# MUTUAL FUND DEALERS ASSOCIATION

## HOUSEKEEPING AMENDMENTS TO FORM 1 – FINANCIAL QUESTIONNAIRE AND REPORT

## I. PART II – AUDITORS' REPORT

### Current Provisions

In accordance with MFDA Rule 3.5.1(b), Members are required to submit audited financial statements to the MFDA on an annual basis in a prescribed form. Currently, the prescribed form includes a standard Part II Auditors' Report in a version dated December 1, 2006.

### Reasons for Amendments

In September 2003 the Canadian Institute of Chartered Accountants ("CICA") issued a new Handbook section, "Section 5600 Auditors Report on Financial Statements Prepared Using a Basis of Accounting Other than Generally Accepted Accounting Principles". Auditor Reports dated on or after October 1, 2003 are required to comply with the standards outlined in Section 5600.

Section 5600 requires auditors engaged to report on financial statements prepared using a basis of accounting other than generally accepted accounting principles ("GAAP") to modify their standard Auditor's Report to disclose this fact to the financial statement users. This Section applies when the financial statements are prepared in accordance with regulatory or legislative requirements to meet the specific needs of a regulator or a legislator (s. 5600.04(a)). Consequently, the MFDA's Part II Auditors' Report must be amended to reflect the requirements of this Handbook section. Auditors complying with Generally Accepted Auditing Standards ("GAAS") will not be able to sign off on the MFDA's Part II Auditors' Report that is currently in place. The proposed amendment seeks to ensure that the Part II Auditors' Report is consistent with the changes made to the Part I Auditors' Report.

### Description of Amendments

The Part II Auditors' Report has been amended to incorporate the required changes to comply with Section 5600 of the CICA Handbook. In summary, the amendments to the Part II Auditors' Report are as follows:

- Adding a sentence to state that the Auditors have audited Part I of the MFDA Financial Questionnaire and Report ("Part I – FQR"). By adding this sentence, the Part II report establishes the basis of accounting which is referenced in the Part I report.

- Adding a sentence to clearly state that no additional procedures have been completed by the auditor other than those necessary to form an opinion on the Statements referenced in the Part I report.

- Deleting all reference to questions 2 through 7 on the Certificate of Partners or Directors ("PDO certificate"). The proposed amendments to the Part II Auditors' Report removes all references to the PDO certificate since it has been concluded that the reference no longer applies or alternatively, the auditor has performed sufficient work to provide appropriate audit evidence to the MFDA.

- A statement has been added indicating that the additional information set out in Part II was not intended to be prepared in accordance with Canadian generally accepted accounting principles, and that it is not intended to be, and should not be, used by anyone other than the specified users or for any other purpose.

The amendments are housekeeping in nature in that they reflect changes in administrative practices that are consistent with industry standards and do not impose any significant barrier or any burden to competition that is not appropriate.

**Comparison with Similar Provisions**

The proposed amendments to the MFDA Part II Auditors' Report are consistent with amendments recently made and approved by the Investment Dealers Association of Canada ("IDA") to address the CICA Handbook changes.

## II. STATEMENT D – SUMMARY STATEMENT OF INCOME – "REFERRAL FEES"

**Current Provisions**

In accordance with MFDA Rule 3.5.1(a), Members are required on a monthly basis to file with the MFDA a financial report of the Member as at the end of each fiscal month in the prescribed form. Currently, the prescribed form requires Members to report income from referral fees under "Other Income".

**Reason for Amendments**

The rationale for requiring separate disclosure of referral fee revenue is to enhance oversight of Member referral activities, which have become of greater regulatory concern. Furthermore, separate disclosure of referral fee revenue provides the MFDA with meaningful information with respect to business relationships Members have with other entities.

**Description of Amendments**

A line has been added to Statement D of the FQR that will require Members to separately disclose revenue earned from "referral fees". As a result of adding this line to Statement D, other amendments to the FQR are required. These amendments, which are composed of additional note disclosure and cross-referencing, are considered housekeeping in nature and are summarized below.

| | Reference | Change Required | Rationale |
|---|---|---|---|
| **1.** | Statement C (Notes and Instructions) | **Line 2 – Change reference to Statement D, Line 20.** | **Update cross-reference** |
| 2. | Statement D | **Line 12 – Add "Referral fees" Renumber lines and line references accordingly.** | **Enhanced disclosure of referral fee revenue.** |
| 3. | Statement D (Notes and Instructions) | **Add the following note: "12 Includes all fees earned as a result of referring clients to another entity for products or services."** <br><br> **Amend line numbering and references accordingly.** | **Enhanced disclosure of referral fee revenue.** |
| 4. | Statement E | **Line C(2)(a) – Change reference to D-24** <br> **Line C(2)(b) – Change reference to D-25** <br> **Line C(2)(c) – Change reference to D-26** | **Update cross-reference** |
| 5. | Schedule 3 | **Line A(5) – Change reference to D-22(a)** | **Update cross-reference** |

The amendments are housekeeping in nature in that they reflect changes in administrative practices of the MFDA and do not impose any significant barrier or any burden to competition that is not appropriate.

