Registrant outreach seminar: working capital calculations

September 20, 2013

ONTARIO SECURITIES COMMISSION

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Agenda

- Capital requirements
- Frequency of working capital calculations
- Financial reporting obligations
- Subordinated loans
- Case study
- Capital deficiencies
- Opportunity to be heard process
- Useful references
- Electronic submissions
- Summary
- Questions

Capital requirements

- S. 12.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) outlines the capital requirements that firms must maintain

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Capital requirements (cont'd)

- For the purpose of completing Form 31-103F1 *Calculation of Excess Working Capital* (**Form 31-103F1**), the minimum capital is:

Registration category	Minimum capital
Adviser	$25,000
Dealer	$50,000
Investment fund manager (IFM)	$100,000

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Capital requirements (cont'd)

- Where a firm is registered in multiple categories (S. 12.1 of Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**31-103CP**)):
  - Minimum capital amounts are NOT cumulative
  - Minimum capital amount is the highest minimum capital amount applicable to the firm's registration categories (e.g. the minimum capital for a firm registered as a dealer and IFM would be $100,000)

Frequency of working capital calculations

- Section 12.1 of 31-103CP provides the following **guidance**:
  - Registered firms should know their working capital position at all times
  - Frequency of preparing working capital calculations depends on many factors:
    - Size of firm
    - Nature of business and stability of the components of firm’s working capital

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Frequency of working capital calculations (cont'd)

- *"For example, it may be sufficient for a sole proprietor firm with a dedicated and stable source of working capital to do the calculation on a monthly basis"*

- Maintain evidence of calculations

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Financial reporting requirements

- Reporting requirements can be found in s. 12.10 through s. 12.14 of NI 31-103
- Annual and interim financial statements must be prepared using the same accounting principles (ss. 12.11(2) of NI 31-103)
- If registered in multiple categories use most stringent requirement (e.g. a firm registered as an adviser and IFM would follow the IFM reporting requirements)

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Financial reporting requirements (cont'd)

Registration category	Annual financial information	Interim financial information
Adviser	- No later than 90th day after end of financial year - Audited financial statements - Form 31-103F1	- No filing requirement unless registered in another category where interim financial information is required. If applicable: - No later than 30th day after the end of first, second and third interim period of financial year - Unaudited financial statements - Form 31-103F1
Dealer	- No later than 90th day after end of financial year - Audited financial statements - Form 31-103F1	- No filing requirement for exempt market dealers unless the firm is registered in another category. If applicable: - No later than 30th day after the end of first, second and third interim period of financial year - Unaudited financial statements - Form 31-103F1
Investment fund manager (IFM)	- No later than 90th day after end of financial year - Audited financial statements - Form 31-103F1 - Net asset value adjustment	- No later than 30th day after the end of first, second and third interim period of financial year - Unaudited financial statements - Form 31-103F1 - Net asset value adjustment

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Subordinated loan requirements

Executing subordination agreements and delivery to the regulator

- 100% of long-term related party debt must be included on Line 5 of Form 31-103F1 unless the firm and lender have executed a subordination agreement and delivered a copy to the regulator or, in Québec, the securities regulatory authority

- Subordination agreement should be in the form set out in Appendix B of NI 31-103

- The agreement must be delivered to the regulator **prior** to excluding the loan from Line 5 of Form 31-103F1

- Deliver the subordination agreement showing the amount that the subordinated loan increased rather than the loan's full balance

Subordinated loan requirements (cont'd)

Repayment of subordinated loans

- Must notify the regulator or, in Québec, the securities regulatory authority 10 days before it:
  - repays the loan or any part of the loan, or
  - terminates the agreement

  (s. 12.2 of NI 31-103)

- Provide OSC with:
  - updated interim financial information and Form 31-103F1 to show firm will have sufficient working capital following repayment
  - Schedule indicating the updated outstanding subordinated loan balances (if more than one loan)

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Case study

- Please review case materials in Appendices A and B

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Line 1 Current assets

- When distinction is made between *current* and *non-current* assets on the statement of financial position or balance sheet:
  - Obtain current assets amount from statement of financial position or balance sheet
- When no distinction is made:
  - Firm to provide additional documentation outlining the current and non-current assets
- Total current assets per F/S = $5,017,600

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Line 1 Current assets (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

	Component	Current period	Prior period
1.	Current assets	$5,017,600.00	$208,500.00

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Line 2 Less current assets not readily convertible to cash (e.g. prepaid expense)

- "Readily convertible into cash"
  - Not defined in the Securities Act
  - Determination requires professional judgment and depends on the nature of the item and all relevant circumstances

- Maintain documentation to support determinations that an item is readily convertible to cash

Line 2 Less current assets not readily convertible to cash (cont'd)

Prepaid expenses

- Specifically identified as not readily convertible to cash on Form 31-103F1
- Generally, are deposits or expenses paid in advance (e.g. rent) and can not be converted to cash quickly or at all

- Prepaid expenses of $3,500 should be included in Line 2

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Line 2 Less current assets not readily convertible to cash (cont'd)

Restricted cash as a component of cash and cash equivalents

- Per Note 3 to the financial statements, included in cash and cash equivalents are pledged monies

- The pledged amount of $1,000,000 should be included in Line 2 because the amount is not available to meet short-term cash needs

