Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

THE FORM 1 REFERENCE MANUAL

March 2014

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GLOSSARY

AE	Acceptable Entity
AI	Acceptable Institution
AMF	Autorité des marchés financiers
ASL	Acceptable Securities Location
AUA	Assets Under Administration
CDIC	Canada Deposit Insurance Corporation
CRA	Canada Revenue Agency
CSA	Canadian Securities Administrators
EFS	Electronic Filing System
FIB	Financial Institution Bond
GIC	Guaranteed Investment Certificate
IFRS	International Financial Reporting Standards
Line A1	Statement A line 1 → *Please note that most references to specific Statement line numbers have been truncated. For example, Statement B line 1 is denoted as "Line B1".*
MFDA	Mutual Fund Dealers Association of Canada
MFDA IPC	MFDA Investor Protection Corporation
NSF	Non-Sufficient Funds
OCI	Other Comprehensive Income
QDIC	Quebec Deposit Insurance Corporation
RAC	Risk Adjusted Capital
RESP	Registered Education Savings Plan
RRSP	Registered Retirement Savings Plan
SLA	Subordinated Loan Agreement

This guidance topic is intended to assist Members and their Auditors in the interpretation, application of and compliance with requirements under MFDA By-laws, Rules and Policies. Examples or best practices provided are for illustration and are not exhaustive or intended to imply particular rules or requirements.

CHAPTER 1 - MFDA OVERSIGHT

Introduction

The MFDA is responsible for regulating Member business with a view to enhance investor protection and strengthen public confidence in the Canadian mutual fund industry. The prime objectives of the Financial Compliance department of the MFDA are to monitor the financial status of its Members and ensure that Members' financial processes and internal controls are in adherence with MFDA By-laws, Rules, Policies and Forms. To fulfill the MFDA's mandate, the Financial Compliance department performs the following functions:

- Reviewing monthly unaudited and annual audited Form 1s.
- Conducting on-site examinations of MFDA Members.
- Reviewing external auditor's working paper files.

Role of MFDA IPC

Investments held by a MFDA Member are covered under the MFDA IPC. The MFDA IPC provides protection to eligible clients of MFDA Members on a discretionary basis to prescribed limits if securities, cash and other property held by any such Member are unavailable as a result of the Member's insolvency. The MFDA IPC is sponsored by the MFDA and coverage is automatic when an investor becomes a client of a MFDA Member. Coverage is in the amount of up to $1 million per client account in respect of the loss of client property held by an MFDA Member.

The MFDA is required to communicate to the CSA and MFDA IPC any significant financial matters related to MFDA Members.

Review of Unaudited and Audited Form 1 Filings

The Form 1 is a set of regulatory financial statements in prescribed format containing a Member's financial information. It is designed to provide advanced warning of Member firms encountering financial difficulties. Members are required to submit monthly unaudited and annual audited Form 1 filings to the MFDA.

Each Form 1 filing submitted by Members is reviewed by the Financial Compliance department. The Form 1 review process consists primarily of enquiries, analytical procedures, and discussion with management to assess the financial status, trends, profitability, and general reasonability of the reported financial information. Upon discovery of potential financial difficulties, preventive measures are implemented to ensure the safeguard of client assets and the ongoing viability of the Member firm.

On-site Examinations

MFDA staff perform on-site examinations to ensure Members have an adequate reporting and internal control infrastructure in place to manage their financial processes as they relate to the Members' adherence with MFDA By-laws, Rules, Policies and Forms. MFDA staff performs substantive procedures by obtaining adequate documentation to ensure amounts reported on the Form 1 are prepared in accordance with the Notes and Instructions to the Form 1. In addition, MFDA staff reviews the Member's policies and procedures to ensure that they meet the minimum requirements of MFDA Policy No. 4, Internal Control Policy Statements.

Beginning in January 2014, the MFDA amended its Financial Compliance examination process to further integrate a risk-based methodology. The MFDA will perform routine financial compliance examinations of its Level 4 Members on a one- or two-year cycle, and its Level 2 and 3 Members on a two- or four-year cycle. The frequency of these routine examinations will be based on an assessment of risk factors specifically relating to financial matters of the firm. These factors are reviewed on an ongoing basis and it is possible for a Member's examination cycle to change.

Where a Level 2 or 3 Member's financial compliance examination cycle is consistent with its sales compliance examination cycle, a combined examination will be performed. However, in cases where the financial and sales compliance examination cycles differ, separate examinations will be conducted.

Upon completion of the on-site examination, the MFDA will issue a report to the Member summarizing the deficiencies noted for immediate corrective action. The Member is required to respond in writing within 15 business days of the date of the report, describing the steps the Member has taken or intends to take to rectify deficiencies noted in the report. Any significant or repeat deficiencies arising from the on-site examinations may be considered for referral to MFDA Enforcement department, where applicable (e.g. inadequate books and records, failure to report material information on the Form 1, failure to reconcile key accounts or assets).

Review of Auditor's Working Papers

Members are required to submit an annual audited Form 1 within 90 calendar days of its fiscal year-end. To obtain assurance that the audited financial filings are prepared in accordance with the Notes and Instructions to the Form 1, MFDA staff perform a review of the auditor's working paper files to ensure the regulatory requirements specifically related to the MFDA By-laws, Rules, Policies and Forms are adhered to. (Refer to Chapter 16 for further information about Auditor's Working Paper Reviews.)

CHAPTER 2 – THE FORM 1

The Form 1 is a third-party assurance report that includes financial statements and schedules and is to be prepared in accordance with IFRS, except as prescribed by the MFDA. Each Member must complete and file all of the statements and schedules of the Form 1. For purposes of the statements and schedules, the balances must be reported on a trade date basis and on a gross (not net) basis, unless specified otherwise in the Notes and Instructions to the Form 1.

Prescribed IFRS Departures

The following are the Form 1 IFRS departures prescribed by the MFDA:

Trading Balances

When reporting trading balances relating to Member and client securities and other investment transactions, the MFDA allows the netting of receivables from and payables to the same counterparty.

Preferred Shares

Preferred shares issued by the Member and approved by the MFDA are classified as shareholders' capital.

Presentation

Statements A and D contain terms and classifications (such as allowable and non-allowable assets) that are not defined under IFRS. In addition, specific balances may be classified or presented on Statements A, D and E in a manner that differs from IFRS requirements. The General Notes and Definitions to the Form 1, and the applicable Notes and Instructions to the Statements, should be followed in those instances where departures from IFRS presentation exist.

Statements B, C and F are supplementary financial information, which are not statements contemplated under IFRS.

Separate Financial Statements on a Non-Consolidated Basis

Consolidation of subsidiaries is not permitted for regulatory reporting purposes, except for related companies that meet the definition of "related Member" in MFDA By-law No. 1 and the MFDA has approved the consolidation.

Because Statement D only reflects the operational results of the Member, a Member must not include the income or loss of an investment accounted for by the equity method.

Statement of Cash Flow

A statement of cash flow is not required as part of the Form 1.

Valuation

Investments are to be valued and reported at "market value". (Refer to Appendix 1 for the definition of market value of securities.)

Prescribed Accounting Treatments

The following are the Form 1 prescribed accounting treatments based on available IFRS alternatives:

Hedge Accounting

Hedge accounting is not permitted for regulatory reporting purposes. All security and derivative positions of a Member must be marked-to-market at the reporting date. Gains or losses of the hedge positions must not be deferred to a future point in time.

Securities Owned and Sold Short as Held-for-Trading

A Member must categorize all investment positions as "held-for-trading" financial instruments. These security positions must be marked-to-market. Because the MFDA does not permit the use of "available for sale" and "held-to-maturity" categories, a Member must not include OCI and will not have a corresponding reserve account relating to the marking-to-market of available for sale security positions.

Valuation of a subsidiary

A Member must value subsidiaries at cost.

Filing Requirements

Members are required to file an unaudited Form 1 on a monthly basis and an audited Form 1 on an annual basis. Both the unaudited and audited financial filings must be reported in the prescribed Form 1 format.

Monthly Unaudited Form 1 Filings

MFDA Rule 3.5.1(a) requires Members to file a monthly unaudited Form 1 to the MFDA within 20 business days of each month-end. For Members designated in early warning pursuant to MFDA Rule 3.4, the monthly unaudited Form 1 must be filed within 15 business days of each month-end.

Annual Audited Form 1 Filings

The Members are also required to file an annual audited Form 1 together with relevant financial information within 90 calendar days of its fiscal year-end pursuant to MFDA Rule 3.5.1(b). Two complete and appropriately signed paper copies of the annual audited Form 1, including the two Independent Auditor's Reports, the Report on Compliance for Insurance and Segregation of Cash and Securities, and a duly signed Certificate of Partners or Directors, must be filed. The signed Form 1s are expected to be received by the MFDA within three business days of the filing due date. (Refer to MFDA Bulletin #0471-C for further information.)

If there is a change in the Member's fiscal year-end, the Member is required to notify the MFDA within five business days of the change. A resolution of the Member's board of directors approving the change may be requested by the MFDA to evidence the change.

The Member may request consideration from the MFDA to perform an audit for a period greater than the standard 12 months (e.g. a change in fiscal year-end). A letter from the Member requesting the approval and the reasons why must be submitted to the MFDA. If the request is valid and there are no other significant concerns, the request will be evaluated by the MFDA, taking into consideration that audited information should be submitted on a timely basis to allow for effective monitoring of the Member's capital position.

Basis of Presentation

The two Independent Auditor's Reports to the annual audited Form 1 include references to the basis of accounting described in the Notes to the Form 1. The auditor is asserting that the financial statements have been prepared in accordance with IFRS, except for the specific departures which are detailed in the Notes to the Form 1. (Refer to MFDA Staff Notice MSN-0052 for guidance as to the basis of presentation used in the annual audited Form 1.)

Process for Year-End Audit Engagements

Commencing for fiscal years ended December 31, 2008 and later, standard letters are exchanged between the MFDA and a Member's external auditor. The letters document the roles and responsibilities of the Member's auditor, the MFDA, and MFDA IPC for the year-end audit engagement. The standard letters include an Instruction Letter, an Acknowledgement Letter and a Confirmation Letter. (Refer to MFDA Bulletin #0348-C for further information.)

Electronic Filing System

All Form 1 filings must be submitted to the MFDA using the MFDA's web-based filing system, EFS. After submitting an electronic Form 1 filing, the Member is required to print a complete paper version of the Form 1. There is a date stamp denoted on each page which corresponds to the electronic submission date and time. Two qualified individuals must sign the paper copy of the Certificate of Partners or Directors. Qualified individuals are listed in the Notes and Instructions to the Certificate of Partners or Directors. For monthly unaudited Form 1 filings, Members do not have to submit a copy of the signed Certificate of Partners or Directors to the MFDA. However, Members must retain the signed Form 1 package in paper format so that MFDA staff are able to assess compliance with MFDA By-laws, Rules, Policies and Forms.

Late Filings

In the event a Form 1 is not electronically filed with the MFDA by the filing deadline, late filing penalties will be levied. The MFDA's filing deadlines and late filing penalties are published annually in a MFDA Bulletin.

MFDA Rule 3.5.4(b) provides for the levy of fines or assessments for the failure of a Member or its auditor to file any financial information required by the MFDA. As of December 1, 2003, the MFDA started imposing fees for the late filing of financial information, as detailed in MFDA Staff Notice MSN-0021. The late filing fees are:

- $250 per business day for the annual audited Form 1.
- $100 per business day for the monthly unaudited Form 1.
- $100 per business day for any other form or report requested by the MFDA.

If a Member does not submit a Form 1 by the specified due date, the Member will be contacted to determine the reason for the delay and to assess appropriate action that is required by the MFDA. If the monthly unaudited Form 1 filing is not submitted to the MFDA within five business days following the due date, the Member may be designated in discretionary early warning under MFDA Rule 3.4.2, placed with restrictions under MFDA Rule 3.4.3, or referred to the MFDA Enforcement department for further course of action. All early warnings are reported to the respective provincial securities regulatory authorities and MFDA IPC.

Purpose of RAC

In order to monitor the financial viability of mutual fund dealers, the MFDA has adopted a risk adjusted capital calculation, also known as the "capital formula". RAC is derived from the Member's working capital and is the primary means of financial reporting to the MFDA. RAC is a measure of the Member's liquidity and its ability to withstand any adverse fluctuations in operations. In addition to a minimum amount of capital required by MFDA rules, certain provisions or "cushions" are taken into consideration in order to assess the Member's capacity to manage its obligations and protect its clients. The capital formula seeks to assess the Member's ability to continue as a going concern.

Responsibility to Calculate RAC

In accordance with MFDA Rule 3.1.1, it is the responsibility of all Members to continuously monitor and evaluate its capital to ensure RAC is positive at all times. In addition, MFDA Rule 3.2.2 requires that Members maintain positive financial statement capital, defined as shareholders equity plus subordinated debt.

MFDA Policy No. 4, Internal Control Policy Statement 2, requires that Members designate a person, such as a Chief Financial Officer or equivalent, to calculate RAC on at least a monthly basis. A more frequent basis may be required if a Member's business operations warrant such monitoring. In the event of RAC deficiency, the Member must take prompt action to remedy any deficiencies and report such occurrences immediately to the MFDA.

