

The MD&A should complement and supplement the company’s financial statements

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Annual MD&A


Annual MD&A
Change in accounting policy
Overall performance
Selected annual information
Risks and uncertainties
Discussions of operations
Summary of quarterly results
Liquidity and capital resources
Off-balance sheet arrangements
Transactions between related parties
Fourth quarter analysis
Critical accounting estimates
Proposed transactions
Financial instruments
Forward-looking information

Discussion of Operations

Discussion of Operations

Observations

Discussion of operations is boilerplate and does not provide entity-specific disclosure about changes in revenues and cost of sales

Why important

Investors require meaningful discussion of operations so that they can better understand the reasons why there have been changes

Provide analysis of operations by discussing why revenues and costs have changed

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Discussion of Operations Hot Buttons

Areas	Considerations
Revenues	▪ Have changes caused by the following factors been disclosed? ▪ Selling prices ▪ Volume / quantity of goods and services ▪ Introduction of new products or services ▪ Any other factors
Costs	▪ Have changes caused by the following factors been disclosed? ▪ Labour and material costs ▪ Price changes ▪ Inventory adjustments
Segments	▪ Does the disclosure discuss performance of all reportable segments disclosed in the financial statements?

Discussion of Operations
Example of Boilerplate Disclosure

Repetition from financial statements

No discussion of variances

Revenue increased from $900,000 to $1,080,000, a 20% increase. Gross profit increased from $400,000 to $408,000, a 2% increase.

Discussion of Operations
Example of Entity-Specific Disclosure

Discussion of variances

Revenue increased from $900,000 to $1,080,000, a 20% increase. Gross profit increased from $400,000 to $408,000, a 2% increase. Three factors caused revenue to increase by $180,000:

Quantification of factors

- increased sales volume of Product X-$60,000;
- decreased unit price of Product X-($30,000); and
- the introduction of a new product during the fourth quarter, Product Y-$150,000.

Relationship with gross profit

In late 2011, we anticipated new competition entering our market, so we discounted our remaining Product X units to encourage their sale and to allow us to focus on its replacement, Product Y. Discounts on Product X caused the reduced gross profit percentage. We expect to continue discounting Product X in the first quarter, but expect our gross profit to improve as Product Y replaces Product X.

Liquidity and Capital Resources

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Liquidity and Capital Resources

Observations

A meaningful analysis of the company's ability to generate sufficient cash, address its working capital requirements and its ability to access financing to meet its committed expenditures is not always provided

Why important

Investors need to clearly understand any anticipated funding shortfalls and financing resources available to meet a company`s operating needs, obligations and fund any future planned growth

Companies should explain their current liquidity position and how they will fund upcoming operating commitments and other obligations

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Liquidity and Capital Resources Hot Buttons

Areas	Considerations
Ability to generate sufficient cash	▪ Is there analysis of the company's ability to generate sufficient cash, in the short term and the long term to meet: ▪ Funding needs? ▪ Planned growth?
Working capital requirements	▪ Are the company's working capital requirements disclosed? ▪ If a working capital deficiency exists, or is expected, is there a discussion on the company's: ▪ Ability to meet obligations as they become due? ▪ Plans, if any, to remedy the deficiency?

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Liquidity Hot Buttons

Areas	Considerations
Spending requirements	▪ Is analysis provided on commitments for: ▪ Capital expenditures? ▪ Any expenditures required to continue key projects? ▪ Has the nature, amount and purpose of commitments, and expected source of funds to meet these commitments been disclosed?
Sources of financing	▪ Is there a discussion on how difficulties in obtaining financing could affect: ▪ Operations? ▪ Ability to continue as a going concern? ▪ Have the expected sources of financing that are being pursued been identified?

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Liquidity
Example of Boilerplate Disclosure

- Identifies working capital deficiency
- No explanation of how deficiency will be remedied
- No explanation of how will meet obligations

At year end, the company had cash of $10,000, total current assets of $500,000 and total current liabilities of $700,000. This resulted in a working capital deficiency of $200,000. Nonetheless, management is confident that the company has adequate financial resources to address its requirements and can arrange alternative sources of financing, if necessary.

