PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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Re: Communication of Key Audit Matters in the Auditor's Report

BACKGROUND

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to submit the following comments regarding the proposed revisions to Canadian Audit Standard 700, *Forming an Opinion and Reporting on Financial Statements*, related to the communication of Key Audit Matters (**KAM**) in the auditor's report (**Proposals**) published by the Auditing and Assurance Standards Board (**AASB**) (the **Exposure Draft**).

As background, PMAC represents over 270 investment management firms that collectively manage in excess of $2.1 trillion.[1] All of our member firms are registered to do business in Canada as portfolio managers with one or more of the Canadian Securities Administrators (**CSA**). In addition to their primary registration as portfolio managers, the majority of our members are also registered as investment fund mangers and/or exempt market dealers. PMAC's members manage investment portfolios for private individuals, institutions, foundations, universities and pension plans.

OVERVIEW

The Exposure Draft states that the requirement to include KAM is anticipated to have significant public interest benefits by, amongst other things, increasing transparency of audits.

PMAC's mandate is to advance standards for the benefit of investors served by our members. For this reason, we are generally supportive of measures that

[1] For more information about PMAC and our mandate, please visit our website at: www.portfoliomanagement.org.

provide greater transparency and enhanced information to investors. We do, however, have concerns about the scope of the Proposals as they apply to all entities governed by National Instrument 81-106 – *Investment Fund Continuous Disclosure* (**NI 81-106**). Our submission is focused on the anticipated detrimental impact to the investors served by our members if the requirement to include KAM were to apply to all NI 81-106 entities.

NI 81-106 covers a variety of investment funds ranging from closed-end funds, exchange traded funds and mutual funds to unit trusts (commonly called **pooled funds** in the industry). While we believe the Proposal to require the inclusion of KAM for all entities subject to NI 81-106 was meant to facilitate the comparison of an auditing metric amongst a variety of investment funds, it is important to consider whether the additional transparency intended by the disclosure of KAM is needed in the first place in the context of funds.

The AASB's Proposal would extend the requirement to include KAM: 1) beyond the scope adopted in major comparable markets, including the U.S.; and 2) beyond investment funds that are reporting issuers typically distributed to retail investors via a prospectus to private, exempt-market funds. This would be inconsistent with the approach taken in other large investment fund jurisdictions and, to PMAC's mind, is an unintended negative consequence of the Proposal.

Due to the impact the Proposals would have on Canadian savers that are invested in pooled funds, PMAC has taken the opportunity to provide some background on the prevalence, use, and importance of pooled funds to Canadian investors below.

PMAC'S KEY RECOMMENDATIONS

1. Do not extend the Proposals to funds;

PMAC recommends that the AASB exempt all investment funds governed by NI 81-106 – whether listed or not – from the requirement to communicate KAM. We believe that the Proposals would create inconsistencies between Canadian requirements and those of similar markets, while increasing regulatory burden and cost for Canadian investment funds in a way that is unlikely to significantly improve investor disclosure or audit quality.

2. In the alternative, do not extend the Proposals to pooled funds.

While PMAC believes that all funds should be exempt from the requirement to communicate KAM, should the AASB disagree, we believe that pooled funds – at the very least - should be exempt. We believe that the AASB unintentionally captured these non-reporting investment funds in the Proposals and that pooled funds were never meant to be, nor should they be, subject to the requirement to communicate KAM.

Each of these recommendations is set out in greater detail below.

UNNECESSARY TO EXPAND THE PROPOSALS TO APPLY TO FUNDS

In the context of investment funds, PMAC does not see evidence that communicating KAM would provide investors with additional information about funds' investment objectives, risks, and fees that impact decisions to purchase these types of securities.

We do not believe the Proposals should extend to investment funds, nor do we see any policy or other cost-benefit analysis articulated in support of why investment funds require the communication of KAM. In the absence of this analysis, mandating the inclusion of KAM could add cost and regulatory burden without evidence of a corresponding improvement in investor understanding or quality of disclosure.

Funds are subject to specific regulation, including ongoing disclosure requirements – through annually renewed prospectuses or other offering documents and financial statements – that already provide key information about funds' investment objectives, strategies, risks, costs and performance. For public funds, this disclosure is mandated by form requirements approved by the members of the Canadian Securities Administrators (**CSA**) in applicable securities instruments.

While non-investment fund companies may undergo change to their business models in time, funds' business models and investment mandates tend to be more static. These types of changes for public funds are disclosed in their prospectuses, material change reports, and annual and interim management reports of fund performance. Furthermore, changes to the fundamental investment objectives of prospectus qualified funds require stakeholder approval/disclosure, including a unitholder meeting. We do not believe the inclusion of KAM would provide additional material information to investors.

Additionally, to the extent there may be significant audit judgements and estimates involved for a fund, regulatory requirements for their disclosure already exist through prospectuses, fund facts documents and management reports of fund performance. In addition, detailed disclosure is required under IFRS[2] in the financial statements.

Further, PMAC believes that the methods developed to provide the basis of the audit opinion and the existing contents of fund audit reports already serve to protect investors. The role of the auditor is to identify and assess the risk of a material misstatement of the financial statements, design and perform audit procedures in response to these risks and obtain sufficient and appropriate audit evidence to form the opinion. As such, a reasonable investor would assume that any additional or higher risk auditing procedures that are being performed form part of the auditor's opinion. As a result, the inclusion of KAM in the auditor's report would be duplicative, and hence, an

[2] For instance, IFRS 7 and 13 already require the disclosure on fair value of investments in the notes of the financial statements which are covered by the audit opinion.

additional regulatory burden. We do not believe the inclusion of KAM would add significant benefit to investors.