Line 2 Less current assets not readily convertible to cash (cont'd)

Accounts receivable

- Per Note 4 to financial statements:
  - $34,000 due from Sister Company Inc., which is past due

- Per case study Appendix B
  - $34,000 is not considered readily convertible into cash since the related party does not have the means to pay it back in a short period of time. Therefore, include on Line 2

Line 2 Less current assets not readily convertible to cash (cont'd)

Loan advanced to related party

- Per Note 6 to the financial statements:
  - $300,000 loan due from Sister Company Inc. is non-interesting bearing, unsecured and due on demand

- Firms should be able to provide evidence that if related party receivable was called upon, the amount could be promptly received

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Line 2 Less current assets not readily convertible to cash (cont’d)

Loan advanced to related party (cont’d)

- Evidence may include:
  - a copy of the most recent audited financial statements of the related party
  - bank statement supporting the amount of cash available

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Line 2 Less current assets not readily convertible to cash (cont'd)

Loan advanced to related party (cont'd)

- Case study Appendix B
  - The $300,000 loan is not considered readily convertible into cash since the related party does not have the means to pay it back in a short period of time. Therefore, include on Line 2

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Summary of Line 2 Less current assets not readily convertible to cash

Current assets not readily convertible into cash	Amount
Prepaid expenses	3,500
Restricted cash as a component of cash and cash equivalents	1,000,000
Related party receivables	34,000
Related party loans receivable (shareholder and corporation)	300,000
Total	**1,337,500**

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Line 2 Less current assets not readily convertible to cash (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

2.	Less current assets not readily convertible into cash (e.g., prepaid expenses)	$1,337,500.00	$3,500.00

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Line 3 Adjusted current assets

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation
Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

	Component	Current period	Prior period
1.	Current assets	$5,017,600.00	$208,500.00
2.	Less current assets not readily convertible into cash (e.g., prepaid expenses)	$1,337,500.00	$3,500.00
3.	Adjusted current assets Line 1 minus line 2 =	$3,680,100.00	$205,000.00

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Line 4 Current liabilities

- When distinction is made between *current* and *non-current* liabilities on the statement of financial position or balance sheet:
  - Total current liabilities amount taken directly from statement of financial position or balance sheet
- When no distinction is made:
  - Firm to provide additional documentation outlining the current and non-current liabilities
- Total current liabilities per F/S= $2,164,000

Line 4 Current liabilities (cont'd)

- Subordinated loan (current liabilities line item):
  - Per Note 7 to financial statements, loan bears interest at prime rate, repayment on demand
  - Loan is subordinated to the claims of the Company's ordinary creditors
- Line 4 requires <u>all</u> current liabilities to be included on Form 31-103F1
- Related party debt classified as a current liability cannot be subordinated and excluded from Line 4 for the purposes of excess working capital

Line 4 Current liabilities (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation
Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

4.	Current liabilities	$2,164,000.00	$50,000.00

Line 5 Add 100% of long-term related party debt unless…

- Line 5 Add 100% of long-term related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B to NI 31-103 and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority

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Line 5 Add 100% of long-term related party debt unless... (cont'd)

- Loan payable:
  - Note 8 to financial statements indicates loan is from a chartered bank
  - Not related party
  - Therefore, loan is not required to be added back
- Redeemable preferred shares:
  - $900,000 of preferred shares issued to a shareholder
  - Per Note 11 to financial statements:
    - Redeemable at option of holder – financial liability
    - $500,000 subordinated
  - Therefore $400,000 not subordinated

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Line 5 Add 100% of long-term related party debt unless… (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation
Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

5.	Add 100% of long-term related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority	$400,000.00	$0.00

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Line 6 Adjusted current liabilities

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation
Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

4.	Current liabilities	$2,164,000.00	$50,000.00
5.	Add 100% of long-term related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority	$400,000.00	$0.00
6.	Adjusted current liabilities Line 4 plus line 5 =	$2,564,000.00	$50,000.00

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Line 7 Adjusted working capital

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

3.	Adjusted current assets Line 1 minus line 2 =	$3,680,100.00	$205,000.00
4.	Current liabilities	$2,164,000.00	$50,000.00
5.	Add 100% of long-term related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority	$400,000.00	$0.00
6.	Adjusted current liabilities Line 4 plus line 5 =	$2,564,000.00	$50,000.00
7.	Adjusted working capital Line 3 minus line 6 =	$1,116,100.00	$155,000.00

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Line 8 Less minimum capital

- Note 1 to financial statements:
  - Registered as portfolio manager, investment fund manager and exempt market dealer
- Greater of:
  - Adviser - $25,000
  - Dealer - $50,000
  - Investment fund manager - $100,000

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Line 8 Less minimum capital (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

8.	Less minimum capital	$100,000.00	$100,000.00

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Line 9 Less market risk

- For each security/investment included on Line 1 Current assets, a market risk is required to be calculated
- Schedule 1 to Form 31-103F1 outlines margin rates to be applied to the fair value of each type of security
- Case Study: Note 5 to the financial statements indicates the types of investments

Line 9 Less market risk (cont'd)