Liquidity
Example of Entity-Specific Disclosure

- Ability to generate cash
- Ability to meet working capital obligations
- Expected sources of funds

The company has been incurring losses for the past several years and does not anticipate becoming profitable in the foreseeable future. At year end, the company had cash of $10,000, total current assets of $500,000 and total current liabilities of $700,000. This resulted in a working capital deficiency of $200,000. Subsequent to year end, the company has entered into discussions to borrow an additional $2.75 million from shareholders to meet current and future working capital requirements.

In the short term, the company intends to principally rely on advances from shareholders and the exercise of options to fund operating costs. However, there is no assurance that shareholders will advance a sufficient amount of funds to the company or that a sufficient number of options will be exercised.

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Liquidity
Example of Entity-Specific Disclosure

Cash burn rate

Working capital requirements

The company is also exploring other financing alternatives to address both its short term operating and long term financing requirements, such as private placements, potential acquisitions and negotiations with third party lenders.

Negative operating cash flows were $1,200,000 for the year ended December 31, 20xx, representing a monthly cash burn of approximately $100,000. Due to uncertain economic conditions, the company has been ongoing a restructuring of its operations. The company expects to incur restructuring costs in the amount of $500,000, mainly for termination benefits and consolidation of office space over the next 12 months. In addition, the company has budgeted $300,000 for legal costs for a wrongful dismissal suit brought by a former key employee.

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Transactions Between Related Parties

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Transactions Between Related Parties

Observations

MD&A disclosures of transactions between related parties rarely explain the transactions' business purpose and economic substance

Why important

By virtue of their nature, related party transactions lack the independence inherent in arm's length transactions. Investors need to understand the nature, extent and reasons for related party transactions (RPT), as they often constitute significant cash flows for small/medium issuers

Clearly discuss ALL related party transactions, including:
identity of the parties, their relationship with the company,
as well as the business purpose of the transaction

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Transactions Between Related Parties Hot Buttons

Areas	Considerations
Undisclosed RPT	▪ Whether all transactions between related parties have been: ▪ identified (completeness) ▪ discussed in MD&A
Identity and relationship of related party	▪ Whether the **names** of the related parties have been disclosed and not merely their position or relationship to the company ▪ Whether the **names** of ultimate beneficiaries of related party transactions where the transaction is done through a corporate entity has been disclosed ▪ Whether the **relationship** between the company and the related party is clearly disclosed
Business purpose	▪ Whether the reason **why** a particular related party transaction was entered into is clearly disclosed ▪ Avoid generic descriptions such as "for services performed" ▪ Explain **what** was received or paid and **why**

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Examples of Common Related Party Transactions

- Office space rented from a company with common officers and directors to the company
- Administrative services provided by a company controlled by a director
- Advisory fees, management fees or other services to companies controlled by officers or directors
- Loans and advances provided by a director to the company or vice-versa
- Equity investments made by the company in other entities with common officers and directors

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Transactions Between Related Parties Example of Boilerplate Disclosure

Lacks detail on the transaction and the identity of the related party

During the year, the Company paid $300,000 to a director for consulting services and interest on a loan.

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Transactions Between Related Parties Example of Entity-Specific Disclosure

Relationship/ identity

Business purpose and amount

Measurement basis used

During the year, the Company paid $300,000 to Steven Jones, a director who is a consultant. The Company paid $20,000 to Mr. Jones for the use of office space he provided, and $80,000 for his consulting services in connection with the identification of the probable acquisition of ABC Co. The office space and consulting services, which were both provided in the normal course of operations at rates comparable to what would have been paid to unrelated parties, were measured at the exchange amount.

The Company also paid Mr. Jones $200,000 in interest on a loan he provided in the principal amount of $2,000,000. The unsecured loan bears interest at 10% per annum, and matures in five years with an option by the Company to extinguish the debt at any time without penalty. The Company entered into this related party transaction because alternate sources of financing were unavailable due to the Company's limited operating history and limited access to public financing due to current market conditions.

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Critical Accounting Estimates

Critical Accounting Estimates (TSX Issuers)

Observations

Critical accounting estimate disclosure is often boilerplate and does not adequately discuss the methodology and assumptions used to determine the accounting estimate

Why important

Investors should be able to assess whether the assumptions and methodology used by management to determine the estimate are reasonable

MD&A disclosure should supplement the disclosure of the accounting policies provided in the financial statements

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Critical Accounting Estimates Hot Buttons

Areas	Considerations
Qualitative information	▪ Is there a description of the accounting estimate? ▪ Are methodology and assumptions described? ▪ Have known trends, commitments, events or uncertainties that may affect methodology or assumptions been described? ▪ Has the significance of the estimate on the company's financial position been adequately explained?

