APPENDIX A

Financial Statements Deficiencies

This Appendix provides some examples of deficient disclosure contrasted against more robust entity-specific disclosure for three areas of IFRS requirements. Many issuers could improve compliance in these areas.

1. Judgements

In accordance with paragraph 122 of IAS 1 *Presentation of Financial Statements* **(IAS 1)**, an issuer shall disclose in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

We found that the disclosure about judgements that have the most significant effect on the amounts recognised in the financial statements is generally deficient and boilerplate. We noted that some issuers did not disclose any information about judgements. In some instances, issuers included a note with a title referring to judgements and estimates in the financial statements, but the note only included information about estimates. In other instances, issuers listed the financial statements items involving judgements, but they did not disclose the judgements made.

Example of deficient disclosure

Use of estimates and judgements

The preparation of financial statements in compliance with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future. Estimates and underlying assumptions are reviewed on an on-going basis.

Critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements include assessing when depletion of capitalized costs for mining properties begins.

Example of entity-specific disclosure

Judgements

In applying the Company's accounting policies, management used its judgement in areas which have the most significant effect on the amounts recognized in the consolidated financial statements, including:

Determining Production Stage of a Mine

The Company capitalizes costs incurred in exploration, evaluation and development as part of mining properties prior to a mine being capable of operating at levels intended by management. Depletion of capitalized costs for mining properties begins upon the mine entering into production stage, which requires significant judgement in its determination. Management considers various factors to determine when a mine is substantially complete and ready for its intended use. These factors include: 1) level of capital expenditures compared to construction cost estimates; 2) completion of a reasonable period of testing of major mine and plant components; 3) achievement of consistent operational results over a reasonable period of time; 4) achievement of planned production capacity for plant and mill; and 5) ability to sustain ongoing production. The Company determined that the ABC mine was capable of operating at levels intended by management and moved into production stage on March 1, 2013.

2. Impairment of goodwill

In accordance with paragraph 134 of IAS 36 *Impairment of Assets* (**IAS 36**), an issuer must disclose information on each cash-generating unit (**CGU**) or group of CGUs for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that CGU or group of CGUs is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives. If the CGU or group of CGUs' recoverable amount is based on value in use, this information includes a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the CGU or group of CGUs' recoverable amount is most sensitive.

Some issuers did not disclose all the information required by paragraph 134 of IAS 36.

Example of deficient disclosure

Goodwill is tested at least annually for impairment. The Corporation performed its impairment test as at December 31, 2012. For the purpose of impairment testing, goodwill is tested for impairment at the CGU level. The recoverable amount of the CGUs is based on value in use. If the carrying value exceeds the recoverable amount, an impairment charge is recognized to the extent that the carrying value exceeds the recoverable amount.

The recoverable amount of all CGUs has been determined based on cash flow projections on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using estimated growth rates of 2%.

Example of deficient disclosure (continued)

The discount rates used are pre-tax and reflect specific risks relating to the relevant CGUs. The pre-tax discount rate used for the value in use calculation was 16%.

No impairment charge has arisen as a result of the review performed as at December 31, 2012. Reasonably possible changes in key assumptions would not cause the recoverable amount of CGUs to fall below the carrying value.

In the above example, the issuer did not provide:

- the carrying amount of goodwill allocated to the CGU or group of CGUs for which the carrying amount of goodwill is significant in comparison with the issuer's total carrying amount of goodwill (Paragraph 134 (a) of IAS 36);
- a complete description, by CGU or group of CGUs, of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the CGU or group of CGUs' recoverable amount is most sensitive (Paragraph 134 (d) (i) of IAS 36). Examples may include revenue growth or gross margin percentage assumptions; and
- a description of management's approach in determining the value (or values) assigned to each key assumption, whether these values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information (Paragraph 134 (d) (ii) of IAS 36). For example, if the gross margin percentage for a specific CGU or group of CGUs is higher in the cash flow projection than what has been experienced, it would be important for users to be alerted to this and to understand why.

Example of entity-specific disclosure for paragraph 134 (a) of IAS 36

For the purpose of annual impairment testing, goodwill is allocated to the following CGUs which are the units expected to benefit from the synergies of the business combinations in which the goodwill arises.

CGU A: $300,000
CGU B: $150,000
CGU C: $95,000
CGU D: $80,000

Note 1 : Assumes that CGU A, B, C and D are adequately described in another note. Also assumes that all other information required by paragraph 134 of IAS 36 is disclosed.

3. Going concern

Under IAS 1, when management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the issuer's ability to continue as a going concern, the issuer must disclose these uncertainties.

Under paragraph 19 of the Canadian Auditing Standards 570 *Going Concern*, if adequate disclosure is made in the financial statements, the auditor shall express an unmodified opinion and include an "Emphasis of Matter" paragraph in the auditor's report to highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern and draw attention to the note in the financial

statements that discloses the matters set out in this paragraph.

We sometimes see inconsistent information between the going concern disclosure provided in an issuer's financial statements and the going concern disclosure included in the auditor's report.

Some issuers provide indications of financial difficulty, sometimes under a going concern heading, without explicitly stating that the disclosed uncertainties may cast significant doubt upon the issuer's ability to continue as a going concern despite the fact that the auditor's report highlights the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the issuer's ability to continue as a going concern.

Example of deficient disclosure

Extract from the auditor's report

Emphasis of Matter paragraph

We draw attention to Note 2 to the financial statements that highlights the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern. Our opinion is not qualified in respect of this matter.

Extract from the financial statements

Note 2 - Going concern assumption

At year-end the Company had minimal cash and a working capital deficiency. While the Company has prepared its financial statements on the going concern basis, it is dependent on its ability to obtain additional financing from related parties and external financing to sustain operations and fund its expenditures.

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.

Example of entity-specific disclosure

Extract from the auditor's report

Emphasis of Matter paragraph

We draw attention to Note 2 to the financial statements that highlights the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern. Our opinion is not qualified in respect of this matter.

Extract from the financial statements

Note 2 - Going concern assumption

The financial statements were prepared on a going concern basis. The going concern basis assumes that the Company will continue to operate in the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

For the year ended December 31, 2012, the Company had a net loss from operations of $3 million, a negative cash flow from operations of $2 million. As at year-end, the Company had a working capital deficiency of $1.5 million and cash on hand of $2 million.

Extract from the financial statements (continued)

The Company has a history of operating losses. In recent years, it had negative cash flows from operations and working capital deficiencies. The Company's credit facility contains certain financial covenants that are subject to periodic reviews. As part of its debt agreement, the Company must maintain a working capital ratio of at least 1:1. As at December 31, 2012, this ratio was 0.5:1. Given the breach, the lender has the right to demand full repayment at any time. As a result, the bank debt has been reclassified to short term liabilities resulting in a higher working capital deficiency. The Company is currently in negotiations with the lender to waive the covenant violations.

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 complete a short term financing to make the payment for the credit facility, raise sufficient working capital to maintain operations, reduce operating expenses and increase revenues. Subsequent to year end, the Company completed a private placement of $3 million to fund ongoing operations and to pay off the credit facility in the event the waiver cannot be obtained.

We remind issuers, that when there are uncertainties that cast doubt on the issuer's ability to continue as going concern, the MD&A should also provide a discussion and analysis on how the issuer expects to resolve the uncertainty event or condition.