

2012 BCSECCOM 433

November 20, 2012

Headnote

Multilateral Instrument 11-102 *Passport System* and National Policy 11-203 *Process for Exemptive Relief Applications in Multiple Jurisdictions* – National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*, s. 5.1 -- The auditors must issue an auditor's report that contains a reservation due to a limitation of scope -- The limitation of scope is not imposed by, and could not be reasonably eliminated by management -- The scope issue will not recur in future -- The audit report will be unmodified except for the reservation related to the limitation of scope

Applicable Legislative Provisions

National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*, sections 3.3(a) and 5.1

In the Matter of
the Securities Legislation of
British Columbia and Ontario
(the Jurisdictions)

and

In the Matter of
the Process for Exemptive Relief Applications in Multiple Jurisdictions

and

In the Matter of
Versatile Systems Inc.
(the Filer)

Decision

Background

- ¶ 1 The securities regulatory authority or regulator in each of the Jurisdictions (the Decision Maker) has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the Legislation) that the requirement that financial statements that are required by securities legislation to be audited be accompanied by an auditor's report that expresses an unmodified opinion does not

2012 BCSECCOM 433

apply to the annual consolidated financial statements of the Filer for the years ended June 30, 2012 and June 30, 2013 (the Exemption Sought).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a dual application):

- (a) the British Columbia Securities Commission is the principal regulator for this application,
- (b) the Filer has provided notice that section 4.7(1) of Multilateral Instrument 11-102 *Passport System* (MI 11-102) is intended to be relied upon in Alberta, and
- (c) the decision is the decision of the principal regulator and evidences the decision of the securities regulatory authority or regulator in Ontario.

Interpretation

- ¶ 2 Terms defined in National Instrument 14-101 *Definitions* and MI 11-102 have the same meaning if used in this decision, unless otherwise defined.

Representations

- ¶ 3 This decision is based on the following facts represented by the Filer:
- 1. the Filer was incorporated under the *Companies Act* (British Columbia) on September 28, 1955 under the name Alice Lake Mines Limited N.P.L., before changing its name to Alice Lake Mines Limited on December 20, 1982; on October 29, 1993, the Filer changed its name to Consolidated Alice Lake Mines Limited, then to International Sales Information Systems Inc. on June 1, 1994 and finally to Versatile Mobile Systems (Canada) Inc. on September 20, 2000 before being continued under the *Business Corporations Act* (Yukon) on February 15, 2004; the Filer was continued under the *Business Corporations Act* (British Columbia) on November 15, 2005 under its current name Versatile Systems Inc.; the principal office of Filer is located at Suite 910-355 Burrard Street, Vancouver, BC V6C 2G8;
 - 2. the Filer is a reporting issuer in British Columbia, Alberta and Ontario, and its common shares are listed on the TSX Venture Exchange under the symbol “VV”;
 - 3. the Filer is not in default of securities legislation in any jurisdiction of Canada other than its obligation to file, on or before October 28, 2012, audited financial statements and management’s discussion and analysis for the year ended June 30, 2012 as required under National Instrument 51-102

2012 BCSECCOM 433

Continuous Disclosure Obligations and the related certificates as required under National Instrument 52-109 *Certificate of Disclosure in Issuer's Annual and Interim Filings*;

4. the Filer's core business is developing solutions that solve customers' problems in the storage, security, transmission and collection of mission critical data; the Filer also holds an investment of common stock of Equus Total Return, Inc. (Equus);
5. the Filer's auditor is Deloitte & Touche LLP (Deloitte or the Auditor);
6. commencing in 2009, the Filer (through its subsidiary Mobiquity Investments Limited) began acquiring shares in Equus Total Return Inc. (Equus) in the open market; as at June 30, 2012, the Filer indirectly held 970,087 shares in Equus, representing approximately 9.2% of Equus' issued and outstanding shares (the Equus Investment);
7. Equus is a company that exists under the laws of Delaware that has elected to be treated as a business development company under the United States Investment Company Act of 1940;
8. Equus is a closed-end investment management company that in the ordinary course of business, indirectly acquires, holds and disposes of investments in various portfolio entities;
9. the shares of common stock of Equus (Equus Shares) trade on the New York Stock Exchange under the symbol "EQS";
10. effective May 10, 2010, four directors of the Filer were elected to the nine member board of directors of Equus; on June 9, 2010 Equus announced the appointment of John Hardy as the Executive Chairman of Equus; John Hardy is also the Chief Executive Officer and Chairman of the Filer;
11. the financial statements of Equus are prepared in accordance with accounting principles generally accepted in the United States (US GAAP) and in accordance with the requirements of reporting on Form 10-Q and Article 10 of Regulation S-X (Regulation S-X), under the United States Securities Act of 1933 and the United Securities Exchange Act of 1934, each as amended; in accordance with Article 6 of Regulation S-X, Equus does not consolidate any of its portfolio company investments, including those in which Equus has a controlling interest;

