KPMG

Current Developments: Canadian Securities and Auditing Matters

December 2016

kpmg.ca

Canadian Securities and Auditing Matters

This edition provides a summary of newly effective and forthcoming regulatory and auditing matters in Canada from October 1, 2016 to December 31, 2016.

Canadian Securities: New guidance

Canadian Securities: Proposed guidance

Auditing Matters

Canadian Securities: New guidance

OSC Financial Reporting Bulletin

In November 2016, the Ontario Securities Commission (OSC) issued Staff Notice (SN) 52-723 *Financial Reporting Bulletin* to highlight observations from the Office of the Chief Accountant about various financial reporting topics relevant to reporting issuers that prepare financial statements in accordance with International Financial Reporting Standards (IFRS).

The SN encourages issuers to take a "fresh look" at their financial statement disclosures to consider how information could be more efficiently and effectively presented and to consider financial reports as communication documents rather than a "compliance exercise".

The notice reminds issuers that amendments were made to IAS 1 *Presentation of Financial Statements* which came into effect for annual periods beginning on or after January 1, 2016 and specifically states that issuers do not need to provide specific disclosures required by IFRS if that disclosure is not material and conversely that an entity should provide disclosure if compliance with specific IFRS disclosure requirements is insufficient. The SN reiterates that securities regulations also refer to principles of materiality and that when effectively applied, this concept should result in more concise, effective and relevant information being provided to investors.

The SN also shares observations on three recent areas of focus: going concern, non-GAAP financial measures and fair value measurements.

OSC observations in the area of going concern were that:

- the quality of disclosures required by IAS 1 varied, with some issuers providing generic and boilerplate information about the material uncertainties that cast significant doubt on the entity's ability to continue as a going concern; and
- instances of inadequate disclosures existed with respect to the significant judgements made in concluding that there are no material uncertainties.

OSC observations in the area of non-GAAP measures were that:

- the prominence of disclosure given to non-GAAP financial measures related to earnings when compared to the prominence of earnings measures specified, defined, or determined under a reporting issuer's GAAP was inappropriate;
- numerous non-GAAP financial measures are being presented in the same disclosure document, increasing the potential for investors to be confused and/or material information to be obscured; and
- non-GAAP financial measures, particularly those presented in press releases, are not being reconciled to the most comparable GAAP measure.

OSC observations in the area of fair value measurement were that:

- most disclosures required by IFRS 13 *Fair Value Measurement* were appropriately provided by the issuers examined; however, the quality of disclosures varied, with some issuers providing less entity specific information than others;
- opportunities for improvement exist with certain disclosures pertaining to fair value measurements categorized within level 3 of the fair value hierarchy; and

- instances where the disclosures for instruments categorized within level 2 of the fair value hierarchy did not provide enough detail about the specific observable inputs.

The SN also described the OSC's expectations regarding the adoptions of new accounting standards such as IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, and IFRS 16 *Leases*. The OSC expects that issuers have begun, or will soon begin, the work necessary to implement the new accounting standards and that issuers will provide increasingly detailed qualitative and quantitative disclosure about the expected effects of the new accounting standards as they make progress in their implementation efforts and the effective dates approach. Audit committees are expected to be actively engaged in oversight of the implementation process. Throughout the SN, the OSC has included questions for management to "consider and assess" how they are addressing the matters raised.

Mandated Summary Disclosure Document for Exchange Traded Mutual Funds

In December 2016, the Canadian Securities Administrators (CSA) issued amendments to National Instrument (NI) 41-101 *General Prospectus Requirements* and related consequential amendments to mandate mutual funds in continuous distribution, the securities of which are listed and traded on an exchange or alternative trading system (ETFs), to produce and file a summary disclosure document called "ETF Facts", which must be made available on the ETF's or the ETF manager's website. New Form 41-101F4 Information Required in an ETF Facts Document sets out the required contents.

The amendments also introduce a new delivery regime which will require dealers that receive an order to purchase ETF securities to deliver an ETF Facts to investors within two days of the purchase (post sale). Delivery of the prospectus will not be required, but there will be a requirement for the prospectus to be made available to investors upon request, at no cost.

The CSA believes the introduction of the ETF Facts will help provide investors with access to key information about an ETF, in language they can easily understand. The CSA expects to consider, through a consultation process, the feasibility of requiring pre-sale delivery of the ETF Facts.