Quantitative Information	▪ If quantitative information is reasonably available and would provide material information to investors, has it been disclosed?
	    ▪ Sensitivity Analysis
	    ▪ Upper/lower ends of a range of estimates

Examples of critical accounting estimates	▪ Valuation of financial instruments ▪ Impairment of loans and other assets ▪ Revenue recognition ▪ Asset retirement obligations

Risks and Uncertainties

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Risks and Uncertainties

Observations

Disclosure of risks and uncertainties is often boilerplate in nature and the potential impact of how the risks may affect the company is rarely disclosed

Why important

Investors need to understand the entity-specific risks and how those risks may impact the company and its business, both of which may affect an investment decision or the value of their investment should the risks be realized

Throughout each section of the MD&A, companies should disclose risks and uncertainties that are material and entity-specific

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Risks and Uncertainties Hot Buttons

Areas	Considerations
Enterprise risk management	▪ Has information been sought from industry associations and competitors to remain abreast of emerging risks? ▪ Has the Board been informed of the risks that **are not** being actively managed and those that **are** being actively managed?

Disclosure	▪ Have all risks **material** to the company been disclosed?
	
	    ▪ Is there disclosure on how the risk may impact the company?
	
	    ▪ Has the risk disclosure been updated to reflect changes in current and expected conditions?
	
	Note: Do not provide a 'laundry list' of every conceivable risk

To provide meaningful information, companies should disclose the strategies used to manage its risks

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Risks and Uncertainties
Example of Boilerplate Disclosure

General and not specific to company

Potential impact is not disclosed

The company is reliant on a key supplier for the supply of component parts for widgets.

Risks and Uncertainties
Example of Entity-Specific Disclosure

Entity-specific

Potential impact

Reliance on Supplier XYZ

The company obtains its supply of the component parts for widgets from Supplier XYZ under the Supply Agreement dated March 31, 2010 for a five year term. Under the terms of the Supply Agreement, the company is required to purchase a minimum of 30% of its supply of component parts of widgets from Supplier XYZ on an annual basis and Supplier XYZ is to also provide the supplies upon the company's request. The company obtains a discount on the supplies of component parts. Should the supplier fail to meet its obligations under the terms, manufacturing operations could be negatively impacted as the production process of widgets may be set back. Further, the possible non-renewal of the Supply Agreement may result in significant increased production costs and a possible compromise on the quality of widgets.

Risks and Uncertainties
Example of Entity-Specific Disclosure

Risk management

Risk Management Strategy
The company manages the risks of reliance on Supplier XYZ through alternative supply arrangements with various other suppliers of component parts. These arrangements provide for similar discounts and are of comparable quality as those provided under the Supply Agreement.

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Risks and Uncertainties
Example of Boilerplate Disclosure

General and not specific to company

Potential impact is not disclosed

Reliance on Key Personnel Risk

The success of the company is dependent on a small number of key personnel, including its President, management and other employees

Risks and Uncertainties
Example of Entity-Specific Disclosure

Entity-specific

Potential impact

Reliance on Key Personnel Risk

The success of the company is dependent on a small number of key personnel, including its President, Mr. Smith. Mr. Smith is one of the founders of the company and has developed key relationships with clients and the company's key service providers over many years. Mr. Smith is responsible for key decision making on the company's investment portfolio as well as key strategic operating decisions. The company has been able to expand its operations to the U.S. due to Mr. Smith's knowledge and expertise.

The loss of Mr. Smith's services could result in the loss of clients, service providers and other relationships key to the development of the company. This could in turn have a material adverse impact on the business, financial condition or results of operations.

The success of the Company will continue to be dependent on its ability to retain existing staff and to attract new staff in the future, as a result of growth. The reputation and industry experience of personnel are important factors the company considers on an on-going basis. The Company has employment agreements with key personnel, however the Company does not have employee insurance for its key personnel.

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Risks and Uncertainties
Example of Entity-Specific Disclosure

Risk management

Risk Management Strategy

Given the dependence on the knowledge and expertise of Mr. Smith, the Company has developed a succession plan and has identified two possible individuals to succeed the existing President.

