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MFDA Bulletin

Compliance

For Distribution to Members' Audit Firms and other Relevant Parties within your Firm

Auditor Working Paper Review – Common Deficiencies

Objective

The purpose of this Bulletin is to enhance awareness and understanding of the special audit requirements for external auditors engaged to perform a financial audit of an MFDA Member firm in accordance with Rule 3.5.1(b).

Requirements

MFDA Rule 3.5.1(b) requires each Member to file annually with the MFDA, through its auditor, audited financial information of the Member within 90 days of the Member's fiscal year end. The audited financial information must be reported in the Form 1 – Financial Questionnaire and Report ("FQR") format and filed using the MFDA web-based application, the Electronic Filing System ("EFS"). In accordance with Rule 3.5.3, the audit engagement is to be conducted in accordance with Canadian generally accepted auditing standards ("GAAS"). In addition, Rule 3.6 outlines specific audit engagement requirements that are to be performed by the external auditor of an MFDA Member, in addition to the GAAS requirements. Furthermore, Rule 3.6.5 requires the external auditor to retain copies of the FQR and all audit working papers for a period of seven years and allow access to them for review by the MFDA and the MFDA Investor Protection Corporation.

Common Deficiencies

The following are some of the deficiencies identified to date during MFDA staff's review of auditor working paper files performed pursuant to Rule 3.6.5:

Auditors' Reports

- The date of the Part I Auditors' Report referenced on the Part II Auditors' Report was different than the actual date of the Part I Auditors' Report (*Form 1*).

Materiality Level

- There was no documentary evidence that the auditor considered Risk Adjusted Capital and Early Warning Excess when determining materiality level for the audit (*Rule 3.6.2(a)*).

Review of Back Office System

- There was no documentary evidence that the auditor reviewed the Member's back office system (*Rule 3.6.4*).

Trade Date Basis of Reporting

- There was no documentary evidence that the auditor ensured that the Member reported the market value of nominee name purchases and redemption proceeds on Statement A on a trade date basis (*Form 1 – General Notes and Definitions #4 and Rule 3.6.1*).

Trust Accounts

- There was no documentary evidence that the auditor reconciled trust asset and liability balances reported on the audited FQR to the back office trading system (*Rule 3.6.1*).
- There was no documentary evidence that the auditor ensured all suspense trust account balances were reported on the Member's FQR (*Rule 3.6.1*).
- There was no documentary evidence that the auditor reviewed the Member's trust account reconciliations, including physical trust accounts and suspense general ledger trust accounts (*Rule 3.6.2(b)(iv)*).
- There was no documentary evidence that the auditor obtained written confirmation of all Member's trust accounts (*Rule 3.6.2(b)(vi)(A)*).

Nominee Name Assets

- There was no documentary evidence that the auditor reviewed the Member's nominee name asset reconciliations, including Guaranteed Investment Certificates (*Rule 3.6.2(b)(iii)*).
- There was no documentary evidence that the auditor ensured there are signed custodial agreements in place with entities holding securities and other investment products on behalf of the Member (*Rule 3.6.2(b)(v)*).

- There was no documentary evidence that the auditor ensured that the minimum regulatory clauses of MFDA Rule 3.3.3(b) were contained in the terms of signed custodial agreements (*Rule 3.6.1*).
- There was no documentary evidence that the auditor performed alternative verification procedures on nominee name account confirmations where responses to second requests were not received (*Rule 3.6.2(b)(vi)*).
- There was no documentary evidence that the auditor obtained written confirmation of the Member's nominee name client accounts, including those accounts of the Member's directors and officers (*Rule 3.6.2(b)(vi)(E) and (F)*).
- There was no documentary evidence that the auditor confirmed, on a test basis, client accounts with nil balances and those accounts that were closed since the last audit date (*Rule 3.6.2(b)(vi)(F)*).

Security Positions

- There was no documentary evidence that the auditor accounted for all securities in physical possession by physical examination and comparison with the books and records of the Member (*Rule 3.6.2(b)(ii)*).
- There was no documentary evidence that the auditor obtained written confirmations of the Member's nominee name security positions held at the issuing institutions (*Rule 3.6.2(b)(vi)(B)*).
- There was no documentary evidence that the auditor obtained written confirmations of the Member's own security positions held at external locations (*Rule 3.6.2(b)(vi)(D)*).

Other Written Confirmations

- There was no documentary evidence that the auditor obtained written confirmation of the Member's operating bank account (*Rule 3.6.2(b)(vi)(A)*).
- There was no documentary evidence that the auditor obtained written confirmation of the Member's executed MFDA Uniform Subordinated Loan Agreement (*Rule 3.6.2(b)(vi)(C)*).

Policies and Procedures Manual

- There was no documentary evidence that the auditor reviewed the Member's internal policies and procedures relating to segregation of client cash and securities. In addition, the Member's policies and procedures manual did not meet the minimum requirements of MFDA Policy No. 4 – Internal Control Policy Statement 5 and the auditor did not report

the exceptions on the Report on Compliance with Segregation of Cash and Securities (*Rule 3.6.2(b)(ix)*).

- There was no documentary evidence that the auditor reviewed the Member's internal policies and procedures relating to monitoring bonding and insurance. Furthermore, the Member's policies and procedures manual did not meet the minimum requirements of MFDA Policy No. 4 – Internal Control Policy Statement 3 and the auditor did not report the exceptions on the Report on Compliance for Insurance (*Rule 3.6.3(a)*).

Incorrect Reporting of Balances

- A balance reported on Statement A line 7, which forms part of Total Other Allowable Assets on Statement A line 10, was not receivable from Acceptable Entities (*Form 1 – Notes and Instructions to Statement A*).
- Long-term loan owing to a related party which was not subordinated was incorrectly classified on Statement A line 34 rather than as a current liability on Statement A line 30 (*Form 1 - General Notes and Definitions #11*).
- Retractable preferred shares that were not subject to a signed Undertaking in accordance with MFDA Member Regulation Notice MR-0013 (“MR-0013”) were incorrectly reported as capital on Statement A line 38 rather than as a current liability on Statement A line 30 (*MR-0013*).

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