Canadian Securities and Auditing Matters

This edition provides a summary of newly effective and forthcoming regulatory and auditing matters in Canada from April 1, 2017 to June 30, 2017.

Canadian Securities: New guidance

Canadian Securities: Proposed guidance

Auditing Matters
Canadian Securities: New guidance

Update on the Use of the Rights Offering Exemption

In April 2017, the Canadian Securities Administrators (CSA) released Staff Notice 45-323 Update on Use of the Rights Offering Exemption in National Instrument 45-106 Prospectus Exemptions. The notice provides an update on use of the streamlined rights offering exemption for reporting issuers since December 8, 2015 and guidance based on reviews of offerings using the exemption.

Use of prospectus-exempt rights offerings by reporting issuers has increased significantly since adoption of the exemption. Prior to adoption, there were appropriately 13 prospectus-exempt rights offerings each year. As of December 31, 2016, 30 issuers had used the exemption to raise $247.6 million. In total, 23 venture issuers used the exemption as compared to 7 TSX listed issuers. Further, the time to complete a rights offering has been reduced from an average of 85 days to 38 days.

CSA staff reviewed 30 rights offerings and found compliance with the rule generally to be satisfactory. The following areas were noted where compliance and disclosure could use improvement:

- Stand-by commitments – Disclosure regarding the relationship between the issuer and the stand-by guarantors. Prior disclosure in continuous disclosure documents is not sufficient.
- Use of available funds – Some issuers failed to disclose changes in working capital since the most recently audited annual financial statements. Disclosures are required even if the change is from a negative to a positive position. Some issuers with working capital deficiencies that had insufficient funds to cover short-term liquidity requirements and overhead expenses for the next 12 months did not provide the required disclosure. The CSA also noted instances where the level of detail in the breakdown of the use of funds could be improved. The CSA noted simply allocating funds to working capital is not sufficient and provided examples of their expectations.
- Closing news release – Some issuers did not file a closing news release with all the required details. In particular, details about who subscribed to the rights offering, including the amount subscribed by insiders and stand-by guarantors, distinguishing between the basic and additional subscription privileges, were missing in some instances.

Guidance on Small Firms Compliance and Regulatory Obligations

In May 2017, the CSA released Staff Notice 31-350 Guidance on Small Firms Compliance and Regulatory Obligations summarizing the results of a compliance review of 65 small firms registered with the CSA in one or more of the following categories: investment fund manager, portfolio manager and exempt market dealers. The firms selected were primarily sole proprietorships or firms with one registered individual.

The following table summarizes the common deficiencies identified.

<table>
<thead>
<tr>
<th>Deficiency Observed</th>
<th>% with Deficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant business interruptions plan and succession planning – inadequate or missing</td>
<td>35%</td>
</tr>
<tr>
<td>Monitoring systems – inadequate written policies and procedures</td>
<td>71%</td>
</tr>
<tr>
<td>Issue</td>
<td>Percentage</td>
</tr>
<tr>
<td>----------------------------------------------------------------------</td>
<td>------------</td>
</tr>
<tr>
<td>Monitoring systems – incomplete books and records</td>
<td>25%</td>
</tr>
<tr>
<td>Monitoring systems – inadequate marketing materials</td>
<td>15%</td>
</tr>
<tr>
<td>Chief Compliance Officer annual report – inadequate or missing</td>
<td>29%</td>
</tr>
<tr>
<td>Interim financial statements and accounting policies – incorrect</td>
<td>15%</td>
</tr>
<tr>
<td>accounting method and insufficient procedures</td>
<td></td>
</tr>
<tr>
<td>Inadequate excess working capital</td>
<td>9%</td>
</tr>
<tr>
<td>Inadequate relationship disclosure information</td>
<td>63%</td>
</tr>
<tr>
<td>Inadequate collection/documentation of know-your-client information</td>
<td>54%</td>
</tr>
<tr>
<td>Non-delivery of or inadequate client statements</td>
<td>45%</td>
</tr>
<tr>
<td>Inadequate or outstanding filings to regulators</td>
<td>34%</td>
</tr>
</tbody>
</table>

The notice provides further details and guidance with respect to the deficiencies noted.

**Ontario Exempt Market Report**

In June 2017, the Ontario Securities Commission (OSC) released Staff Notice 45-715 2017 Ontario Exempt Market Report. The report summarizes capital raising activity by non-investment fund issuers in Ontario’s exempt market during 2015 and 2016. Additionally, the report examines capital formation by small Canadian issuers in Ontario’s exempt market and the impact of recently introduced prospectus exemptions.

