

CANADIAN SECURITIES ADMINISTRATORS STAFF NOTICE 51-313

Frequently Asked Questions
National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*

April 8, 2004

Background

National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities* (NI 51-101) sets out requirements and standards for disclosure by reporting issuers engaged in oil and gas activities. The Companion Policy to NI 51-101 sets out the views of the Canadian Securities Administrators (CSA) as to the interpretation and application of NI 51-101 and its related forms.

Frequently asked questions on NI 51-101

To assist persons and companies using NI 51-101 and its related forms, we are publishing a number of frequently asked questions (FAQs) and CSA staff responses.

Many of the terms used in these FAQs are defined in NI 51-101 or Appendix 1 to the Companion Policy. NP 2-B refers to former National Policy Statement No. 2-B *Guide for Engineers and Geologists Submitting Oil and Gas Reports to Canadian Provincial Securities Administrators*.

The FAQs are grouped into the following categories:

- A. Annual Filings
- B. Prospectuses
- C. All Disclosure
- D. Reserves Evaluations and Evaluators
- E. Exemptions

A. Annual Filings

A-1 Q: We have incorporated our NI 51-101 annual filings into our AIF. We filed our AIF on SEDAR in the SEDAR AIF category. Do we need to file anything else on SEDAR?

A: Yes. Even though you have filed your AIF on SEDAR, you also need to make one of the following filings under the SEDAR Oil and Gas Annual Disclosure (NI 51-101) category:

- (a) file your annual NI 51-101 information, excerpted from your AIF, under the SEDAR Filing Subtype/Document Type *Oil and Gas Annual Disclosure Filing (Forms 51-101 F1, F2 & F3)*,

- (b) file a notification that advises the public your annual NI 51-101 information is in your AIF in the SEDAR Filing Subtype/Document Type *Oil and Gas Annual Disclosure Filing (Forms 51-101 F1, F2 & F3)*, or
- (c) if the news release you disseminated pursuant to section 2.2 of NI 51-101 explains that your annual NI 51-101 information is in your AIF, file the news release under either the SEDAR Filing Subtype/Document Type *Oil and Gas Annual Disclosure Filing (Forms 51-101 F1, F2 & F3)* or the SEDAR Filing Subtype/Document Type *News Release (section 2.2 of 51-101)*.

Whichever option you choose, you must make this additional SEDAR filing under a different project number than you used for the AIF filing.

See section 2.4(b) of the Companion Policy.

A-2 Q: We do not have any reserves, only a few prospects, some unproved properties and some resources. Does NI 51-101 apply to us?

A: Yes. You must comply with NI 51-101 even if you do not have reserves because NI 51-101 applies to all reporting issuers engaged in oil and gas activities, which includes exploration activities and development of unproved properties. That means you must still make annual NI 51-101 filings and ensure that you comply with other NI 51-101 requirements. The requirement to make annual NI 51-101 filings is not limited to only those issuers that have reserves and related future net revenue.

Form 51-101F1

Section 1.4 of NI 51-101 states that the instrument applies only in respect of information that is material in respect of a reporting issuer. If indeed your company has no reserves, we would consider that fact alone material. Your disclosure, under Part 2 of Form 51-101F1, should make clear that your company has no reserves and hence no related future net revenue.

Supporting information regarding reserves data required under Part 2 (e.g., price estimates) that are not material to your company may be omitted. However, if your company had disclosed reserves and related future net revenue in the previous year, and has no reserves as at the end of its current financial year, you are still required to present a reconciliation to the prior-year's estimates of reserves and related future net revenue, as required by Part 4 of Form 51-101F1.

You are also required to disclose information required under Part 6 of Form 51-101F1. Those requirements apply irrespective of the quantum of reserves, if any. This would include information about properties (items 6.1 and 6.2), costs (item 6.6), and exploration and development activities (item 6.7). Your disclosure should make clear that you had no production, as that fact is material.

Form 51-101F2

NI 51-101 requires reporting issuers to retain an independent qualified reserves evaluator or auditor to evaluate or audit the company's reserves data and report to the board of directors. If you had no reserves during the year and hence did not retain an evaluator or auditor, then you would not need to retain one just to file a (nil) report of the independent evaluators on the reserves data in the form of Form 51-101F2. If, however, you did retain an evaluator or auditor to evaluate reserves, and the evaluator or auditor concluded that they could not be so categorized, or reclassified those reserves to resources, you would have to file a report of the qualified reserves evaluator because the evaluator has, in fact, evaluated the reserves and expressed an opinion.