POOLED FUNDS SHOULD NOT BE SUBJECT TO THE PROPOSALS

PMAC believes the requirement to communicate KAM in the auditor's report for pooled funds is an unintended consequence of the Proposals and that the AASB did not mean to capture these private funds.

A pooled investment vehicle offers Canadians, particularly the middle class, access to various asset classes on a cost-effective basis given the ability to find economies of scale by pooling investments and sharing costs.

Canadian individual investors and pension plans invest in these pooled funds as retirement savings vehicles. According to a Strategic Insight report from 2017, Canadians have $65 billion invested in pooled funds and the majority of these investments are funds available through employer sponsored defined contribution pension plans.

Many portfolio managers offer pooled funds which are investment funds that are very similar to mutual funds, but which are offered pursuant to exemptions from the prospectus requirements under securities laws. The prospectus-exempt investors in these pooled funds are not necessarily high net worth individuals, instead, they can be managed accounts of a portfolio manager and/or various retirement and other savings vehicles that are eligible to invest in them. Pooled funds are typically offered at substantially lower costs than mutual funds and give access to different asset classes to middle class Canadians. Additionally, pooled funds may use offering memoranda as a means to communicate information to investors similar to what is contained in a prospectus, including disclosure about the fund's objectives and strategies, valuation, and net asset value.

PMAC further notes that there are investment funds in Canada that are not subject to NI 81-106 as a result of certain exemptions in that securities instrument. The application of the Proposals would treat pooled funds differently than such non-NI 81-106 funds, creating further policy incongruity.

As a result, PMAC is concerned about measures that increase the costs of offering pooled funds to Canadian investors, which we believe the requirement to include KAM for such funds would do without corresponding investor benefit.

INTERNATIONAL ALIGNMENT

PMAC generally has concerns when proposals applicable to Canadian businesses go beyond international standards without a clearly articulated policy rationale, as this adds regulatory burden for Canadian business, and can create disincentives for foreign participation in our market, to the detriment of Canadian investors.

The Proposals would misalign the Canadian position with the International Standards on Auditing (**ISAs**), making the Canadian requirements different than those of international jurisdictions.

There are two ways in which the Proposals would misalign the Canadian requirements with those of other major investment fund jurisdictions.

After the U.S completed its analysis as to the appropriate scope of application of requirements similar to KAM in the U.S market, the U.S. Public Company Accounting Oversight Board (**PCAOB**) and the U.S. Securities and Exchange Commission determined to exempt investment companies under the U.S. Investment Company Act of 1940. Of note is the PCAOB's conclusion that such reporting would not be meaningful for investment companies and may increase cost to filers.

PMAC believes that the considerations noted in the U.S. with respect to why the PCAOB excluded investment companies (set out in detailed on page 2 of the Exposure Draft) are relevant to Canadian funds and their investors. For this reason, we believe that the rationale applied in the U.S. to exempt investment funds from the new auditor reporting standard ought to result in the same policy outcome in the Canadian context.

In other jurisdictions, such as Australia, the European Union and Ireland, non-listed funds are exempt from the requirement to include KAM. PMAC believes that the exclusion of private funds is appropriate in those markets as it would be in Canada.

POTENTIAL IMPACT OF THE PROPOSALS

In addition to PMAC's concerns about the negative impact of misaligning Canadian requirements with the ISAs, the following examples of additional cost that would be incurred by funds to include KAM are important potential impacts of the Proposals on Canadian businesses and, ultimately, on Canadian investors.

Members have observed that funds in international jurisdictions that have adopted KAM are including disclosure that is more boilerplate than fund-specific. As such, in practice, KAM disclosure may be less meaningful to investors. Additionally, due to the similarity of auditing procedures on balance sheets and income statement accounts across the fund industry, KAM will generally fall into a narrow range of topics that primarily include auditing investment valuation, auditing investment existence, and recalculation of related party expense. Disclosure of the risks surrounding these matters is already available in the fund prospectus and is unlikely to provide additional value to investors.

We anticipate increased costs in the form of time and resources used by auditors, management, legal, and compliance to review KAM. The added layers of review could slow the production of financial statements, all which need to be completed in 90 days, translated into French, and printed. Members have also noted that in cases where a company produces a book of financial statements for a group of funds with just one audit opinion, business challenges and logistical issues can arise if one of those funds has noted KAM. The business may then feel the need to separate out that one fund to prepare an individual audit report, especially to allay the risk of investor confusion in such a scenario. The additional cost of creating individual audit reports for individual funds (in the form of additional printing and the time and professional resources spent) would be high, especially since there is no evidence that fund investors would, in fact, benefit from the inclusion of KAM to begin with.

We have concerns about imposing additional time, cost, and regulatory burdens on funds when the necessity for this disclosure has not been carefully articulated and where comparable jurisdictions have determined there is no investor benefit to extending similar requirements to funds and/or to pooled funds.

CONCLUSION

In light of the overriding goal of the AASB to adopt the ISAs into the Assurance Handbook as Canadian Auditing Standards without amendment, save for in certain circumstances, PMAC strongly encourages the AASB to adopt only the requirements included in the ISA and not to extend the requirements to all funds subject to NI 81-106. In the alternative, we believe the Proposals not should apply to pooled funds, all for the reasons set out above.

Thank you for the opportunity to response to the AASB’s Exposure Draft. We would be pleased to continue the dialogue on this important issue and discuss the recommendations included in this submission in more detail. Please do not hesitate to contact Katie Walmsley at (416) 504-7018.

Yours truly,
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