2012 BCSECCOM 433

12. as of June 30, 2010, Equus held controlling interests in the following four investments:
 - (a) 100% interest in Equus Media Development Company, LLC (Equus Media), incorporated by Equus in January 2007;
 - (b) 64.6% investment in Riptide Entertainment, LLC, (Riptide) made in December 2005;
 - (c) 64.6% investment in Sovereign Business Forms, Inc., (Sovereign) made in August 1996; and
 - (d) 79% investment in Spectrum Management, LLC, (Spectrum) made in December 1999;
13. as of June 30, 2010, Equus also held a 32.2% interest in ConGlobal Industries Holding, Inc. (ConGlobal) through an investment that was made in February 1997;
14. some of Equus' investments represented indirect investments in several additional operating businesses; for example, Riptide is a holding company with investments in several operating businesses, including Big Apple Entertainment Partners (Big Apple), London Bridge Entertainment (London Bridge), and DCAB Entertainment;
15. in the case of Riptide, Equus had also made cash advances to certain associated entities of Riptide pursuant to promissory notes issued by each of 1848 Capital Partners LLC (1848) for \$3,731,000, Big Apple for \$3,233,000, and London Bridge for \$2,816,000;
16. during 2011 and 2012, Equus disposed of its investments in Riptide (including the associated investments in 1848, Big Apple and London Bridge), Sovereign and ConGlobal (the Disposed Portfolio Entities);
17. as at June 30, 2012, the only investments in which Equus held a controlling interest were its investments in Equus Media and Spectrum, together with a 100% interest in a new entity, Equus Energy, LLC;
18. for the quarter ended September 30, 2009, during which the Filer first made its investment in Equus, the Filer recorded its investment in Equus as a short term investment;

2012 BCSECCOM 433

19. at June 30, 2010, under Canadian GAAP – Part V (as hereinafter defined), the Filer recorded the Equus Investment at \$2,203,043, representing the fair value thereof; the Filer also disclosed that the investment was available for sale; during the year ended June 30, 2010, the net change in the fair value of the Equus Investment was -\$519,670, which was recorded as an Accumulated Other Comprehensive Loss;
20. as at June 30, 2011, under Canadian GAAP – Part V, the Filer recorded the Equus Investment at \$2,311,109, representing the fair value thereof; during the year ended June 30, 2011 the net change in the fair value of the Equus Investment was -\$201,490, which was recorded as an Accumulated Other Comprehensive Loss; the total cumulative losses on the Equus Investment through to June 30, 2011 was \$721,160;
21. the Canadian Accounting Standards Board (AcSB) has incorporated International Financial Reporting Standards into the Handbook as Canadian GAAP for most publicly accountable enterprises; as a result, the Handbook contains two sets of standards for public companies:
 - (a) Part I of the Handbook - Canadian GAAP for most publicly accountable enterprises which is International Financial Reporting Standards incorporated into the Handbook, that applies for financial years beginning on or after January 1, 2011 (IFRS); and
 - (b) Part V of the Handbook - Canadian GAAP for public enterprises that applies for financial years beginning before January 1, 2011 (Canadian GAAP – Part V);
22. each of the Disposed Portfolio Entities are private entities such that their securities are not registered under applicable securities laws and are not trading on any stock exchange or public market and, accordingly, such entities were not required to publicly file audited financial statements;
23. the investment agreements that Equus entered into with portfolio entities did not generally require the portfolio entities to provide audited financial statements to Equus; in the case of Riptide, Riptide was only obligated to provide Equus with tax returns for Riptide and its associated entities;
24. in accordance with US GAAP Equus recorded its investments in its portfolio entities as trading or mark-to-market basis with gains and losses recorded in the statement of operations; in accordance with Article 6 of Regulation S-X, Equus does not consolidate portfolio company investments, including those in which it has a controlling interest; portfolio investments are carried at fair