Forward-Looking Information

Forward-Looking Information

Observations

Companies are not always aware that disclosure of future operational activities is considered forward-looking information (FLI) which is subject to additional disclosure requirements under securities legislation

Why important

Securities legislation requires companies to discuss in their MD&A occurrences that are likely to cause actual results to differ materially from previously disclosed FLI. This allows investors to evaluate the company's forecast and see how it is progressing toward the achievement of its objectives.

Companies are not required to disclose FLI. However, if companies choose to do so, then they are also required to provide updates in subsequent MD&A.

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Forward-Looking Information Hot Buttons

Areas	Considerations
General	▪ Is there a reasonable basis for the disclosed FLI? ▪ Are assumptions supportable and entity-specific? ▪ Is the FLI presented for a reasonable period?
Disclosure	▪ Is FLI identified? ▪ Are the assumptions used to develop FLI disclosed? ▪ Has previously disclosed FLI been updated if actual results differ materially?

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Forward-Looking Information Example of Boilerplate Disclosure

FLI not identified

No assumptions provided

In fiscal 2012, the company anticipates meeting the following targets:

- Total revenues expected to be between $1.5 - $2 billion
- Organic product sales growth > 4%
- Cash EPS expected to be between $3.00 - $3.50
- Adjusted Cash Flow from Operations > $350 million

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Forward-Looking Information
Example of Entity-Specific Disclosure

Identification of FLI

Assumptions

The following represents forward-looking information and users are cautioned that actual results may vary. In fiscal 2012, the company expects total sales to increase by 5.0% to 6.0%. This expectation is based on same-store sales growth of between 3.0% and 4.0% and the introduction of new brands to our city centre stores. It is expected that new brands will contribute to the increase in sales and will be offset by increased competition from U.S. retailers. Key performance indicator for the company includes retail per square foot, this target is assuming an average sale per square feet of $45. Increase of 25 basis points in the interest rates may cause sales target to decrease by 1-2%.

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Forward-Looking Information
Example of Updating Previously Disclosed FLI

2011 objectives	Accomplishments in 2011
Sales growth of 3-4%	<u>Sales growth of 10.5%</u> The increase in sales growth achieved during fiscal 2011 was due to the introduction of product XX in Q4 which resulted in a growth of 6% of sales, reduction of the selling price of product Y which resulted in the increase in sales volume of 75%, and the increase in the sales volume of product R.
Capital expenditure $25-35 million	<u>Capital expenditure of $15 million.</u> Spending was substantially lower than anticipated due to lower information technology enhancement requirements ($8 million) and less equipment replacements ($7 million).

Forward-Looking Information
Example of Boilerplate Disclosure

FLI not identified

No assumptions provided

In fiscal 2012, the Company anticipates meeting the following targets:

- Net income growth of 5%
- Growth in assets under management (AUM) of between $1B- $1.5B
- Return on equity of 12%

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Forward-Looking Information
Example of Entity-Specific Disclosure

Identification of FLI

Assumptions

The following represents forward-looking information and users are cautioned that actual results may vary. In fiscal 2012, the company expects net income growth to increase by 5%. This expectation is based on the fact that we have recently acquired an established asset management company overseas, AssetManagement Co. We expect that the addition of this portfolio will expand our client base and the level of services provided to our existing clients. As a result, we also expect AUM to increase by $1B-$1.5B. The income growth will be offset by competition from firms offering similar products and services, as discussed under risk factors.

Forward-Looking Information
Example of Updating Previously Disclosed FLI

2011 objectives	Accomplishments in 2011
Net income growth of 5%	<u>Net income growth of 8%</u> The increase in net income growth achieved during fiscal 2011 was due to the acquisition of AssetManagement Co. However, the increase in net income growth above expectations is due to a new series of products introduced to our existing client base from AssetManagement Co. This contributed an additional 20% to revenues, and in turn a net income growth that was higher than expected.
Grow AUM $1B-$1.5B	<u>AUM growth of $2 billion</u> The growth in AUM in fiscal 2011 was due to the acquisition of AssetManagement Co. Growth was higher than expected as the company's investment returns outperformed those of its competitors and as a result, the company was able to attract several new high net worth clients.