How to Calculate RAC

The calculation of RAC is determined in the Form 1, which encompasses the following statements and schedules:

Statement A	Statement of Financial Position
Statement B	Statement of Risk Adjusted Capital
Statement C	Statement of Early Warning Excess
Statement D	Statement of Income and Comprehensive Income
Statement E	Statement of Changes in Capital and Retained Earnings (Corporations) or Undivided Profits (Partnerships)
Statement F	Statement of Changes in Subordinated Loans
Schedule 1	Analysis of Securities Owned and Sold Short at Market Value
Schedule 2	Analysis of Clients' Debit Balances
Schedule 3	Current Income Taxes
Schedule 4	Insurance
Schedule 5	Early Warning Tests
Schedule 6	Other Supplementary Information

Each statement and schedule is outlined and discussed in detail in the following chapters of this reference manual. In addition, any applicable rules and amendments relating to the Form 1 are included. Members are cautioned that the current versions of MFDA By-laws, Rules, Policies and Forms should be used as final references, as they are updated regularly and may have changed since the preparation of this reference manual.

CHAPTER 3 – CERTIFICATE OF PARTNERS OR DIRECTORS

The Certificate of Partners or Directors represents the Member's management's responsibility for the contents of the Form 1.

FORM 1 – CERTIFICATE OF PARTNERS OR DIRECTORS

____
(Member Name)

I/We have examined the attached statements and schedules and certify that, to the best of my/our knowledge, they present fairly the financial position and capital of the Member at ___________________________ (Member) and the results of operations for the period then ended, and are in agreement with the books of the Member.

I/We certify that the following information is true and correct to the best of my/our knowledge for the period from the last audit to the date of the attached statements which have been prepared in accordance with the current requirements of the Corporation:

ANSWERS

1. Do the attached statements fully disclose all assets and liabilities including the following:
   - (a) All future purchase and sales commitments? ________
   - (b) Writs issued against the Member or partners or any other litigation pending? ________
   - (c) Income tax arrears? ________
   - (d) Other contingent liabilities, guarantees, accommodation, endorsements or commitments affecting the financial position of the Member? ________
2. Does the Member promptly segregate clients' cash and securities in accordance with the Rules and Policies? ________
3. Does the Member determine on a regular basis its segregation amount and act promptly to segregate assets as appropriate in accordance with the Rules and Policies? ________
4. Does the Member carry insurance of the type and in the amount required by the Rules and Policies? ________
5. Does the Member monitor on a regular basis its adherence to early warning requirements in accordance with the Rules and Policies? ________
6. Does the Member perform regular reconciliations of its trust accounts in accordance with the Rules and Policies? ________
7. Does the Member perform regular reconciliations of its transactions with fund company and other financial institution records in accordance with the Rules and Policies? ________
8. Does the Member have adequate internal controls in accordance with the Rules and Policies? ________
9. Does the Member maintain adequate books and records in accordance with the Rules and Policies? ________

____
[date]

Name and Title - Please print	Signature

The answers to the questions require qualified signatories of the Member to disclose all pertinent information to ensure that the Form 1 has been prepared in accordance with MFDA Rules, By-laws, Policies and Forms. Qualified signatories are responsible to certify only to the best of their knowledge, yet in instances where the signatories rely on information provided by other Member staff, there is an expectation that a reasonable amount of due diligence has been performed to gain comfort in the validity of the information relied upon. Qualified signatories include the Ultimate Designated Person, Chief Executive Officer, Chief Financial Officer, Chief Accountant, and one Director or Partner who is not any of the aforementioned. Where there is only one individual that meets the qualifications of the positions listed above, this individual must sign the Certificate of Partners or Directors.

Special consideration should be given to the Member's reliance on service providers and the outsourcing of certain functions. A Member that engages outside service providers must ensure that the outsourced services meet all applicable regulatory requirements. The Member must exercise due care, skill and diligence in the selection of any service provider to ensure that the service provider has the ability and capacity to effectively undertake the outsourced services. In addition, procedures for monitoring the performance of the third-party service provider on an ongoing basis should be established to ensure that services continue to be performed in compliance with all applicable regulatory requirements. (Refer to MFDA Staff Notices MSN-0044 and MSN-0061 for further information about Members' obligations regarding service providers and outsourcing.)

For all Level 3 and 4 dealers, all questions on the Certificate of Partners or Directors must be answered either "Yes" or "No", as the Member has the ability to hold cash and/or securities on behalf of clients. Details must be provided for all "No" responses.

For all Level 1 and 2 dealers, questions #2, 3 and 6 may be answered "N/A", as the Member is not authorized to accept and hold client cash in a trust account or securities on behalf of clients. All other questions must be answered either "Yes" or "No". Details must be provided for all "No" responses.

As described in MFDA Bulletin #104-C, the signed Certificate of Partners or Directors does not have to be submitted to the MFDA. Instead, immediately following the electronic submission of the Form 1, the Member is required to print a complete paper version of the Form 1. Each page in the Form 1 package, *including the signed Certificate of Partners or Directors*, must have a date stamp that coincides with the time of the electronic filing. The signed Form 1 package must then be retained in paper format by the Member in accordance with MFDA Rule 5.6 and made available upon request by the MFDA.

CHAPTER 4 – STATEMENT OF FINANCIAL POSITION {STATEMENT A}

This statement is equivalent to a balance sheet with categorization of line items that are prepared in accordance with the Notes and Instructions to the Form 1.

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. On Statement A, allowable assets are divided into two sections: liquid assets and other allowable assets.

Liquid Assets

	LIQUID ASSETS:	
1.		Cash on deposit with acceptable institutions
2.		Client funds held in trust with acceptable institutions
3.	Sch.1	Securities owned at market value
4.		Receivable from carrying dealer or mutual fund
5.		Trading balances
6.		TOTAL LIQUID ASSETS

Line A1 – Cash on Deposit with Acceptable Institutions

Line A1 includes reconciled operating cash balances that are held at AIs, such as Canadian banks, trust companies and credit unions. Each bank account is required to be reconciled timely, in writing, and on a monthly basis. Senior personnel are responsible for reviewing and approving all bank reconciliations.

Line A2 – Client Funds Held in Trust with Acceptable Institutions

Line A2 includes reconciled client cash balances in trust accounts that are held at AIs, such as Canadian banks, trust companies and credit unions. Client cash balances must be operated in accordance with MFDA Rule 3.3.2. In accordance with MFDA Rule 3.3.2(d), each financial institution must be advised in writing that:

(i) the account is established for the purpose of holding client funds in trust and the account shall be designated as a “trust account”;
(ii) money may not be withdrawn, including by way of electronic transfers, by any person other than authorized employees of the Member; and
(iii) the money held in trust may not be used to cover shortfalls in any other accounts of the Member.

Each trust account is required to be reconciled at least monthly, in writing. MFDA Policy No. 4, Internal Control Policy Statement 4, requires that deposits to the trust account be balanced daily against deposit records, receivable records and mutual fund settlement records.

MFDA Rule 3.3.2(c) requires that the Member, in the event of a deficiency in the amount of cash required to be held in trust for a client, immediately provide from its own funds an amount necessary to correct the deficiency and any unsatisfied obligation to do so to be immediately charged to the capital of the Member. This includes deficiencies in the trust account resulting from client NSF cheques.

Member firms normally hold client cash in interest-bearing trust accounts. In accordance with MFDA Rule 3.3.2(e), the Member must disclose to clients whether interest will be paid on the cash held in trust and, if so, the rate that will be earned. Notwithstanding this requirement, the Member may retain the interest earned in excess of the amount of interest payable to the client. The Member may only revise the rate of interest upon the delivery of at least 60 days' written notice to the client. (Refer to MFDA Staff Notice MSN-0080 for further information about the payment of interest.)

Line A3 – Securities Owned at Market Value

Line A3 includes the market value of investments held by the Member as its own assets (i.e. proprietary property). This line is derived from Schedule 1 of the Form 1. (Refer to Chapter 10 for further information about Schedule 1.)

The Member is required to hold its investments at an ASL. (Refer to Appendix 1 for the definition of ASL.) The location where the securities or other investment products are held must be one of the entities listed as an ASL in the General Notes and Definitions to the Form 1 and:

- (i) all mutual fund companies and financial institutions where proprietary or other investment products are held for the Member must enter into the prescribed Custodial Agreement with the MFDA; or
- (ii) the Member must enter into a written custodial agreement with an AE where proprietary or other investment products are held. The custodial agreement must contain the provision outlined in MFDA Rule 3.3.3(b).

(Refer to Appendix 2 for the standard custodial agreements.)

A list of all executed custodial agreements with the MFDA is published on a regular basis on the MFDA's website. If the mutual fund company or financial institution where assets are held for the Member is named on this list, the Member can conclude that the assets are held at an ASL.

If the investments are not held at an ASL, the Member must report 100% of the market value of the investments on Statement B line 12.

Investments are to be valued and reported at "market value of securities". (Refer to Appendix 1 for the definition of market value of securities.) This is a prescribed IFRS departure listed in the General Notes and Definitions to the Form 1.

The Member must categorize all investment positions as "held-for-trading" financial instruments. This is a prescribed accounting treatment listed in the General Notes and Definitions to the Form 1. The investment positions must be marked-to-market. Because the MFDA does not permit the use of "available for sale" and "held-to-maturity" categories, a Member must not include OCI and will not have a corresponding reserve account relating to the marking-to-market of available for sale investment positions.

Another prescribed accounting treatment is that hedge accounting is not permitted for regulatory reporting purposes. All investment positions of a Member must be marked-to-market at the reporting date. Gains or losses of the hedge positions must not be deferred to a future point in time.

Line A4 – Receivable from Carrying Dealer or Mutual Fund

Line A4 includes commissions, trailer fees and other fees due from mutual fund companies or carrying dealers as at trade date.

For any gross commissions or fees receivable reported on Lines A10 or A20, the salesperson's portion may be classified as an allowable asset on Line A4 if there is a written agreement that the Member does not have a liability to pay the salesperson's portion until the gross commissions or fees are received. The Member's portion of the gross commissions or fees receivable would continue to be reported on Lines A10 or A20.

Line A5 – Trading Balances

Line A5 includes other trade-related balances that do not necessarily fit into classification on Line A4, such as amounts owed to the Member for the sale or redemption of nominee name client securities.

When reporting trading balances relating to Member and client securities and other investment transactions, the MFDA allows the netting of receivables from and payables to the same counterparty. This is a prescribed IFRS departure listed in the General Notes and Definitions to the Form 1.

Other Allowable Assets

	OTHER ALLOWABLE ASSETS *[Receivables from Acceptable Entities]*:	
7.		Interest and dividends receivable
8.	Sch.3	Current income tax assets
9.		Recoverable and overpaid taxes
10.		Other receivables *[provide details]*
11.		TOTAL OTHER ALLOWABLE ASSETS
12.		TOTAL ALLOWABLE ASSETS *[line 6 plus line 11]*

This section should only include receivables from AEs. (Refer to Appendix 1 for the definition of AE.)

Line A7 – Interest and Dividends Receivable

Line A7 includes interest and dividends receivable from AEs, such as Canadian banks, the Government of Canada, and corporations with a minimum net worth of $75 million at their last audited statement of financial position.

Note that interest receivable on investments held by the Member as its own assets (i.e. proprietary property) should be reported on Schedule 1 of the Form 1.

Line A8 – Current Income Tax Assets

Line A8 includes only overpayment of prior years' income taxes or current year tax 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 is derived from Schedule 3 of the Form 1.

Line A9 – Recoverable and Overpaid Taxes

Line A9 includes receivables relating to GST, HST, capital tax, Part IV tax and property tax.

Line A10 – Other Receivables

Line A10 includes amounts due from AEs, such as banks, insurance companies and segregated fund companies. For example, GIC commissions receivable from financial institutions would be reported on Line A10.

Non-Allowable Assets

		NON ALLOWABLE ASSETS:
13.	Sch.2	Client debit balances
14.		Deferred tax assets
15.		Intangible assets
16.		Property, plant and equipment
17.		Finance lease assets
18.		Due from related parties *[provide details]*
19.		Investments in subsidiaries and affiliates
20.		Other assets *[provide details]*
21.		TOTAL NON ALLOWABLE ASSETS
22.		TOTAL ASSETS *[line 12 plus line 21]*

Non-allowable assets mean those assets that do not qualify as allowable assets. Generally, non-allowable assets include items that are not readily convertible into cash. Also, receivables due from non-creditworthy counterparties and/or where collection is not assured would be considered non-allowable assets.

Line A13 – Client Debit Balances

Line A13 is the sum of advanced redemption proceeds receivable and other client receivables in registered and non-registered accounts. This line is derived from Schedule 2 of the Form 1.

Advanced redemption proceeds are receivables from clients relating to mutual fund redemption proceeds that are advanced to the clients prior to actual trade settlement. Pursuant to MFDA Rule 3.2.3(c), the Member should not advance the monies to the clients unless the clients have authorized payment to and retention by the Member of the redemption proceeds.

With the exception of advanced redemption proceeds, MFDA Rule 3.2.1 prohibits Members from lending or extending credit to clients. Member firms should be aware of inadvertently lending or extending credit to clients when trades have settled, but client cheques are declared NSF and replacement cheques are not received within a timely manner.

Line A14 – Deferred Tax Assets

Line A14 represents a Member's deferred tax asset balance.

Line A15 – Intangible Assets

Line A15 includes such items as goodwill and client lists. Start-up and organizational costs cannot be capitalized.

Line A16 – Property, Plant and Equipment

Line A16 represents the net book value of the Member's property, plant and equipment, which must be amortized in accordance with IFRS.

