Re: TSX- and TSXV-listed natural resource companies with negative working capital

TMX GROUP:

1) These listed companies are administered by the TMX Group and are subject to the TSXV Corporate Policy Manual http://apps.tmx.com/en/listings/venture_issuer_resources/finance_manual.html

2) Policy 2.5 in the manual covers Continuous Listing Requirements ("CLR"). http://apps.tmx.com/en/pdf/Policy2-5.pdf

3) CLR are defined under Policy 2.5, Heading 2.1 and, as a minimum, include a simple requirement that companies must have a minimum of $50,000 working capital.

4) In the case of exploration companies, there is a good reason to have this minimum working capital requirement. The nature of the exploration business should preclude the concept of negative working capital as a form of financing.

5) Policy 2.5, Heading 3 addresses the "Inability to Meet CLR" and defines the steps the exchange will take when a company does not meet CLR.

6) Financial information is readily available because all listed companies must file their quarterly and annual financial statements on Sedar http://www.sedar.com/issuers/issuers_en.htm.

7) A review of the financial statements filed on Sedar at the end of 2014 reveals there are approximately 600 companies that have negative working capital, meaning they obviously can not comply with CLR. No activity test (also a CLR) was undertaken. A list of those companies accompanies this summary as Schedule "A".

8) The companies are also sorted by auditor, shown in Schedule "B".

9) The total negative working capital of these companies is over $2 billion, and the same companies claim to have over $5 billion of "assets" in the form of exploration and development expense that has been capitalized.

10) If these 600 companies were somehow resurrected, $2+ billion for old bills and a significant amount for future general and administrative expenses would possibly be drained from the limited pool of money available for exploration.

11) The TMX Group has been aware of this deteriorating working capital situation for over two years but has chosen to not give notices as required by Policy 2.5, Heading 3 except in a very limited number of circumstances. Policy 2.5, Heading 3.2.e is not applicable.

12) The TMX Group is a for-profit entity. It would lose significant listing and filing fees if 600 companies were to be de-listed.

13) In an attempt to “help” listed issuers, the TMX Group temporarily allowed placements at lower than normal prices without any reference to rights offerings - to the detriment of existing shareholders.

14) In an attempt to “help” listed issuers, the TMX Group continues to allow rollbacks up to 10:1 without shareholder approval, and also green-lights post-rollback shares for debt arrangements - to the detriment of existing shareholders.

15) National Instrument 52-101 confirms the definition of 'material'. “Would a reasonable investor’s decision whether or not to buy, sell, or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated? If so, the information is likely material.”

16) By definition, all TSX- and TSXV-listed companies have at least one material contract in common - their listing agreement.

17) Without doubt, the value of listing agreements is material and can be measured by:
a) the substantial initial costs of obtaining, and ongoing costs of maintaining, a listing; and
b) the benefit of being able to raise funds from the public: the company through selling treasury shares, and the shareholders through selling company shares in the market.

COMPANY DIRECTORS:

18) Directors, either directly or through the audit committee, must approve all quarterly and annual financial statements and Management Discussion and Analysis (“MD&A”) reports, and are charged with the responsibility of ensuring the disclosure of all information fundamental to users' understanding of those documents.

19) Most companies state directly that they are TSX- or TSXV-listed, either in the financial statements (see Financial Statements Note 1. Nature of Operations) or in the MD&A, or both, but the directors of each and every company on this negative working capital list have not disclosed that their companies do not comply with the terms (“CLR”) of their listing agreements.

20) All companies on this list address “going concern” considerations in their financial statement notes. While there is some debate about when accounting should reflect going concern problems, there can be no debate that imminent material risks should be disclosed.

21) Directors have responsibility for making and disclosing their own “going concern” judgments and ensuring the transparency of material uncertainties. They cannot count on the benefit of a continued TSX or TSXV listing by presuming inappropriate tolerance or inattention on the part of the TMX Group.

22) No reasons have been advanced for directors ignoring the fact that inclusion of CLR compliance or non-compliance is material information when considering going concern uncertainty.

23) In either or both the financial statements and the MD&A's, it is usual for companies to describe additional equity as the main potential source of financing, but no mention is made of the significant risk resulting from non-compliance with CLR.

24) Given that shareholders and other stakeholders (arms'-length creditors) should be adequately informed, directors have an obligation to disclose material risks, which should include non-compliance with CLR.

25) Given that shareholders and other stakeholders (arms'-length creditors) should be adequately protected, and given the lack of disclosure of non-compliance with CLR, directors have an obligation to give detailed disclosure of the reasoning behind undertakings like rollbacks without shareholder approval and post-rollback debt settlements, both of which damage shareholder interests beyond repair, while coincidentally benefitting insiders.

26) Directors have a responsibility to ensure that their companies' financial statements contain no material misstatements. That responsibility extends to the treatment of exploration and development expenditures, which many companies show in their entirety on the balance sheet as 'assets'. While IFRS 6 offers only limited guidance, due in part to Canada's inadequate representation while it was being drafted, it does address the concept of impairment. Most directors ignore the concept and allow assets on their companies' statements of financial position to be grossly overstated.

Confirmation of this point can be made on a macro basis. This list of companies with negative working capital boasts a total of over $5 billion in 'exploration assets'.

AUDITORS

27) Auditors' engagement letters contain references to provision of information on known or probable instances of non-compliance with legislative or regulatory requirements, on regulatory non-compliance or trading restrictions of any kind, and on information regarding compliance with contractual agreements.

