



Current Developments: Canadian Securities and Auditing Matters

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Canadian Securities and Auditing Matters

This edition provides a summary of newly effective and forthcoming regulatory and auditing matters in Canada from October 1, 2018 to December 31, 2018.



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Canadian Securities: New guidance

Alternative Mutual Funds

In October 2018, the Canadian Securities Administrators (CSA) published a notice of amendment Modernization of Investment Fund Product Regulation – Alternative Mutual Fund which amends NI 81-102 *Investment Funds*, NI 81-104 *Commodity Pools*, NI 81-101 *Mutual Fund Prospectus Disclosure*, NI 41-101 *General Prospectus Requirements*, NI 81-106 *Investment Fund Continuous Disclosure* and NI 81-107 *Independent Review Committee for Investment Funds*.

The CSA is introducing a new category of mutual fund, “alternative mutual funds” which refers to mutual funds that have adopted investment objectives that permit those funds to invest in physical commodities or specified derivatives, or, borrow cash or engage in short selling in a manner not typically permitted for other mutual funds. The term effectively replaces the term “commodity pool”.

The amendments create different investment restrictions for alternative mutual funds as compared to more conventional mutual funds. The notice details investment restrictions in the following areas: concentration restrictions, investments in physical commodities, illiquid assets, fund-of-fund investing, cash borrowing, short selling, combined limit on cash borrowing and short selling, aggregate exposure to borrowing, short selling and specified derivatives and other derivative provisions. The amendments also codify existing relief regarding the use of cleared derivatives.

All mutual funds will have the same seed capital and start-up requirements being at least \$150,000 in seed capital, provided by either its manager or other related entities, at the time of launch. Commodity pools previously had a lower requirements of \$50,000. The seed capital cannot be withdrawn until the mutual fund has received

at least \$500,000 in subscriptions from outside investors. Previously, the minimum seed capital for commodity pools could never be withdrawn.

Certain rules contained within NI 81-104 related to commodity pools have been moved to NI 81-102 to apply for alternative mutual funds. NI 81-104 is renamed Alternative Mutual Funds and will only deal with the unique proficiency standards for dealers distributing these funds which the CSA believes are required because these funds can be more complex than other types of funds. In particular, dealer representatives must possess one of the following:

- Passing grade on the Canadian Securities Course;
- Passing grade on the Derivatives Fundamentals Course;
- Successful completion of the Chartered Financial Analyst Program; or
- Any applicable proficiency standard mandated by a self-regulatory agency.

Alternative mutual funds now have to follow the disclosure regime applicable to other mutual funds with respect to forms of prospectus and point of sale documents. In addition, certain specific disclosures are required to describe how the alternative mutual fund differs from conventional mutual funds, as well as additional disclosures regarding their lenders (if the fund intends to borrow cash) and the use of leverage. These additional requirements also apply to non-redeemable investment funds.

The CSA provides a transition period to grant existing commodity pools which will become alternative mutual funds after the amendments come into force January 3, 2019 time to make operational changes to comply with the amendments.

Problematic Promotional Activities

In November 2018, the CSA issued Staff Notice (SN) 51-356 *Problematic Promotional Activities by Issuers*. The CSA summarizes activities of concern and reiterates relevant securities laws applicable when engaging in promotional activities.



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The following were promotional activities noted in the notice by staff that may potentially be misleading:

- Disseminating presentations, marketing materials, social media posts, or other information that describe early-stage plans with unwarranted certainty, or make unsupported assertions about growth of markets or demand for a product;
- Issuing numerous news releases that disclose no new material facts;
- Compensating third parties, who use social media and general investing blogs to promote issuers, but do not disclose their agency, compensation and/or financial interest;
- Announcing an issuer name and/or business change to reference an emerging industry or technology such as block chain, cannabis, battery minerals or cryptocurrency without a supporting business plan or comprehensive risk disclosure;
- Announcing a positive event such as a large acquisition then subsequently changing or cancelling the transaction with no announcement. In addition, the initial announcement sometimes fails to disclose material conditions necessary to complete the transaction such as financing or due diligence, and the issuer sometimes fails to file corresponding material contracts or material change reports; and
- Discussing details about mineral projects that:
 - o Suggest without direct evidence from sampling or exploration, that a property holds high potential for development including production. For example, including photos of assayed core beside new core, to imply mineralization prior to third party verification;
 - o Rely on projected peak versus long-term commodity prices, or
 - o Imply that a property holds a specific fair market value without a feasibility report.