**Status Report on Proposals to Enhance the Obligations of Advisers, Dealers and Representatives toward their Clients**

In May 2017, the CSA released Staff Notice 33-319 Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients.

The report summarizes comments on proposed targeted amendments to NI 31-103 that would better align the interest of registrants with the interests of their clients and enhance various specific obligations that registrants owe their clients. As a result of the consultation the CSA has identified certain reforms that should be given higher priority including: conflicts of interest, suitability, know your client, know your product, relationship disclosure and titles and designations.

The report also discusses comments on the proposed regulatory best interest standard that would serve as an overarching standard and governing principle that all other client-related obligations would be interpreted by. As a result of the consultation most jurisdictions expressed strong concerns about the benefits of introducing a regulatory best interest standard over and above targeted reforms, however, Ontario and New Brunswick still supported such guidance and will continue to consult on this matter.

Over the 2017-2018 fiscal year, the CSA will prioritize the work on the targeted reforms. Work on a regulatory best interest standard will continue in parallel in those jurisdictions interested in that project.
Canadian Securities: Proposed guidance

Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers

In April 2017, the CSA released Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers to identify and consider areas of securities legislation applicable to non-investment fund reporting issuers where regulatory requirements could be modified without compromising investor protection or the efficiency of the capital market.

The CSA asks for comments on a number of options to reduce the regulatory burden associated with both capital raising in the public markets and the ongoing costs of remaining a reporting issuer including:

- extending the application of streamlined rules for venture issuers to smaller non-venture reporting issuers;
- reducing the regulatory burdens associated with the prospectus rules and offering process by:
  - reducing the audited financial statements requirement in an initial public offering prospectus;
  - streamlining other prospectus requirements;
  - streamlining public offerings for reporting issuers; and
  - other potential areas
- reducing ongoing disclosure requirements by:
  - removing or modifying the criteria to file a business acquisition report;
  - reducing disclosure requirements in annual and interim filings; and
  - permitting semi-annual reporting
- eliminating overlap in regulatory requirements; and
- enhancing electronic delivery of documents

The comment period has been extended from July 7, 2017 to July 28, 2017.

Auditor Oversight Issues in Foreign Jurisdictions

In April 2017, the CSA released Consultation Paper 52-403 Auditor Oversight Issues in Foreign Jurisdictions. The paper describes a proposal from the Canadian Public Accountability Board (CPAB) to the CSA to amend National Instrument 52-108 Auditor Oversight to require certain audit firms involved in the audit of a reporting issuer’s financial statements to register as a participating audit firm (PAF) which would give CPAB a legal basis to inspect the audit work done by these audit firms in relation to reporting issuer audits. In particular, CPAB wants all component auditors to be required to register as a PAF. The paper notes that this could create challenges in finding component auditors to perform work and creates the potential for higher audit fees charged to reporting issuers. The paper also acknowledges that access will likely still be denied in certain jurisdictions including China. The CSA is seeking views on whether component auditor registration is an appropriate solution, whether there are additional implications to consider and whether there should be a threshold in applying the guidance (e.g. to component auditors of larger components) and if so, how to determine the threshold.
The paper also describes potential disclosure enhancements to inform stakeholders about any restrictions CPAB faced in inspecting the audit work performed by a PAF or component auditor. The CSA is seeking views as to whether such disclosures would be useful to investors, any potential implications of such disclosures and who should be required to provide this disclosure, CPAB or the reporting issuer.

The comment period expired June 24, 2017.

**Proposal to Adopt a T+2 Settlement Cycle**

In April 2017, the CSA released Amendments to NI 24-101 Institutional Trade Matching and Settlement and Proposed Amendments to NI 81-102 Investment Funds. The former shortens the settlement cycle for equity and long-term debt markets and the latter proposes shortening the settlement cycle for conventional mutual funds from three days after the trade to two days (T+2) after the date of a trade. These changes are being made to align with the United States markets which are also moving to a T+2 settlement cycle in September 2017.

Comments on the proposed amendments are due by July 26, 2017.

**Proposal for New Prospectus Exemption**

In June 2017, the CSA released Proposed Amendments to NI 45-102 Resale of Securities related a new prospectus exemption for the resale of securities of a foreign issuer.

