**Notice and Request for Comments**

**Proposed Amendments to**
**National Instrument 81-106 *Investment Fund Continuous Disclosure***
**and Companion Policy 81-106CP *Investment Fund Continuous Disclosure***
**and Related Amendments**

## Introduction

The Canadian Securities Administrators (CSA or we), except the Autorité des marchés financiers and the New Brunswick Securities Commission, are publishing for a 90 day comment period proposed amendments to:

- National Instrument 81-106 *Investment Fund Continuous Disclosure* (the Instrument) and
- Companion Policy 81-106CP *Investment Fund Continuous Disclosure* (the Policy).

We are also publishing for comment proposed amendments to:

- Form 41-101F2 *Information Required in an Investment Fund Prospectus,*
- National Instrument 81-101 *Mutual Fund Prospectus Disclosure,*
- Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure,*
- National Instrument 81-102 *Mutual Funds*, and
- National Instrument 81-104 *Commodity Pools*.

We are publishing all of the proposed amendments with this Notice. You can also find the proposed amendments on the websites of many CSA members.

This notice forms parts of a series of notices that address proposed changes to securities legislation arising from the upcoming changeover to International Financial Reporting Standards (IFRS). This notice sets out the proposed changes specific to investment funds.

## Substance and purpose of the amendments

*Background*

The Instrument currently refers to existing Canadian generally accepted accounting principles (GAAP) which are established by the Canadian Accounting Standards Board (AcSB) and published in the Canadian Institute of Chartered Accountants (CICA) Handbook. Following a period of public consultation, the AcSB adopted a strategic plan to move financial reporting for Canadian publicly accountable enterprises to IFRS as issued by the International Accounting Standards Board (IASB). For financial years beginning on or after January 1, 2011, Canadian GAAP for publicly accountable enterprises will be IFRS incorporated into the CICA Handbook.

*Purpose*

The purpose of the proposed amendments published today is to accommodate the transition to IFRS. The proposed amendments require investment funds, for financial years beginning on or after January 1, 2011, to prepare financial statements in accordance with Canadian GAAP applicable to publicly accountable enterprises and to report compliance with IFRS. We are also proposing to update the accounting terms and phrases in the Instrument to reflect that, for financial years beginning on or after January 1, 2011, Canadian GAAP for publicly accountable enterprises will be IFRS incorporated into the CICA Handbook.

The proposed amendments to the Instrument are consistent with the CSA's proposal to repeal and replace National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency* (to be renamed *Acceptable Accounting Principles and Auditing Standards*) (NI 52-107), published for comment on September 25, 2009. The proposed amendments are also consistent with proposed changes to National Instrument 51-102 *Continuous Disclosure Obligations*, National Instrument 41-101 *General Prospectus Requirements* and National Instrument 14-101 *Definitions* also published for comment on September 25, 2009.

The changeover to IFRS will also result in certain consequential amendments to other rules and forms applicable to investment funds, including the prospectus rules (Form 41-101F2 *Information Required in an Investment Fund Prospectus* and National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, including Form 81-101F1 *Contents of Simplified Prospectus*).

The proposed amendments are not intended to substantively alter securities law requirements, but the adoption of IFRS will change the accounting principles currently used by investment funds, and will impact the presentation of financial statements. The proposed amendments cover terminology differences between Canadian GAAP and IFRS (a list of changed terms is in Appendix A), and also reflect changes to financial statement presentation stemming from the adoption of IFRS. Two of the major changes that impact investment funds are the classification of securities issued by investment funds and consolidation.

*Classification of Investment Fund Securities (Puttable Instruments)*

International Accounting Standard (IAS) 32 *Financial Instruments: Presentation* classifies a puttable financial instrument as a financial liability, unless the instrument has certain features, in which case it is classified as an equity instrument. Generally, puttable instruments are securities which are redeemable by the securityholder. As most investment funds issue redeemable securities, investment funds will have to determine if their securities are puttable instruments, and if so, whether they should be classified as financial liabilities or as equity instruments.

