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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Securities Commission – Securities Division
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Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Financial Services Regulation Division, Department of Government Services, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
E-Mail: jstevenson@osc.gov.on.ca

January 14, 2010

Dear Sirs:

Proposed Amendments to National Instrument 81-106 *Investment Funds Continuous Disclosure* and Companion Policy 81-106CP *Investment Funds Continuous Disclosure* and related amendments

This letter is in response to the Request for Comment published at (2009) 32 OSCB 8381 concerning proposed amendments to National Instrument 81-106 *Investment Funds Continuous Disclosure* and Companion Policy 81-106CP *Investment Funds Continuous Disclosure* and related amendments.

Generally, we support the direction the CSA has taken in the proposed materials; however, with respect to the significant matter of consolidation on which specific comment was requested we do not support the position taken. We have also provided some comments with respect to some changes arising from adjustments related to the classification of investment fund securities (puttable instruments).

Consolidation

We believe users of investment fund financial statements do not find consolidated financial statements useful and that what is required to understand the financial performance is a statement of investment portfolio on a non-consolidated basis. We believe the CSA has explicitly acknowledged that fact, since the CSA itself is recommending that:

- a statement of investment portfolio be prepared on a non-consolidated basis
- the non-consolidated statement of investment portfolio will be audited; and
- the financial highlights in the Management Report of Fund Performance ("MRFP") be presented on a non-consolidated basis.

However, we do not support the method proposed by the CSA for reporting the non-consolidated investment portfolio. We believe that presentation of a statement of investment portfolio on a non-consolidated basis with equal prominence to statements on a consolidated basis is misleading and that a modified audit report would result. We believe that any basis of presentation note would be confusing to readers as two basis of presentation would be equally prominent.

Further, we believe significant costs will be incurred to prepare consolidated financial statements by those in the investment fund industry and question whether the costs exceed the benefits. In fact, we question what benefits exist given the lack of comparability that will exist between investment funds consolidating underlying funds or operating entities and those not-consolidating underlying funds or operating entities.

As IFRS exists today, preparation of financial statements on a non-consolidated basis following a fair presentation framework is not an option since the conditions to prepare non-consolidated financial statements in IAS 27 paragraph 10 are not met. IAS 27 paragraph 16 indicates a subsidiary cannot be excluded from consolidation simply because the investor is a venture-capital organization, mutual fund, unit trust or similar entity. An audit report on such non-consolidated financial statements would result in a modified opinion, most likely an adverse opinion, as the auditor would likely conclude that the impact of non-consolidation is both material and pervasive to the financial statements.

Currently, the International Accounting Standards Board is re-evaluating the IFRS consolidation standard with ED 10 *Consolidated Financial Statements*. If the IASB adopts an investment company override, then non-consolidated financial statements by investment companies would be compliant with IFRS. In this case, we believe that presenting a non-consolidated statement of investment portfolio within the financial statements would be acceptable under a fair presentation framework.

However, given that this preferred outcome is uncertain, we strongly recommend that courses of action be investigated by the CSA which will allow the preparation of non-consolidated financial statements. We believe two possible courses of action exist:

1 The CSA should mandate that financial statements of investment funds be prepared on a non-consolidated basis in accordance with IFRS except that investments should be accounted for in compliance with AcG-18 *Investment Companies*. CSA guidance must clearly specify the accounting policies to be followed in order for us to be able to report compliance with such a basis.