Line A17 – Finance Lease Assets

Line A17 includes assets arising from finance leases (also known as capitalized leases).

Line A18 – Due from Related Parties

Line A18 includes receivable balances from related parties, such as advances.

Trading-related inter-company receivables can be reported as allowable assets if the criteria for such reporting is otherwise satisfied.

Non-trading inter-company receivables must be reported on a gross basis unless the criteria for netting under IFRS are met.

Inter-company accounts are required to be reconciled to the related entity's books and records on a monthly basis and reviewed and approved by senior personnel.

Where a MFDA Member performs services for a related entity, a written agreement with the related entity documenting the nature and terms of the transactions is required by MFDA Rule 5.1. Where a related entity performs services for a MFDA Member, a written agreement between the related entity and the Member evidencing the material terms of the services is required under MFDA Rule 1.1.3. In general, Members that engage outside service providers must ensure that the outsourced services meet all applicable regulatory requirements. Members must exercise due care, skill and diligence in the selection of any service provider to ensure that the service provider has the ability and capacity to effectively undertake the outsourced services. In addition, procedures for monitoring the performance of the third-party service provider on an ongoing basis should be established to ensure that services continue to be performed in compliance with all applicable regulatory requirements. (Refer to MFDA Staff Notices MSN-0044 and MSN-0061 for further information about Members' obligations regarding service providers and outsourcing.)

A Member may be related to another MFDA Member if the definition of "related Member" in MFDA By-law No. 1 is met. All related Members are required under MFDA Rule 3.2.4 to guarantee obligations to clients incurred by each related Member and execute a standard Uniform Guarantee Agreement. (Refer to Appendix 3 for the standard Uniform Guarantee Agreement.) Once the agreement is executed, a Member is guaranteeing a percentage of its regulatory capital to cover obligations to clients incurred by its related MFDA Member. The amount of the guarantee provided is dependent upon the ownership interest of each Member, as detailed in MFDA Rule 3.2.4(a).

Line A19 – Investments in Subsidiaries and Affiliates

Line A19 includes the Member's investment in related entities. Investments in subsidiaries and affiliates must be valued at cost. This is a prescribed accounting treatment listed in the General Notes and Definitions to the Form 1.

Line A20 – Other Assets

Line A20 includes receivables from non-acceptable entities, such as prepaid expenses, provincial contingency fund deposits, commissions and other receivables, cash surrender value of life insurance, and petty cash.

Current Liabilities

	CURRENT LIABILITIES:	
23.		Overdrafts and loans
24.	Sch.1	Securities sold short at market value
25.		Trust liabilities
26.		Trading balances
27.		Provisions
28.	Sch.3	Current income tax liabilities
29.		Variable compensation payable
30.		Bonuses payable
31.		Accounts payable and accrued expenses
32.		Other current liabilities *[provide details]*
33.		TOTAL CURRENT LIABILITIES

Current liabilities are deducted 100% in the determination of RAC.

Line A23 – Overdrafts and Loans

Line A23 represents overdrawn operating cash balances and loans payable on demand or within the year.

Line A24 – Securities Sold Short at Market Value

Line A24 includes the market value of investments sold short by the Member. This line is derived from Schedule 1 of the Form 1. (Refer to Chapter 10 for further information about Schedule 1.)

Line A25 – Trust Liabilities

Line A25 includes amounts owed by the Member to the fund companies and to clients.

The trust liabilities balance on Line A25 may differ from the trust assets balance on Line A2 due to the following:

- Client debit balances resulting from NSF cheques.
- Trustee fees from clients.
- Undistributed commissions.
- Operating money "floats" in the trust accounts to fund potential trust account deficiencies.

Line A26 – Trading Balances

Line A26 includes amounts owed by the Member for the purchase of nominee name client securities.

When reporting trading balances relating to Member and client securities and other investment transactions, the MFDA allows the netting of receivables from and payables to the same counterparty. This is a prescribed IFRS departure listed in the General Notes and Definitions to the Form 1.

Line A27 – Provisions

Line A27 includes the portion of provisions for legal and constructive obligations due within one year of the Form 1 date. Provisions should be specific, not general. A Member cannot hold provisions as a general reserve to be applied against some other unrelated expenditure.

Line A28 – Current Income Tax Liabilities

Line A28 includes taxes payable to the CRA. This line is derived from Schedule 3 of the Form 1.

Line A29 – Variable Compensation Payable

Line A29 includes sales commissions and trailer fees owing to salespersons due within one year of the Form 1 date. Commissions receivable from fund companies should not be netted against commissions payable to salespersons.

Line A30 – Bonuses Payable

Line A30 includes discretionary bonuses payable, and bonuses payable to shareholders due within one year of the Form 1 date.

Line A31 – Accounts Payable and Accrued Expenses

Line A31 includes operating amounts payable and due within one year of the Form 1 date. For example, trade payables to vendors, accruals for regulatory filing fees, and sales tax payable.

Line A32 – Other Current Liabilities

Line A32 includes all other current liabilities, excluding those reported on Lines A38, A39 and A40.

Non-Current Liabilities

	NON-CURRENT LIABILITIES:
34.	Provisions
35.	Deferred tax liabilities
36.	Other non-current liabilities *[provide details]*
37.	TOTAL NON-CURRENT LIABILITIES

Non-current liabilities are deducted at a rate of 10% in the determination of RAC.

Line A34 – Provisions

Line A34 includes the portion of provisions for legal and constructive obligations due outside of one year of the Form 1 date. Provisions should be specific, not general. A Member cannot hold provisions as a general reserve to be applied against some other unrelated expenditure.

Line A35 – Deferred Tax Liabilities

Line A35 represents a Member's deferred tax liability balance, which is considered non-current for regulatory reporting purposes.

Line A36 – Other Non-Current Liabilities

Line A36 includes all other non-current liabilities, excluding those reported on Lines A38, A39 and A40.

Where applicable to liabilities disclosed on Line A36, MFDA Rule 3.2.5 requires Members to notify the MFDA of any request by a creditor for accelerated payments over and above the payments required under an existing repayment schedule. The notification is intended to alert the MFDA of situations which may indicate a firm is experiencing financial difficulty.

Other Liabilities

	OTHER LIABILITIES		
38.		Finance leases and lease-related liabilities *[provide details]*
39.		Due to related parties *[provide details]*
40.	F-6	Subordinated loans
41.		TOTAL OTHER LIABILITIES
42		TOTAL LIABILITIES *[line 33 plus lines 37 plus 41]*

Line A38 – Finance Leases and Lease-Related Liabilities

Line A38 includes both the current and non-current portions of finance leases and lease-related liabilities. The intent is to be RAC neutral, since finance lease assets are classified as non-allowable, finance lease liabilities are not deducted from allowable assets on Statement B in the determination of RAC.

MFDA Rule 3.2.5 requires Members to notify the MFDA of any request by a creditor for accelerated payments over and above the payments required under an existing repayment schedule. The notification is intended to alert the MFDA of situations which may indicate a firm is experiencing financial difficulty.

Line A39 – Due to Related Parties

Line A39 includes liability balances with related parties. This liability balance is fully deducted on Line B4 in the determination of RAC.

Non-trading inter-company receivables must be reported on a gross basis unless the criteria for netting under IFRS are met.

Inter-company accounts are required to be reconciled to the related entity's books and records on a monthly basis and reviewed and approved by senior personnel.

Refer to "Line A18" in this chapter for information about service arrangements and related member guarantees.

Line A40 – Subordinated Loans

Line A40 includes cash injections into the Member by way of a subordinated loan and is classified as financial statement capital on the Form 1 if the standard SLA is executed in triplicate by all parties. The standard SLA must be executed by the lender, the Member firm, and the MFDA. (Refer to Appendix 4 for a standard SLA.)

The SLA subordinates the claims of the lender to all other creditors of the Member, including the Member's clients. This subordination allows the loan to be treated as capital by the Member because the loan cannot be repaid until higher-ranking creditors have already been paid in full, and the Member has to obtain written approval from the MFDA prior to any subordinated loan repayment being made.

Once the Member has entered into a subordinated loan arrangement, any increases or decreases to the subordinated loan must be approved by the MFDA in writing. (Refer to Chapter 9 for further information about subordinated loans.)

Subordinated loans are reported at face value on the Form 1.

Capital and Reserves

	CAPITAL AND RESERVES:	
43.	Stmt. E	Issued capital
44.	Stmt. E	Reserves
45.	Stmt. E	Retained earnings or undivided profits
46.		TOTAL CAPITAL
47.		TOTAL LIABILITIES AND CAPITAL *[line 42 plus line 46]*

Line A43 – Issued Capital

Line A43 includes share capital and share premium. The balance is derived from Statement E of the Form 1. (Refer to Chapter 8 for further information about issued capital.)

Line A44 – Reserves

Line A44 includes reserves, which are amounts set aside for future use, expense, loss or claim. The balance is derived from Statement E of the Form 1. (Refer to Chapter 8 for further information about reserves.)

Line A45 – Retained Earnings or Undivided Profits

Line A45 includes retained earnings, which represents the accumulated balance of income less losses arising from the operation of the business, after taking into account dividends and other direct charges or credits. The balance is derived from Statement E of the Form 1. (Refer to Chapter 8 for further information about issued capital.)

CHAPTER 5 – STATEMENT OF RISK ADJUSTED CAPITAL {STATEMENT B}

This statement calculates the Member's regulatory capital position as at the Form 1 date. A Member must have and maintain at all times RAC greater than zero.

RAC Subtotal

	LIQUID ASSETS:	
1.	A-12	Total Allowable Assets
2.	A-33	**Deduct:** Total Current Liabilities
3.		ALLOWABLE WORKING CAPITAL
4.	A-39	**Deduct:** Due to related parties
5.		ADJUSTED ALLOWABLE WORKING CAPITAL
6.		**Deduct:** Minimum capital
7.		SUBTOTAL
8.	A-37	**Deduct:** 10% of__________ Non-current liabilities
9.		SUBTOTAL

Line B1 – Total Allowable Assets

Line B1 is the carry forward balance from Line A12, which includes liquid assets and other allowable assets from AEs.

Line B2 – Total Current Liabilities

Line B2 is the carry forward balance from Line A33, which are the liabilities due within one year of the Form 1 date.

Line B3 – Allowable Working Capital

Line B3 is the difference between total allowable assets on Line A12 and total current liabilities on Line A33. Allowable working capital is a measure of the Member's liquidity.

Line B4 – Due to Related Parties

Line B4 is the carry forward balance from Line A39. For purposes of the capital calculation, all amounts owing to related parties must be reported as a deduction to RAC.

Line B5 – Adjusted Allowable Working Capital

Line B5 is the difference between allowable working capital on Line B3 and the due to related parties balance on line A39. Adjusted allowable working capital represents the Member's capital prior to deduction of the minimum capital cushion and any applicable margin requirements.

Line B6 – Minimum Capital

Line B6 is a prescribed amount established under MFDA Rule 3.1.1. It is deducted from adjusted allowable working capital (Line B5) as a basic minimum provision for the risk of operating as a mutual fund dealer. The minimum capital amount is dependent on the nature of the mutual fund dealer's operations. MFDA Rule 3.1.1 requires a Member to maintain minimum capital in the following amounts:

Dealer	*Minimum Capital*	*Description*
Level 1	$25,000	▪ A mutual fund dealer which does not hold client cash in a trust account and does not hold client securities or other property. ▪ A Level 1 dealer is an introducing dealer, is not a Level 2, 3 or 4 dealer, and is not otherwise registered in any other category of registration under securities legislation.
Level 2	$50,000	▪ A mutual fund dealer which does not hold client cash in a trust account and does not hold client securities or other property. ▪ Note that a Level 2 dealer that is also registered as an investment fund manager under securities legislation must maintain minimum capital of at least $100,000.
Level 3	$75,000	▪ A mutual fund dealer which holds client cash in a trust account, but does not hold client securities or other property. ▪ Note that a Level 3 dealer that is also registered as an investment fund manager under securities legislation must maintain minimum capital of at least $100,000.
Level 4	$200,000	▪ A mutual fund dealer which holds client cash, client securities, or other property. ▪ A Level 4 dealer includes carrying dealers and mutual fund dealers not designated as a Level 1, 2 or 3 dealer.

Line B8 – 10% of Total Non-Current Liabilities

Line B8 represents a risk-related deduction of 10% of total non-current liabilities (Line A37).

RAC – Margin Deductions

		Deduct: Margin required:
10.	Sch.1	Securities owned and sold short
11.	Sch.4	Financial institution bond deductible *[greatest under any clause]*
12.		Securities held at non-acceptable securities locations *[see note]*
13.		Guarantees *[provide details]*
14.		Unresolved differences in nominee name accounts
15.		Unresolved differences in trust accounts
16.		Other *[provide details]*
17.		TOTAL MARGIN REQUIRED *[lines 10 through 16]*
18.		RISK ADJUSTED CAPITAL *[line 9 minus line 17]*

Lines B10 to B16 represent regulatory provisions (i.e. "margin") deducted from Line B9 to arrive at the Member's RAC. The regulatory margin reported on the Form 1 is a measurement of risk. Margin is provided at varying rates intended to adjust for risks associated with the asset, liability or other item. The purpose of a margin is to protect against:

- Decrease in value of certain assets on the statement of financial position.
- Increase in value of certain liabilities on the statement of financial position.
- Certain risk exposures which the Member has assumed or accepted.