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Other Key Obligations Observations

Financial Statements	MD&A	Other Key Obligations
• Financial Instruments • Classification • Measurement • Disclosure • Financial Instruments – Convertible Debt • Revenue Recognition • Impairment of Assets • Going Concern • Heads Up	• Discussion of Operations • Liquidity and Capital Resources • Transactions Between Related Parties • Critical Accounting Estimates • Risks and Uncertainties • Forward-Looking Information	• Material Contracts • Non-GAAP Financial Measures

Material Contracts

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Material Contracts

Observations	Companies often do not identify and file material contracts such as credit agreements, purchase/sale agreements, management or advisory agreements
Why important	Material contracts are important for investors in understanding the company's business and the potential impact of these contracts on operations

Companies are required to file copies of material contracts and should be aware of the exceptions to the use of the ordinary course of business exemption

Material Contracts Example

Examples of material contracts entered into in the ordinary course of business	Required to file?
Employment contract	In general, no
Contract with supplier	Yes, if ▪Company's business is substantially dependent on the contract, or ▪Continuing contract to purchase the majority of the company's goods, services or raw materials
Credit agreement with financial institution	Yes, if ▪Company's business is substantially dependent on the contract, or ▪Contract has terms that have a direct correlation with anticipated cash distributions
External management agreement/Advisory agreement	Yes, if ▪Company's business is substantially dependent on the contract

Non-GAAP Financial Measures

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Non-GAAP Financial Measures

Observations

Many companies disclose non-GAAP financial measures, such as EBITDA, however they often do not explain why these measures provide useful information to investors. As well, these measures are not always reconciled to the most directly comparable GAAP measure.

Why important

Since non-GAAP financial measures do not form part of IFRS and as such do not have a standardized meaning or calculation, it is critical that companies explain the composition of the measure and its relevance so that investors and analysts are fully informed

When providing non-GAAP financial information, companies should not mislead investors nor obscure the company's GAAP results

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Non-GAAP Financial Measures Hot Buttons

Areas	Considerations
Usefulness	▪ Has the company disclosed: ▪ Why the non-GAAP financial measure is useful to an investor? ▪ Why management considers the non-GAAP financial measure to be useful?
Reconciliation	▪ Is a reconciliation between the non-GAAP financial measure and the most directly comparable GAAP measure provided?
No standardized meaning	▪ Does the disclosure explicitly state that there is no standardized meaning of the non-GAAP financial measure?
Prominence	▪ Has the comparable GAAP measure been presented with equal or greater prominence to the non-GAAP financial measure?
Explain changes from previous years	▪ If composition of the non-GAAP financial measure has changed from the previous year, has disclosure of the reasons for these changes been made?

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Non-GAAP Financial Measures
Example of Boilerplate Disclosure

- No explanation of why useful
- No reconciliation provided
- Standardized language missing

Our operating income before specific items rose 31%, reaching a new peak of $101 million.

Non-GAAP Financial Measures
Example of Entity-Specific Disclosure

Our profit for the fiscal year was $50 million compared to $31 million in the previous fiscal year. Operating income before specific items (OIBI) rose 31%, reaching a new peak of $101 million. OIBI of the previous fiscal year was $77 million.

Highlights that no standardized meaning

OIBI is a non-GAAP measure and is mainly derived from the consolidated financial statements but does not have any standardized meaning prescribed by IFRS. Therefore it is unlikely to be comparable to similar measures presented by other companies.

Why useful

OIBI is used by management to evaluate the performance of its operations based on a comparable basis which excludes specific items that are non-recurring. When a specific item occurs in more than two consecutives fiscal years, it is no longer considered to be non-recurring by management.

Non-GAAP Financial Measures
Example of Entity-Specific Disclosure (cont'd)

Why useful

We believe that a significant number of users of our MD&A analyze our results based on OIBI since it is a yearly comparable measure of the performance of the company.