2012 BCSECCOM 433

value with the net change in unrealized appreciation or depreciation included in the determination of net assets; valuations of portfolio securities are performed in accordance with US GAAP and the financial reporting policies of the United States Securities and Exchange Commission; Equus did not require audited financial statements for its portfolio entities to establish the fair value of its investments;

25. Equus has advised the Filer that it does not have audited financial statements for the Disposed Portfolio Entities for all of the periods in which Equus held investments in such entities; Equus no longer exerts any control over the Disposed Portfolio Entities so is not in a position to require that these be prepared;
26. Equus does not have audited financial statements for any period for Riptide; furthermore, Equus does not have audited financial statements for any of the equity investments held by Riptide, including its 25% member's interest in Big Apple Entertainment Advisors LLC, its 25% member's interest in Big Apple Entertainment Management LLC, its 23.18% members interest in London Bridge Entertainment Partners LLP, its 40% member's interest in DCAB Entertainment Advisors LLC and its 40% member's interest in DCAB Entertainment Management LLC; Equus only received tax returns for some of these investee entities; the investment agreement did not require that Riptide produce audited financial statements or allow Equus to demand that these be produced; now that the investment in Riptide has been disposed of, Equus does not have any access to Riptide's financial information;
27. Equus does not have audited financial statements for either of ConGlobal or Sovereign at the time that the initial investments were made, being August 1996 for Sovereign and February 1997 for ConGlobal or for some of the subsequent periods for ConGlobal; Sovereign's year-end is December 31st, so Equus only has audited financial statements for the years ended December 31, 2011 but does not have any audited financial statements for the year ended June 30, 2012;
28. with the disposition of its investments in the Disposed Portfolio Entities, the Filer is able to obtain the required information to enable it to consolidate Equus' remaining controlling interests for the purposes of preparing its financial statements as at June 30, 2012 and for future periods;
29. section 3.3(1)(a)(i) of NI 52-107 requires that financial statements, other than acquisition statements, that are required by securities legislation to be audited must be accompanied by an auditor's report that expresses an unmodified opinion;

2012 BCSECCOM 433

30. in September 2012, following discussions with the Auditor, the Filer determined that the election of four of the Filer's directors to the nine member board of directors of Equus in May 2010 and the appointment of the Filer's Chief Executive Officer as Executive Chairman of Equus thereafter were indicia of the Filer's significant influence over Equus, thus requiring the Filer to account for the Equus Investment as an associate and apply the equity method of accounting under International Accounting Standard 28 (IAS 28) from the date significant influence was obtained;
31. in order to determine the IFRS-compliant amount of the carrying value of the Filer's investment in Equus and the related equity method income (loss) that the Filer should have recorded from the date significant influence was first acquired, the financial results of Equus would be required to be converted to IFRS compliant amounts; the Filer identified some key differences between the US GAAP basis of accounting applied by Equus and IFRS requirements;
32. under International Accounting Standard 27 (IAS 27), Equus would be obligated to apply consolidation accounting to the investments in which it held a controlling interest; under IAS 28, Equus would be obligated to apply the equity method to account for an investment in an entity over which it has significant influence; under US GAAP, Equus accounted for these investments at fair value; these specific investments are described above in paragraphs 12 and 13;
33. as it relates to the accounting for Equus' investments, the Filer has determined that there are no other differences between US GAAP and IFRS other than those described in paragraph 32 above;
34. based on inquiries by the Filer and Equus about financial information related to the Disposed Portfolio Entities, the Filer has concluded that it does not have access to certain financial statements and other information required in order to prepare financial information for Equus that fully reflects the impact of differences between US GAAP and IFRS described in paragraph 32 above on the carrying value of the Filer's investment in Equus as at June 30, 2011 and July 1, 2010 or the equity method income (loss) for the years ended June 30, 2012 and 2011; the required information is not in the possession of either of the Filer or Equus nor do either of the Filer or Equus have access to such information as discussed above in paragraphs 22 to 27; as a result, a reservation will be required in the auditor's report accompanying the Filer's June 30, 2012 financial statements, as follows:

2012 BCSECCOM 433

“Versatile Systems Inc. owns an investment in Equus Total Return, Inc. (“Equus”), a Regulated Investment Company, and has the ability to exercise significant influence over this investment; Equus is carried at [XX] million as at June 30, 2012, [XX] million as at June 30, 2011 and, [XX] million as at July 1, 2010; Equus applies United States of America Generally Accepted Accounting Principles and is not required to consolidate portfolio company investments, including those in which Equus has a controlling interest, however, under International Financial Reporting Standards, Equus would be required to consolidate investments in which it had a controlling interest and equity account for those investments Equus significantly influenced; Versatile Systems Inc. is unable to obtain information for dates prior to June 30, 2012 that would allow the preparation of financial information for Equus that fully reflects the impact of these differences between United States of America Generally Accepted Accounting Principles and International Financial Reporting Standards; as a result, Versatile Systems Inc. is unable to determine whether any adjustments were necessary to the carrying value of its investment in Equus as at June 30, 2011 and July 1, 2010 or the equity method income (loss) for the years ended June 30, 2012 and 2011; and as a result of this limitation in scope, we were unable to determine whether any adjustments were necessary to the carrying value as at June 30, 2011 and July 1, 2010 or equity income (loss) for the years ended June 30, 2012 and 2011 as required by International Financial Reporting Standards”;

35. as a result of the scope limitation described in paragraph 34, a reservation will be required in the auditor’s report accompanying the Filer’s June 30, 2013 financial statements; the reservation will relate only to comparative information presented for the year ended June 30, 2012;
36. with Equus’ disposition of Riptide, Sovereign and ConGlobal, the Filer has concluded that Equus is able to consolidate the remaining control investments as at June 30, 2012 and in future periods;
37. the Filer has requested that Equus provide access to the information that it requires in order for the Auditor to complete its audit and issue the required opinion; however, Equus has advised that it does not have such information, nor does it have access to the current management for any of the Disposed Portfolio Entities to obtain the required information, nor does it have any contractual arrangements whereby it can demand that this information be delivered; in certain cases, the information does not exist, as certain of the Disposed Portfolio Entities did not produce financial statements for the required periods;

2012 BCSECCOM 433

38. as the Filer's interim financial reports for the interim periods ended September 30, 2011, December 31, 2011 and March 31, 2012 did not correctly account for the Filer's investment in Equus, the Filer's management's discussion and analysis for the year ended June 30, 2012 will include revised financial information for those interim periods along with an explanation of the restated amounts; the Filer's interim financial reports for the periods ended September 30, 2012, December 31, 2012 and March 31, 2013 will present the restated comparative amounts; and
39. in its annual financial statements for the year ended June 30, 2012, the Filer's IFRS transition note will include disclosure clearly indicating that the change in accounting policy discussed in paragraph 30 is an error correction and not an IFRS transition difference.

Decision

- ¶ 4 Each of the Decision Makers is satisfied that the test set out in the Legislation for the Decision Maker with the jurisdiction to make the decision has been met.

The decision of the Decision Makers under the Legislation is that the Exemption Sought is granted provided that the only modification in the auditor's report accompanying the Filer's annual financial statements

- (a) for the year ended June 30, 2012, relates to a limitation in scope for the inability to determine whether any adjustments were necessary to the carrying value of the Filer's investment in Equus as at June 30, 2011 and July 1, 2010 or equity income (loss) for the years ended June 30, 2012 and 2011; and
- (b) for the year ended June 30, 2013, relates to comparative information presented for the year ended June 30, 2012.

Peter Brady
Director, Corporate Finance
British Columbia Securities Commission