The components of the Form 1 margin requirements are discussed as follows:

Line B10 – Securities Owned and Sold Short

Line B10 represents margin on securities owned and sold short as calculated on Schedule 1 of the Form 1. (Refer to Chapter 10 for further information about Schedule 1). Securities owned and sold short reported on Lines A3 and A24, respectively, are stated at market value. The amount required to margin on these securities provides a capital cushion for any future adverse market fluctuations. Margin is calculated on each individual security position and summarized on Schedule 1 of the Form 1.

Line B11 – Financial Institution Bond Deductible

Line B11 represents the greatest deductible amount under any clause required to be maintained in the FIB, including any FIB policy riders in place because of MFDA requirements (e.g. Agent Rider). (Refer to Chapter 13 for further information about the insurance requirements.)

Line B12 – Securities Held at Non-Acceptable Securities Locations

A Member is required to hold its investments, and assets held on behalf of the clients but in the name of or under the control of the Member, at ASLs. (Refer to Appendix 1 for the definition of ASL.)

The Member is required by the General Notes and Definitions to the Form 1 to execute a custodial agreement with each security location where investments/securities are held. (Refer to Appendix 2 for the standard custodial agreements.) The custodial agreement must meet the minimum requirements of MFDA Rule 3.3.3(b), which outlines the terms and conditions upon which the securities are deposited.

If the security is not held at an ASL or the custodial agreement does not meet the requirements of MFDA Rule 3.3.3(b), the Member must report 100% of the market value of the securities on Line B12 as a deduction against its regulatory capital. 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.

Line B13 – Guarantees

If a Member is guaranteeing the liability of another party, the total amount of the guarantee must be provided for in the calculation of RAC. The Member should maintain and retain the details of the margin calculations for guarantees for review by MFDA staff.

Line B14 – Unresolved Differences in Nominee Name Accounts

A Level 4 dealer may hold property in nominee name. Nominee name assets include mutual funds, GICs, bonds, segregated funds, exempt securities and any other investment products that are held in the name of or under the control of the Member. This includes assets registered in the name of a trustee, whereby the Member acts as agent in a bare trustee relationship.

MFDA Policy No. 4, Internal Control Policy Statement 4, requires a Member that holds nominee name assets to reconcile its security positions with third party information on a monthly basis. An unreconciled short position occurs when the client records of the securities registered in nominee name exceed the positions registered in nominee name reported by the mutual fund company (i.e. the Member's books and records show a position for a client, but the mutual fund company's records show a lesser quantity for the same client). To the extent there is an unreconciled short position, the Member is required to provide margin on the difference. The amount of margin required is equal to the market value of the short position plus the applicable margin on the short position. (Note that the additional "applicable margin on the short position" reflects the risk of having to repurchase the investment from the issuer or the market.) If the deficiency has not been resolved within 30 days of being discovered, the Member shall immediately purchase the securities that are short.

Where a mutual fund company or financial institution does not provide a monthly statement or electronic file confirming all of the Member firm's 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.

Items are considered unresolved unless a journal entry to resolve the difference has been processed as of the due date of the Form 1. This does not include journal entries writing off the difference to profit or loss in the period subsequent to the date of the Form 1.

All reconciliations must be properly documented and made available for review by MFDA staff and the Member's auditor.

Line B15 – Unresolved Differences in Trust Accounts

MFDA Policy No. 4, Internal Control Policy Statement 4, requires all trust accounts to be reconciled in writing on a monthly basis. In other words, on a monthly basis, the Member is required to reconcile client funds reported on its back office trading system with the physical cash held in trust at the financial institution.

All reconciliations must be properly documented and made available for review by MFDA staff and the Member's auditor.

Line B16 – Other

Line B16 includes all margin requirements that cannot otherwise be categorized on Lines B10 to B15 (e.g. unresolved differences in operating bank accounts.) (Refer to "Line B14" in this chapter for further information about unresolved differences.)

Line B18 – Risk Adjusted Capital

Line B18 is the resulting balance representing RAC, which should never be less than zero. As stated in MFDA Rule 3.1.1, each Member shall have and maintain at all times RAC greater than zero. Furthermore, MFDA Rule 3.1.2 requires that the Member notify the MFDA immediately if RAC is less than zero.

MFDA Policy No. 4, Internal Control Policy Statement 2, requires that Members designate a person, such as a Chief Financial Officer or equivalent, to calculate RAC on at least a monthly basis. A more frequent basis may be required if a Member's business operations warrant such monitoring.

CHAPTER 6 – STATEMENT OF EARLY WARNING EXCESS {STATEMENT C}

This statement calculates the liquidity of the Member's capital position. The calculation forms part of the early warning system, which is designed to provide advanced warning of a Member encountering financial difficulties. The early warning system anticipates capital shortages and/or liquidity problems and encourages Members to build a capital cushion.

Early Warning Excess

1.	B-18	RISK ADJUSTED CAPITAL
		LIQUIDITY ITEMS
		DEDUCT:
2.	A-11	Total other allowable assets
		ADD:
3.	B-8	10% of Non-current liabilities
4.		EARLY WARNING EXCESS

Line C1 – Risk Adjusted Capital

Line C1 is the RAC balance from Line B18.

Line C2 – Other Allowable Assets

Line C2 is the total other allowable assets balance from Line A11. Total other allowable assets are deducted from RAC because the timing of these receivables is less certain and they may not be liquidated as fast as allowable assets in the event the Member experiences financial difficulties. Therefore, it is conservative to exclude these assets when determining the liquidity of the Member's capital position.

Line C3 – 10% of Non-Current Liabilities

Line C3 is the calculated balance from Line B8, which was initially deducted in the determination of RAC. The calculated balance is added back to RAC because non-current liabilities are not considered current obligations and can be used for financing purposes by the Member.

CHAPTER 7 – STATEMENT OF INCOME AND COMPREHENSIVE INCOME {STATEMENT D}

This statement represents changes in equity during a period, including profit and loss for the period and OCI. OCI captures certain gains and losses outside of net income. The categorization of line items is prepared in accordance with the Notes and Instructions to the Form 1.

Commission Revenue

COMMISSION REVENUE	
1.	Mutual Funds
2.	Segregated Funds
3.	Deposit Instruments
4.	Limited Partnerships
5.	Other securities *[provide details]*
6.	Insurance

Line D1 – Mutual Funds

Line D1 includes all gross commissions and trailer fees earned on mutual fund transactions.

Line D2 – Segregated Funds

Line D2 includes all gross commission and trailer fees earned from the sale of segregated funds.

Line D3 – Deposit Instruments

Line D3 includes all gross commission revenue resulting from the sale of deposit instruments.

Line D4 – Limited Partnerships

Line D4 includes all gross commission revenue resulting from the sale of limited partnerships.

Line D5 – Other Securities

Line D5 includes all gross commission revenue resulting from the sale of other securities, such as principle protected notes.

Line D6 – Insurance

Line D6 includes all gross commission revenue resulting from the sale of insurance products.

Other Revenue

OTHER REVENUE	
7.	Interest
8.	Fees from clients
9.	Management fees
10.	Referral fees
11.	Realized/unrealized gain (loss) on marketable securities
12.	Other *[provide details]*
13.	TOTAL REVENUE

Line D7 – Interest

Line D7 includes all interest revenue, such as interest earned from operating bank accounts and interest earned by the Member on its own investments.

Interest earned by the Member from holding client cash balances in trust should also be reported on this line. The related interest cost paid to clients should be reported on Line D18.

Line D8 – Fees from Clients

Line D8 includes any charges to clients that are not related to commissions or interest, such as portfolio service fees and RRSP fees.

Line D9 – Management Fees

Line D9 includes fund management fees and consulting fees charged to parties other than clients.

Line D10 – Referral Fees

Line D10 includes all fees earned as a result of referring clients to another entity for products or services. In accordance with MFDA Rule 2.4.2, referral fees must be recorded on the books and records of the Member.

Line D11 – Realized/Unrealized Gain (Loss) on Marketable Securities

Line D11 includes all trading profits or losses from principal trading activities and adjustment of marketable securities to market value. For example, if the Member holds a security that has appreciated in market value and the security has not been disposed as of the Form 1 date, the appreciation in value represents an unrealized gain and should be reported on Line D11.

Line D12 – Other Revenue

Line D12 includes foreign exchange profits or losses and all other revenue not reported on any other line of Statement D.

Expenses

EXPENSES	
14.	Variable compensation
15.	Commissions and fees paid to third parties
16.	Interest expense on subordinated debt
17.	Bad debt expense
18.	Financing costs
19.	Operating expenses
20.	Unusual items *[provide details]*
21.	Profit (loss) for the year from discontinued operations
22.	Profit (loss) for Early Warning test
23.	Income – Asset revaluation
24.	Expense – Asset revaluation
25.	Interest expense on internal subordinated debt
26.	Bonuses
27.	**Net income (loss) before income tax**
28. S-3(5)	Income tax expense (recovery)
29.	PROFIT (LOSS) FOR PERIOD

Line D14 –Variable Compensation

Line D14 includes commissions, bonuses and other variable compensation of a contractual nature, such as commission payouts to salespersons. All contractual bonuses should be accrued monthly. Discretionary bonuses should be reported separately on Line D26.

Line D15 – Commissions and Fees Paid to Third Parties

Line D15 includes payouts to other parties, such as fees paid as a result of clients being referred from another entity for products or services.

Line D16 – Interest Expense on Subordinated Debt

Line D16 includes all interest on external subordinated debt, as well as non-discretionary contractual interest on internal subordinated debt. The interest expense should be consistent with the interest rate and terms specified in the SLA.

Line D18 – Financing Costs

Interest earned by the Member from holding client cash balances in trust is reported on Line D7. The related interest cost paid to clients should be reported on Line D18.

Line D19 – Operating Expenses

Line D19 includes all operating expenses except those mentioned elsewhere. For example, rent, utilities, and marketing expenses.

Line D20 – Unusual Items

Line D20 includes items resulting from transactions or events that are not expected to occur frequently over several years, or do not typify normal business activities.

Discontinued operations, such as a branch closure, should be reported separately on Line D21.

Line D21 – Profit (Loss) for the Year from Discontinued Operations

Line D21 includes the profit or loss on discontinued operations for the year is on a pre-tax basis. The tax component is to be included as part of the income tax expense or recovery on Line D28.

A discontinued operation is a business component that has either been disposed or is classified as held for sale and represents (or is part of a plan to dispose) a separate significant line of business or geographical area of operations (e.g. a branch closure).

Line D22 – Profit (Loss) for Early Warning Test

Line D22 is the profit or loss balance used for the early warning profitability test. The balances in the current month and prior months are used in the "loss for current quarter" calculation on Schedule 5 of the Form 1.

Line D23 – Income – Asset Revaluation

When a Member uses the revaluation model for its intangible assets and property, plant and equipment, changes to the fair value may result in recognizing income after considering accumulated depreciation (or amortization) and OCI surplus.

Line D24 – Expense – Asset Revaluation

When a Member uses the revaluation model for its intangible assets and property, plant and equipment, changes to the fair value may result in recognizing expense after considering accumulated depreciation (or amortization) and OCI surplus.

Line D25 – Interest Expense on Internal Subordinated Debt

Line D25 includes interest expense on subordinated debt with related parties for which the interest charges can be waived if required.

Line D26 – Bonuses

Line D26 includes discretionary bonuses and all bonuses to shareholders in accordance with share ownership. These bonuses are in contrast to those reported on Line D14.

Line D28 –Income Tax Expense (Recovery)

Line D28 includes only income taxes and the tax component relating to the profit or loss on discontinued operations for the year. Realty and capital taxes should be included on Line D19.

Other Comprehensive Income

OTHER COMPREHENSIVE INCOME	
30.	Gain (loss) arising on revaluation of properties
31.	Actuarial gain (loss) on defined benefit pension plans
32.	Other comprehensive income for the period, net of tax *[Lines 30 plus 31]*
33.	**Total comprehensive income for the period** *[Lines 29 plus 32]*

For regulatory financial reporting, there are two acceptable sources of OCI:

(i) The use of the revaluation model for intangible assets and property, plant and equipment; and
(ii) Actuarial gain or loss on defined benefit pension plans.

There is no OCI reporting option regarding securities owned and sold short. All MFDA Members must categorize all investment positions as "held-for-trading" financial instruments, with the mark-to-market adjustment recorded as normal profit or loss on Line D11. This is a prescribed accounting treatment listed in the General Notes and Definitions to the Form 1. The "available for sale" and "held-to-maturity" categories are not permitted within the Form 1.

Line D30 – Gain (Loss) Arising on Revaluation of Properties

When a Member uses the revaluation model to re-measure its intangible assets and property, plant and equipment, changes to fair value may result in a change to shareholders' equity after considering accumulated depreciation (amortization) and income or expense from asset revaluation.

Line D31 – Actuarial Gain (Loss) on Defined Benefit Pension Plans

When a Member has a defined benefit pension plan and initially adopts a policy of recognizing actuarial gains and losses in full in OCI, the subsequent adjustments must be recognized in OCI.

CHAPTER 8 – STATEMENT OF CHANGES IN CAPITAL AND RETAINED EARNINGS (CORPORATIONS) OR UNDIVIDED PROFITS (PARTNERSHIPS) {STATEMENT E}

This statement is comprised of three sections: "Changes in Issued Capital", "Changes in Reserves", and "Changes in Retained Earnings".

