

13.1.2 Notice of Commission Approval – Housekeeping Amendments to IDA Form 1, Part II Auditors Report

**INVESTMENT DEALERS ASSOCIATION OF CANADA –
CICA HANDBOOK SECTION 5600 – AUDITORS REPORT ON FINANCIAL STATEMENTS
PREPARED USING A BASIS OF ACCOUNTING OTHER THAN
GENERALLY ACCEPTED ACCOUNTING PRINCIPLES – PART II AUDITORS REPORT**

I OVERVIEW

A Current Rules

To certify that the annual filing of Form 1 presents fairly, in all material respects, the financial position of a particular Member firm, the Panel Auditors file with the IDA and the CIPF the Part II Auditors' Report (See Appendix I).

B The Issue(s)

The Canadian Institute of Chartered Accountants (CICA) introduced significant amendments to Section 5100 of the CICA Handbook effective for audit reports issued on or after October 1, 2003 regarding the expression of audit opinions on general purpose financial statements, which among other things, restricted industry accounting practices as an alternative to CICA Handbook accounting principles.

The CICA also introduced new generally accepted audit standards (GAAS) Section 5600 for those reporting entities such as securities dealers that because of their industry's regulatory requirements must prepare and report financial statements that are not fully in accordance with generally accepted accounting principles (GAAP) in order to express an audit opinion. For example, IDA Regulations require that its member firms prepare and report their financial statements on an unconsolidated basis. This is a departure from GAAP, and Section 5600 of the CICA handbook recognizes this by allowing a modified form of audit opinion to be expressed. The proposed amendment seeks to ensure that the Part II Auditors' Report is consistent with the changes made to the Part I Auditors' Report.

The current Part II Auditors' report refers to questions 2 through 8 on the Certificate of Partners or Directors ("PDO certificate") (See Appendix I). The proposed Part II Auditors' Report removes the reference to questions 2 through 8 (See Appendix II). The IDA has reviewed these assertions and has concluded that the reference to questions 2 – 8 of the PDO Certificate in the Part II Auditors' Report no longer applies or alternatively, the Panel Auditor has performed sufficient work to provide appropriate audit evidence to the SRO. The following is the analysis performed:

- a) *"Are all Exchange seats which are operated by the firm owned outright and clear of encumbrance by the firm?"* – Stock exchange seats are reported as a non-allowable asset and 100% capital is provided resulting in no additional risk to the firm's capital. In addition, stock exchange seats have been or are in the process of being converted into shares and therefore the assertion will no longer apply.
- b) *"Does the firm promptly segregate clients' securities in accordance with the rules and regulations prescribed by the appropriate Joint Regulatory Body?"* – This assertion was included as part of the PDO certificate prior to the "Report on Compliance for Segregation of Securities" was implemented on July 1, 1997. The "Report on Compliance for Segregation of Securities" is prepared by the Panel Auditor and provides sufficient representation that clients' securities are promptly segregated. As a result, this assertion by the Panel Auditor is no longer required to be referred to in the Part II Auditors' Report.
- c) *"Does the firm determine on a regular basis its free credit segregation amount and act promptly to segregate assets as appropriate with the rules and regulations prescribed by the appropriate Joint Regulatory Body?"* – When this assertion was included in the PDO certificate there were no prescriptive rules for free credit segregation. Subsequent requirements to include a separate statement for free credit segregation and a compliance report for segregation were introduced. There is sufficient representation provided by the Panel Auditor through the audit of Statement D "Statement of free credit segregation amount" and the preparation of the "Report on Compliance for Segregation of Securities." As a result, this assertion by the Panel Auditor is no longer required to be referred to in the Part II Auditors' report.
- d) *"Does the firm carry insurance of the type and in the amount required by the rules and regulations of the appropriate Joint Regulatory Body?"* – This assertion was included as part of the PDO Certificate prior to the "Report on Compliance for Insurance" was implemented on July 1, 1997. The "Report on compliance for Insurance" is prepared by the Panel Auditor and provides sufficient representation that the appropriate insurance is carried by the member firm. As a result, this assertion by the Panel Auditor is no longer required to be referred to in the Part II Auditors' report.

- e) *“Have all “concentration of securities”, as described in the rules, regulations and policies of the appropriate Joint Regulatory Body, been identified on Schedule 9?”* – This assertion and the concentration regulation came into effect in 1989. At the time of implementation there was no prescriptive rule for a concentration charge. In April 1993, a concentration charge was introduced and a line item on Statement B of Form 1 was added. As a result of the inclusion of the separate line item in Statement B, the Panel Auditor performs an audit of Statement B, line 26, “Securities Concentration charge” and ensures existence, accuracy and completeness. As a result, this assertion by the Panel Auditor is no longer required to be referred to in the “Part II Auditors’ Report”.
- f) *“Has the “most stringent rule” requirement (as described in the general instructions) been adhered to in the preparation of these statements and schedules?”* – The Panel Auditors’ will include a note in the financial statements to ensure that the most stringent rule requirement has been adhered to in the preparation of the statements and schedules.
- g) *“Does the firm monitor on a regular basis its adherence to early warning requirements in accordance with the rules and regulations prescribed by the appropriate Joint Regulatory Body?”* – There were no prescriptive rules present when this assertion came into effect in April 1993. IDA Internal Control Policy #3 was developed and came into effect on March 1, 1996. The policy requires member firms to monitor its capital at all times. In December 2001 amendments to IDA By-law No. 30 came into effect which requires member firms to report any Early Warning Level 1 or 2 violations intra-month so that the IDA may monitor and take remedial action as required to prevent any further financial deterioration. Member firms also currently file the Monthly Financial Report (“MFR”) with the SRO on a monthly basis which includes schedules 13 and 13A, “Early Warning Tests 1 & 2”. In addition, the IDA conducts annual field examinations of the member and reviews the internal control procedures of the firm’s early warning monitoring procedures. As a result, this assertion by the Panel Auditor is no longer required to be referred to in the “Part II Auditors’ Report”.

