Mutual Fund Dealers Association of Canada

Housekeeping Amendments to
MFDA Policy No. 4 *Internal Control Policy Statements*
and
MFDA Financial Questionnaire and Report – Form 1

Current Requirements

MFDA Policy No. 4 *Internal Control Policy Statements* prescribes requirements and provides guidance on compliance with MFDA Rule 2.9, which requires that Members establish and maintain internal controls as prescribed by the MFDA from time to time.

MFDA Financial Questionnaire and Report ("FQR") – Form 1 is the prescribed form for Members to file their financial statements with the MFDA in accordance with Rule 3.5.1.

Reasons for Amendments

MFDA Policy No. 4 *Internal Control Policy Statements* was drafted before the MFDA Investor Protection Corporation was established and incorrectly refers to the MFDA Investor Protection Plan.

The proposed amendments to the FQR are housekeeping in nature in that they are intended to clarify existing requirements and correct cross-references.

Description of Amendments

The proposed amendment to MFDA Policy No. 4 will update the legal name of the Investor Protection Plan by substituting MFDA Investor Protection "Plan" with MFDA Investor Protection "Corporation".

Housekeeping amendments to the FQR are summarized in the table below:

	Reference	Change Required	Rationale
1.	**Statement A (Notes and Instructions)**	Line 4 – Add "or fees" and remove reference "from mutual fund company"	Clarification of amounts that can be reported on that line
2.	**Statement B (Notes and Instructions)**	Line 11 – add "or financial institution" and "and other investment products"	Clarification that requirement extends to all investment products held in nominee name
3.	**Statement C (Notes and Instructions**	Line 2 – change "Quarterly" to "Monthly"	Updated to reflect monthly reports are filed rather than quarterly reports

	Reference	Change Required	Rationale
4.	**Statement D (Notes and Instructions)**	Line 26 – change Statement "E" to Statement "D"	Correction to cross-reference

Effective Date
The amended Policy and Form will be effective on a date to be subsequently determined by the MFDA.

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MFDA Policy No. 4 *Internal Control Policy Statements*

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following housekeeping amendments to MFDA Policy No. 4 *Internal Control Policy Statements*:

MFDA POLICY NO. 4
INTERNAL CONTROL POLICY STATEMENTS

MFDA INTERNAL CONTROL POLICY STATEMENT 1 – GENERAL MATTERS

This Policy Statement is one in a series that prescribes requirements for and provides guidance on compliance with MFDA Rule 2.9 that states "every Member shall establish and maintain adequate internal controls as prescribed by the Corporation from time to time."

“Internal control” is defined as follows:

> ***"Internal control consists of the policies and procedures established and maintained by management to assist in achieving its objective of ensuring, as far as practical, the orderly and efficient conduct of the entity's business. The responsibility for ensuring adequate internal control is part of management's overall responsibility for the ongoing activities of the entity." (CICA Handbook, 5200.03)***

The effectiveness of specific policies and procedures is affected by many factors, such as management philosophy and operating style, the function of the board of directors (or equivalent) and its committees, organizational structure, methods of assigning authority and responsibility, management control methods, system development methodology, personnel policies and practices, management reaction to external influences, and internal audit. These and other aspects of internal control affect all parts of the Member firm.

In addition to compliance with required policies and procedures set out in these Policy Statements, a Member must consider the following, to the extent that they suggest a higher standard than would otherwise be required:

(ii) Authoritative literature such as publications of the Mutual Fund Dealers Association of Canada, the MFDA Investor Protection ~~Plan~~ Corporation, the Internal Control Guidelines published by the Investment Dealers Association of Canada and publications of the Canadian Institute of Chartered Accountants;

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MFDA Financial Questionnaire and Report – Form 1

On May 22, 2008, the Board of Directors of the Mutual Fund Dealers Association of Canada made the following housekeeping amendments to the MFDA Financial Questionnaire and Report – Form 1:

FORM 1

MFDA FINANCIAL QUESTIONNAIRE AND REPORT

STATEMENT A
NOTES AND INSTRUCTIONS

[comparative figures to be completed at audit date only]

Line 4 - In the case of commissions or fees receivable~~s from mutual funds~~, to the extent that there is written documentation that the Member does not have a liability to pay salespersons' commission until it is received ~~from the mutual fund company~~, the salespersons' portion of the commission or fee receivable is an allowable asset.

Line 8 - Include **only** overpayment of prior years' income taxes or current year installments. Taxes recoverable due to current year losses may be included to the extent that they can be carried back and applied against taxes previously paid. This line should not include future tax debits arising from losses carried forward.

Line 9 - Include GST receivables, capital tax, Part IV tax, sales and property taxes.

Line 10 - Includes **only** receivables from Acceptable Entities but does not include subordinated loans receivable from other Members which should be shown on line17. Allowable assets are those assets which due to their nature, location or source are either readily convertible into cash or from such creditworthy entities as to be allowed for capital purposes.

Line 18 - Including but not limited to such items as:

- prepaid expenses
- future income tax debits
- cash surrender value of life insurance
- intangibles
- deferred charges
- advances to employees

Line 23 - Includes amounts owed by the Member for the purchase of client securities.

Line 27 - Include discretionary bonuses payable and bonuses payable to shareholders.