Changes in Issued Capital

PART A. CHANGES IN ISSUED CAPITAL

		Notes	Share capital or Partnership capital	Share premium	Issued capital
			[a]	[b]	[c] = [a] + [b]
			C$	C$	C$
1	Beginning balance	–			
2	Increases (decreases) during the period *[provide details]*				
	(a)				
	(b)				
	(c)				
3	Ending balance	–			
					A 43

This section provides a continuity of the Member's issued capital.

Preferred Shares

Preferred shares that are retractable or redeemable at the option of the holder would normally be classified as a current liability for regulatory reporting purposes. However, the preferred shares may be classified as shareholders' capital if an Undertaking is submitted to the MFDA. (Refer to Appendix 6 for the standard Undertaking.) This is a prescribed IFRS departure listed in the General Notes and Definitions to the Form 1. The purpose of the Undertaking is to ensure the Member obtains prior written consent from the MFDA in respect of the following:

- Exercises any right to redeem, retract or require the repurchase of all or any of the preferred shares;
- Accepts any redemption, retraction, repurchase or other proceeds or return of capital in any manner in respect of all or any of the preferred shares; or
- Transfers all or any of the preferred shares to any other person.

Share Premium

Share premium represents the excess amount received by the Member over the par value (or nominal value) of the shares when the shares are sold (initial issuance or from treasury). Share premium cannot be used to pay out dividends.

Changes in Reserves

PART B. CHANGES IN RESERVES

		Notes	General	Properties revaluation	Employee benefits	Total reserves
			[a]	[b]	[c]	[d] = [a] + [b] + [c]
			C$	C$	C$	C$
4	Beginning balance	–				
5	Changes during the period					
	(a) Other comprehensive income for the period – properties revaluation (From D 30)		N/A		N/A	
	(b) Other comprehensive income for the period – actuarial gain (loss) on defined benefit pension plans (From D 31)		N/A	N/A		
	(c) Recognition of share-based payments (From D 19)		N/A	N/A		
	(d) Transfer from/to retained earnings (From/to E 12)			N/A	N/A	
	(e) Other *[provide details]*					
6	Ending balance	–				
						A 44

This section provides a continuity of the Member's reserve accounts.

General Reserve

The general reserve includes amounts set aside for future use, expense, or claim from retained earnings. The creation of a general reserve gives the Member an added measure of protection.

Properties Revaluation Reserve

The properties revaluation reserve includes accumulated changes from OCI if the revaluation model is chosen for intangibles and property, plant and equipment. When using the revaluation model for certain non-allowable assets, the Member will account for the initial increase in value as OCI and will accumulate the increase (and subsequent changes) in a revaluation reserve account.

Employee Benefits Reserve

An employee benefits reserve includes accumulated changes from OCI regarding defined benefit pension plans. When the Member has a defined benefit pension plan and initially adopts a policy of recognizing actuarial gains and losses in full in OCI, all subsequent adjustments must be recognized as OCI and will be accumulated in a reserve account.

The employee benefits reserve also includes the offset to expense regarding stock options or shares granted. When the Member has stock option or share awards granted to its employees by issuing new shares, the Member recognizes the fair value of the option or new shares granted as an expense with a corresponding increase in the reserve account.

Changes in Retained Earnings

PART C. CHANGES IN RETAINED EARNINGS

		Notes	Retained earnings (current year/month)	Retained earnings (previous year/month)
			C$	C$
7	Beginning balance	–		
8	Effect of change in accounting policy *[provide details]*			
	(a)		N/A	
	(b)		N/A	
9	As restated	–	N/A	
10	Payment of dividends or partners drawings			
11	Profit or loss for the period (From D 29)	–		
12	Other direct charges or credits to retained earnings *[provide details]*			
	(a)			
	(b)			
	(c)			
13	Ending balance	–		
			A 45	

This section provides a continuity of the Member's retained earnings. The beginning balance of the current period must be the ending balance of the prior period.

Line 8 – Effect of Change in Accounting Policy

This line is the amount for a change in accounting policy in the current year that requires retroactive adjustment of the prior year's retained earnings.

Line 10 – Payment of Dividends or Partners Drawings

This line is the amount of dividends paid (for corporations) or partners' drawings (for partnerships).

Chapter 9 – Statement of Changes in Subordinated Loans {Statement F}

This statement is an analysis of changes to subordinated loans which have been approved by the MFDA.

For the purpose of the Form 1, a subordinated loan is a legal agreement between a lender, a Member firm, and the MFDA, in which the lender is providing a loan to a MFDA member where repayment of the loan is subject to MFDA approval. Subordinated loans can be approved as a source of financial statement capital provided that the standard SLA has been executed. (Refer to Appendix 4 for a standard SLA.)

The SLA subordinates the claims of the lender to all other creditors of the Member, including clients. This subordination allows the loan to be treated as capital by the Member because the loan cannot be repaid until higher-ranking creditors have already been paid in full, and the Member has to obtain written approval from the MFDA prior to any subordinated loan repayment being made.

Changes to the subordinated loan must be approved by the MFDA in writing. Specifically, subordinated loan repayment requests will only be granted if the Member's financial condition would be sufficient subsequent to the repayment of the subordinated loan. Repayment of subordinated loans without MFDA approval is a violation of the SLA and may be referred to the MFDA Enforcement department.

1.	Balance at last period-end
2.	Increases during period *[give name of lender and date of increase]*
	(a)
	(b)
	(c)
	(d)
	(e)
	(f)
3.	Subtotal
4.	Decreases during period *[give name of lender and date of decrease]*
	(a)
	(b)
	(c)
	(d)
	(e)
	(f)
5.	Subtotal
6.	Present subordinated loans

Increases in Subordinated Loans

Line F2 – Increases During Period

Line F2 includes any increases in the Member's subordinated loan balance during the period. This line should include the name of the creditor, date of the increase and the amount of the increase. The Member must provide the MFDA with a new SLA for any increases to the subordinated loan balance. Note that the SLA must be formally executed by the MFDA prior to the Member reporting the loan as subordinated and, thus, as capital in the firm. In practice, sufficient lead-time should be considered for the MFDA to receive and analyze the requested increase prior to the Member's desired effective reporting date.

Decreases in Subordinated Loans

Line F4 – Decreases During Period

Line F4 includes any decreases in the Member's subordinated loan balance during the period. This line should include the name of the creditor, date of the decrease and the amount of the decrease. Prior written consent must be obtained from the MFDA before repaying a subordinated loan. In addition, the Member must provide the MFDA with a new SLA for any decreases to the subordinated loan balance. In practice, the Member should submit its written request to the MFDA, wait for formal approval from the MFDA, and then submit its new SLA to the MFDA for signatures.

CHAPTER 10 – ANALYSIS OF SECURITIES OWNED AND SOLD SHORT AT MARKET VALUE {SCHEDULE 1}

Investments held by Members are generally considered to be allowable assets, with a margin requirement to address the risk exposures of the underlying investments. The margin rates imposed on Member's investments are designed, as part of the capital formula, to quantify the risks associated with the specific types of investments.

Schedule 1 of the Form 1 categorizes the types of securities owned and sold short and calculates the applicable margin provisions required on the securities. (Refer to Appendix 5 for the standard margin rates.)

Investments are to be valued and reported at "market value". (Refer to Appendix 1 for the definition of market value of securities.) This is a prescribed IFRS departure listed in the General Notes and Definitions to the Form 1.

The Member must categorize all investment positions as "held-for-trading" financial instruments. This is a prescribed accounting treatment listed in the General Notes and Definitions to the Form 1. The security positions must be marked-to-market. Because the MFDA does not permit the use of "available for sale" and "held-to-maturity" categories, a Member must not include OCI and will not have a corresponding reserve account relating to the marking-to-market of available for sale security positions.

Another prescribed accounting treatment is that hedge accounting is not permitted for regulatory reporting purposes. All security and derivative positions of a Member must be marked-to-market at the reporting date. Gains or losses of the hedge positions must not be deferred to a future point in time.

Acceptable Securities Location

MFDA Rules require Members holding investment products beyond their physical possession to ensure the assets are held at an ASL. For an entity to be considered an ASL, it must be an entity listed in the General Notes and Definitions to the Form 1, and there must be a written custodial agreement in place with that entity. Members are required to deduct from its regulatory capital a margin amount equal to the market value of all assets held at the non-acceptable location(s). (Refer to Chapters 4 and 5 for further information about ASLs.)

Category	Notes	Market Value Long C$	Market Value Short C$	Margin required C$
1. Money market				
Accrued interest				NIL
TOTAL MONEY MARKET				
2. Money market mutual funds			NIL	
3. Mutual funds (other than money market mutual funds)			NIL	
4. Equities				
Accrued interest on convertible debentures				NIL
TOTAL EQUITIES				
5. Debt				
Accrued interest				NIL
TOTAL DEBT				
6. Other *[provide details]*				
Accrued interest				NIL
TOTAL OTHER				
7. TOTAL		A-3	A-24	B-10

Components of Schedule 1

Market Value – Long

This column represents the market value of investments owned and accrued interest, where applicable, as at the Form 1 date.

Market Value – Short

This column represents the market value of investments sold short and accrued interest, where applicable, as at the Form 1 date.

Margin Required

This column represents the provision against capital to be taken against the investments as a measurement of their risk. Margin is calculated in accordance with the rates specified in the Notes and Instructions to Schedule 1 of the Form 1. Note that margin is not required on accrued interest.

Line 1 – Money Market

This line includes instruments, such as treasury bills guaranteed by the Government of Canada, Bankers Acceptances, Commercial Paper, and GICs issued by a Canadian chartered bank.

Line 2 – Money Market Mutual Funds

This line includes money market mutual funds as defined by National Instrument 81-102. In general, money market mutual funds have all of their assets invested in cash, cash equivalents and/or indebtedness that mature in 365 days or less.

Line 3 – Mutual Funds

This line includes mutual funds (excluding money market mutual funds on Schedule 1 line 2) that are qualified by prospectus for sale in any province of Canada.

Line 4 – Equities

This line includes stocks, convertible debentures, rights and warrants listed on any recognized stock exchange in Canada or the United States.

Line 5 – Debt

This line includes debt instruments, such as those guaranteed by the Government of Canada, certain foreign governments, any province of Canada, and certain municipalities.

Line 6 – Other

This line includes all other types of investments, such as high interest savings accounts and exempt securities.

CHAPTER 11 – ANALYSIS OF CLIENTS' DEBIT BALANCES {SCHEDULE 2}

This schedule provides details on clients' debit balances that are receivable by the Member.

Line		Advanced Redemption Proceeds Receivable	Other Client Receivables	Client Debit Balances
		[a]	[b]	[c] = [a] + [b]
		C$	C$	C$
1.	Non – registered accounts			
2	RRSP and other registered accounts			
3	TOTAL			
				A-13

SUPPLEMENTARY DISCLOSURE:

NAME OF RRSP TRUSTEE(S)

1. ______________________________

2. ______________________________

3. ______________________________

4. ______________________________

Components of Schedule 2

Advanced Redemption Proceeds Receivable

This column represents receivables from clients relating to mutual fund redemption proceeds that are advanced to clients prior to actual trade settlement. Pursuant to MFDA Rule 3.2.3(c), the Member should not advance the monies to the clients unless the clients have authorized payment to and retention by the Member of the redemption proceeds.

With the exception of advanced redemption proceeds, MFDA Rule 3.2.1 prohibits Members from lending or extending credit to clients. Member firms should be aware of inadvertently lending or extending credit to clients when trades have settled, but client cheques are declared NSF and replacement cheques are not received within a timely manner.

Other Client Receivables

This column represents other receivables from clients, such as replacement cheques related to NSF cheques.

Supplementary Disclosure

This section should include disclosure of the name of the trustee for the Member's in-house RRSPs and the name of the financial institution at which RRSP cash is held, if different.

Requirement for CDIC or AMF (formerly QDIC) Insurance on RRSP or Similar Balances

According to the Notes and Instructions to Schedule 2, each Member must ensure that all cash held for its clients in these registered plans is insured by either the CDIC or the AMF. Consequently, client cash for registered plans must be held in trust at a financial institution that is covered by one of these deposit protection programs.

In order to ensure that CDIC or AMF maximum coverage is provided to each of the underlying clients with respect to their individual cash balances rather than to the Member in respect of its omnibus trust account at the financial institution, the Member must provide certain disclosures to the financial institution where the cash is held. In the case of CDIC insured accounts, once per year:

- (i) the name and address of each client holding funds in the trust account (which information can be reflected as alphanumeric codes) must be reported to the financial institution; and
- (ii) the amount or percentage of the deposit for each client must be included on the report.

In order to comply with this requirement, obtain the proper forms, and obtain information about the reporting deadlines, Members should discuss these matters directly with the financial institution where their client cash for registered plans is held. Furthermore, Members are encouraged to apply these same procedures to client cash held in trust for non-registered plans, so that the same coverage may be provided.

These disclosures are in addition to those required by MFDA Rule 3.3.2 with respect to client trust accounts which require written notice to the financial institution that:

- (i) the account is holding client funds in trust and should be designated as a trust account;
- (ii) money may not be withdrawn by any person other than authorized employees of the Member; and
- (iii) the money held in trust may not be used to cover shortfalls in any other accounts of the Member.

CHAPTER 12 – CURRENT INCOME TAXES {SCHEDULE 3}

This schedule provides an analysis of the Member's current income tax receivable/payable reported for the period.