Form 51-101F3

Irrespective of whether you have reserves, the requirement to file a report of management and directors in the form of Form 51-101F3 applies. (As for all reporting issuers, this requirement does not apply in British Columbia, however.)

Other NI 51-101 Requirements

NI 51-101 does not require companies to disclose anticipated volumes, cash flows or values in respect of unproved properties, prospects or resources. However, if you choose to disclose that type of information, sections 5.9 and 5.10 of NI 51-101 apply to that disclosure.

B. Prospectuses

B-1 Q: We are not yet subject to NI 51-101. Can our prospectus contain the disclosure required by NI 51-101?

A: Yes. Until you become subject to NI 51-101, by filing or being required to file your annual NI 51-101 information under Part 2 of NI 51-101, you can disclose information about your oil and gas activities in the prospectus using one of two options. See Section 1.3 of Companion Policy 51-101CP for when NI 51-101 first applies to an issuer.

Option 1: You may disclose the information in accordance with NP 2-B. You can satisfy those requirements by applying the reserves classifications of NI 51-101 instead of the reserves classifications of NP 2-B, if you choose. In all other respects you must satisfy the requirements of NP 2-B, including filing the underlying reserves evaluation report when you file your prospectus.

You should state in the prospectus that the information is presented in accordance with NP 2-B.

See ASC Notice *Oil and Gas Reserves and Related Information Reporting Standards* dated September 27, 2002 – “Use of Handbook Reserves Classifications”.

Option 2: If you wish to disclose the information in accordance with NI 51-101, disclosure in your prospectus must be in accordance with NI 51-101. That means that the prospectus must include (or if it is a short form prospectus, it must incorporate by reference) the following:

- the information required by Form 51-101F1,
- the report of one or more qualified reserves evaluators or qualified reserves auditors in the form of Form 51-101F2, and
- the report of management and directors in the form of Form 51-101F3.

The information set out, or incorporated by reference, in your prospectus must also comply with Part 5 of NI 51-101.

You should state in the prospectus that “the information disclosed in the prospectus is presented in accordance with NI 51-101” only if you follow this second option.

See subclause (4) in Item 9 of ASC Form 14 *Information Required in a Prospectus of a Natural Resource Issuer*, as amended; or Item 6.5 of OSC Form 41-501F1 *Information Required in a Prospectus*, as amended.

B-2 Q: What oil and gas information about a significant acquisition do we need to disclose in a prospectus?

A: In addition to the specific prospectus requirements for financial information satisfying significant acquisitions, you must disclose sufficient information for a reader to determine how the acquisition affects the reserves data and other information previously disclosed in your annual NI 51-101 filings. This requirement stems from Part 6 of NI 51-101 with respect to material changes. See Part 6 of the Companion Policy for additional guidance.

B-3 Q: We have a December 31 year-end and are filing a preliminary prospectus in September. We want to disclose our reserves data and other oil and gas information as at a more recent date than December 31. Would we also have to disclose the reserves data and other information as at December 31?

A: An issuer may determine that its obligation to provide full, true and plain disclosure obliges it to include in its prospectus reserves data and other oil and gas information as at a date more recent than specified in the prospectus requirements. The prospectus requirements state that the information must be as at your most recent financial year-end in respect of which the prospectus includes financial statements. The prospectus requirements, while certainly not presenting an

obstacle to such more current disclosure, would nonetheless require that the corresponding information also be provided as at that financial year-end.

We would not generally object to granting relief to permit an issuer in these circumstances to include in its prospectus the oil and gas information prepared with an effective date more recent than the financial year-end date, without also including the corresponding information effective as at the year-end date. You should request such relief in the covering letter accompanying your preliminary prospectus. The grant of the relief would be evidenced by the prospectus receipt.

C. All Disclosure

C-1 Q: Does NI 51-101 apply to news releases?

A: Yes. Part 5 of NI 51-101 sets out requirements that apply to all disclosure. You must include in the news release, where applicable, the cautionary statements prescribed by NI 51-101. For example, if the news release refers to BOEs, it must contain the cautionary statement prescribed by section 5.14(d) of NI 51-101.

C-2 Q: Does our news release have to contain all of the information required by Form 51-101F1 if it contains information about our oil and gas reserves?

A: No. Form 51-101F1 sets out information that you must file annually or include in a prospectus. Although the news release must be consistent with that information, you can provide a summary of that information or a portion of it. See Parts 4 and 5 of NI 51-101.

C-3 Q: Does NI 51-101 apply to presentations by our company?