28) Auditors demonstrate awareness of the issue of non-compliance by including expressions similar to the following in their communication with companies being audited. “We are unaware of any instances of non-compliance or possible non-compliance with laws or regulations whose effects should be considered when preparing financial statements.”

29) For reasons unknown, the auditors of the approximately 600 companies on the negative working capital list have not reported on whether the listing contracts common and material to all companies are in good standing. Whether or not auditors have obtained copies of and reviewed the listing agreements is subject to question.

30) If auditors are unable to convince the directors to disclose the non-compliance with CLR in the financial statements notes, they have an alternate and accepted method of drawing attention to the situation through a non-contentious paragraph in the audit report called Emphasis of Matter. While beyond the scope of this report, it appears that no auditor has chosen to disclose this material shortcoming in the audit report.

31) Given that directors have the responsibility of ensuring the disclosure of all information fundamental to users' understanding of the financial statements and MD&A, auditors are therefore charged with the same responsibility.

32) Auditors are, or should be, aware of the materiality of listing agreements for all of the companies listed on Schedule “A”. Considering that auditors have a responsibility to ensure that financial statements are not misleading, when companies state that they are TSX- or TSXV-listed but omit the fact that they do not comply with CLR, it is difficult to explain why there appears to be no discussion or communication regarding the omission, and no comments on the part of the auditors.

33) Considering that there is widespread agreement among auditors that imminent material risks to going concern status should be disclosed, the fact that non-compliance with CLR has not been mentioned in any of the financial statements of the companies on this negative working capital list is inexplicable.

34) When companies state that they intend to rely on equity financing to maintain themselves as going concerns, it is difficult to rationalize why auditors have never insisted on disclosure of the risks to equity financing when companies are non-compliant with the CLR provisions of their listing agreements.

35) Given that auditors are fully aware that shareholders and other stakeholders (arms'-length creditors) should be adequately informed, it is difficult to rationalize why auditors have failed to insist on the disclosure of non-compliance with CLR - an obvious material risk.

36) It is generally agreed that stakeholders have perceived “exploration assets” on the balance sheet as an indicator of a mineral exploration company’s value. Therefore directors and auditors need to be cognizant of the potentially material misstatement of this number.

37) Auditors appear to be relying on an unquestioning acceptance of IFRS 6 allowance of capitalization of exploration expenses instead of giving professional consideration to whether exploration expenses should be capitalized under any circumstances. It is only recently that there appears to be the beginning of a significant shift away from the probable misleading presentation of expenses as assets. See http://www.miningglobal.com/operations/1326/Is-it-Time-for-Junior-Miners-to-Cease-Capitalization-of-Exploration-Costs

38) While auditors may not be qualified to put a valuation on exploration assets, and therefore almost invariably defer to the companies' management and directors, there is no reason they cannot use a common sense approach in questioning why a company with negative working capital is carrying significant 'assets' on its balance sheet when it may not even be able to maintain the properties in question.

39) Discussions with CPA Canada during the preparation of this report produced no evidence of any concern that non-compliance with CLR is a problem for either TSX- or TSXV-listed companies or the auditors, even though compliance with agreements, statutes, and regulations is covered in the Assurance Handbook (5815) and specific comments on compliance are made. For example, “When there are other reporting responsibilities, other than those under the Canadian Audit Standards, the auditor’s report should address these in a separate section of the auditor’s report. An example of this may include matters such as compliance with the Society Act for NPOs.” Are NPO's more important than TSX- and TSXV-listed companies with their thousands of shareholders? https://www.cpacanada.ca/

40) The 'watchdog that didn't bark'
https://www.cpacanada.ca/connecting-and-news/blogs/audit-blog/2012/07/going-concern-when-should-the-watchdog-bark

41) A discussion with the Canadian Public Accountability Board (“CPAB”) during the preparation of this report produced no evidence of awareness that there is non-compliance with CLR and therefore no perception of a potential problem for either TSX- or TSXV-listed companies or the auditors. Given the lack of awareness, it is a legitimate question to wonder if shareholders and other stakeholders are protected per the CPAB's mandate as expressed here http://www.cpab-ccrc.ca/en/Pages/default.aspx.

42) Conversations with several of the auditors of the companies listed in Schedule “A” have produced little or no evidence of any concern that non-compliance with CLR is a condition to be disclosed by either TSX- or TSXV-listed companies or their directors, or the auditors.

43) Although outside the scope of this report, serious questions of auditor independence arose during its preparation. Have audits been commenced while receivables are still outstanding from previous audits? Have audits been signed off when there is a general awareness that the company is incapable of assuring payment in full of the audit invoice?

SECURITIES COMMISSIONS

44) The Ontario Securities Commission http://www.osc.gov.on.ca/en/home.htm, the BC Securities Commission http://bcsc.bc.ca/ , and the Alberta Securities Commission all have mandates that emphasize investor protection and market integrity, as do ten other commissions across Canada. All are 'lawyer-heavy' but have accounting staff that check Sedar-filed financial statements in detail. They have never questioned the materiality of non-compliance with CLR by any of the companies on the negative working capital list in Schedule “A”.

Given the demonstrated lack of awareness, it is a legitimate question to wonder if shareholders and other stakeholders are protected per the Securities Commissions' mandates as expressed on their websites.