		C$	C$
A.	**INCOME TAX LIABILITY (ASSET)**		
1.	Balance payable (recoverable) at last period-end		....
2.	(a) Payments (made) or received relating to above balance	----------------	
	(b) Adjustments, including reassessments, relating to prior periods *[provide details if significant]*	....	
3.	Total adjustment to prior periods' payable (recoverable) taxes during current period		____________
4.	Subtotal *[add or subtract line 3 from line 1]*		____________
5.	Income tax expense (recovery)	.... D-28	
6.	less: Current installments	....	
7.	Other adjustments *[provide details if significant]*	....	
8.	Total adjustment for current year's tax liabilities (assets)		____________
9.	TOTAL LIABILITY (ASSET) *[add or subtract line 8 from line 4]*		____________ A-8 -- if asset A-28 -- if liability

Components of Schedule 3

Line 2(a) – Payments (Made) or Received Relating to Above Balance

This line represents any current income tax payments/refunds made or received during the period.

Line 2(b) – Adjustments, Including Reassessments, Relating to Prior Periods

This line represents any prior period adjustments to the current income tax payable/recoverable balance resulting from reassessments by the CRA or provincial tax authorities.

Line 7 – Other Adjustments

This line represents other current tax adjustments.

CHAPTER 13 – INSURANCE {SCHEDULE 4}

The purpose of insurance coverage is to protect the assets of the Member and its clients from losses. Each Member is required by MFDA Rule 4.1 to keep in force insurance against losses by way of a FIB policy or policies (with a Discovery rider attached or provisions incorporated within the FIB). The FIB shall be underwritten by a qualified carrier pursuant to MFDA Rule 4.6. The MFDA requires that standard clauses and coverage amounts specify the terms and coverage limit as obtained from any qualified insurer. An aggregate limit coverage means that the actual insurance coverage should be reduced by the reported loss claim amount, if any, during the policy period. A FIB must have either a double aggregate limit or a provision for full reinstatement.

In addition, MFDA Policy No. 4, Internal Control Policy Statement 3, outlines the minimum internal controls that should be in place at the Member to effectively monitor its insurance needs.

Required Clauses

Each Member is required to maintain insurance against losses arising in the following clauses. The purpose of each clause is described as follows:

Clause (A) – Fidelity

This clause provides coverage for loss as a result of dishonest or fraudulent acts by employees or agents of the mutual fund dealer in conducting Member business.

Clause (B) – On Premises

This clause provides coverage for loss of cash and/or securities or other property resulting from events, such as robbery, burglary, theft, hold up, mysterious disappearance, damage or destruction while the property is within the Member’s office, the office of any banking institution, clearing house or recognized safe-deposit box locations.

Clause (C) – In Transit and Mail

This clause provides coverage for loss of property (similar to those events denoted in Clause (B)) while in transit in the custody of any employee or the messenger for the Member.

Clause (D) – Forgery or Alterations

This clause provides coverage for loss through forgery or alteration of cheques, drafts, promissory notes or other written instructions to pay sums in cash, excluding securities.

Clause (E) – Securities

This clause provides coverage for any loss resulting from the insured having purchased or acquired, sold or delivered or acted upon securities or other written instruments which prove to be forged, counterfeited, altered, lost or stolen.

Notice of Termination

Each FIB policy maintained by a Member is required by MFDA Rule 4.2 to contain a separate rider requiring the underwriter to notify the MFDA at least 30 days prior to the termination of the FIB, except in the event of: (a) expiration of the bond period; (b) written notice of intent to cancel the FIB by the insured; (c) the takeover of the insured by a receiver or other government assigned officials; and (d) upon the takeover of the insured by another entity.

At such time that the insured is to be taken over by another entity as denoted in MFDA Rule 4.3, the Member will ensure that there is bond coverage which covers a period of twelve months from the effective date of the takeover in which to discover any losses sustained by the Member prior to the effective date of the takeover.

Agent Rider

A Member may conduct its business by Approved Persons retained or contracted by it as agents provided that compliance with MFDA Rule 1.1.5 is maintained. An Approved Person is defined in MFDA By-law No. 1. In accordance with MFDA Rule 1.1.5(e), the FIB and insurance policies required to be maintained by the Member pursuant to MFDA Rule 4 must cover and relate to the conduct of the agent. This requirement is normally met by the addition of a standard Agent Rider to the FIB.

Global FIB

A FIB policy that names or benefits the Member together with any other person or entities as the insured is considered a global insurance policy. A Member that maintains a global insurance policy is required to include a separate rider to the FIB policy stating the following provisions of MFDA Rule 4.7:

(a) the Member shall have the right to claim directly against the insurer in respect of losses, and any payment or satisfaction of such losses shall be made directly to the Member; and

(b) the individual or aggregate limits under the policy may only be affected by claims made by or on behalf of
  - (i) the Member, or
  - (ii) any of the Member's subsidiaries whose financial results are consolidated with those of the Member, or

(iii) a holding company of the Member provided that the holding company does not carry on any business or own any investments other than its interest in the Member,

without regard to the claims, experience or any factor referable to any other person.

Components of Schedule 4

The primary functions of Schedule 4 of the Form 1 are to: (a) calculate the Member's minimum insurance coverage requirement; and (b) provide disclosure pertaining to FIB and mail policies and any relevant claims made against the FIB.

Part A. Financial Institution Bond (FIB) Clauses (A) to (E)

PART A. FINANCIAL INSTITUTION BOND (FIB) CLAUSES (A) TO (E)		C$
1. Minimum coverage required for each clause:		
LEVEL 1, 2 OR 3 DEALERS		
(a) Lesser of $50,000 per Approved Person or $200,000		_______
(b) Allowable assets (A-12)	$________ x 1%	_______
Greater of (a) and (b) above		═══
The actual coverage required for each clause is the greater of (a)and (b) above to a maximum requirement of $25,000,000.		
LEVEL 4 DEALERS		
(a) Minimum coverage of		$500,000
(b) Total client cash and securities held by the Member	$________ x 1%	_______
(c) Allowable assets (A-12)	$________ x 1%	_______
Greater of (a), (b) and (c) above		═══
The actual coverage required for each clause is the greater of (a), (b) and (c) above to a maximum requirement of $25,000,000.		
2. Coverage maintained per FIB		_______
3. Excess / (Deficiency) in coverage		═══
4. Amount deductible under FIB (*greatest under any clause)*		═══
		B-11

Line 1 – Minimum Coverage Required for Each Clause

This section calculates the minimum FIB coverage required for Level 1, 2, 3 and 4 dealers.

Level 1, 2 or 3 Dealers

The minimum coverage for Level 1, 2 or 3 dealers is calculated as the greater of (a) and (b), as follows:

(a) Lesser of $50,000 per Approved Person or $200,000
(b) 1% of the Member's allowable assets as reported on Line A12

Note: An Approved Person is defined in MFDA By-law No. 1.

Level 4 Dealers

The minimum coverage required for Level 4 dealers is calculated as the greatest of (a), (b) and (c), as follows:

(a) Minimum coverage of $500,000
(b) 1% of total client cash and securities held by the Member
(c) 1% of the Member's allowable assets as reported on Line A12

Note: "Total client cash and securities held by the Member" should include all cash held in trust on Line A2.

The maximum FIB coverage required for Level 1, 2, 3 and 4 dealers is $25,000,000.

Line 2 - Coverage Maintained per FIB

This line denotes the lowest required insurance coverage reported on the Member's FIB policy.

Line 3 – Excess/(Deficiency) in Coverage

This line is the difference between the minimum coverage required as calculated in section 1 and the actual coverage maintained by the Member, as described above. Pursuant to MFDA Rule 4.5(b), if the Member experiences insufficient insurance coverage that does not exceed 10% of the insurance requirement, the Member must rectify the insurance deficiency within two months of the completion of the Form 1. If the insufficient insurance coverage is 10% or more of the insurance requirement, the Member must immediately notify the MFDA and correct the matter within ten days.

Line 4 – Amount Deductible under FIB

This line is the highest required deductible amount reported in the Member's FIB policy, including all applicable riders (e.g. Agent Rider).

Part B. Registered Mail Insurance

PART B. REGISTERED MAIL INSURANCE	
1. Coverage per mail policy	

This section discloses the registered mail insurance coverage based on the Member's registered mail policy. A Member is not required to effect and keep in force mail coverage where the Member does not use mail for outgoing shipments of cash, securities or other property, negotiable or non-negotiable. If required, such insurance must provide at least 100% coverage.

Part C. FIB and Registered Mail Policy Information

PART C. FIB AND REGISTERED MAIL POLICY INFORMATION *[Note 8]*

Insurance Company	Name of the Insured	FIB/ Registered Mail	Expiry Date	Coverage	Premium

This section discloses information relating to the insurer, name of the insured, policy expiry date, coverage and the applicable premium.

Part D. Losses and Claims

PART D. LOSSES AND CLAIMS *[Note 9]*

Date of Loss	Date of Discovery	Amount of Loss	Deductible Applying to Loss	Description	Claim Made?	Settlement	Date Settled

This section includes details of any losses and claims incurred by the Member including the date of loss, the date of discovery, the loss amount, the deductible applied towards the loss, the description of the claim, the settlement amount, and the date that claim was settled. All losses should be reported until settled, including those losses less than the amount of the deductible.

CHAPTER 14 – EARLY WARNING TESTS {SCHEDULE 5}

This schedule illustrates the results of the four early warning tests based on the financial condition of the Member.

		C$	Early Warning
	A. CAPITAL DEFICIENCY		
B-18	**Is RAC less than 0?**		YES/NO
	B. LIQUIDITY TEST		
C-4	**Is Early Warning Excess less than 0?**		YES/NO
	C. PROFITABILITY TEST *[note 3]*		
	1. Loss for current quarter		
B-18	2. RAC *[at questionnaire date]*		
	Is line 2 less than line 1?		YES/NO
	D. FREQUENCY PENALTY		
	Has the Member triggered Early Warning more than 2 times in the past 12 months?		YES/NO

The early warning system employs four tests designed to provide advanced warning of a Member encountering financial difficulties. The early warning system anticipates capital shortages, liquidity issues, and/or profitability issues. The four early warning tests measure the Member's capital, profitability, and liquidity positions, in addition to the frequency with which the Member triggers the early warning tests. A Member would be considered in early warning if any one of the following conditions applies:

- RAC is less than zero (Capital Deficiency Test).
- Early Warning Excess is less than zero (Liquidity Test).
- RAC is less than the net operating loss for the most recent three months (Profitability Test).
- The Member has been designated in early warning more than two times in the preceding twelve months (Frequency Test).
- If, at the discretion of the MFDA, the condition of the Member is not satisfactory (e.g. financial difficulties, inadequate books and records, late Form 1 filings).

In the calculation of the loss for the current quarter reported on line 1 of Part C, only the summation of the balances reported on Line D22 of the current month and the immediate preceding two months should be reported. A net loss for the three months would be reported in absolute value terms and a net profit for the three months would be reported as zero.

For the monthly unaudited filings, the loss for current quarter calculation is automatically generated by EFS. However, note that any manual filings (i.e. non-EFS filings) will not be taken into consideration, so a separate calculation by the Member may be necessary to reflect the proper total.

For the annual audited filings, the loss for current quarter calculation is not automatically generated by EFS, since any year-end adjustments reported on Statement D should also be included in the total. Members must calculate the loss for the current quarter separately and input the ending balance on line 1 of Part C in the annual audited Form 1.

Early Warning System - MFDA Rule 3.4.2

The early warning tests encourage the Members to maintain a capital cushion that is sufficient and commensurate with their business operations.

In the event a Member is designated in early warning, the Member is required to communicate to the MFDA, in writing, the following:

(A) advise the specific early warning test(s) that has/have been triggered;
(B) provide an explanation on the problems that have triggered the early warning test(s);
(C) provide a detailed proposal to rectify the problems; and
(D) acknowledge the fact that the Member is in early warning and the Member adheres to the restrictions contained in MFDA Rule 3.4.2(b)(iv).

The MFDA will send a letter confirming that the Member is designated in early warning pursuant to MFDA Rule 3.4 and all the requirements of MFDA Rule 3.4.2 apply, including the restrictions under MFDA Rule 3.4.2(b)(iv). The restrictions are such that the Member shall not perform the following without the prior written consent of the MFDA:

(A) reduce its capital in any manner (e.g. through redemption, repurchase or cancellation of the shares);
(B) reduce or repay the subordinated loan;
(C) make payments through loan, advance, bonus, dividend, capital repayment or distribution of assets directly or indirectly to director, officer, partner, shareholder, related company, affiliate or associate; and
(D) increase its non-allowable assets unless a prior binding commitment is in place.

The underlying purpose of MFDA Rule 3.4.2(b)(iv) is to preserve the Member's capital while the MFDA has concerns over the financial condition of the Member. This requirement assists in preventing the Member's financial position from deteriorating any further. If the Member violates one of the restrictions listed under MFDA Rule 3.4.2(b)(iv) without first obtaining written approval from the MFDA, the matter may be referred to the MFDA Enforcement department for consideration.

Upon receiving the letter from the MFDA, the Member must respond in writing within five business days of receipt of the letter, with a copy to be sent to the auditor of the Member, containing information and acknowledgement and any updated information if circumstances or facts have changed.

The Member's response, together with the letter from the MFDA, may be forwarded to MFDA IPC and the relevant provincial securities regulatory authorities.