Presented with equal prominence to IFRS

Quantitative reconciliation

Reconciliation of OIBI to profit in thousands of dollars:

OIBI	$101	$77
Restructuring of distribution network	($6)	$0
Relocation of production	$0	($9)
Gross income as per financial statements	$95	$68
Sales and administrative expenses.	$23	$19
Financial expenses	$12	$9
Tax expenses	$10	$9
Net income as per financial statements	$50	$31

Latest Developments

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Exempt Market Review

- Published CSA Staff Notice 45-310 *Update on Staff Consultation Note 45-401 Review of Minimum Amount and Accredited Investor Exemptions*
  - Review of the minimum amount and accredited investor prospectus exemptions
- OSC Staff Notice 45-707 OSC *Broadening Scope of Review of Prospectus Exemptions*
  - Considering the introduction of new capital raising prospectus exemptions
  - Subject to further consultation

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Proportionate Regulation for Venture Issuers

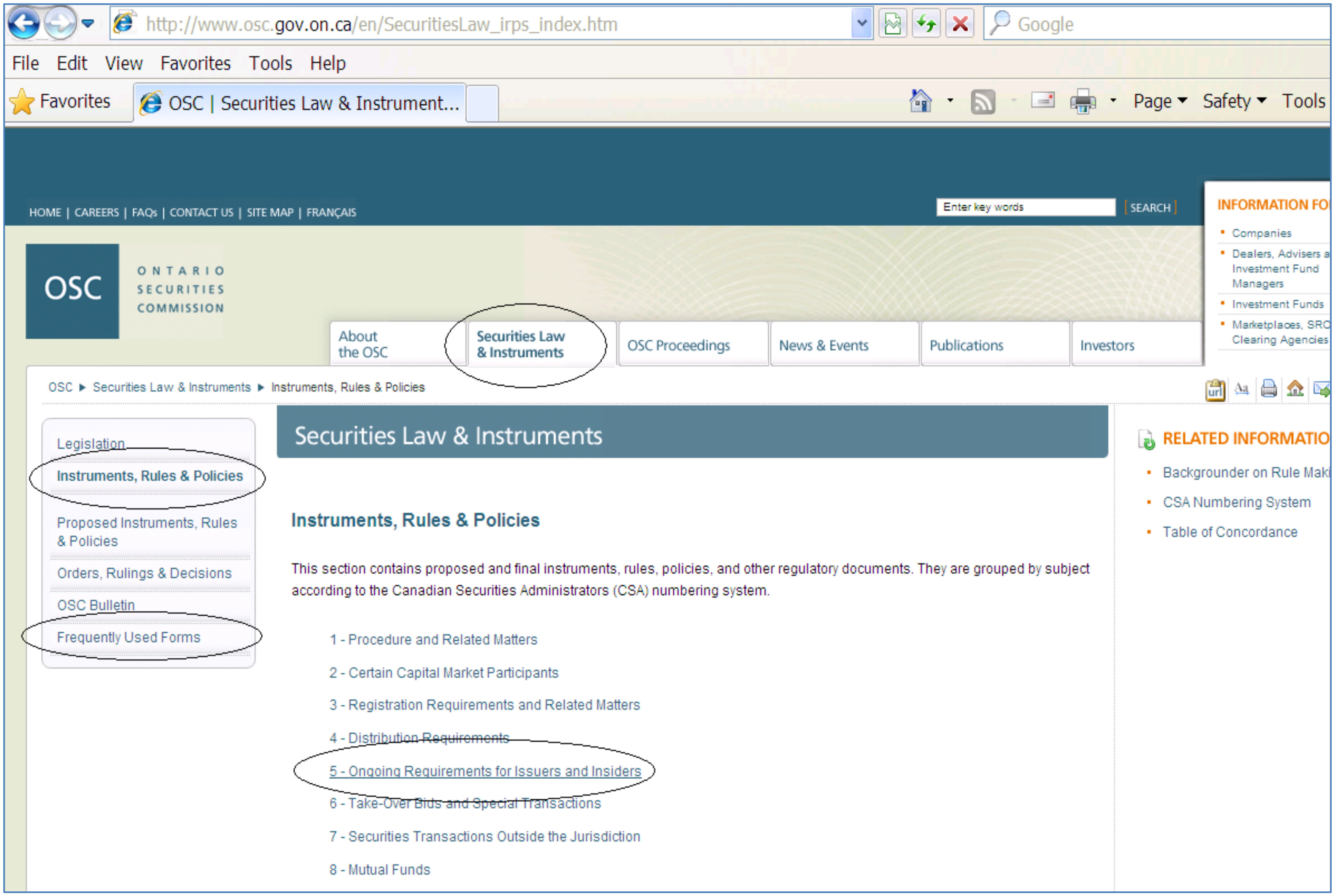
- Proposed National Instrument 51-103 *Ongoing Governance and Disclosure Requirements for Venture Issuers* was republished on September 13, 2012