**Comparison with Similar Provisions**

The IDA does not currently require its Members to separately disclose referral fee revenue on the Summary Statement of Income. However, MFDA staff note some significant differences between investment dealers and mutual fund dealers such as the scope of permitted activities and extent of principal/agent relationships. Referral fee revenue is generally much more significant for mutual fund dealers.

## III. EFFECTIVE DATE

The proposed amendments will be effective on a date to be subsequently determined by the MFDA.

## MUTUAL FUND DEALERS ASSOCIATION OF CANADA

## FORM 1 - FINANCIAL QUESTIONNAIRE AND REPORT

On June 15, 2007, the Board of Directors of the Mutual Fund Dealers Association of Canada made and enacted the following amendments to MFDA Form 1 – Financial Questionnaire and Report:

**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~~19~~]. Note that the "current quarter" figure must also reflect any audit adjustments made subsequent to the filing of the Quarterly Financial Report.

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

STATEMENT D

# PART I
# MFDA FINANCIAL QUESTIONNAIRE AND REPORT

______________________________________________

(Firm Name)

**SUMMARY STATEMENT OF INCOME FOR THE PERIOD ENDED** ______________________

*[with comparative figures for the year /month ended* ________________________*]*

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1. Number of salespersons ............................................ _ _ _ _ _ _ _ _ _

2. Assets Under Administration at statement date ............. _ _ _ _ _ _ _ _ _

| | | CURRENT YR/MO | PREVIOUS YR/MO |
|---|---|---|---|
| **COMMISSION REVENUE** | | | |
| 3. | Mutual funds | | |
| 4. | Segregated Funds | | |
| 5. | Deposit Instruments | | |
| 6. | Limited Partnerships | | |
| 7. | Other securities (provide details) | | |
| 8. | Insurance | | |
| **OTHER REVENUE** | | | |
| 9. | Interest | | |
| 10. | Fees from clients | | |
| 11. | Management fees | | |
| 12. | Referral fees | | |
| 1~~2~~3. | Other (provide details) | | |
| 1~~3~~4. | TOTAL REVENUE | | |
| **EXPENSES** | | | |
| 1~~4~~5. | Variable compensation | | |
| 1~~5~~6. | Interest on subordinated debt | | |
| 1~~6~~7.~~–~~ | Realized/unrealized (gain) loss on marketable securities - | | |
| 1~~7~~8. | Unusual items *[attach details]* | | |
| 1~~8~~9. | Operating expenses other than lines 20 to 22 | | |
| ~~19~~20. | Income [loss] before lines 20 to 22 | | |
| 2~~0~~1. | Bonuses | | |
| 2~~1~~2. S-3(5) | Provision for (recovery of) income taxes | | |
| | (a) current | | |
| | (b) future | | |
| 2~~2~~3. | Extraordinary items *[attach details]* | | |

| | | | |
|---|---|---|---|
| 2~~3~~4. | NET INCOME [LOSS] FOR PERIOD | $ | $ |
| 2~~4~~5. | Dividends paid or partners drawings | | |
| 2~~5~~6. | Other *[attach details]* | | |
| 2~~6~~7. | NET CHANGE TO RETAINED EARNINGS *[lines 23 to 25]* | $ | $ |

## 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 1~~4~~5.

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 or compensation earned as a result of referring clients to another entity.

1~~2~~3 Includes foreign exchange profits/losses and all other revenue not reported above.

1~~4~~5 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 2~~0~~1. All contractual bonuses should be accrued monthly and included on line 1~~4~~5.

1~~5~~6 Includes all interest on subordinated debt.

1~~6~~7 Includes trading profits/losses from principal trading activities and adjustment of marketable securities to market value.

1~~7~~8 Unusual items are items that have some but not all of the characteristics of extraordinary items *[line 2~~2~~3]*. An example of an unusual item may include costs associated with a branch closure.

1~~8~~9 Includes all operating expenses except those mentioned elsewhere: Variable compensation *[line 1~~4~~5]*, discretionary bonuses *[line 2~~0~~1]*.

2~~0~~1 This category should include discretionary bonuses and all bonuses to shareholders in accordance with share ownership. However, please read the instructions for line 1~~4~~5 before completing.