While the Member remains designated in early warning, the Member is required to submit its monthly Form 1 to the MFDA no later than 15 business days after the month-end pursuant to MFDA Rule 3.4.2(b)(ii)(B).

Additional Early Warning Restrictions - MFDA Rule 3.4.3

Pursuant to MFDA Rule 3.4.3, at the discretion of the MFDA, additional restrictions may be imposed. The Member may be prohibited from opening new branch offices, hiring new salespersons, opening new client accounts or changing the investment positions of the Member.

The Member may face additional restrictions if any of the following conditions exist:

- Significant or on-going capital deficiency.
- Significant concerns over a business combination or reorganization.
- Failure to submit financial reports/information.
- Other conditions causing significant concerns over the Member's continued business operations.

Duration

The Member shall remain designated in early warning, until the latest filed monthly Form 1 or other supporting documentation demonstrate, in the opinion of the MFDA, that the Member is no longer required to be designated in early warning.

Other Remedies

Under Section 24.3 of By-law No. 1, the MFDA has the ability to be heard before a Hearing Panel for suspension a Member's rights and privileges of membership where it appears that the Member has breached a By-law, Rule or Policy and such breach is likely to result in financial loss to the public.

CHAPTER 15 – OTHER SUPPLEMENTARY INFORMATION {SCHEDULE 6}

This schedule provides operational data to the MFDA and is submitted with the Member's monthly unaudited Form 1 filings. The schedule is not required at the audit date.

1.	Number of salespersons		
	(a)	Registered only in Quebec	_____
	(b)	Registered outside Quebec	_____
	Total		_____
			C$
2.	Assets Under Administration at statement date		_____

Components of Schedule 6

Line 1 – Number of Salespersons

Line 1 consists of the number of Approved Persons who are engaged in selling activities. This would include licensed assistants, trading partners/directors/officers registered to the Member firm, and sales representatives who have direct dealings with clients.

Line 2 – Assets Under Administration at Statement Date

Line 2 represents the market value of all mutual funds reflected in the client accounts (nominee name and client name) of the Member in all provinces of Canada, excluding Quebec.

The AUA of non-resident clients should also be included on this line, as the Member firm is providing some service to the clients, whether it be advice, periodic client statements, or other back-office support.

CHAPTER 16 – AUDITOR'S WORKING PAPER REVIEW

Background

When a mutual fund dealer applies for MFDA membership, the engagement partner of a Member firm must sign a Letter of Acknowledgement - Schedule H.1 of the MFDA Membership Application Guide. The Letter of Acknowledgement confirms the engagement partner is familiar with MFDA Rules, By-laws, Policies and Forms as they relate to the audit procedures to be performed by the external auditor. (Refer to Appendix 7 for a standard Letter of Acknowledgment.)

All annual audited Form 1s require electronic approval from the Member's auditor via EFS in addition to the Member's approval. The Member's auditor should obtain an auditor username and password to EFS from the MFDA. This information will be provided directly to the Member's auditor upon receipt of the Letter of Acknowledgement and/or direct authorization from a responsible person of the Member. The annual audited Form 1 will only be eligible for electronic submission after both the Member and the Member's auditor have approved the same Form 1. A Member's annual audited Form 1 is subject to an initial desk review by the Financial Compliance department. The desk review, in part, identifies any potential discussion points to be addressed with the auditor.

The purpose of the review of the auditor's working papers is to determine whether the external auditor has performed adequate and appropriate work to substantiate the audit opinions stated on the two Independent Auditor's Reports and the Report on Compliance for Insurance and Segregation of Cash and Securities of the annual audited Form 1. The review is intended to determine whether the external auditor exercised due diligence in conducting the audit under Canadian Auditing Standards and the regulatory audit requirements contained in MFDA Rule 3.6.

Auditor's Working Paper Review Process

To better clarify the review requirements of an external auditor of a Member firm, and the auditor's corresponding reporting relationship to the MFDA and MFDA IPC, standard letters will be exchanged between the MFDA and the external auditor for each year-end audit engagement.

Below is a description of the standard letters exchanged between the MFDA and the external auditor, which include: (1) Instruction Letter; (2) Acknowledgement Letter; and (3) Confirmation Letter.

Instruction Letter

The Instruction Letter will be sent to the external auditor by the MFDA prior to the Member's fiscal year-end. The purpose of this letter is to specifically outline the requirements for the external auditor for the year-end audit engagement which include the following:

- Two duly signed copies of the Form 1 are to be filed on behalf of the Member by the auditor. For the purposes of filing the Form 1 with the MFDA, the regulatory filing must consist of all forms as produced by EFS. The annual audited filing must be received within 90 days of the Member's fiscal year-end {MFDA Rule 3.5.1(b)};
- For Member firms with EDP service providers, auditors are reminded that the review of the accounting system should encompass the EDP environment. File documentary evidence of the review would include the most recent audit opinion on the control environment of the EDP service provider {MFDA Rule 3.6.4};
- Auditors are required to report any material breaches of MFDA By-laws, Rules, Policies and Forms pertaining to the calculation of the Member's financial position, handling and custody of securities, insurance and maintenance of adequate records that are observed during the regular conduct of the audit. In addition, a copy of the Management Letter reporting on any internal control weaknesses of the Member firm should be filed within 90 days of the Member's year-end {MFDA Rule 3.6.6}; and
- The auditor acknowledges that the firm's working papers relating to the MFDA Member engagement are to be made available for review by the MFDA and MFDA IPC subsequent to the filing date of the Form 1. {MFDA Rule 3.6.5}.

Acknowledgement Letter

The Acknowledgement Letter will be sent by the external auditor to both the MFDA and MFDA IPC prior to completing the Member's fiscal year-end audit. The purpose of this letter is to provide assurances from the external audit firm that it has been engaged by the Member to perform its year-end audit, the firm received the MFDA's Instruction Letter, and the audit firm acknowledges the special terms of the engagement. Specifically, upon receipt of the Instruction Letter, the Member's auditor is required to sign the Acknowledgement Letter and return a copy to both the MFDA and MFDA IPC which includes the following:

- The audit engagement team has read MFDA Rule 3.6 and understands its requirements;
- The auditor acknowledges that the MFDA and MFDA IPC each reserve the right to review the auditor's audit working papers in relation to the Member subsequent to the filing date of the Form 1;
- A summary of the nature and scope of the audit engagement (i.e. the Part I financial statements which are the responsibility and representations of the Member's management);
- The purpose of the Auditor's Reports addressed to the MFDA and MFDA IPC; and
- An acknowledgement that the MFDA has agreed to write to the audit firm prior to signoff and completion date of the engagement, to advise of any significant matters that the MFDA is aware relating to the Member.

Confirmation Letter

The Confirmation Letter will be sent to the external auditor by the MFDA prior to the filing due date of the audited financial reports. The purpose of this letter is to specifically confirm the following details to the audit firm:

- Any financial compliance regulatory matters that may be relevant to the audit opinion that have not otherwise been reported in the MFDA's last field examination report;
- Any issued or outstanding MFDA notices of hearing with respect to the Member; and
- Other than early warning financial triggers as already reported by the Member's Form 1 filings on EFS, any other reason to designate the Member into discretionary early warning or impose business restrictions.

Auditor's Working Paper Review Procedures

To commence an external auditor working paper review, the MFDA will contact the external auditor and coordinate a convenient time to conduct the review.

During the review of the audit working papers, pursuant to MFDA Rule 3.6, the MFDA performs procedures to ensure the audit was performed in accordance with Canadian Auditing Standards. Also, that the audit encompasses a review of the accounting system, internal accounting control and procedures for safeguarding assets. When determining the materiality threshold, the auditor should take into consideration the Member's RAC and the Early Warning Excess. Furthermore, certain substantive audit procedures must be performed as of the year-end date.

As part of the audit procedures, the external auditor should review bank reconciliations; trust reconciliations; nominee name asset reconciliations; custodial agreements with ASLs; and a security count for all securities held in the physical possession of the Member should be performed.

The external auditor must obtain written confirmations for bank balances and other deposits; cash, security positions and deposits with mutual fund companies and similar financial institutions; cash and securities loaned or borrowed; accounts with brokers or dealers; accounts of directors, partners or officers of the Member held by the Member in a nominee name environment; status of lawsuits and other legal matters pending; and other accounts which in the opinion of the external auditor should be confirmed.

If the external auditor encounters any material breach of MFDA By-laws, Rules, Policies and Forms relating to the RAC calculation, handling and safeguarding of client and Member's assets and maintaining proper books and records, the auditor is required by MFDA Rule 3.6.6 to report such deficiencies to the MFDA.

Copies of the Form 1 and all audit working papers are to be retained by the external auditor for a period of seven years. Pursuant to MFDA Rule 3.6.5, the two most recent years shall be kept in a readily accessible location and all working papers shall be made available for review by the MFDA and MFDA IPC and the Member shall direct its auditor to provide such access on request.

In accordance with MFDA Rule 3.6.8, the reports and audit opinions are to be signed by an engagement partner authorized to do so in accordance with applicable legislation in the jurisdiction in which the principal office of the Member is located.

Further to the statements and schedules contained in the monthly unaudited Form 1 filing, the annual audited Form 1 also consists of two Independent Auditor's Reports, whereby an opinion is expressed by the auditor asserting that the statements are prepared in accordance with the Notes and Instructions to the Form 1. Any exceptions resulting from the prescribed procedures performed should be documented by the external auditor.

Independent Auditor's Report for Statements A, D and E
and
Independent Auditor's Report for Statements B, C and F

The two Independent Auditor's Reports include references to the basis of accounting described in the Notes to the Form 1. (Refer to Appendix 8 for the standard Auditor's Reports.) Consequently, upon signing the standard Independent Auditor's Reports, the auditor is asserting that the financial statements have been prepared in accordance with IFRS, except for the prescribed departures and accounting treatments which are detailed in the Notes to the Form 1. The following, while not necessarily inclusive, is a list of departures from IFRS required by the Form 1 that should be considered by the Member and its auditor:

- Trading balances relating to Member and client securities and other investment transactions may be netted if the receivable and payable balances are with the same counterparty;
- Preferred shares issued by the Member and approved by the MFDA are classified as capital;
- Certain statements are prepared in accordance with MFDA requirements;
- Certain statements and all schedules are prepared in accordance with MFDA requirements and are not contemplated under IFRS;
- The financial statements are prepared on a non-consolidated basis;
- A statement of cash flow is not required;
- Securities owned and sold short are to be valued and reported at market value;
- Subordinated loans are classified as capital;
- Client cash held in trust by the Member and the corresponding liability must be included in the statements; and
- Accounting Standards for Private Enterprise may not be used.

Report on Compliance for Insurance and Segregation of Cash and Securities

The external auditor is required to report on the results of the specified procedures performed in connection with compliance for segregation of cash and securities and compliance for insurance, pursuant to MFDA Rules 3.6.2(b)(ix) and 3.6.3(a), respectively. The results must be reported in the Report on Compliance for Insurance and Segregation of Cash and Securities. (Refer to Appendix 8 for the standard Auditor's Reports.)

Scope Limitation

The Notes and Instructions to the Independent Auditor's Reports require any scope limitations related to the audit to be discussed in advance with the MFDA. MFDA staff will assess the nature of the limitation(s) and appropriate step(s) will be discussed with the Member and the external auditor. Discretionary scope limitations are not acceptable to the MFDA.

Auditor's Working Paper Review Letter

Deficiencies identified during the review of the auditor's working papers are presented to the engagement partner in a letter. The external auditor is required to provide a written response to the letter.

Extension of Audit Period

The Member may request consideration from the MFDA to have an external audit performed for a period greater than the standard 12 months (e.g. a change in fiscal year-end). A letter from the Member requesting the approval and the reasons why must be submitted to the MFDA. If the request is reasonable and there are no other significant concerns, the request will be evaluated by the MFDA, taking into consideration that audited information should be submitted on a timely basis to allow for effective monitoring of the Member's capital position.

Change of Auditor

In the event of a change in the Member's external auditor and/or engagement partner, the MFDA must be notified and a newly signed Letter of Acknowledgement (Schedule H.1) must be submitted to the MFDA.

APPENDIX 1: DEFINITIONS

1. **"acceptable entity"** means:

(a) Acceptable institutions.

(b) Government of Canada, the Bank of Canada and Provincial Governments.

(c) Insurance companies licensed to do business in Canada or a province thereof.

(d) Canadian provincial capital cities and all other Canadian cities and municipalities, or their equivalents.

(e) All crown corporations, instrumentalities and agencies of the Canadian federal or provincial governments which are government guaranteed as evidenced by a written unconditional irrevocable guarantee or have a call on the consolidated revenue fund of the federal or provincial governments.

(f) Canadian pension funds which are regulated either by the Office of Superintendent of Financial Institutions or a provincial pension commission.

(g) Corporations (other than Regulated Entities) with a minimum net worth of $75 million on the last audited balance sheet, provided acceptable financial information with respect to such corporation is available for inspection.

(h) Members of the Corporation.

(i) Regulated entities.

2. **"acceptable institutions"** means:

(a) Canadian banks, Quebec savings banks, trust companies licensed to do business in Canada or a province thereof.

(b) Credit and central credit unions and regional caisses populaires.