Currently, the Instrument contemplates that the securities issued by investment funds are usually classified as equity. The proposed amendments alter some of the line items in the financial statements to accommodate either an equity or liability presentation. The proposed amendments attempt to keep the financial statement presentation as consistent as possible, regardless of whether the investment fund's own securities are classified as equity or liability under IFRS. For example, the proposed amendments allow an investment fund to disclose either total equity (if the fund's own securities are classified as equity) or net assets attributable to securityholders (if the fund's own securities are classified as liabilities).

While the classification of an investment fund's securities as either equity instruments or financial liabilities will affect the presentation of the financial statements, we do not expect it to impact other aspects of investment fund disclosure such as performance or management expense ratios.

The CSA is seeking feedback on this approach to the treatment of the classification of securities issued by investment funds.

*Consolidation*

Under current Canadian GAAP, the requirement to consolidate (Accounting Guideline 15 *Consolidation of Variable Interest Entities*) does not apply to investment funds that account for their investments at fair value in accordance with Accounting Guideline 18 *Investment Companies* (AcG-18). Generally, AcG-18 requires investment funds to measure their portfolio assets at fair value and present them on this basis in their financial statements.

Current Canadian GAAP differs from IFRS as IAS 27 *Consolidated and Separate Financial Statements* applies to all entities including investment funds. Paragraph 16 of IAS 27 stipulates that "a subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation, mutual fund, unit trust or similar entity."

The IASB is currently reviewing the consolidation requirements under IFRS. The IASB published Exposure Draft 10 - *Consolidated Financial Statements* (ED 10) for comment in December 2008. Investment funds are included in the scope of the proposed revised standard which is expected to be issued later this year. The objective of ED 10 is to clarify the definition of control in IFRS and to provide more specific application guidance. The interpretation of "control" could lead to situations where investment funds may have to consolidate underlying investments.

Some respondents to the IASB's request for comments on ED 10, including members of the Canadian investment fund industry, asked the IASB to reconsider the application of the consolidation standard to investment funds. Some respondents noted that consolidation does not provide meaningful, relevant information to readers of the financial statements. These respondents are of the view that investment funds should always measure and present their investments at fair value, whereas consolidation could result in underlying investments being presented using another valuation method employed by the subsidiary (for example, at cost). In 2009, the CICA published a research report, *Financial Reporting By Investment Funds (Second Edition)*[1], which outlines a study group's views on financial reporting issues that may arise from the changeover to IFRS for investment funds, including the preparation of consolidated financial statements.

[1] This document is periodically updated by the CICA. The latest version currently available is dated July 2009.

It is unclear how many investment funds will have to prepare consolidated financial statements under IFRS given certain restrictions, either in securities law or the investment fund's own policies, on their ability to control or become involved in the management of issuers in which they invest. However, the proposed definition of control in ED 10 will result in some investment funds concluding that they have to consolidate certain portfolio investments when preparing their financial statements under IFRS. This could be a significant change in a long-standing Canadian accounting practice and will affect the presentation of investment fund financial statements.

Consolidation for investment funds is an important issue which the CSA will continue to monitor. Currently, it appears that under IFRS, investment funds may be required to present consolidated financial statements, but the specifics of this requirement will not be known until the IASB publishes its decision with respect to ED 10. Until then, the proposed amendments to the Instrument contemplate that:

- investment funds will prepare and file consolidated financial statements (other than the statement of investment portfolio), if required by IFRS
- the statement of investment portfolio will be prepared on a non-consolidated basis
- the statement of investment portfolio will be audited
- the financial highlights in the management reports of fund performance will be presented on a non-consolidated basis.

The CSA is seeking feedback on this approach to consolidation for investment funds. We would like specific information about the impact of consolidation on Canadian investment funds, including your analysis and determination of how this standard will be applied and the consequences to the presentation of the financial statements.

We also invite focused comments on the ability of investment funds to prepare the statement of investment portfolio on a non-consolidated basis, and to have this statement audited in accordance with Canadian GAAS using a fair presentation framework. In addition, will the proposed requirement to explain differences between the statement of investment portfolio and the statement of financial position result in useful disclosure about the relationship between these two statements? If not, would a numerical reconciliation achieve this result?

The CSA is of the view that the consolidation requirement will not impact the calculation of net asset value, as this calculation must continue to be done using the fair value standard established in the Instrument. However, the requirement to consolidate could result in additional differences between net assets (as shown on the financial statements) and net asset value, which could impact the reconciliation of these amounts required to be disclosed in the notes to the financial statements. Please consider whether this will result in any additional presentation issues.