Subject to Ministerial approval requirements for rules, the amendments come into force on March 8, 2017, which is 3 months after the publication date. The amendments, as they pertain to the ETF Facts delivery requirement, will come into force on a later date in those jurisdictions that require legislative amendments in order to implement the ETF Facts. As of the date of publication of the amendments, Alberta, Manitoba, New Brunswick, Nova Scotia, Ontario, Québec, and Saskatchewan have either obtained the necessary legislative amendments, or have determined that legislative amendments are not required.

CSA Mutual Fund Risk Classification Methodology for Use in Fund Facts and ETF Facts

In December 2016, the CSA issued amendments to NI 81-102 *Investment Funds* and related consequential amendments to mandate a CSA risk classification methodology for use by fund managers to determine the investment risk level of conventional mutual funds and exchange-traded mutual funds (ETFs) for use in the Fund Facts document and in the ETF Facts document, respectively. An investment risk level will need to be determined for each filing of the Fund Facts or ETF Facts and at least annually. The rating scale has five categories and investment risk is determined based on standard deviation ranges.

The amendments will be proclaimed into force 90 days after their publication that is on March 8, 2017. The amendments have a transition period of 9 months after the publication date, therefore the amendments will take effect on September 1, 2017.

As of the effective date, the investment risk level must be determined using the prescribed methodology.

Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members

In November 2016, the CSA issued SN 31-347 *Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members* to provide information and guidance to registered portfolio managers (PMs) that enter into service arrangements with dealer members (DMs) of the Investment Industry Regulatory Organization of Canada (IIROC). Under these Portfolio Manager–Dealer Member Service Arrangements (PMDSAs), a DM typically holds an investor's cash and securities (Investments) in an account over which a PM has discretionary trading authority, and executes and settles the investor's trades in the account based on instructions from the PM. The investor is thus a client of both the PM and the DM.

Since the PM and the DM have different roles and responsibilities to the shared client, they have different regulatory obligations to the client. However, each has a regulatory obligation to deliver statements of Investment positions and trades (Statements) to the shared client, as well as to maintain their own records of each client's Investment positions and trades. Nonetheless, practices have developed whereby some PMs operating with PMDSAs look to the delivery of a Statement by a DM to satisfy the PM's Statement delivery obligation, and rely on a DM's records to satisfy the PM's books and records obligation. The SN provides guidance from the CSA about acceptable practices when PMs enter into these arrangements.

Key points on PMDSAs are as follows:

- a PM must maintain its own records of its client's Investment positions and trades, and may not rely on a DM's records as a substitute for its own records;
- it is expected that the PM and DM will have a written agreement on the PMDSA, which includes the key terms, and the roles and responsibilities of the PM and DM;
- it is expected that the PM will provide written disclosure to its clients on the PMDSA, which summarizes its purpose and material terms, including the key services provided, and key obligations owed by the PM and DM to the client;
- a PM that holds any Investments for a client must prepare and deliver its own Statements to the client; and
- if all of the Investments that a PM is authorized to trade for a client are held by a DM, it is of the view that the PM may satisfy its Statement delivery obligations in NI 31-103 if the DM delivers a Statement to the shared client (covering the same Investment positions and trades) that is compliant with the requirements in IIROC Dealer Member Rules, provided that the PM takes the appropriate steps outlined in this SN to verify that the DM's Statement is complete, accurate and delivered on a timely basis.

Investment Funds Practitioner Guide

In December 2016, the OSC issued its *Investment Funds Practitioner Guide*. The guide provides an overview of recent issues. In this issue the following topics were addressed:

- portfolio disclosure practices of exchange-traded funds;
- notification of commencement of an issue-oriented review of scholarship plans registered as Registered Education Savings Plans;
- consideration of different security holder interests by independent review committees;
- application for relief to use notice-and-access procedures for security holder meetings;
- application for relief for mutual funds to be allowed to use cleared swaps;
- reminder for managers of scholarship plans that have made an Undertaking to allow the plans to make limited investments of the income portion of the plans in equity securities that the terms of the Undertaking must be filed on SEDAR no later than the date of the final renewal prospectus for such plans; and
- guidance on mutual fund sales practices.