- **Canadian government bonds**
  - Note 5 to financial statements
    - $500,000 issued and guaranteed by the Government of Canada, maturing Dec. 31, 2016
    - Due over 3 to 7 years
  - Paragraph (a) from Schedule 1 to Form 31-103F1:
    - 2% margin for government bond maturing over 3 to 7 years
  - Market risk calculation:
    - Fair value X margin rate
    - $500,000 X 2% = $10,000

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Line 9 Less market risk (cont’d)

- **Exchange traded funds (ETFs)**
  - ETFs are securities listed on an exchange
  - Note 5 to financial statements - Fair value of $190,000
  - Case study Appendix B - All ETFs trading on TSX with stock price > $2

  - Paragraph(e)(i) from Schedule 1 to Form 31-103F1:
    - Securities listed on any exchange in Canada that are selling at $2.00 or more, apply 50% margin

  - Market risk calculation:
    - Fair value X margin rate
    - $190,000 X 50% = $95,000

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Line 9 Less market risk (cont'd)

- **Mutual funds**
  - Note 5 to financial statements
    - Total fair value of $635,000
    - Includes funds qualified by prospectus in Canada of $400,000
  - Case study Appendix B - NAV per unit > $2
  - Paragraph (d)(ii) from Schedule 1 to Form 31-103F1:
    - For securities of mutual funds (other than money market funds) qualified by prospectus for sale in any jurisdiction of Canada, the margin rate determined on the same basis as for listed stocks, multiplied by the net asset value of the fund
  - Market risk calculation for mutual funds qualified by prospectus for sale in Canada:
    - NAV X margin rate
    - $400,000 X 50% = $200,000

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Line 9 Less market risk (cont'd)

- **Mutual funds (cont'd)**
  - Note 5 to financial statements
    - Total fair value of $635,000
    - Includes funds qualified by prospectus in Canada of $400,000
    - Therefore, $235,000 are not qualified by prospectus in Canada
  - Paragraph (g) from Schedule 1 to Form 31-103F1:
    - For all other securities, 100% of fair value
  - Market risk calculation for mutual funds not qualified by prospectus in Canada:
    - NAV X margin rate
    - $235,000 X 100% = $235,000

Line 9 Less market risk (cont'd)

- **Investment in Private Co.**
  - Private company
  - Does not meet any of the criteria under (a) to (f) of Schedule 1 to Form 31-103F1

  - Paragraph (g) from Schedule 1 to Form 31-103F1:
    - For all other securities, 100% of fair value

  - Market risk calculation:
    - Fair value X margin rate
    - 125,000 X 100% = $125,000

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Line 9 Less market risk (cont'd)

- **Investment in ABC Partnership**
  - Private company
  - Does not meet any of the criteria under (a) to (f) of Schedule 1 to Form 31-103F1
  - Paragraph (g) from Schedule 1 to Form 31-103F1:
    - For all other securities, 100% of fair value
  - Market risk calculation for investment in private companies:
    - Fair value X margin rate
    - 50,000 X 100% = $50,000

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Line 9 Less market risk (cont'd)

Summary of market risk calculation

Type of security	Fair value	Margin rate (per Schedule 1 to Form 31-103F1)	Market risk	Schedule 1 reference
Government bonds	$500,000	2%	$10,000	Paragraph (a)
ETFs	$190,000	50%	$95,000	Paragraph (e)(i)
Mutual funds	$400,000	50%	$200,000	Paragraphs (d)(ii) and (e)(i)
Mutual funds (other)	$235,000	100%	$235,000	Paragraph (g)
Investment in Private Co.	$125,000	100%	$125,000	Paragraph (g)
Investment in ABC Partnership	$50,000	100%	$50,000	Paragraph (g)
		Total market risk to be included on Line 9	**$715,000**	

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Line 9 Less market risk (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation
Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

9.	Less market risk	$715,000.00	$2,000.00

Recommendation:

- Provide OSC with breakdown of market risk calculation

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Line 10 less any deductible under the bonding or insurance policy…

- Appendix B to case study:
  - Bonding policy meets all requirements under Part 12 of NI 31-103
  - Deductible amount from the bonding policy is $25,000

Line 10 less any deductible under the bonding or insurance policy… (cont’d)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

10.	Less any deductible under the bonding or insurance policy required under Part 12 of National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*	$25,000.00	$25,000.00

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Line 11 Less guarantees

- If registrant guarantees the liability of another party:
  - Total amount of the guarantee must be included on Line 11 of Form 31-103F1 (if not already included on Line 4 Current Liabilities)
- ABC Corporation
  - No guarantees identified from financial statements

Line 11 Less guarantees (cont’d)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation
(as at December 31, 2012 with comparative figures as at December 31, 2011)

11.	Less Guarantees	$0.00	

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Line 12 Less unresolved differences

- Any unresolved differences that could result in a loss from either firm or client assets must be included in the capital calculation

- Note 14 to financial statements
  - Company in dispute regarding a number of units of a security held by a client that the Company manages
  - Fair value of the discrepancy is $200,000

- Include $200,000 on Line 12 of Form 31-103F1

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Line 12 Less unresolved differences (cont'd)

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

12.	Less unresolved differences	$200,000.00	

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Line 13 Excess working capital

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

ABC Corporation

Firm Name

Capital Calculation

(as at December 31, 2012 with comparative figures as at December 31, 2011)