Line 29 - Include current portion of deferred lease inducements.

Line 38 - Include contributed surplus, if applicable.

STATEMENT B
NOTES AND INSTRUCTIONS

EACH MEMBER SHALL HAVE AND MAINTAIN AT ALL TIMES RISK ADJUSTED CAPITAL IN AN AMOUNT NOT LESS THAN ZERO.

Line 4 - Rule 3.1.1 requires the following minimum capital amounts:

Level 1	$ 25,000
Level 2	50,000
Level 3	75,000
Level 4	200,000

Line 11 - 100% of the market value of securities must be provided in the case where client or firm securities are held at locations which do not qualify as acceptable securities locations (see General Notes and Definitions). Securities held by an entity with which the Member has not entered into a written custodial agreement as required by the By-laws and Rules of the MFDA shall be considered as being held at non-acceptable securities locations.

For nominee name accounts, where a mutual fund company or financial institution does not provide a monthly statement or electronic file confirming all of the Member firm's ~~mutual fund~~ positions, the Member shall provide margin equal to 100% of the market value of such mutual funds and other investment products held on behalf of clients.

Line 12 and 13 - Items are considered unresolved unless a journal entry to resolve the difference has been processed as of the Due Date of the questionnaire.

This does not include journal entries writing off the difference to profit or loss in the period subsequent to the date of the questionnaire.

Margin must be provided for adverse unresolved differences in nominee name accounts in an amount equal to the market value of the securities short plus the applicable margin rates related to the security. If the deficiency has not been resolved within thirty days of being discovered, the Member shall immediately purchase the securities that are short.

Line 14 - This item should include all margin requirements not mentioned above as outlined in the By-laws and Rules of the MFDA

STATEMENT C
NOTES AND INSTRUCTIONS

1. The objective of the various Early Warning Tests is to measure characteristics likely to identify a firm heading into financial trouble and to impose restrictions and sanctions to reduce further financial deterioration and prevent a subsequent capital deficiency. “Yes” answers indicate Early Warning has been triggered.

   If the firm is currently capital deficient (i.e. risk adjusted capital is negative), only Part A of the early warning tests need be completed.

2. The profit or loss figures to be used are before bonuses, income taxes and extraordinary items [Statement D, line 20]. Note that the “current quarter” figure must also reflect any audit adjustments made subsequent to the filing of the ~~Quarterly~~ Monthly Financial Report.

3. If the current quarter is profitable, enter a "No" answer for Part C.

STATEMENT D — NOTES AND INSTRUCTIONS

A comparative statement of income prepared in accordance with generally accepted accounting principles and containing at least the information shown in the pre-printed Statement D may be substituted. It should be affixed to the statement provided.

It is recognized that the components of the revenue and expense classification on this statement may vary between firms. However, it is important that each firm be consistent between periods. Fair presentation may require the separate disclosure of additional large and/or unusual items by way of a note to this statement.

Lines

2 Assets under Administration means the market value of all mutual funds reflected in the client accounts (nominee and client name) of a Member in all provinces of Canada, excluding Quebec.

3-7 All **Commission Revenue** should be reported net of payouts to carrying dealers. Commission paid to salespersons should be shown on line 15.

3 Includes all gross commissions and trailer fees earned on mutual fund transactions, net of any payouts to the mutual funds.

10 Includes any charges to clients that are not related to commissions.

11 Includes fund management fees and other consulting fees not charged to clients.

12 Includes all fees earned as a result of referring clients to another entity for products or services.

13 Includes foreign exchange profits/losses and all other revenue not reported above.

15 This category should include commissions, bonuses and other variable compensation of a contractual nature. Examples would encompass commission payouts to salespersons. Discretionary bonuses should be included on line 21. All contractual bonuses should be accrued monthly and included on line 15.

16 Includes all interest on subordinated debt.

17 Includes trading profits/losses from principal trading activities and adjustment of marketable securities to market value.

18 Unusual items are items that have some but not all of the characteristics of extraordinary items *[line 23]*. An example of an unusual item may include costs associated with a branch closure.

19 Includes all operating expenses except those mentioned elsewhere: Variable compensation *[line 15]*, discretionary bonuses *[line 21]*.

21 This category should include discretionary bonuses and all bonuses to shareholders in accordance with share ownership. However, please read the instructions for line 15 before completing.

22 Includes ONLY income taxes. Realty and capital taxes should be included in line 19. Taxes at 33-1/3% on partnership profits should be disclosed on this line. The current provision should be net of loss carryforwards, the details of which should be disclosed on Schedule 3.

23 Extraordinary items have the following characteristics:

(a) they are not expected to occur frequently over several years;
(b) they do not typify normal business activities; and
(c) they do not depend primarily on decisions or determinations by management.

They should be reported net of tax. An example of an extraordinary item would include the destruction of a company's uninsured art collection by fire.

26 Includes only direct charges or credits to retained earnings that are capital transactions (e.g. premium on share redemptions), income of a subsidiary accounted for by the equity method and prior period adjustments. Any adjustment(s) required to reconcile retained earnings on the Monthly Financial Report to the MFDA Financial Questionnaire and Report should be posted to the individual Statement ~~E~~D line items on the first Monthly Financial Report that is filed after the adjustment(s) is known.