

## Corporate Securities

SEPTEMBER 5, 2002

### OSC Continuous Disclosure Review Program

The Continuous Disclosure Team of the Ontario Securities Commission's ("OSC") Corporate Finance Branch issues a report at least annually on the progress of its Continuous Disclosure Review Program (the "CD Review Program"). A report covering the year ended March 31, 2002 has recently been released. The Corporate Finance branch completed 517 CD reviews, representing some 29% of active Ontario-based reporting issuers. Of the 517 reviews, 97 were full CD reviews, 75 were part of a targeted review of revenue recognition practices, 150 reviews were of interim financial statements and interim MD&A, 112 were prospectus reviews, and 83 were issue-oriented reviews (responding to items identified through daily reviews, investor complaints, or through other sources).

#### Overview

No significant changes or outcomes were found in 57% of reviews, which the OSC considers reasonably encouraging overall. In 9% of reviews, filings were identified that were so deficient that the issuers were required to refile certain disclosure materials. The vast majority of these deficiencies related to issues identified in interim financial statements. As well, in 3% of reviews, issues that led to accounting changes were found. Overall, the OSC concludes companies are clearly more aware of the importance of good disclosure practices. However, the OSC also found many companies tend toward a minimal approach to disclosure with 23% of the reviews resulting in companies agreeing to enhance future disclosure. Set out below is a summary of the OSC findings with respect to issuers' corporate disclosure practices and the deficiencies found by the OSC in accounting and financial reporting.

#### Corporate Disclosure Policies

A survey was conducted in October 1999 ("the Survey") to seek information from reporting issuers on disclosure practices. Of the companies reviewed, 41% now have formalized written disclosure policies, compared to 29% in 1999. The following highlights of findings are based on companies with formalized written disclosure policies:

- **Spokesperson(s):** 79% (69% in the Survey) of companies have defined spokespersons responsible for communicating with the media, investors and analysts.
- **Conference Calls:** 32% (18% in the Survey) of companies broadcast their conference calls in an open forum (where interested parties can listen by telephone or via webcast).
- **Working with Analysts:** 54% of companies (98% in the survey) acknowledge that they do have one-on-one meetings with analysts. Note the significant change in this practice which can help avoid selective disclosure of material information being made to analysts.
- **Trading Blackouts and Quiet Periods:** 72% of the companies have a policy with respect to blackout periods as part of their trading policies when trading by employees is prohibited. The most common blackout

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period was from the end of the year or quarter to the release date of the financial results plus two days. 33% of the companies have specific quiet periods as part of their disclosure policies when companies will not comment on expected results.

## Accounting and Financial Reporting Matters

- **Final Report on Staff's Review of Revenue Recognition:** Of the 75 companies reviewed, 29 committed to make enhanced disclosure in the notes to the financial statements or in the MD&A of their revenue recognition policies. Many companies not included in the review have also increased their disclosure of revenue recognition policies.
- **Interim Reporting:** Of the 150 issuers reviewed, 17 failed to include the minimum components of interim financial statements, or failed to include the minimum for the appropriate periods. These companies were required to refile their interim financial statements. The OSC encourages companies to review OSC Staff Notice 52-713 issued in February, 2002 and to consult with their advisers, particularly where unusual transactions occur and need to be reported in a timely manner, during the course of an interim period.
- **Non-GAAP Earnings Measures:** Approximately 44% of 137 Ontario-based TSE 300 companies reviewed used non-GAAP earnings measures in their earnings releases in manners the OSC considers deficient. Companies commonly failed to: (a) state explicitly that non-GAAP earnings measures had no standardized meaning; (b) explain the objectives for using non-GAAP earning measures and why certain items were excluded; and (c) present the GAAP measures prominently. Issuers are reminded by the OSC that regulatory actions might be taken against issuers that disclose information in their earnings releases in a manner considered misleading and therefore potentially harmful to the public interest.
- **Management Discussion & Analysis:** The OSC frequently found that issuers were not adequately discussing: (a) their short-term and long-term abil-

ity to generate adequate amounts of cash; (b) known trends or expected fluctuations in liquidity; (c) commitments for capital expenditures; and (d) risk factors that could have an effect on future operations and financial position. Proposed National Instrument 51-102 - *Continuous Disclosure Obligations*, issued for comment in June 2002, will expand the MD&A guidance currently provided.

## Resolving Continuous Disclosure Issues

Through the continuous disclosure review process, deficiencies are identified in filings and brought to the attention of an issuer in a comment letter from the OSC. The two resulting responsibilities are:

- **The Issuer's Responsibility to Promptly Correct the Public Record:** To resolve a deficiency, an issuer may have to restate past filings, make immediate disclosure in a press release, or improve disclosure in future filings. How a deficiency is resolved with the OSC depends on the nature of the deficiency, the timing of the issuer's filings and the issuer's willingness to correct the deficiency. Issuers are encouraged to inform the OSC of a problem with their public filings when it comes to their attention.
- **The OSC's Responsibility to Take Action Against Issuers that have Breached the Securities Act:** While the main concern of the OSC is to have deficiencies promptly corrected, once an issuer has fixed the public record, the OSC will still consider if any further regulatory action is warranted. Considerations taken into account by the OSC include whether the deficiency is an isolated incident or the latest occurrence in the issuer's history of poor disclosure practices, what actions have been taken by the senior management of the issuer and its board of directors and audit committee in response to the deficiency and whether the issuer initially brought the matter to the attention of the OSC.

## Recommendations to Issuers Regarding Other Continuous Disclosure Matters

- **Executive Compensation:** Issuers should now use the S&P/TSX Composite Index in preparing the

performance graph required by Form 40, *Statement of Executive Compensation*.

- **SEDAR Profile Information:** Issuers are reminded of their responsibility for maintaining an accurate and current SEDAR filer profile.
- **Defaulting Reporting Issuers:** Issuers are reminded that OSC Policy 51-601 — *Reporting Issuer Defaults*, discusses the guidelines followed and factors considered by the OSC in determining if a reporting issuer is in default. Defaults in complying with financial statement filing requirements may result in a cease trade order.

### Future Considerations

The OSC notes that recent major corporate accounting failures have raised a number of issues concerning transparency and disclosure, the adequacy of corporate governance structures, the objectivity of the auditor and the effectiveness of the audit process. A greater number of full reviews of selected issuers will be carried out by the OSC during the year to March 31, 2003, concentrating on companies that have a large impact in the capital market.

The OSC states that National Instrument 51-102, when finalized, will harmonize continuous disclosure requirements among all Canadian jurisdictions and will greatly assist in establishing a common approach to regulatory review. Goodmans will be pleased to assist issuers in evaluating their continuous disclosure policies and practices. Please contact any member of our securities team.

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