7.	Adjusted working capital Line 3 minus line 6 =	$1,116,100.00	$155,000.00
8.	Less minimum capital	$100,000.00	$100,000.00
9.	Less market risk	$715,000.00	$2,000.00
10.	Less any deductible under the bonding or insurance policy required under Part 12 of National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*	$25,000.00	$25,000.00
11.	Less Guarantees	$0.00	
12.	Less unresolved differences	$200,000.00	
13.	**Excess working capital**	$76,100.00	$28,000.00

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Management certification

- Two officers or directors (where applicable) of the registered firm should sign and date that they have examined the capital calculation and certify that the firm is in compliance with the capital requirements
- Where possible, a person independent of the preparer should be one of the officers or directors who sign and certify the calculation

Registered Firm Name: ABC Corporation

We have examined the attached capital calculation and certify that the firm is in compliance with the capital requirements as at December 31, 2012.

Name and Title	**Signature**	**Date**
1. Officer #1 CCO	Officer #1	March 28, 2013
2. Officer #2 UDP	Officer #2	March 28, 2013

Capital deficiencies

- Requirements when capital deficiency is identified:
  - Section 12.1(1) of NI 31-103
    - If at any time, the excess working capital of a registered firm is less than zero, the firm must notify the regulator as soon as possible
  - Section 12.1(2) of NI 31-103
    - The excess working capital must not be less than zero for 2 consecutive days

Capital deficiencies (cont'd)

- Resolving a capital deficiency - Examples:
  - Cash injection into the firm in return for equity
  - Borrowing from a related party and entering into a subordination agreement with the related party for the <u>long-term</u> portion of the amount borrowed

- Documentation to be provided to OSC:
  - Bank statement to support cash injection
  - Executed subordination agreement for long-term related party debt
  - Most recent interim financial information (e.g. trial balance or general ledger)
  - Form 31-103F1 to support most recent interim financial information

Capital deficiencies (cont'd)

- Possible regulatory actions by OSC to address capital deficiencies:
  - Terms and conditions
  - Warning letter
  - Suspension

- Determined on a case-by-case basis

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Opportunity to be heard process

- Firm can exercise an opportunity to be heard under s. 31 of the Act before Director imposes terms and conditions or suspension

- OTBH general link:

http://www.osc.gov.on.ca/en/Dealers_opportunity-heard_index.htm

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Useful references

Form 31-103F1 *Calculation of Excess Working Capital*:

http://www.osc.gov.on.ca/en/SecuritiesLaw_reg_forms_index.htm

NI 31-103 and Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*:

http://www.osc.gov.on.ca/en/13596.htm

Guide to financial filing requirements:

http://www.osc.gov.on.ca/en/Dealers_ro_guide-financial-filing-requirements.htm

OSC Staff Notice 33-738 – 2012 *Annual Summary Report for Dealers, Advisers and Investment Fund Managers*:

http://www.osc.gov.on.ca/en/SecuritiesLaw_33-738.htm

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Electronic submissions

- Currently firms can deliver required documents to: registration@osc.gov.on.ca

- Proposed OSC Rule 11-501 *Electronic Delivery of Documents to the Ontario Securities Commission* will require mandatory electronic delivery of:
  - Form 31-103F1, financial statements and other interim financial information required by s. 12.12, 12.13 and 12.14 of NI 31-103
  - Notice of repayment of subordinated related party loan or termination of subordination agreement (s. 12.2)
  - Notice of change in, claim made under or cancellation of insurance/bonding policy (s. 12.7)

- Online submission process to be in place in 2014

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Summary

- **Frequency of calculations depends:**
  - Size of firm
  - Nature of business and stability of the components of firm's working capital

- **Subordinated loans:** Provide copy/notice to regulator

- **Form 31-103F1**:
  - Readily convertible to cash – depends on the nature of the item and all relevant circumstances
  - Only non-current related party debt can be subordinated
  - Market risk must be calculated for all types of securities (provide calculation as backup)

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Summary (cont'd)

- **Capital deficiencies:**
  - Know minimum capital at all times
  - Notify regulator ASAP when deficient

- **Electronic submission process to be implemented in 2014**

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Contact information

If you have any questions regarding the contents of this presentation, please contact:

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Questions?

ABC CORPORATION

NON-CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

APPENDIX A - CASE STUDY

INDEPENDENT AUDITORS' REPORT

To the Directors of ABC Corporation

We have audited the accompanying financial statements of ABC Corporation, which comprise the statement of financial position as at December 31, 2012 and 2011 and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by management to meet the requirements of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, based on the financial reporting framework specified in paragraph 3.2(3)(a) of National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*, for financial statements delivered by registrants.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting framework specified in paragraph 3.2(3)(a) of National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards* for financial statements delivered by registrants, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

APPENDIX A - CASE STUDY

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of ABC Corporation as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with the financial reporting framework specified in paragraph 3.2(3)(a) of National Instrument 52-107, *Acceptable Accounting Principles and Auditing Standards* for financial statements delivered by registrants.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to Note 2 to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Corporation to meet the requirements of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for the Directors of ABC Corporation and the Ontario Securities Commission and should not be used by parties other than the Directors of ABC Corporation and the Ontario Securities Commission.