Cannabis Industry

In October 2018, the CSA issued Staff Notice (SN) 51-357 *Staff Review of Reporting Issuers in the Cannabis Industry* which summarized findings from the review of 70 reporting issuers operating in the cannabis industry.

The notice identified the following key areas where the staff expect issuers to improve their disclosure:

- Licensed cannabis producers (LPs) often did not provide sufficient information in their financial statements and management’s discussion and analysis (MD&A) for an investor to understand their financial performance. 100% of the LPs reviewed needed to improve their fair value and fair value related disclosures. The notice specifically discusses the CSA’s expectations in the following areas:
 - o Disclosure about the impact of fair value accounting on the financial statements;
 - o Disclosure of accounting policies related to biological assets;
 - o Disclosure issues for LPs that expense costs related to biological assets as incurred;
 - o Disclosure about the fair value measurement process; and
 - o Disclosure about non-GAAP financial measures developed in response to fair value.
- Some issues did not consistently comply with securities requirements for forward-looking information, guidance for providing balanced disclosure and certain other requirements summarized in section 5 of the notice; and
- 74% of issuers with cannabis operations in the U.S. did not provide sufficient disclosure about the risks related to their U.S. operations to satisfy the disclosure expectations set out in CSA Staff Notice 51-352 (Revised) *Issuers with U.S. Marijuana-Related Activities*. 17% were required to refile their MD&A.



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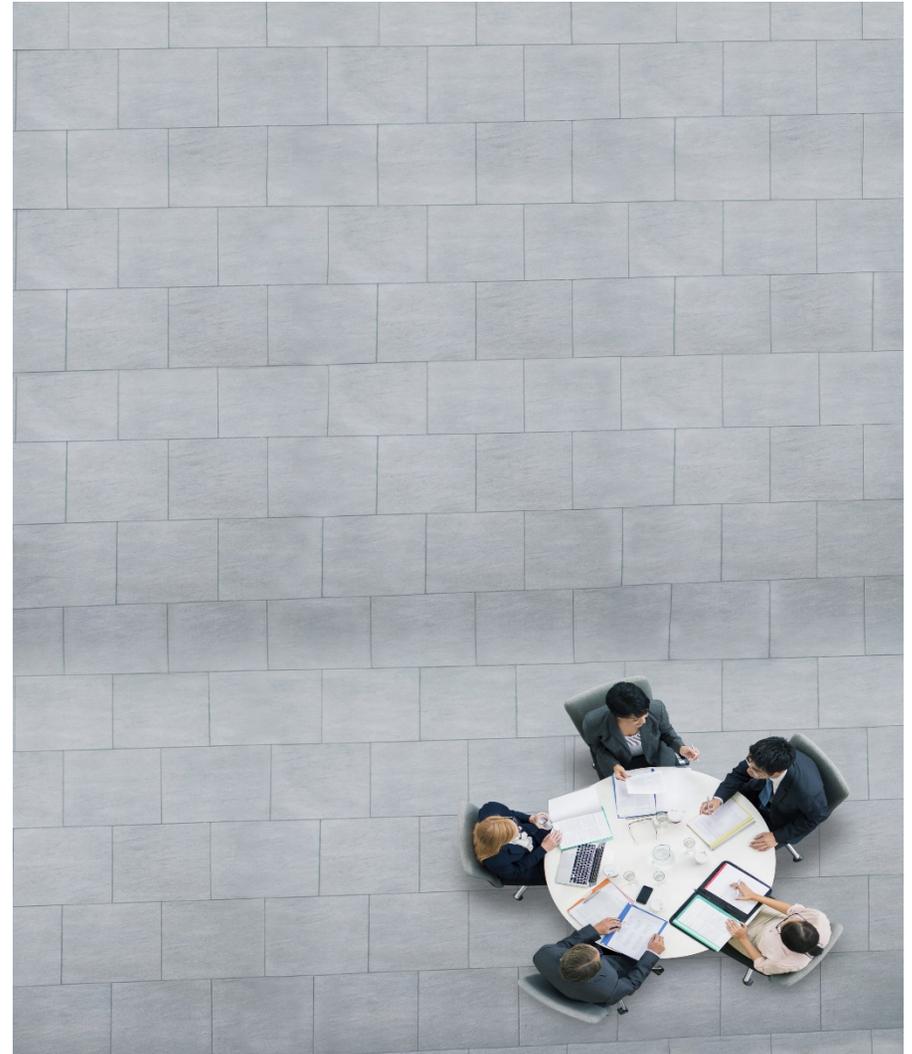
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OSC Whistleblower Program