- Purpose of initiative
  - To streamline and tailor venture issuer disclosure to make it more useful and user-friendly for investors
  - To make the disclosure requirements for venture issuers more suitable and more manageable for issuers at this stage of development

- The 90-day comment period ends December 12, 2012
  - Please provide your input

Helpful Information about the OSC

Useful Links for Companies



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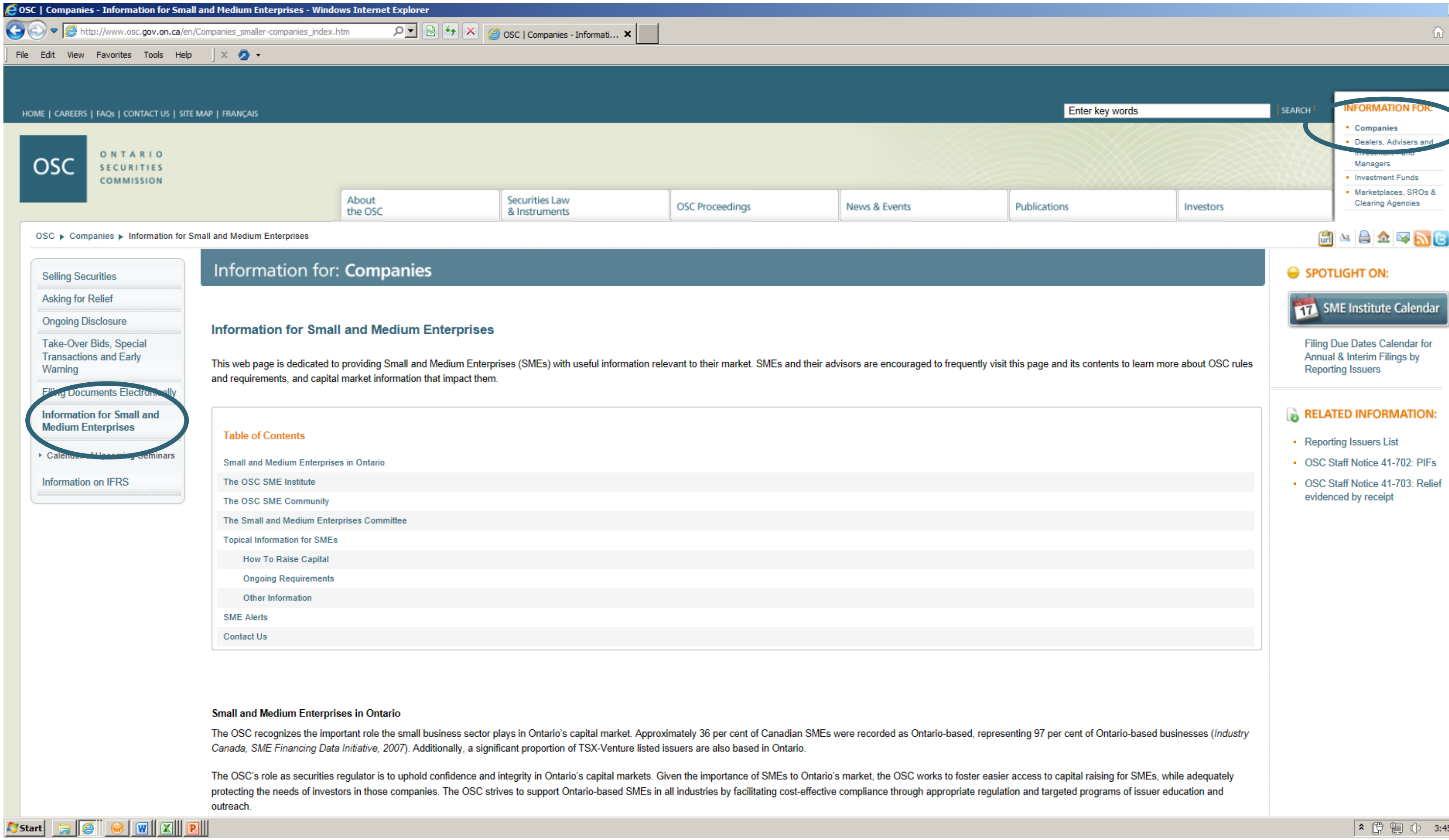
Useful Links for Companies



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Responding to OSC Comment Letters

- Contact staff if clarification is required
- Provide a comprehensive response to each question asked
- Include detailed analysis, if requested, which reconciles to financial statements and other filings
- Cite authoritative accounting references in response to questions related to financial statements

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What if I Don't Comply?

