

CSA responds to potential impact of s. 3855 of CICA handbook on investment funds

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On August 12, 2008, the Minister of Finance approved amendments to National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106), that came into force September 8, 2008 (the NI 81-106 Amendments). The NI 81-106 Amendments respond to the potential impact on investment funds following the introduction of Section 3855 *Financial Instruments -- Recognition and Measurement* of the Canadian Institute of Chartered Accountants (CICA) Handbook (section 3855).


Background

In 2005, the Accounting Standards Board of the CICA introduced section 3855, which applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Section 3855 provides more specific guidance on how to measure financial instruments at fair value for financial statement purposes when fair value measurement is required. To comply with the guidance in section 3855, investment funds would have needed to change how they value a large portion of the securities in their portfolios, particularly those that are traded on a recognized exchange. For example, those securities traded on a recognized exchange would need to be valued at the bid or ask price on each valuation day, as opposed to valued at the closing price, which is predominantly the current valuation practice.

Prior to the Amendments, section 14.2 of NI 81-106 required investment funds to calculate net asset value in accordance with Canadian generally accepted accounting principles (Canadian GAAP). Maintaining this requirement after the introduction of section 3855 would mean that investment funds would have to change long-standing industry valuation practices. This would potentially have had adverse consequences to investment fund securityholders. The Canadian Securities Administrators (CSA) granted exemptive relief, permitting investment funds to calculate net asset value for purposes other than financial statements without giving effect to section 3855. This exemptive relief, originally set to end no later than September 30, 2007, was extended until the earlier of (i) September 30, 2008; and (ii) the effective date of the amendments to NI 81-106 to address this issue. As noted, amendments to NI 81-106 were made effective as of September 8, 2008.

Amendments to NI 81-106 in force September 8, 2008

The NI 81-106 Amendments permit investment funds to have two different net asset values: one for financial statement purposes, which is to be prepared in accordance with Canadian GAAP (being referred to as “**net assets**” under



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This newsletter was prepared by members of the Investment Funds Group at Stikeman Elliott.

NI 81-106 following the NI 81-106 Amendments); and another for all other purposes, including unit pricing (being referred to as “**net asset value**” under NI 81-106 following the NI 81-106 Amendments). Under the NI 81-106 Amendments, section 3.6 of NI 81-106 has been amended to require that the notes to the financial statements disclose the net asset value per security as at the date of the financial statements compared to the net assets per security as shown on the statement of net assets and to provide an explanation of the differences between these amounts.

The NI 81-106 Amendments remove the requirement in section 14.2 of NI 81-106 to calculate net asset value in accordance with Canadian GAAP and replace it with a requirement to calculate the net asset value of an investment fund using the fair value of the investment fund’s assets and liabilities. For this purpose, fair value of assets and liabilities means the market value based on reported prices and quotations in an active market (see section 14.2(1.2)(a), NI 81-106). When the current market value is not available or the manager of the investment fund determines that it is unreliable, fair value means a value that is fair and reasonable in all relevant circumstances (see section 14.2(1.2)(b), NI 81-106). The NI 81-106 Amendments require that the manager maintain a record of the determination of fair value and the reasons supporting that determination (section 14.2(1.4)). Section 14.2 of NI 81-106 has also been amended to require the manager to establish and maintain policies and procedures for determining fair value of the investment fund’s assets and liabilities. Section 9 of the Companion Policy to NI 81-106 has been amended to provide guidance in this regard and provides that the policies and procedures should be approved by the manager’s board of directors. Section 9 of the Companion Policy has also been amended to provide guidance for determining fair value.

Is there anything investment funds currently in existence should be doing?

- > Review and assess **internal policies and procedures** to determine what changes, if any, will be required to comply with section 3855 as regards financial statements (in consultation with internal and external auditors).
- > Review **constating documents** and **material contracts** to determine if any amendments are required.
 - The constating documents of most investment funds stipulate a methodology for calculating net asset value (for issuances, redemptions, the calculation of management fees, etc.) and if the methodology refers to Canadian GAAP, the fund may need to follow section 3855, unless amendments are implemented. If amendments are necessary, the fund must determine whether those amendments can be implemented without shareholder approval.
- > Contact all **service providers and/or pricing or information** sources to ensure that net asset value is being calculated appropriately and to ensure that information is available to permit compliance with s. 3855 for financial statement reporting purposes.
Consider if a press release or other disclosure is required to inform investors of a change in the valuation methodology.

Is there anything investment funds currently being formed should be doing?

- > Review draft material contracts, including all third party contracts to ensure they accurately reflect the calculation of net assets and net asset value.
- > Review prospectus disclosure to ensure that it accurately describes methods of calculating net asset value.

For further information, please contact your Stikeman Elliott representative, the author Danielle Laise (dlaise@stikeman.com) or any of the members of our Investment Funds Group listed at www.stikeman.com