C Objective(s)

The objective of the housekeeping amendment is to conform to the new CICA Section 5600.

D Effect of Proposed Rules

The proposed rule will have no impact on:

- market structure,
- members, non-members,
- competition,
- costs of compliance and
- other rules.

II DETAILED ANALYSIS

A Present Rules, Relevant History and Proposed Policy

To certify that the annual filing of Form 1 presents fairly, in all material respects, the financial position of a particular Member firm, the Panel Auditors currently file with the IDA and the CIPF the Part II Auditors’ Report.

B Issues and Alternatives Considered

No other alternatives were considered.

C Comparison with Similar Provisions

Given the nature of the rule amendment being proposed, detailed analyses of the present requirement, the proposed amended requirement and the alternatives to the proposed amended requirements were considered unnecessary. A comparison with similar regulations of regulators and SRO’s both foreign and in Canada was also considered unnecessary.

D Systems Impact of Rule

The securities industry’s regulatory financial filing system (referred to as “SIRFF”) has been modified to accommodate the changes to the Part II “Auditors’ Report”.

E Best Interests of the Capital Markets

The Board has determined that this housekeeping rule is not detrimental to the best interests of the capital markets.

F Public Interest Objective

According to the IDA's Order of Recognition as a self regulatory organization, the IDA shall, where requested, provide in respect of a proposed rule change "a concise statement of its nature, purposes (having regard to paragraph 13 above) and effects, including possible effects on market structure and competition. The purpose of the proposal is to standardize industry practices where necessary or desirable for investor protection.

The proposal does not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. It does not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

The amendment is believed to be housekeeping in nature as it is intended to clarify an existing requirement.

III COMMENTARY

A Filing in Other Jurisdictions

This proposed amendment will be filed for approval in Alberta, British Columbia, Ontario and Quebec and will be filed for information in Manitoba, Nova Scotia and Saskatchewan.

B Effectiveness

As stated above, the purpose of the proposal is to amend the current Part II Auditors' Report in Form 1 to comply with changes made by the CICA.

C Process

This proposal was developed by the Brokers Auditors Committee, an ad hoc committee of Panel Auditors. It was reviewed and approved by the Internal Controls Subcommittee of the Financial Administrators Section and subsequently approved by the Financial Administrators Section of the IDA. This proposal was mandated by the CICA and not initiated by the IDA.

IV SOURCES

References:

- Part II Auditors' Report in Form 1

V OSC REQUIREMENT TO PUBLISH FOR COMMENT

The Association has determined that the entry into force of the proposed amendments is housekeeping in nature. As a result, a determination has been made that these proposed rule amendments need not be published for comment.

APPENDIX I - BOARD RESOLUTION

INVESTMENT DEALERS ASSOCIATION OF CANADA

PART II AUDITORS REPORT

THE BOARD OF DIRECTORS of the Investment Dealers Association of Canada hereby makes the following amendments to the By-laws, Regulations, Forms and Policies of the Association:

1. In the Part II Auditors Report of Form 1, the following text is repealed and is replaced with the text as outlined in Appendix II:

“The additional information set out in Part II, Schedules 1 to 14 (and the answers contained in questions 2 through 8 on the Certificate of Partners or Directors) have been subjected to the procedures applied in the audit of the financial statements A to G in Part I, and in our opinion, present fairly the information contained therein, in all material respects, in relation to these financial statements taken as a whole.”

PASSED AND ENACTED BY THE Board of Directors this 18th day of January 2006, to be effective on a date to be determined by Association staff.

APPENDIX II - NEW LANGUAGE TO BE USED IN STANDARD REPORT

INVESTMENT DEALERS ASSOCIATION OF CANADA

PART II AUDITORS REPORT

We have audited Part I of the Joint Regulatory Financial Questionnaire and Report (Part I – JRFQ) of _____ as at _____ and for the year then ended, and reported thereon as of _____.
(Member) *(date)*
(date)

The additional information set out in Part II of the Joint Regulatory Financial Questionnaire and Report – Schedules 1 to 14 (Part II – JRFQ) have been subjected to the procedures applied in the audit of Part I – JRFQ and in our opinion, presents fairly the information contained therein, in all material respects, in relation to Part I – JRFQ taken as a whole.

No procedures have been carried out in addition to those necessary to form an opinion on Part I – JRFQ.

The additional information set out in Part II – JRFQ, which has not been, and was not intended to be, prepared in accordance with Canadian generally accepted accounting principals, is solely for the information and use of the Member, the Investment Dealers Association and the Canadian Investor Protection Fund to comply with the regulations, bylaws and policies of the Investment Dealers Association. The additional information set out in Part II – JRFQ is not intended to be and should not be used by anyone other than these specified users or for any other purpose.