A: Yes. Part 5 of NI 51-101 sets out requirements that apply to all disclosure by or on behalf of a reporting issuer. Some of the provisions in Part 5 refer specifically to “written disclosure”; some refer only to “disclosure”, which includes oral presentations. The requirements in those provisions that refer to written disclosure apply not only to filed disclosure –material change reports, annual NI 51-101 filings – but also to news releases and written materials provided in paper or electronically at company presentations.

For example, if material distributed at a company presentation refers to BOEs, the material should include, near the reference to BOEs, the cautionary statement required by section 5.14(d) of NI 51-101. That requirement does not apply to oral presentations. You would not have to make the prescribed cautionary statement in your speech even if you refer to BOEs.

C-4 Q: Can we state that our estimates of reserves have been (or may be) reduced because of the application of the new reserves definitions under NI 51-101? Should we disclose this potential effect of the new definitions as a risk factor?

A: No. We believe that a significant reduction in reserves cannot properly be attributed to NI 51-101 or the new reserves definitions as such. Section 6.5 of the COGE Handbook explains that any difference in reserves as a result of the implementation of the new reserves definitions should not be significant. You should provide a more comprehensive explanation for any significant reduction in reserves.

We do not consider the implementation of NI 51-101, the new reserves definitions or new industry standards a “risk factor” for investors.

C-5 Q: If we disclose finding and development costs, we must disclose comparatives from prior periods under clause 5.15(b)(iii) of NI 51-101. Can these comparatives be calculated using NP 2-B definitions?

A: Yes. The comparatives can use NP 2-B definitions provided the NP 2-B probable reserves have been risked and you have calculated the comparatives using method 1 and method 2 set out in paragraph 5.15(a) of NI 51-101. The methodology should be briefly explained.

D. Reserves Evaluations

D-1 Q: Who should we contact if we have technical questions about evaluating oil and reserves?

A: Contact:

Glenn Robinson, Senior Petroleum Evaluation Engineer
Alberta Securities Commission
(403) 297-4846
glenn.robinson@seccom.ab.ca

or

David Elliott, Senior Petroleum Evaluation Geologist
Alberta Securities Commission
(403) 297-4008
david.elliott@seccom.ab.ca

D-2 Q: We are preparing a reserves evaluation report for a client that has a December 31 year-end. We are preparing the evaluation report in March but it has an effective date of December 31.

(a) Can we prepare the evaluation using information that relates to events that occurred after December 31?

(b) Can we use our March price forecasts rather than the December ones?

- A:**
- (a) No. Information that relates to events that occurred after December 31 should not be incorporated into the forecasts. For example, information about drilling results from wells drilled in January or February, or changes in production that occurred after December 31, should not be used. Even though this more recent information is available, you should not go back and change the forecast information. The forecast is to be based on your perception of the future as of December 31, the effective date of your report.
 - (b) No. You should not use the March price forecasts; you should use the prices that you forecasted on or around December 31. You should also use the December forecasts for exchange rates and inflation. Revisions to price, exchange rate or inflation rate forecasts after December 31 would have resulted from events that occurred after December 31.

Forecast prices and costs are defined in NI 51-101 to be “generally recognized as being a reasonable outlook on the future”. Section 4.1 of the Companion Policy explains that we would not consider that future prices or costs would satisfy this requirement if they fall outside the range of forecasts of comparable prices or costs used, as at the same [effective] date, for the same future period, by major independent qualified reserves evaluators or auditors.

The effective date of an evaluation of oil and gas reserves is a point in time that separates historical information from forecast information. Even though reserves evaluations are forecasts of the future, those forecasts are based primarily on historical information. The historical information pertains to the period of time ending on the effective date.

The evaluator should not go back and change the numbers because of technical and financial information that pertains to time after the effective date. However, to ensure that investors are not misled, the issuer may need to supplement its reserves data disclosure with a discussion of the effect of more recent information on its reserves data if the effect is material to the issuer. Item 5.2 of Form 51-101F1 requires an issuer to identify and discuss important economic factors or significant uncertainties that affect particular components of the reserves data. Like a “subsequent event” note in a financial statement, the issuer should discuss this type of information even if it pertains to a period subsequent to the effective date.

For example, if events subsequent to the effective date have resulted in significant changes in expected future prices, such that the forecast prices reflected in the reserves data differ materially from those that would be considered to be a reasonable outlook on the future around the date of the company’s “statement of reserves data and other information”, then the company’s statement might include, pursuant to item 5.2, a discussion of that change and its effect on the disclosed future net revenue estimates.