CSA Review of Compensation Practices in Fund Industry

In December 2016, the CSA published SN 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*. The notice outlines the results of a survey of practices that surveyed firms used to compensate their representatives, including direct tools such as commissions, performance reviews and sales targets, as well as indirect tools such as promotions and valuation of representatives' books of business for various purposes (for example, retirement and awards).

In addition, the CSA set out their view of the potential material conflicts of interest that could arise from some of these compensation arrangements and other practices to allow firms to more effectively manage potential or actual conflicts of interest that may arise. CSA Staff reminded firms that they consider a conflict of interest to be any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent.

Canadian Securities: Proposed guidance

Amendments to Canada Business Corporations Act (CBCA)

In September 2016, the Canadian federal government introduced to parliament Bill C-25: *An Act to amend the Canada Business Corporations Act et al*. Subject to any exceptions which may be prescribed by regulation, the following changes will apply to CBCA corporations with publicly traded securities or which are otherwise considered to be distributing corporations:

- Majority Vote Standard for Director Elections – if at a meeting to elect directors, only one candidate is nominated for each position available on the board, shareholders will be able to vote "against" director nominees and each candidate is elected only if the number of votes cast "for" the nominee exceeds the number of votes cast "against" the nominee. If the vote results in the candidate not being elected, the board cannot appoint the candidate as a director before the next meeting of shareholders at which directors are to be elected;
- Annual director elections – all directors would have to be elected annually. The CBCA would, subject to any exceptions in regulations, prohibit staggered boards (e.g. 1/3 turnover per year);
- No slate elections – each director would have to be elected separately;
- Diversity disclosure – corporations would have to provide to shareholders information to be prescribed by regulation respecting diversity among the directors and members of senior management; and
- Notice-and-access – the CBCA Director would have the power to grant exemptions to permit corporations to provide shareholders with notice and online access to financial statements and to permit corporations and dissidents to send proxy materials to shareholders using notice and access, but would not have the power to grant an exemption from the requirement to send diversity disclosure to shareholders.

Auditing Matters

Auditor Reporting Model

Background – More insight and transparency

In response to calls from users for the auditor's report to provide more than a pass/fail opinion, the International Auditing and Assurance Standards Board (IAASB), has issued new requirements on auditor reporting.

Without changing the scope of an independent audit, these requirements open the door for the auditor to give users more insight into the audit and improve transparency.

For listed companies, the engagement partner's name will need to be disclosed, as will the 'key audit matters' (i.e., those areas where there were significant judgments or in which the auditor focused on during the audit).

For more details, refer to KPMG's Audit Point of View article.

Update on the new auditor reporting requirements

International	Canada	United States
New and revised auditor reporting standards issued by the IAASB effective for years ending on or after December 31, 2016.	Auditing and Assurance Standards Board (AASB) is deliberating comments received on its invitation to comment. Considerations include deferral of adoption date and whether to allow early adoption.	On May 11, 2016, the PCAOB issued its re-proposal of *The Auditor's Report on an Audit of Financial Statements when the auditor expresses an unqualified opinion.* No adoption date has been specified.

In November 2016, the Chair of the AASB in Canada issued an update on auditor reporting indicating the AASB continues to deliberate over the new and revised standards including whether key audit matter reporting should be required for other listed entities (TSX-V). The AASB expects key audit matters will first be required by TSX-listed entities and will conduct research on expanding this requirement to other listed entities. The PCAOB expects to finalize the U.S. auditor reporting standard in early 2017 which will allow the AASB to determine the impact for Cross-Listed Reporting Issuers by spring 2017.

The AASB currently does not anticipate making the CASs effective prior to periods ending on or after December 31, 2018; however, early adoption will be permitted, or in some cases may be required by law or regulation.

For more details, refer to the *AASB update*.

Non-compliance with Laws and Regulations

The AASB approved revisions to CAS 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, and conforming amendments to other standards, related to adoption of the IAASB's limited amendments to address non-compliance with laws or regulations. The AASB concluded that changes made in finalizing the standards were not significantly different from the proposals in the Exposure Draft and, therefore, no re-exposure is necessary. The amendments will be effective for financial statement periods ending on or after December 15, 2018 and are expected to be included in a Handbook update in early 2017.

Print

Back

Home