

Analysis of the 60 Most Recent SEC Comment Letters Issued to Canadian Form 40-F Filers

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Since January 1, 2016, the SEC has publicly released its correspondence relating to 60 comment letters sent to Canadian issuers with respect to annual reports filed on Form 40-F pursuant to the Canada-U.S. Multi-Jurisdictional Disclosure System (MJDS). We have analyzed the content and key takeaways from these letters, including:

- The SEC's most common areas of focus;
- Recent trends; and
- Common errors to be avoided.

Background

The MJDS system allows Canadian issuers that satisfy certain market capitalization and other requirements to file an annual report with the SEC on Form 40-F. Except for a few items, a Form 40-F does not impose U.S. disclosure requirements upon a Canadian issuer and, instead, includes and relies upon the disclosures contained in the issuer's annual information form, MD&A, and audited financial statements filed in Canada. The incremental requirements of Form 40-F include that the issuer's financial statements comply with IFRS as issued by the IASB or be reconciled to U.S. GAAP, that the audit report meet certain requirements, that the auditor be independent, that certain disclosures be included with respect to the issuer's disclosure controls and procedures and internal control over financial reporting, that certain officer certifications and third-party consents be included, and that certain additional MD&A disclosures be included.

While the limited nature of Form 40-F reduces the number of areas in which the SEC may comment, Congress has directed the SEC to review the filings of SEC reporting issuers at least once every three years. For this reason, all companies that report with the SEC, even those that report under the MJDS, should expect their filings to be reviewed from time to time. If upon such review, the SEC has questions or believes that the issuer's filing is deficient, it may provide comments to the issuer by letter. The issuer must then respond to the SEC's comments, and may need to amend its filings to address the comments.

Related People

- Christopher L. Doerksen

Related Capabilities

- Canada Cross-Border Transactions

Industry Breakdown

The industry breakdown of the 60 most recent Form 40-F comment letters was:

- Twenty-four to companies involved in mining, mineral exploration, or the holding of mineral royalties or minerals;
- Five to energy companies;
- Five to technology and telecommunications companies;
- Four to life sciences companies;
- Four to banking and insurance companies;
- Three to real estate companies; and
- Six to companies involved in other industries, including transportation, manufacturing, entertainment, publishing, and professional services.

Repeat Letters

An issuer's chance of receiving a comment letter may increase once the SEC has taken an interest in the issuer's filings. The recipients of the comment letters included nine issuers who received a comment letter in both of the fiscal years covered by our review.

Self-Inflicted Wounds

Some comments could easily have been avoided. For example:

- Six letters noted technical problems with the audit report (missing auditor name, signature, date, or entire report; or failed to say financials comply with IFRS "as issued by the IASB");
- Four noted technical problems with officer certifications or the internal control attestation report (wrong period, date, or content; or missing entirely);
- Four noted technical problems with the content of the controls sections of the Form 40-F;
- Three related to non-IFRS measures that the SEC considered misleading because terms were used inconsistently or the titles of the terms did not match the definitions (e.g., using the term EBITDA but calculating it in a manner inconsistent with market norms);
- Two noted technical problems with the contractual obligation table; and
- Two objected to an issuer's conclusion that disclosure controls were effective when the issuer had disclosed that internal controls were ineffective.

Paying Attention

The SEC pays attention to an issuer's website and earnings calls and may comment on inconsistencies between the Form 40-F and these other disclosures or raise other comments based on these disclosures. For example, several comment letters asked issuers about their business activities in sanctioned countries based on disclosures on their website. One letter questioned why management touted improvements in internal controls on the earnings call but disclosed no material change in internal controls in its Form 40-F. Another requested a different presentation of revenues based on sales

information disclosed on an earnings call.

Most Common Topics

By far the most common topic of an SEC comment letter was the issuer's financial disclosures. Forty-two of the 60 letters included comments relating to the issuer's financial statements, audit report, auditor, or MD&A. These included, among others:

- Twenty-four with questions regarding revenue recognition policies, breakout of revenues by product (usually asking why further breakouts of revenue were not provided), methodology and disclosures around asset valuation and capitalization of expenditures, tax assets and rates, depletion/depreciation, or impairment analysis;
- Thirteen with questions about the accounting treatment of a specific other matter; and
- Nine requesting improvements to the disclosure of period-to-period changes, a particular accounting analysis, liquidity, cash flow, or other matters.

Second-most common was comments relating to technical disclosure requirements for issuers involved in the mining or oil & gas industries, accounting for 13 of the 60 letters. Ten letters addressed mining company technical disclosures, including supplemental requests for copies of technical reports, studies, or other information in support of disclosures (the SEC does not require such reports to be publicly filed, unless also filed in Canada and material), and comments relating to:

- the issuer's failure to comply with NI 43-101 (compliance with NI 43-101 is a pre-requisite for not complying with SEC Industry Guide 7);
- the issuer's failure to update reserve calculations, for past production or more generally; and
- inconsistent or unclear disclosures.

Three letters related to oil & gas company technical disclosures, all of which requested enhanced disclosures and alleged failures to satisfy FASB disclosure standards.

The third-most common topic of the comment letters was comments relating to deficiencies in the officer certifications or disclosures relating to disclosure controls and internal controls. This topic was addressed in eight of the 60 comment letters, most of which related to failures to satisfy the form requirements.

Fourth-most common was comments inquiring about the issuer's business dealings in sanctioned countries (usually Sudan and Syria) or with companies known to operate in those countries and the adequacy of any related disclosures, usually triggered by the SEC's realization that this may be relevant to the issuer. Seven of the 60 letters included such inquiries.

Waves and Trends

Comment letters have tended to come in waves.

- The letters from January 2016 through June 2017 dealt primarily with financial statement and MD&A issues;

- Two of the three letters issued to real estate companies were issued in the same week of September 2016;
- All of the letters issued to banks were issued in March 2017;
- All of the letters dealing with oil & gas technical disclosures were issued in the fourth quarter 2017; and
- Eight of the 10 letters dealing with mining technical disclosures were issued between June and December of 2017.

It's not yet clear if the shift toward commenting on mining technical disclosures is a trend.

Lessons

To reduce the likelihood of SEC comments, a Canadian issuer that files SEC annual reports on Form 40-F should attend to the technical compliance of its audit report, officer certifications, controls disclosures, and other Form 40-F mandated disclosures; include a robust and understandable MD&A; avoid the inconsistent or misleading use of non-IFRS terms; and, for resource extraction issuers, comply with the technical disclosure requirements applicable to it under Canadian and U.S. laws.