Financial Compliance

Alberta Securities Commission

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Agenda

- What we do
- Capital and financial reporting requirements
- Common issues
- Excess working capital calculation
- Firm's financial viability
- Impact of IFRS changes

Financial team - what we do

- Review between 350 to 400 filings per year
  - Annual and interim financial statements (NI 31-103)
  - Subordination agreement filings (NI 31-103)
  - Terms and conditions filings
- Financial compliance reviews
- Solvency – fitness for registration requirement

Capital and financial reporting requirements

- Excess working capital requirements (s. 12.1)
  - Firms must maintain excess working capital at all times
  - If you are below zero for 2 consecutive days – this is a breach
  - If you go below zero at any time, you must report it ASAP

- Financial reporting requirements (ss. 12.10 to 12.14)
  - Annual financial statements
  - Interim financial statements
  - Form 31-103F1 *Calculation of excess working capital* – annual/interim

- Form 31-103F4 *Net asset value adjustments* – IFMs

Financial reporting requirements – ss. 12.10 to 12.14

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- Use the most stringent financial reporting requirement if the firm is registered in multiple categories
- Annual/interim financial statements must be prepared using the same accounting principles
- Annual/interim financial statements must comply with NI 52-107

Common filing issues

- Late submission
- Incomplete or draft submission
- Submitted to the incorrect regulator
- Incorrect prior period – Form 31-103F1
- Incorrect comparative period for interim financial statements
- Statement of financial position is not signed
- No typewritten or printed name
- No reference to IFRS on the annual financial statements
- See s. 2.7 of 52-107CP for guidance

Excess working capital calculation

Purpose

- Insolvency protection
- Client protection
- Serves as a signal
- Fitness for registration

Basis of the Calculation

- Based on firm’s net working capital
- Downward adjustments that set minimum capital which the firm must maintain at all times

Example excess working capital calculation

	Component	Current Period	Prior Period
1.	Current assets	$3,000,000	$3,100,000
2.	Less current assets not readily convertible into cash	810,000	900,000
3.	Adjusted current assets (line 1 minus line 2)	2,190,000	2,200,000
4.	Current liabilities	500,000	600,000
5.	Add 100% of non-current related party debt unless subordinated	0	0
6.	Adjusted current liabilities (line 4 plus line 5)	500,000	600,000
7.	Adjusted working capital (line 3 minus line 6)	$1,690,000	$1,600,000

Example excess working capital calculation cont.

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	Component	Current Period	Prior Period
8.	Less minimum capital	$100,000	$100,000
9.	Less market risk	318,000	315,000
10.	Less any deductible under the bonding or insurance policy	10,000	10,000
11.	Less guarantees	0	0
12.	Less unresolved differences	0	0
13.	**Excess working capital**	**$1,262,000**	**$1,175,000**

Common issues – excess working capital calculation

- Line 2 – not including all currents assets not readily convertible into cash
- Cannot reconcile the amount on Line 2
- Collectability of related party receivables
- Incorrectly excluding subordinated loan from Line 5
- Cannot verify or recalculate market risk on Line 9

Line 2: Less current assets not readily convertible into cash (e.g. prepaid expenses)

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- "readily convertible into cash"
  - Not defined in Securities Act
  - Requires professional judgement
  - Depends on nature of asset and all relevant circumstances

- Maintain documentation to support Line 2 amount

Line 2: Less current assets not readily convertible into cash (e.g. prepaid expenses) cont.

Prepaid expenses:

- Identified as not readily convertible into cash on Form 31-103F1
- Expenses paid for goods and service to be received in the future (e.g. rent); therefore, cannot be converted into cash
- Must include prepaid expenses on Line 2

Line 2: Less current assets not readily convertible into cash (e.g. prepaid expenses) cont.

Restricted cash:

- Financial statements indicate that a portion of cash and cash equivalent is pledged
- Must include restricted cash on Line 2 as this is not available to meet short-term cash needs

Line 2: Less current assets not readily convertible into cash (e.g. prepaid expenses) cont.

Accounts receivable:

- Financial statements indicate receivables due from related party is past due
- Not readily convertible into cash as the balance is not expected to be collectible from the related party
- Must include receivable not collectible on Line 2

Line 5: Add 100% of non-current related party debt unless…

Add 100% of non-current related party debt <u>unless</u>

- Firm and lender have executed a subordination agreement
- Subordination agreement is in the form of Appendix B to NI 31-103, and
- Firm has delivered a copy of the agreement to ASC on time

Line 5: Add 100% of non-current related party debt unless… cont.

Subordinated Loan Issues:

- Not executed in required form (Appendix B)
- Not delivered to ASC on time – 10 day requirement
- Incorrect execution date
- Late notification of repayment or termination

Line 9: Less market risk

- Line 9 amount must be calculated according to the instructions in Schedule 1 to Form 31-103F1

- Schedule supporting Line 9 amount should be provided to ASC

Line 9: Less market risk cont.

Type of Security	Fair Value	Margin Rate (Per Schedule 1 of Form 31-103F1)	Market Risk	Schedule 1 Reference
Government bonds	$300,000	1%	$3,000	Paragraph (a)
Exchange traded funds	$30,000	50%	$15,000	Paragraph (e)(i)
Investment in XYZ Corporation	$300,000	100%	$300,000	Paragraph (g)
Total market risk to be included on Line 9			**$318,000**	

Firm's financial viability

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- Auditor's report
- Continuous losses and increasing deficit
- Unusual or significant movements/items
- Solvency or going concern issues
- Regulatory action

Impact of IFRS changes

- IFRS 16 *Leases*
  - Will replace current guidance in IAS 17 *Leases*
  - Effective date for periods beginning on/after January 1, 2019
- IFRS 9 *Financial instruments*
  - Replaced IAS 39 *Financial Instruments – recognition and measurement*
  - Effective for periods beginning on/after January 1, 2018
- IFRS 15 *Revenue from contracts with customers*
  - Replaced IAS 11 *Construction contracts* and IAS 18 *Revenue*
  - Effective for periods beginning on/after January 1, 2018

Impact of IFRS 16 *Leases*

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- IAS 17 required a lessee to classify a lease as a finance lease or operating lease

- IFRS 16 requires lessees to recognize nearly all leases on Statement of Financial Position

Impact on excess working capital

- Increase in non-current assets with offsetting increase in current and non-current liabilities

- Increase in current liabilities will decrease excess working capital

Impact of IFRS 9 *Financial instruments*

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- Based on how an entity manages its financial assets in the context of its business model and the contractual cash flow characteristics of the financial assets
- Expected credit loss model for calculating impairment on financial assets replaces the incurred loss impairment model used in IAS 39

Impact on excess working capital

- Change in classification and measurement of the financial asset
- New expected credit loss model will result in earlier recognition of impairment losses
- Increase in impairment provision will decrease carrying amount of the asset, which will decrease excess working capital

Impact of IFRS 15 *Revenue from contracts with customers*

- Revenue depicts the transfer of promised items in exchange for an expected amount of consideration

- Revenue recognition - based on the satisfaction of performance obligations

- Must follow a five-step process

Impact on excess working capital

- Potential increase in liabilities, which may decrease excess working capital

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