2~~1~~2 Includes ONLY income taxes. Realty and capital taxes should be included in line 1~~8~~9. 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.

2~~2~~3 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.

2~~5~~6 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 line items on the first Monthly Financial Report that is filed after the adjustment(s) is known.

STATEMENT E

# PART I
# MFDA FINANCIAL QUESTIONNAIRE AND REPORT

______________________________________________

(Firm Name)

**STATEMENT OF CHANGES IN CAPITAL AND RETAINED EARNINGS (CORPORATIONS) OR UNDIVIDED PROFITS (PARTNERSHIPS) FOR THE YEAR ENDED ______________________________**

| REFERENCE | | CURRENT YEAR |
|---|---|---|
| **A.** | **CHANGES IN CAPITAL** | |
| 1. | Balance at last year-end.................................................... | $_ _ _ _ _ _ _ |
| 2. | Increases (Decreases) during period *[provide details]* | |
| | (a)................................................................................ | _ _ _ _ _ _ _ _ |
| | (b)................................................................................ | _ _ _ _ _ _ _ _ |
| | (c)................................................................................ | _ _ _ _ _ _ _ _ |
| 3. | Present capital ................................................................ | $=========== |
| | | A-38 |
| **B.** | **ANALYSIS OF PRESENT CAPITAL** *[see note 1]* | |
| 1. | (a)................................................................................ | $_ _ _ _ _ _ _ |
| | (b)................................................................................ | _ _ _ _ _ _ _ _ |
| | (c)................................................................................ | _ _ _ _ _ _ _ _ |
| | To agree with line A-3 above ........................................... | $=========== |
| **C.** | **RETAINED EARNINGS [CORPORATIONS] OR UNDIVIDED PROFITS [PARTNERSHIPS]** | |
| 1. | Retained earnings or undivided profits, at last year-end.................. | $_ _ _ _ _ _ _ |
| 2. | Increases (Decreases) during period *[see note 2]*: | |
| D-2~~3~~4 | (a) Net income (loss) for the period.................................. | _ _ _ _ _ _ _ _ |
| D-2~~4~~5 | (b) Dividends paid or partners drawings ............................ | _ _ _ _ _ _ _ _ |
| D-2~~5~~6 | (c) Other *[provide details]*.................................................. | _ _ _ _ _ _ _ _ |
| | ...................................................................................... | _ _ _ _ _ _ _ _ |
| | ...................................................................................... | _ _ _ _ _ _ _ _ |
| | ...................................................................................... | ___________ |
| 3. | Present retained earnings or undivided profits ................................ | $=========== |
| | | A-39 |

**NOTES:**

1. **Part B -** Disclosure should be made of authorized and issued share capital in accordance with generally accepted accounting principles.

2. **Line C-2** - Direct charges or credits to retained earnings are to be restricted to capital transactions (e.g. dividends, premium on share redemptions, etc.) and prior period adjustments. All income items of an extraordinary or unusual nature (e.g. profits or losses on sale of fixed assets etc.) are to be included in Statement D in arriving at net income or loss for the period. The latter amount is to be transferred in total to retained earnings [Statement E-line C-2(a)].

STATEMENT F

**MFDA FINANCIAL QUESTIONNAIRE AND REPORT**
**PART II - AUDITORS' REPORT**

TO: The MFDA and the MFDA Investor Protection Corporation

~~.~~We have audited Part I of the MFDA Financial Questionnaire and Report ("Part I – FQR") of ______________________________ as at ______________ and for

(firm) (date)

the year then ended, and reported thereon as of ______________.

(date)

The additional information set out in Part II of the MFDA Financial Questionnaire and Report Schedules 1 to 4 ("Part II – FQR") ~~and the answers contained in questions 2 through 7 on the Certificate of Partners or Directors~~ have been subjected to the procedures applied in the audit of ~~the financial statements A to F in~~ Part I - FQR, and in our opinion, present fairly the information contained therein, in all material respects, in relation to ~~these financial statements~~ Part I – FQR taken as a whole.

No procedures have been carried out in addition to those necessary to form an opinion on Part I – FQR.

The additional information set out in Part II – FQR, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Company, the MFDA and the MFDA Investor Protection Corporation to comply with the By-laws, Rules and Policies of the MFDA. The additional information set out in Part II – FQR are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

[name of auditing firm] [date]

[signature] [place of issue]

**NOTES:**

A measure of uniformity in the form of the auditors' report is desirable in order to facilitate identification of circumstances where the underlying conditions are different. Therefore, when auditors are able to express an unqualified opinion, their report should take the above form.

Any limitations in the scope of the audit must be discussed in advance with the MFDA. Discretionary scope limitations will not be accepted.

Copies with original signatures must be provided to the MFDA.