In October 2018, the Ontario Securities Commission (OSC) issued a notice of policy amendment to OSC Policy 15-601 *Whistleblower Program*. The purpose of the change was to clarify that in-house counsel who report information under the policy in breach of applicable provincial or territorial bar or law society rules or equivalent rules applicable in another jurisdiction will not be eligible for a whistleblower award.



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Canadian Securities: Proposed guidance

Custody-Related Amendments

In October 2018, the CSA issued a request for comment regarding Proposed Amendments to NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. As part of the amendments related to alternative mutual funds the CSA codified existing relief granted to investment funds subject to NI 81-102 *Investment Funds* regarding the use of cleared derivatives. Specifically, the rule was amended to allow these investment funds to deal with futures commission merchants and clearing corporations in accordance with the rules of those organizations for cleared over-the-counter derivatives. NI 31-13 is being amended to align with the amendments to NI 81-102 regarding cleared derivatives.

Comments were due December 24, 2018.



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Auditing Matters

Auditor Reporting Model

What's new and effective for 2018?

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 the contents of the auditors' report (opinion first);
- expanded descriptions of responsibilities of management, those charged with governance and the auditors;
- separate section on "Material Uncertainty Related to Going Concern", if applicable;
- separate section on "Other Information" (e.g. MD&A); and
- disclosure of engagement partner's name (listed entities).

Key audit matter reporting

In the fourth quarter, the AASB approved amendments to CAS 700 which requires auditors to communicate Key Audit Matters (KAMs) in the auditor's report for audits of complete sets of general purpose financial statements of entities listed on the Toronto Stock Exchange (TSX), other than entities that are required to comply with National Instrument 81-106, *Investment Fund Continuous Disclosure*. Such requirements will be effective for periods ending on or after December 15, 2020.

U.S. developments

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 KAMs) 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

Regulators have not approved a combined auditor's report and as such auditors of foreign private issuers (FPIs) will need to consider whether there are reporting requirements that may require them to issue a second report referring to the CAS standards.



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Auditing Accounting Estimates and Related Disclosures

The AASB approved CAS 540, *Auditing Accounting Estimates and Related Disclosures*, including the related conforming amendments to other standards.

This standard:

- enhances requirements for risk assessment procedures to include specific factors related to accounting estimates, namely complexity, judgement, 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.

The AASB concluded that no significant changes were made in finalizing the standards from a Canadian standpoint, therefore no re-exposure was necessary.

CAS 540 will be effective for audits of financial statements for periods beginning on or after December 15, 2019 and will be included in the CPA Canada Handbook in early 2019.

Identifying and Assessing the Risk of Material Misstatement

The AASB reviewed comments received from Canadian Stakeholders on its Exposure Draft of proposed revisions to CAS 315, *Identifying and Assessing the Risks of Material Misstatement*. Issues respondents raised that the board discussed included:

- The enhancement and clarification of requirements related to the auditor's identification of controls relevant to the audit; and
- The separate assessment of inherent and control risk at the assertion level.

The AASB submitted their comment letter to the International Accounting and Auditing Standards Board (IAASB) Exposure Draft with the same title on November 22, 2018.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.



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