*Financial Statements Not Required by IFRS*

As the statement of investment portfolio is not one of the financial statements listed in the complete set of financial statements in IAS 1 *Presentation of Financial Statements*, please provide your views on whether it can be audited as part of annual financial statements audited in accordance with Canadian GAAS using a fair presentation framework. If not, can disclosure equivalent to the disclosure currently provided in the statement of investment portfolio be instead provided in the notes to the financial statements or in an audited supplementary schedule?

**Summary of proposed amendments**

We summarized the significant proposed amendments in Appendix A. This summary is not a complete list of all the amendments.

We are publishing amending instruments as follows:

- for the Instrument (Appendix B)
- for the Policy (Appendix C)
- for Form 41-101F2 *Information Required in an Investment Fund Prospectus* (Appendix D)
- for National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (Appendix E)
- for Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* (Appendix F)
- for National Instrument 81-102 *Mutual Funds* (Appendix G)
- for National Instrument 81-104 *Commodity Pools* (Appendix H)

We are also publishing blacklined versions of the Instrument and Policy that show the proposed changes (Appendix I).

**Alternatives considered**

No alternatives were considered. The proposed amendments reflect the changes to the CICA Handbook for publicly accountable enterprises.

**Impact on Investors**

The CSA support the AcSB's plan to move financial reporting for Canadian publicly accountable enterprises to IFRS – a globally accepted, high quality set of accounting principles. The proposed amendments are intended to provide investment funds with an efficient transition to IFRS.

The proposed amendments introduce IFRS terminology. By replacing existing Canadian GAAP terms and phrases with IFRS terms and phrases, we expect that a more consistent interpretation will be given to the Instrument than would be the case if the proposed amendments were not implemented. More consistent disclosure practices should increase transparency and thereby benefit investors.

The proposed amendments attempt to maintain comparability of financial statement presentation and performance reporting among investment funds. The changeover to IFRS is not expected to substantially impact the disclosure provided to investors in the management report of fund performance, nor to affect the calculation of the management expense ratio or the trading expense ratio. The fair value principles on which the calculation of net asset value is based should also remain unchanged.

**Anticipated costs and benefits**

The anticipated costs and benefits of adopting IFRS as the basis for financial reporting in Canada were included in the notice accompanying the proposed changes to NI 52-107 published on September 25, 2009.

**Unpublished materials**

In proposing the amendments, we have not relied on any significant unpublished study, report or other written materials.

**Local Notices and Amendments**

In connection with the implementation of the proposed amendments to the Instrument, certain securities regulatory authorities will amend local securities legislation. These jurisdictions will publish any proposed local changes or other information required by local securities legislation in Appendix J to this notice.

**Publications in Quebec and New Brunswick**

The Autorité des marchés financiers and the New Brunswick Securities Commission are publishing for comment today staff notices that set out the substantive proposed changes reflected in the amending instruments published in the other CSA jurisdictions. Because of the legal obligation to publish amending instruments simultaneously in French and English in Québec and New Brunswick, and because the French IFRS terminology is still in a state of flux, publication for comment of amending instruments in these provinces is presently not feasible. It is expected that the Autorité des marchés financiers and the New Brunswick Securities Commission will publish for comment corresponding amending instruments, in French and in English, during the first quarter of 2010. However, investment funds in Québec and New Brunswick are encouraged to comment on the substantive proposed changes presented in the staff notices and on the amendments published by the other CSA jurisdictions.

**Request for Comments**

We welcome your comments on the proposed amendments.

Please submit your comments in writing on or before January 14, 2010. If you are not sending your comments by email, you should also send an electronic file containing your submission (in Windows format, Word).

Address your submission to the following members of the CSA:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission – Securities Division
Manitoba Securities Commission
Ontario Securities Commission
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

Deliver your comments **only** to the address that follows. Your comments will be forwarded to the other participating CSA member jurisdictions.

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario  M5H 3S8
Fax: (416) 593-2318
e-mail: jstevenson@osc.gov.on.ca

Comments received will be made publicly available and posted at www.osc.gov.on.ca and the websites of certain other securities regulatory authorities. We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period.

**Questions**

Please refer your questions to any of:

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