D-3 Q: Paragraph 2(c) of Item 4.1 of Form 51-101F1 requires reconciliations of reserves to separately identify and explain technical revisions. Is it acceptable to include infill drilling results as a technical revision?

A: No. Technical revisions show changes in existing reserves estimates, on carried-forward properties, over the period of the reconciliation. Reserves additions derived from infill drilling during the year are not attributable to revisions to the previous year's reserves estimates. Infill drilling reserves should be included in the "improved recovery" category.

D-4 Q: NI 51-101 requires future net revenue to be estimated and disclosed both before and after deduction of income taxes. However, we are not subject to income taxes because of our [royalty or income] trust structure. What tax rate should we use in computing our future net revenue?

A: You should use the rate that most appropriately reflects the income tax you reasonably expect to pay on the future net revenue. If you are not subject to income tax because of your royalty trust structure, then the most appropriate income tax rate would be zero.

The general instructions in Form 51-101F1 give considerable flexibility in how you present the information required by that form. In your case, you could present the estimates of future net revenue in only one column and explain, in a note to the table, why the estimates of before-tax and after-tax future net revenue are the same.

D-5 Q: Does the royalty granted by its subsidiary to the trust affect the computation of "net" reserves?

A: No. NI 51-101 requires that certain reserves data be provided on both a "gross" and "net" basis, the latter being adjusted for both royalty entitlements and royalty obligations. The typical oil and gas income trust structure involves the grant of a royalty by an operating subsidiary of the trust to the trust itself, the royalty being the source of the distributions to trust investors. In this case, the royalty is wholly within the combined or consolidated trust entity (the trust and its operating subsidiary). This is not the type of external entitlement or obligation for which adjustment is made in determining, for example, "net reserves". Viewing the trust and its consolidated entities together, the relevant reserves and other oil and gas information is that of the operating subsidiary without deduction of the internal royalty to the trust.

D-6 Q: Should we consider tax pools when computing future net revenue after income taxes?

A: Yes. The definition of "future income tax expense" is set out in Part 1 of Appendix 1 to Companion Policy 51-101. Essentially, future income tax expenses represent estimated cash income taxes payable on the reporting issuer's future pre-tax cash flows. These cash income taxes payable should be computed

by applying the appropriate year-end statutory tax rates, taking into account future tax rates already legislated, to future pre-tax net cash flows reduced by appropriate deductions of estimated unclaimed costs and losses carried forward for tax purposes and relating to oil and gas activities (i.e., tax pools). Such tax pools may include Canadian oil and gas property expense (COGPE), Canadian development expense (CDE), Canadian exploration expense (CEE), undepreciated capital cost (UCC) and unused prior year's tax losses. (Issuers should be aware of limitations on the use of certain tax pools resulting from acquisitions of properties in situations where provisions of the Income Tax Act concerning successor corporations apply.)

D-7 Q: Are we required to have funding available to develop our reserves before reserves can be assigned to an undeveloped property?

A: No. Reserves must be estimated assuming that development of the properties will occur without regard to the likely availability of funding required for that property. Your evaluator does not have to consider whether you will have the capital necessary to develop the reserves. (See section 7.8.2 of COGE Handbook and section 4.2(1)(a)(iii) of NI 51-101.)

Item 5.3 of Form 51-101 requires a company to discuss its expectations as to the sources and costs of funding estimated future development costs. If you expect that the costs of funding would make development of a property uneconomic, then even if reserves were assigned, you must also discuss that expectation and your plans for the property.

Further, if you do not disclose the proved undeveloped reserves just because you have not yet spent the capital to develop these reserves, you may be omitting material information, thereby causing the reserves disclosure to be misleading. Also, if the proved undeveloped reserves are not disclosed to the public, then those who have a special relationship with your company and know about the existence of these reserves would not be permitted to purchase or sell the securities of your company until that information has been disclosed. If your company has a prospectus, the prospectus might not contain full true and plain disclosure of all material facts if it does not contain information about these proved undeveloped reserves.

D-8 Q: Occasionally the proved reserves that can be assigned to a discovery well may be insufficient to justify development of the project based on these limited reserves. This situation is common in frontier areas, especially in offshore regions. If there is good reason to believe that, eventually, significantly more reserves than the original proved reserves would be assigned to the reservoir, could these incremental reserves be classified as only "possible reserves"?