ABC Audit Firm, LLP, Chartered Professional Accountants, Licensed Public Accountants
March 19, 2013
Toronto, Canada

APPENDIX A - CASE STUDY

ABC Corporation
Incorporated under the laws of Ontario

STATEMENTS OF FINANCIAL POSITION
(In Canadian dollars)

As at December 31

	2012	2011
	$	$
ASSETS		
Current		
Cash and cash equivalents *[note 3]*	1,425,000	75,000
Accounts receivable *[note 4]*	1,764,000	20,000
Investments *[note 5]*	1,500,000	100,000
Loan advanced to related party *[note 6]*	300,000	-
Other receivables	25,000	10,000
Prepaid expenses	3,500	3,500
Harmonized Sales Tax refund receivable	100	-
Total current assets	**5,017,600**	**208,500**
Investments in subsidiaries	625,000	625,000
Capital assets, net	45,000	47,000
Total assets	**5,687,600**	**880,500**
LIABILITIES AND SHAREHOLDER'S DEFICIT		
Current		
Accounts payable and accrued liabilities	1,314,000	50,000
Subordinated loan *[note 7]*	850,000	-
Total current liabilities	**2,164,000**	**50,000**
Deferred tax liabilities	100	100
Loan payable *[note 8]*	250,000	250,000
Redeemable preferred shares [*note 11]*	900,000	-
Total Liabilities	**3,314,100**	**300,100**
Contingencies *[note 14]*		
Equity		
Share *capital [note 10]*		
Authorized		
Unlimited common shares		
Issued		
100 Class A common shares	100	100
Equity (deficit)	2,373,500	580,400
Total shareholder's equity (deficit)	**2,373,600**	**580,500**
	5,687,700	**880,600**

See accompanying notes
On behalf of the Board

ABC Corporation Director
19-Mar-13

APPENDIX A - CASE STUDY

THE STATEMENTS OF COMPREHENSIVE INCOME, STATEMENTS OF CHANGES IN EQUITY AND STATEMENTS OF CASH FLOWS HAVE BEEN EXCLUDED FOR THE PURPOSES OF THIS CASE STUDY

APPENDIX A - CASE STUDY

ABC CORPORATION

NOTES TO FINANCIAL STATEMENTS
(In Canadian dollars)

December 31, 2012

1. ORGANIZATION

ABC Corporation (the "Company") is a limited company incorporated under the laws of the Province of Ontario and domiciled in Toronto. The Company is principally regulated by the Ontario Securities Commission ("OSC") and registered in the categories of portfolio manager, investment fund manager and exempt market dealer. The Company's registered office is 123 ABC Street, Toronto.

These non-consolidated financial statements of the Company as at December 31, 2012 and 2011 and for the years ended December 31, 2012 and 2011 were authorized by the Board of Directors on March 19, 2013.

The significant accounting policies used in the preparation of the non-consolidated financial statements are summarized below.

2. BASIS OF PRESENTATION

These non-consolidated financial statements are prepared in accordance with the financial reporting framework specified in subsection 3.2(3)(a) of National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards* for financial statements delivered by registrants (the "framework"). This framework requires the financial statements relating to a financial year beginning on or after January 1, 2011 be prepared in accordance with International Financial Reporting Standards ("IFRS"), except that any investments in subsidiaries, jointly controlled entities and associates must be accounted for as specified for separate financial statements in IAS 27 *Separate Financial Statements*. The financial statements have been prepared by management to meet the requirements of National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, and as a result, the financial statements may not be suitable for another purpose.

The financial statements of the Company have been prepared on a going concern basis. The Company's presentation currency is the Canadian dollar, which is also the Company's functional currency.

THE NOTES PRESENTED ARE RELEVANT FOR PRESENTATION PURPOSES ONLY. THE NOTES PRESENTED DO NOT CONTAIN ALL REQUIRED DISCLOSURES. THE NOTES ALSO DO NOT REFLECT ALL OF THE NOTES REQUIRED FOR A FULL SET OF FINANCIAL STATEMENTS.

ABC CORPORATION

NOTES TO FINANCIAL STATEMENTS
(In Canadian dollars)

December 31, 2012

3. CASH AND CASH EQUIVALENTS

The Company has pledged $1,000,000 (2011: $ nil) as collateral for its long-term debt with ABC Bank. The Company cannot withdraw, assign or transfer the pledged amount so long as a portion of the Company's long-term debt remains outstanding.

4. ACCOUNTS RECEIVABLE

Accounts receivable is comprised of the following:

	2012	**2011**
	$	$
Accounts receivable	**1,764,000**	20,000

The ageing of receivables is as follows:

	2012	**2011**
	$	$
Current	**1,230,000**	20,000
31-60 days	**500,000**	—
61-90 days	—	—
Over 90 days	**34,000**	—
	1,764,000	20,000

There were no allowances for doubtful receivables or balances written-off for the years ended December 31, 2012 and 2011. Included in accounts receivable is a balance totaling $34,000 (2011: $ nil) due from Sister Company Inc., which is past due but is not considered impaired.

THE NOTES PRESENTED ARE RELEVANT FOR PRESENTATION PURPOSES ONLY. THE NOTES PRESENTED DO NOT CONTAIN ALL REQUIRED DISCLOSURES. THE NOTES ALSO DO NOT REFLECT ALL OF THE NOTES REQUIRED FOR A FULL SET OF FINANCIAL STATEMENTS.