The general purpose audit report of any financial statements prepared on such a basis could not receive an unmodified opinion following a fair presentation framework. The CSA rule would need to change to accommodate acceptance of a compliance framework. The audit report in the opinion paragraph following a compliance framework would state:

> *In our opinion, the financial statements of ABC Company for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with the accounting requirements prescribed by Regulator in NI 81-106.*

An emphasis of matter paragraph would draw the reader's attention to the basis of presentation note which would explain that the financial statements are not consolidated. The emphasis of matter paragraph in the auditor's report may read as follows:

> *We draw attention to Note X to the financial statements, which describes the basis of accounting used in the preparation and presentation of these financial statements, which are not, and are not intended to be, prepared and presented in accordance with Canadian generally accepted accounting principles. Note X also describes the differences between the financial reporting framework used in these financial statements and Canadian generally accepted accounting principles for publicly accountable enterprises that are applicable to the entity's financial statements and how the reported financial position and performance of the entity would have differed if it had complied with Canadian generally accepted accounting principles. Our opinion is not qualified in respect of this matter.*

The basis of presentation note would indicate that the presentation complies with the requirements in NI 81-106 but would <u>not</u> describe the financial statements as "complying with IFRS except on a non-consolidated basis" as we believe such presentation is misleading. However, the basis of presentation note would describe the various accounting policies applied.

We observe that precedents exist for the CSA accepting non-consolidated financial statements. National Instrument 31-103 today accepts financial statements on a non-consolidated basis for registrants. The proposed amendments to NI 31-103 together with the proposed amendments to

NI 52-107 continue this practice and also establish a precedent for accepting financial statements prepared following a compliance framework.

2 The CSA should encourage the Accounting Standards Board to scope out any investment fund within the scope of NI 81-106 from the definition of a publicly accountable enterprise.

If the definition of publicly accountable enterprises did not include investment funds within the scope of NI 81-106 then the CSA could alter its rule to require investment funds to prepare financial statements prepared in accordance with Canadian GAAP applicable to non-public enterprises. The audit of such financial statements would be done following a fair presentation framework.

If the CSA, despite our concerns noted above, continues to believe the best course of action is to require investment funds to prepare consolidated financial statements and to address users' needs for non-consolidated financial information through additional disclosure, with an audit report following a fair presentation framework, then we believe this may be accomplished in three different ways (described below). We believe any of the following three alternatives would be acceptable:

1 Investment fund prepares consolidated financial statements. A note in the financial statement includes a schedule of investment portfolio prepared on a non-consolidated basis and describes the basis of presentation of the schedule. We believe that preparation of such a schedule is in compliance with IFRS7 *Financial Instruments: Disclosures*. The CAS700 general purpose audit report would cover the schedule of investment portfolio.

2 Investment fund prepares consolidated and non-consolidated financial statements with the non-consolidated financial statements including a statement of investment portfolio (IAS 27 paragraph 10 allows the preparation of non-consolidated financial statements if consolidated financial statements have been prepared). The CAS700 general purpose audit report would cover the statement of investment portfolio.

3 Investment fund prepares consolidated financial statements. In addition, a stand alone non-consolidated statement of investment portfolio is prepared. A CAS805 general purpose audit report following a compliance framework would accompany the statement. A fair presentation framework would not be appropriate because generally accepted accounting principles would require the statement to be prepared on a consolidated basis.

While we believe any of the above alternatives are acceptable, we encourage the CSA to select one method. We believe the first alternative may be the least costly as two different reports audited using possibly different materiality levels is not required. However, we wish to emphasize that our preferred course of actions would be to not require the preparation of consolidated financial statements in the first place.

Further, we do not believe the regulator should impose any additional requirements to explain the differences between the statement/schedule of investment portfolio and the statement of financial position. We believe that after following one of our three proposed alternatives users will have sufficient information to understand the basis of presentation of each of the statements/schedules.

Classification of Investment Fund Securities (Puttable Instruments)

We are concerned that the requirement in Section 3.2 Item 19 to report in the statement of comprehensive income the increase or decrease in net assets attributable to security holders from operations per security as this appears to be a non-GAAP earnings measure and should not be presented in the financial statements.

We observe that Section 3.3 item 4 requires disclosure of the aggregate amounts paid on redemption of securities of the investment fund in the statement of changes in financial position. However, for funds using equity treatment, the value presented could potentially be bifurcated between share capital (cost) and retained earnings.

Thank you for the opportunity to comment on NI 81-106. Should you wish to discuss them in more detail, we would be pleased to respond.

Yours truly,

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