3. **"acceptable securities locations"** means those entities considered suitable to hold securities on behalf of a Member, for both inventory and client positions, without capital penalty, given that the locations meet the requirements outlined in the segregation Bylaws, Rules or Policies of the Corporation including, but not limited to, the requirement for a written custody agreement outlining the terms upon which such securities are deposited and including provisions that no use or

disposition of the securities shall be made without the prior written consent of the Member and the securities can be delivered to the Member promptly on demand. The Corporation will maintain and regularly update a list of those foreign depositories and clearing agencies that comply with these criteria. The entities are as follows:

(a) Depositories

i.	Canada	CDS Clearing and Depository Services Inc.
ii.	United States	Depository Trust Company

(b) Government of Canada, the Bank of Canada and Provincial Governments.

(c) Canadian banks, Quebec savings banks, trust companies and loan companies licensed to do business in Canada or a province thereof.

(d) Credit and central credit unions and regional caisses populaires.

(e) Insurance companies licensed to do business in Canada or a province thereof.

(f) Mutual Funds or their Agents – with respect to security positions maintained as a book entry of securities issued by the mutual fund and for which the mutual fund is unconditionally responsible.

(g) Regulated entities.

4. **"regulated entities"** means those that are Members covered by the Canadian Investor Protection Fund or Members of recognized exchanges and associations. For the purposes of this definition, recognized exchanges and associations are those that are identified as a "regulated entity" by the Investment Industry Regulatory Organization of Canada.

5. **"market value of securities"** means:

(a) <u>for listed securities</u>, the last bid price of a long security and, correspondingly, the last ask price of a short security, as shown on the exchange quotation sheets as of the close of business on the relevant date or last trading date prior to the relevant date, as the case may be, subject to an appropriate adjustment where an unusually large or unusually small quantity of securities is being valued. If not available, the last sale price of a board lot may be used. Where not readily marketable, no market value shall be assigned.

(b) <u>for unlisted and debt securities, and precious metals bullion,</u> a value determined as reasonable from published market reports or inter-dealer quotation sheets on the relevant date or last trading day prior to the relevant date, or based on a reasonable yield rate. Where not readily marketable, no market value shall be assigned.

(c) <u>for commodity futures contracts</u> , the settlement price on the relevant date or last trading day prior to the relevant date.

(d) <u>for money market fixed date repurchases</u> (no borrower call feature), the market price is the price determined by applying the current yield for the security to the term of maturity from the repurchase date. This will permit calculation of any profit or loss based on the market conditions at the reporting date. Exposure due to future changes in market conditions is covered by the margin rate.

(e) <u>for money market open repurchases</u> (no borrower call feature), prices are to be determined as of the reporting date or the date the commitment first becomes open, whichever is the later. Market price is to be determined as in (d) and commitment price is to be determined in the same manner using the yield stated in the repurchase commitment.

(f) <u>for money market repurchases with borrower call features</u>, the market price is the borrower call price.

APPENDIX 2: CUSTODIAL AGREEMENTS

"Bare Trustee" Custodial Agreement

Non-Certified Debt Instrument

Member/Custodian Agreement

APPENDIX 3: UNIFORM GUARANTEE AGREEMENT

Uniform Guarantee by Members and Related Members

APPENDIX 4: SUBORDINATED LOAN AGREEMENT

[Uniform Subordinated Loan Agreement]

[Override Acknowledgement (Schedule B)]

APPENDIX 5: SCHEDULE 1 MARGIN RATES

FORM 1, PART II – SCHEDULE 1
NOTES AND INSTRUCTIONS

1. All securities are to be valued at market (see General Notes and Definitions) as of the reporting date. The margin rates to be used are those outlined below:

(a) **Bonds, Debentures, Treasury Bills and Notes**

(i) Bonds, debentures, treasury bills and other securities of or guaranteed by the Government of Canada, of the United Kingdom, of the United States of America and of any other national foreign government (provided such foreign government securities are currently rated Aaa or AAA by Moody's Investors Services Inc. or Standard & Poor's Corporation, respectively), maturing (or called for redemption):

within 1 year	1% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	5% of market value

(ii) Bonds, debentures, treasury bills and other securities of or guaranteed by any province of Canada and obligations of the International Bank for Reconstruction and Development, maturing (or called for redemption):

within 1 year	2% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	5% of market value

(iii) Bonds, debentures or notes (not in default) of or guaranteed by any municipal corporation in Canada or the United Kingdom maturing:

within 1 year	3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	5% of market value

(iv) Other non-commercial bonds and debentures (not in default):

10% of market value

(v) All other bonds, debentures and notes (not in default):

within 1 year	3% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	10% of market value

(b) **Bank Paper**

Deposit certificates, promissory notes or debentures issued by a Canadian chartered bank (and of Canadian chartered bank acceptances) maturing:

within 1 year	2% of market value multiplied by the fraction determined by dividing the number of days to maturity by 365
over 1 year	10% of market value

(c) **Mutual Funds**

Securities of mutual funds qualified by prospectus for sale in any province of Canada shall be margined at the following rates:

Money Market Funds (as defined in NI81-102) - 5% of market value.

All Other Mutual Funds - 50% of market value.

(d) **Stocks**

On securities (other than bonds and debentures) including rights and warrants listed on any recognized stock exchange in Canada or the United States:

Long Positions - Margin Required

Securities selling at $2.00 or more - 50% of market value

Securities selling at $1.75 to $1.99 - 60% of market value

Securities selling at $1.50 to $1.74 - 80% of market value

Securities selling under $1.50 - 100% of market value

Short Positions - Credit Required

Securities selling at $2.00 or more - 150% of market value

Securities selling at $1.50 to $1.99 - $3.00 per share

Securities selling at $0.25 to $1.49 - 200% of market value

Securities selling at less than $0.25 - market value plus $0.25 per share

(e) **FOR ALL OTHER SECURITIES - 100%.**

APPENDIX 6: UNDERTAKING REGARDING PREFERRED SHARES

MFDA Staff Notice MSN-0013, "Undertaking Regarding Retractable Preferred Shares"

APPENDIX 7: LETTER OF ACKNOWLEDGEMENT

Schedule H - Auditor Requirements

APPENDIX 8: AUDITOR'S REPORTS

FORM 1 – INDEPENDENT AUDITOR'S REPORT FOR STATEMENTS A, D AND E

To: The Mutual Fund Dealers Association of Canada and MFDA Investor Protection Corporation

We have audited the accompanying Statements of ______________________ *(Member)*, which comprise:

Statement A — Statement of financial position as at ______________ *(date)* and ______________ *(date)*

Statement D — Statement of income and comprehensive income for the years ended ______________ *(date)* and ______________ *(date)*

Statement E — Statement of changes in capital for the year ended ______________ *(date)* and changes in retained earnings (corporations) or undivided profits (partnerships) for the years ended ______________ *(date)* and ______________ *(date)*

and a summary of significant accounting policies and other explanatory information. These Statements have been prepared by management based upon the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada.

Management's responsibility for the Statements

Management is responsible for the preparation and fair presentation of these Statements in accordance with the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada and for such internal control as management determines is necessary to enable the preparation of Statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these Statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Member's preparation and fair presentation of the Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Member's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Statements present fairly, in all material respects, the financial position of ______________________ *(Member)* as at ______________ *(date)* and ______________ *(date)* and the results of its operations for the years then ended in accordance with the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada.

Going Concern *(Note: EFS to allow for auditor to include emphasis of matter paragraph for Going Concern – this is an option for auditors but not part of the standard report.)*

Without modifying our opinion, we draw attention to Note __________ in the Statements which indicates that
(note)
___________________________________ incurred a net loss of __________________ during the year ended
(Member) *($ amount)*
_________________________ and, as of that date, ________________________________ 's current liabilities
(date) *(Member's)*
exceeded its total assets by ___________________ . These conditions, along with other matters as set forth in
($ amount)
in Note ________ indicate the existence of a material uncertainty that may cast significant doubt about
(note)
_____________________________________ 's ability to continue as a going concern.
(Member's)

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to Note ___________ to the Statements which describes the
(note)
basis of accounting. The Statements are prepared to assist __________________________________ to meet the
(Member)
requirements of the Mutual Fund Dealers Association of Canada. As a result, the Statements may not be suitable for another purpose. Our report is intended solely for ___________________________________ , the Mutual
(Member)
Fund Dealers Association of Canada and the MFDA Investor Protection Corporation and should not be used by parties other than ________________________________ , the Mutual Fund Dealers Association of Canada and
(Member)
the MFDA Investor Protection Corporation.

(Note: EFS to allow for auditor to include other potential Emphasis of Matter and Other Matter paragraphs should one be required under the CASs or determined appropriate by the auditor to be included in the auditor's report. Such wording would be agreed upon with MFDA prior to the filing of Form 1.)

Unaudited Information

We have not audited the information in Schedule 5 of Part II of Form 1 and accordingly do not express an opinion on this schedule.

[Audit Firm]

[Signature]

[Date]

[Address]

FORM 1 – INDEPENDENT AUDITOR'S REPORT FOR STATEMENTS B, C AND F

To: The Mutual Fund Dealers Association and MFDA Investor Protection Corporation

We have audited the accompanying Statements of Form 1 (the "Statements") of ________________________ ,
(Member)

which comprise:

Statement B – Statement of risk adjusted capital as at ____________________ *(date)* and ____________________ *(date)*

Statement C – Statement of early warning excess as at ____________________ *(date)*

Statement F – Statement of changes in subordinated loans for the year ended ____________________ (date)

These Statements have been prepared by management based on the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada.

Management's responsibility for the Statements

Management is responsible for the preparation of the Statements of Form 1 in accordance with the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada, and for such internal control as management determines is necessary to enable the preparation of Statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the Statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Member's preparation of the Statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Member's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial information in Statement B as at ____________________ *(date)* and ____________________ *(date)*, Statement C as at ____________________ *(date)* and in Statement F for the year ended ____________________ *(date)* is prepared, in all material respects, in accordance with the financial reporting provisions of the Notes and Instructions to Form 1 prescribed by the Mutual Fund Dealers Association of Canada.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to Note __________ (note) to the Statements which describes the basis of accounting. The Statements are prepared to assist ______________________________ (Member) to meet the requirements of the Mutual Fund Dealers Association of Canada. As a result, the Statements may not be suitable for another purpose. Our report is intended solely for ______________________________ (Member), the Mutual Fund Dealers Association of Canada and the MFDA Investor Protection Corporation and should not be used by parties other than ______________________________ (Member), the Mutual Fund Dealers Association of Canada and the MFDA Investor Protection Corporation.

[Audit Firm]

[Signature]

[Date]

[Address]

FORM 1, PART II
REPORT ON COMPLIANCE FOR INSURANCE AND SEGREGATION OF CASH AND SECURITIES

To: The Mutual Fund Dealers Association of Canada (the Corporation) and the MFDA Investor Protection Corporation

We have performed the following procedures in connection with the regulatory requirements for ____________________
(Member firm)

to maintain minimum insurance and segregate client cash and securities as outlined in the By-laws, Rules, and Policies of the Corporation. Compliance with the Corporation By-laws, Rules, and Policies with respect to insurance and the segregation of client cash and securities is the responsibility of the management of the Member firm. Our responsibility is to perform the procedures requested by you.

1. We have read the Member firm's written internal control policies and procedures with respect to maintaining insurance coverage and segregation of client cash and securities to determine that such policies and procedures meet the minimum required, as prescribed by the Rules and Policies of the Corporation in regards to establishing and maintaining adequate internal controls.

2. We obtained representation from appropriate senior management of the Member firm that the Member firm's internal control policies and procedures with respect to insurance and segregation of client cash and securities meet the minimum required, as prescribed by the Policies of the Corporation in regards to establishing and maintaining adequate internal controls and that they have been implemented.

3. We read the Financial Institution Bond Form (the "FIB") insurance policy(s) to determine that the FIB policy(s) includes the minimum required clauses and coverage limits as prescribed in the By-laws, Rules and Policies of the Corporation.

4. We requested and obtained confirmation from the Member firm's Insurance Broker(s) as at ________________ 20 _____
(period end date)

   as to the FIB coverage maintained with the Insurance Underwriter(s) including:

   (a) clauses
   (b) aggregate and single loss limits
   (c) deductible amounts
   (d) name of insurer and insured
   (e) claims made on the policy since last audit
   (f) details of losses/claims outstanding

5. We traced the total client cash and securities held by the Member to the Member's books and records as at the audit date to check that the compilation of the total client cash and securities held by the Member is in accordance with the Notes and Instructions to Schedule 4 of Form 1.

6. We obtained a listing of all securities segregation locations used by the Member firm and determined that each location met the definition of "Acceptable Securities Locations" as defined in the General Notes and Definitions to Form 1.

7. We obtained a listing of all cash segregation locations used by the Member firm and determined that each location met the definition of "Acceptable Institutions" as defined in the General Notes and Definitions of Form 1 and that each account was designated as "in trust" and was interest bearing.

These procedures do not constitute an audit and therefore we express no opinion on the adequacy of the Member firm's insurance coverage, segregation of client cash and securities, or its internal control policies and procedures.

This report is for use solely by the Corporation and the MFDA Investor Protection Corporation to assist in their assessment of the Member firm's compliance with the requirements regarding maintaining minimum insurance and segregating client cash and securities as outlined in the Bylaws, Rules and Policies of the Corporation and not for any other purpose.

____________________ *(auditing firm)*	____________________ *(date)*
____________________ *(signature)*	____________________ *(place of issue)*

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