ABC CORPORATION

NOTES TO FINANCIAL STATEMENTS
(In Canadian dollars)

December 31, 2012

5. INVESTMENTS

Investments consist of the following:

	2012		2011	
	Cost $	**Fair value $**	**Cost $**	**Fair value $**
Government bonds	**500,000**	**500,000**	100,000	100,000
Exchange traded funds	**150,000**	**190,000**	—	—
Investment in mutual funds	**520,000**	**635,000**	—	—
Investment in Private Co.	**100,000**	**125,000**	—	—
Investment in ABC Partnership	**50,000**	**50,000**	—	—
	1,320,000	**1,500,000**	100,000	100,000

Bonds are issued and guaranteed by the Government of Canada at 3% with a maturity date of December 31, 2016.

Investment in mutual funds includes funds qualified by prospectus in Canada of $400,000 (2011: $ nil).

6. LOAN ADVANCED TO RELATED PARTY

The loan receivable from Sister Company Inc. is non-interesting bearing, unsecured and due on demand.

7. SUBORDINATED LOAN

As at December 31,	**2012**	**2011**
	$	**$**
Subordinated loan from shareholder, bearing interest at prime rate, repayment on demand	**850,000**	—
	850,000	—

THE NOTES PRESENTED ARE RELEVANT FOR PRESENTATION PURPOSES ONLY. THE NOTES PRESENTED DO NOT CONTAIN ALL REQUIRED DISCLOSURES. THE NOTES ALSO DO NOT REFLECT ALL OF THE NOTES REQUIRED FOR A FULL SET OF FINANCIAL STATEMENTS.

ABC CORPORATION

NOTES TO FINANCIAL STATEMENTS
(In Canadian dollars)

December 31, 2012

The loan is subordinated to the claims of the Company's ordinary creditors under an agreement between the shareholder and the Company. Repayment of the loan or termination of the subordination agreement may only be done after giving appropriate notice to the regulator.

8. LOAN PAYABLE

The loan was borrowed from a chartered bank at an interest rate of 6% on August 1, 2011, with the full amount due on July 31, 2016.

9. RELATED PARTY TRANSACTIONS

In the normal course of business, related party transactions occur between the Company and several related companies. These transactions give rise to intercompany receivables and payables, which are settled on a regular and timely basis.

The Company has an agreement with 123 Company to provide services including financial, operations and investment management of assets managed by 123 Company. These fees are included in other income and amounted to $10,278,000 (2011 - $264,000).

Included in accounts receivable is $1,764,000 (2011 - $20,000) for management fees due from related parties.

10. SHARE CAPITAL

On January 1, 2011, 100 Class A common shares were issued for $100 cash.

11. REDEEMABLE PREFERRED SHARES

The Company has authorized an unlimited number of preferred shares. The preferred shares have no par value, are entitled to a non-cumulative dividend of 7% per annum and are redeemable at the option of the holder provided certain conditions are met or at the option of the Company. The preferred shares are classified as a financial liability in accordance with IAS 32 *Financial Instruments: Presentation*.

All of the preferred shares were issued to a shareholder of the Company. $500,000 has been subordinated in favour of the Company's creditors. Repayment of the loan is subject to the approval of the regulator.

THE NOTES PRESENTED ARE RELEVANT FOR PRESENTATION PURPOSES ONLY. THE NOTES PRESENTED DO NOT CONTAIN ALL REQUIRED DISCLOSURES. THE NOTES ALSO DO NOT REFLECT ALL OF THE NOTES REQUIRED FOR A FULL SET OF FINANCIAL STATEMENTS.

ABC CORPORATION

NOTES TO FINANCIAL STATEMENTS
(In Canadian dollars)

December 31, 2012

12. CREDIT FACILITY

As at December 31, 2012, the Company had an available operating line of credit to a maximum of $2,500,000. The facility bears interest at prime plus 2.50% per annum. The company did not use its credit facility during the year.

13. CAPITAL MANAGEMENT

The Company's objectives when managing its capital are to maintain financial strength, manage liquidity requirements and maintain compliance with regulatory capital requirements. The Company's capital consists of share capital and retained earnings. The Company's registration with securities commissions in Canada requires it to maintain a minimum working capital equal to the deductible under the financial institution bond plus $100,000, which amounts to $125,000. The company is subject to no other externally imposed capital requirements. The company is in compliance with its capital requirements as at December 31, 2012.

14. CONTINGENCIES

The Company is currently in dispute regarding a number of units of a security held by a client that the Company manages. The fair value of the discrepancy is $200,000 (2011: $ nil). The Company is currently working with the client to investigate the discrepancy and it cannot currently be determined whether there will be any liability on the part of the Company.

15. SUBSEQUENT EVENTS

There were no events subsequent from the financial statements date to the date of authorization by the Board of Directors.

THE NOTES PRESENTED ARE RELEVANT FOR PRESENTATION PURPOSES ONLY. THE NOTES PRESENTED DO NOT CONTAIN ALL REQUIRED DISCLOSURES. THE NOTES ALSO DO NOT REFLECT ALL OF THE NOTES REQUIRED FOR A FULL SET OF FINANCIAL STATEMENTS.