- Placed on default list
  - OSC Policy 51-601 *Reporting Issuer Defaults*
    - Lists key deficiencies resulting in a reporting issuer being noted in default, such as, financial statements, MD&A and technical reports

What if I Don't Remedy?

- National Policy 12-203 *Cease Trade Orders for Continuous Disclosure Defaults*
  - Describes how CSA generally responds to CD defaults by reporting issuers
- If default not remedied within specified time
  - Staff recommends whether CTO is appropriate

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How do I Lift my CTO?

- National Policy 12-202 *Revocation of Cease Trade Orders*
  - Explains what reporting issuers must do for partial or full revocation of cease trade orders
  - Explains some of the factors staff may take into account when considering the appropriateness of partial or full revocation

When I Remedy

- If done quickly – avoid default/CTO
- Once deficiency is remedied – placed on *Refilings & Errors List*
  - File press release (OSC Staff Notice 51-711 *List of Refilings and Corrections of Errors as a Result of Regulatory Reviews*) communicating the refiling to the marketplace

Questions?

Appendices

Appendix A – Key References

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Appendix A – Key References

Topic	Reference
Financial Statements	
Financial instruments – classification & measurement	IAS 39 *Financial Instruments: Recognition and Measurement*
Financial instruments – disclosure	IAS 39 *Financial Instruments: Recognition and Measurement*
Financial instruments – convertible debt	IAS 39 *Financial Instruments: Recognition and Measurement*
Revenue recognition	IAS 18 *Revenue*
Impairment	IAS 39 *Financial Instruments: Recognition and Measurement*
Going concern	IAS 1 *Presentation of Financial Statements* OSC Staff Notice 52-719 *Going Concern Disclosure Review*
Heads up!	IAS 2 *Inventories* IAS 39 *Financial Instruments: Recognition and Measurement*
Management's Discussion and Analysis	
Discussion of operations	Item 1.4 of Form 51-102F1 of NI 51-102 *Continuous Disclosure Obligations*
Liquidity and capital resources	Items 1.6 of Form 51-102F1 of NI 51-102
Transactions between related parties	Item 1.9 of Form 51-102F1 of NI 51-102
Critical accounting estimates	Item 1.12 of Form 51-102F1 of NI 51-102
Risk and uncertainties	Form 51-102F1 of NI 51-102 *Continuous Disclosure Obligations* • Part 1 (a) General Provisions • Item 1.2 Overall Performance • Item 1.4 Discussion of Operations • Item 1.6 Liquidity • Item 1.14 Financial Instruments and Other Instruments
Forward-looking information	Part 4A of NI 51-102 *Continuous Disclosure Obligations*

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Appendix A – Key References (cont'd)

Topic	Reference
<u>Other Key Disclosures</u>	
Material contracts	Item 12.2 of NI 51-102 *Continuous Disclosure Obligations*
Non-GAAP financial measures	CSA Staff Notice 52-306 (Revised) – *Non-GAAP Financial Measures and Additional GAAP Measures*
<u>Additional Reference</u>	
Various	OSC Staff Notice 52-720 *Office of the Chief Accountant Financial Reporting Bulletin*

Appendix B – Financial Examiners

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Appendix B - Financial Examiners

- Financial Examiners maintain CD records, monitor SEDAR filings, and provide assistance for Ontario reporting issuers

Companies with names beginning with…	Financial examiner
Numbers, A, B, G, N	**Sheryl Antonio** **416-595-8941** **finrepnotifications@osc.gov.on.ca**
D, O, P, Q, R, S	**Shirley Kosti-Perciasepe** **416-593-8280** **finrepnotifications@osc.gov.on.ca**
E, F, H, T, U, V, W, X, Y, Z	**Sonia Castano** **416-593-8212** **finrepnotifications@osc.gov.on.ca**
C, I, J, K, L, M	**Diana Gritton** **416-204-8990** **finrepnotifications@osc.gov.on.ca**

Appendix C – Contact Information

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Appendix C – Contact Information

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