A: In this situation, the operator has two options: either (a) continue to develop the project or (b) discontinue development. Assessments are performed at all stages of development of a project to determine whether internal "hurdle rates" are

achievable and whether further development work is justified. Discovery wells provide important additional information for these assessments, which are updated to incorporate this new information.

Because there is substantial uncertainty about the reserves, appropriate risk analysis methods should be used. The simplest method is referred to as an Expected Monetary Value (“EMV”) method. This method can be used to produce “expected net present values” and “expected reserves”. It does so by aggregating the products of a number of mutually exclusive events multiplied by their probability of occurrence, to produce a mean.

- (a) If the expected net present value of the project is positive and meets the company’s hurdle rate, then development of the project is justified. Applying the COGE Handbook definitions, the expected reserves would be equivalent to “proved + probable reserves”. In the situation referred to in the question, where proved reserves are nil, the expected (or proved + probable) reserves would consist entirely of probable reserves.

The expected reserves will be less than the most optimistic of the mutually exclusive events considered. The increment between these two would be “possible reserves”.

- (b) If the expected net present value of the project is negative, or does not meet the company’s hurdle rate, the development of the project would not be justified. In that case, the evaluator could characterize the increment only as contingent resources, indicating that technically recoverable additional volumes of oil and gas are present but not yet commercial.

D-9 Q: Can I use probabilistic methods to prepare reserves evaluations for my client who must report under NI 51-101?

A: Yes. NI 51-101 requires that reserves estimates be prepared or audited in accordance with the COGE Handbook, and the COGE Handbook states that reserves estimates may be prepared using either deterministic or probabilistic methods. The COGE Handbook also states there should not be a material difference between estimates prepared using deterministic and probabilistic methods. (See section 5.5 of the COGE Handbook and section 4.2(1)(a)(ii) of NI 51-101.)

We acknowledge that probabilistic methods, when used in conjunction with good engineering and geological practice, will provide more statistical information than can be achieved through the conventional deterministic method. There are, however, a few critical criteria that you must follow when applying probabilistic methods:

- (a) You must still estimate the reserves applying the definitions and using the guidelines set out in the COGE Handbook.

- (b) Aggregate reserves estimates should be prepared using simple arithmetic summation.
- (c) If you also prepare aggregate reserves estimates using probabilistic methods, you should explain in your evaluation report the method used. In particular, you should specify what confidence levels you used at the entity, property and reported (i.e., total) levels for each of proved, proved + probable and proved + probable + possible (if reported) reserves.

If your client discloses the aggregate reserves that you prepared using probabilistic methods, your client should provide a brief explanation, near its disclosure about the reserves definitions used for estimating the reserves, about the method that you used and the underlying confidence levels that you applied.

- D-10 Q:** I am a member of a professional organization. How can I confirm if it is acceptable for the purposes of NI 51-101?
- A:** You can find a list of professional organizations that are acceptable for the purposes of NI 51-101 on the ASC's website: www.albertasecurities.com under Securities Law and Policy/ Regulatory Instruments/ NI 51-101.

E. Exemptions

- E-1 Q:** Where should we apply for an exemption order?
- A:** If you want to obtain an exemption from any of the requirements of NI 51-101 or the forms, you should apply to the securities regulatory authorities in all of the jurisdictions where you are a reporting issuer. A separate fee may apply in each jurisdiction. If you are reporting in more than one jurisdiction please see National Policy 12-201 *Mutual Reliance Review System for Exemptive Relief Applications* for details about the application process. Also see Part 8 of the Companion Policy.
- E-2 Q:** Where can I find exemptions that securities regulatory authorities have granted?
- A:** The exemption orders are posted on our websites.

For orders granted by the Alberta Securities Commission go to the ASC website at www.albertasecurities.com. Click on "Search" (at top of screen), type in "NI 51-101" as a keyword, click the box beside "exemption orders" so that a checkmark appears in the box and then click on "go". The orders granted most recently will appear at the top of the list. Click on "MRRS Decision Document" in the last column of each row to retrieve the document.

For orders granted by the BC Securities Commission go to the BCSC website at www.bcsc.bc.ca. Click on "Commission Documents Database" and "Search" for "51-101" for a list of documents relating to NI 51-101. To view exemption orders, look at the documents classified as "D&O"(Decisions and Orders).

For orders granted by the Ontario Securities Commission visit the OSC website at www.osc.gov.on.ca. Click on “Rules and Regulation” followed by “Orders and Rulings” to find a list of orders and rulings organized in alphabetical order.

WITHDRAWN PER CSA NOTICE RE: 51-101 DATED 12 OCT 2007