APPENDIX C

The footnotes and text boxes in this document are for explanatory purposes only and are not part of the Form 31-103F1. In some cases, these footnotes and text boxes highlight recent amendments to NI 31-103 and its Companion Policy relating to the change-over in Canada to International Financial Reporting Standards (IFRS) by providing the text of the pre-IFRS law, as it applies to periods relating to financial years beginning before January 1, 2011.

FORM 31-103F1 CALCULATION OF EXCESS WORKING CAPITAL

____
Firm Name

Capital Calculation
(as at ________________ with comparative figures as at ______________)

	Component	Current period	Prior period
1.	Current assets		
2.	Less current assets not readily convertible into cash (e.g., prepaid expenses)		
3.	Adjusted current assets Line 1 minus line 2 =		
4.	Current liabilities		
5.	Add 100% of long-term related party debt unless the firm and the lender have executed a subordination agreement in the form set out in Appendix B and the firm has delivered a copy of the agreement to the regulator or, in Québec, the securities regulatory authority		
6.	Adjusted current liabilities Line 4 plus line 5 =		
7.	Adjusted working capital Line 3 minus line 6 =		
8.	Less minimum capital		
9.	Less market risk		
10.	Less any deductible under the bonding or insurance policy required under Part 12 of National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*		
11.	Less Guarantees		

12.	Less unresolved differences		
13.	**Excess working capital**		

Notes:

This form must be prepared using the accounting principles that you use to prepare your financial statements in accordance with National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards.* Section 12.1 of Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* provides further guidance in respect of these accounting principles.

Line 5. Related-party debt – Refer to the CICA Handbook for the definition of "related party" for publicly accountable enterprises.

Note: The sentence above should be read as follows where this form is delivered in respect of a financial year, or an interim period relating to a financial year, as applicable, beginning before January 1, 2011:

> Refer to Part V of the CICA Handbook for the definition of "related party" which is to be read in accordance with Canadian GAAP applicable to public enterprises

Line 8. Minimum Capital – The amount on this line must be not less than (a) $25,000 for an adviser and (b) $50,000 for a dealer. For an investment fund manager, the amount must be not less than $100,000 unless subsection 12.1(4) applies.

Line 9. Market Risk – The amount on this line must be calculated according to the instructions set out in Schedule 1 to this Form.

Line 11. Guarantees – If the registered firm is guaranteeing the liability of another party, the total amount of the guarantee must be included in the capital calculation. If the amount of a guarantee is included in the firm's statement of financial position[1] as a current liability and is reflected in line 4, do not include the amount of the guarantee on line 11.

Line 12. Unresolved differences – Any unresolved differences that could result in a loss from either firm or client assets must be included in the capital calculation. The examples below provide guidance as to how to calculate unresolved differences:

(i) If there is an unresolved difference relating to client securities, the amount to be reported on Line 12 will be equal to the fair value of the client securities that are short, plus the applicable margin rate for those securities.

(ii) If there is an unresolved difference relating to the registrant's investments, the amount to be reported on Line 12 will be equal to the fair value of the investments (securities) that are short.

(iii) If there is an unresolved difference relating to cash, the amount to be reported on Line 12 will be equal to the amount of the shortfall in cash.

Please refer to section 12.1 of Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* for further guidance on how to prepare and file this form.

Management Certification

[1] For periods relating to financial years beginning before January 1, 2011, the term "statement of financial position" should be read as "balance sheet".

Registered Firm Name: ____

We have examined the attached capital calculation and certify that the firm is in compliance with the capital requirements as at ____________________________.

Name and Title	**Signature**	**Date**
1. ____________________ ____________________	____________________	____________________
2. ____________________ ____________________	____________________	____________________

Schedule 1 of Form 31-103F1 Calculation of Excess Working Capital
(calculating line 9 [market risk])

Note: For periods relating to financial years beginning before January 1, 2011, the term "fair value" should be read as "market value" wherever it occurs in this Schedule 1 of Form 31-103F1 Calculation of Excess Working Capital, except in respect of the definition of "fair value" set out in (1) below and in respect of section (f) Mortgages.

For purposes of completing this form:

(1) "Fair value" means the value of a security determined in accordance with Canadian GAAP applicable to publicly accountable enterprises.[2]

(2) For each security whose value is included in line 1, Current Assets, multiply the fair value of the security by the margin rate for that security set out below. Add up the resulting amounts for all of the securities you hold. The total is the "market risk" to be entered on line 9.

(a) Bonds, Debentures, Treasury Bills and Notes

(i) Bonds, debentures, treasury bills and other securities of or guaranteed by the Government of Canada, of the United Kingdom, of the United States of America and of any other national foreign government (provided such foreign government securities are currently rated Aaa or AAA by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively), maturing (or called for redemption):

within 1 year:	1% of fair value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years:	1 % of fair value
over 3 years to 7 years:	2% of fair value
over 7 years to 11 years:	4% of fair value
over 11 years:	4% of fair value

(ii) Bonds, debentures, treasury bills and other securities of or guaranteed by any jurisdiction of Canada and obligations of the International Bank for Reconstruction and Development, maturing (or called for redemption):

within 1 year:	2% of fair value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years:	3 % of fair value
over 3 years to 7 years:	4% of fair value
over 7 years to 11 years:	5% of fair value
over 11 years:	5% of fair value

(iii) Bonds, debentures or notes (not in default) of or guaranteed by any municipal corporation in Canada or the United Kingdom maturing:

within 1 year:	3% of fair value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year to 3 years:	5 % of fair value
over 3 years to 7 years:	5% of fair value
over 7 years to 11 years:	5% of fair value
over 11 years:	5% of fair value

(iv) Other non-commercial bonds and debentures, (not in default): 10% of fair value

[2] The definition of "fair value" applies only to periods relating to financial years beginning on or after January 1, 2011.