Currently a prospectus exemption for the resale of securities exists where the issuer is not a reporting issuer in any jurisdiction of Canada provided that (i) the resale is on an exchange, or a market, outside of Canada or to a person or company outside of Canada, and (ii) residents of Canada own not more than 10% of the outstanding securities of the issuer and represent not more than 10% of the total number of security holders.

The proposed amendments would repeal the existing exemption and provide a new prospectus exemption for the resale of securities. The exemption would change the second condition because the ownership conditions have been difficult to apply in practice. An exemption would exist where the issuer is not a reporting issuer in any jurisdiction of Canada if the resale is on an exchange, or a market, outside of Canada or to a person or company outside of Canada, and the issuer is incorporated or organized outside of Canada unless certain circumstances suggest that the issuer does not have a minimal connection to Canada (that is, the issuer has a presence in Canada).

The OSC also concurrently proposed changes to OSC Rule 72-503 Distributions Outside Canada to harmonize the resale provisions. Certain other changes are included in the proposed rule to provide clarity as to when the prospectus requirement does not apply to a distribution of securities to investors outside Canada. The exemptions are intended to preserve current cross-border practices and respond to the challenges that issuers and intermediaries face in determining whether a prospectus must be file or an exemption from the prospectus requirements must be relied on in connection with a distribution of securities to an investor outside of Canada.

Comments on the proposed amendments are due by September 27, 2017.
Auditing Matters

Auditor Reporting Model

Background – More insight and transparency

In response to calls from users for the auditors’ 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.

In April 2017, the Auditing and Assurance Standards Board (AASB) in Canada approved the new and revised auditor reporting standards as Canadian Auditing Standards (CASs) effective for periods ending on or after December 15, 2018.

Highlights of the new auditors’ report in Canada include:

- Re-ordering of the auditors’ report, including moving the opinion to the first section;
- Expanded descriptions of management’s, those charged with governance and auditors’ responsibilities;
- Disclosure of engagement partner’s name (listed entities); and
- Description of key audit matters (applicable only when required by law or regulation or when the auditor is engaged to do so).

For more details, refer to AASB’s message from the Chair.

U.S. developments

In June 2017, the Public Company Accounting Oversight Board (PCAOB) adopted their enhanced auditor reporting standards which includes, among other requirements, discussion of critical audit matters (CAMs) (similar to key audit matters) and tenure of the auditor. Highlights and effective dates of the new U.S. standards are:

- New auditors’ report format, tenure and other information: audits for fiscal years ending on or after December 15, 2017;
- Communication of CAMs for audits of large accelerated filers: audits for fiscal years ending on or after June 30, 2019; and
- Communication of CAMs for audits of all other companies: audits for fiscal years ending on or after December 15, 2020.

Impact to Foreign Private Issuers in Canada

Auditors of foreign private issuers (FPIs) are trying to address whether they can still issue a “combined” report (which most FPIs in Canada issue today) that meets both the CAS and PCAOB standards for 2017 year-end engagements and 2018 year-end engagements, when the revised CAS reporting standards are effective.

Determining the feasibility of a “combined” report is currently under review by the AASB. At this time, the major accounting firms in Canada have tentatively concluded that a combined report is possible and we believe the AASB will also conclude the same shortly. However, even if the firms and the AASB conclude that a combined report is possible, the matter of having a combined report will require the approval of the SEC and PCAOB, which may take until the fall of 2017. If the SEC and PCAOB determine that a combined report is not possible, auditors of FPIs may need to issue two reports; one referring to the CASs and one referring to the standards of the PCAOB.
Auditing Accounting Estimates and Related Disclosures

The IAASB has issued an exposure draft on ISA 540 (Revised). Significant changes in how auditors evaluate accounting estimates and related disclosures have been proposed. The AASB has issued an exposure draft that proposes to adopt, with appropriate Canadian amendments if any, the proposed amendments to ISA 540. Stakeholders are invited to provide comments to the IAASB by August 1, 2017.

This proposed standard:

- enhances requirements for risk assessment procedures to include specific factors related to accounting estimates, namely complexity, judgment, and estimation uncertainty;
- sets a more detailed expectation for the auditor’s response to identified risks related to accounting estimates, including augmenting the auditors’ application of professional skepticism; and
- is scalable regardless of the size or sector of the business or audit firm.

For more details, refer to the AASB Update.