(v) Commercial and corporate bonds, debentures and notes (not in default) and non-negotiable and non-transferable trust company and mortgage loan company obligations registered in the registered firm's name maturing:

within 1 year:	3% of fair value
over 1 year to 3 years:	6 % of fair value
over 3 years to 7 years:	7% of fair value
over 7 years to 11 years:	10% of fair value
over 11 years:	10% of fair value

(b) Bank Paper

Deposit certificates, promissory notes or debentures issued by a Canadian chartered bank (and of Canadian chartered bank acceptances) maturing:

within 1 year:	2% of fair value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year:	apply rates for commercial and corporate bonds, debentures and notes

(c) Acceptable foreign bank paper

Deposit certificates, promissory notes or debentures issued by a foreign bank, readily negotiable and transferable and maturing:

within 1 year:	2% of fair value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year:	apply rates for commercial and corporate bonds, debentures and notes

"Acceptable Foreign Bank Paper" consists of deposit certificates or promissory notes issued by a bank other than a Canadian chartered bank with a net worth (i.e., capital plus reserves) of not less than $200,000,000.

(d) Mutual Funds

Securities of mutual funds qualified by prospectus for sale in any jurisdiction of Canada:

(i) 5% of the net asset value per security as determined in accordance with National Instrument 81-106 *Investment Fund Continuous Disclosure*, where the fund is a money market mutual fund as defined in National Instrument 81-102 *Mutual Funds*; or

(ii) the margin rate determined on the same basis as for listed stocks multiplied by the net asset value per security of the fund as determined in accordance with National Instrument 81-106 *Investment Fund Continuous Disclosure*.

(e) Stocks

In this paragraph, "securities" includes rights and warrants and does not include bonds and debentures.

(i) On securities including investment fund securities, rights and warrants, listed on any exchange in Canada or the United States of America:

Long Positions – Margin Required

Securities selling at $2.00 or more – 50% of fair value

Securities selling at $1.75 to $1.99 – 60% of fair value

Securities selling at $1.50 to $1.74 – 80% of fair value

Securities selling under $1.50 – 100% of fair value

Short Positions – Credit Required

Securities selling at $2.00 or more – 150% of fair value

Securities selling at $1.50 to $1.99 - $3.00 per share

Securities selling at $0.25 to $1.49 – 200% of fair value

Securities selling at less than $0.25 – fair value plus $0.25 per shares

(ii) For positions in securities that are constituent securities on a major broadly-based index of one of the following exchanges, 50% of the fair value:

(a) Australian Stock Exchange Limited
(b) Bolsa de Madrid
(c) Borsa Italiana
(d) Copenhagen Stock Exchange
(e) Euronext Amsterdam
(f) Euronext Brussels
(g) Euronext Paris S.A.
(h) Frankfurt Stock Exchange
(i) London Stock Exchange
(j) New Zealand Exchange Limited
(k) Stockholm Stock Exchange
(l) Swiss Exchange
(m) The Stock Exchange of Hong Kong Limited
(n) Tokyo Stock Exchange

(f) Mortgages

(i) For a firm registered in any jurisdiction of Canada except Ontario:

(a) Insured mortgages (not in default): 6% of fair value

(b) Mortgages which are not insured (not in default): 12% of fair value of the loan or the rates set by Canadian financial institutions or Schedule III banks, whichever is greater.

(ii) For a firm registered in Ontario:

(a) Mortgages insured under the *National Housing Act* (Canada) (not in default): 6% of fair value

(b) Conventional first mortgages (not in default): 12% of fair value of the loan or the rates set by Canadian financial institutions or Schedule III banks, whichever is greater.

For periods relating to financial years beginning before January 1, 2011, the term "fair value" in section (f) Mortgages should follow the valuation requirement of a financial instrument in accordance with Canadian GAAP applicable to public enterprises in Part V of the CICA Handbook.

If you are registered in Ontario regardless of whether you are also registered in another jurisdiction of Canada, you will need to apply the margin rates set forth in (ii) above.

(g) For all other securities – 100% of fair value.

APPENDIX B

ADDITIONAL CASE STUDY INFORMATION

ABC CORPORATION

December 31, 2012

INVESTMENTS

1. Exchange traded funds:
    - All exchange traded funds are trading on the Toronto Stock Exchange (TSX).
    - All exchange traded funds had a stock price of greater than $2 at closing on December 31, 2012.

2. Mutual Funds:
    - All mutual funds have a net asset value per unit of greater than $2 at closing on December 31, 2012.

LOAN TO RELATED PARTY

The December 31, 2012 audited financial statements of Sister Company Inc. show that Sister Company Inc. is a start-up company and that it has minimal amounts of cash and revenue.

INSURANCE POLICY

ABC Corporation has a bonding policy that meets all of the requirements under Part 12 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. The deductible amount from the bonding policy is $25,000 for each claim.