

RULE 300

AUDIT REQUIREMENTS

- 300.1. The audit under Rule 16 shall be conducted in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding assets. It shall include all audit procedures necessary under the circumstances to support the opinions which must be expressed in the Dealer Member's Auditor's reports of Parts I and II of Form 1. Because of the nature of the industry, the substantive audit procedures relating to the financial position must be carried out as of the audit date and not as of an earlier date, notwithstanding that the audit is otherwise conducted in accordance with generally accepted auditing standards.
- 300.2. The scope of the audit shall include the following procedures, but nothing herein shall be construed as limiting the audit or permitting the omission of any additional audit procedure which any Dealer Member's Auditor would deem necessary under the circumstances. For purposes of this regulation tests fall into two basic categories (as described in CICA Handbook section 5300.11 to 5300.21):
- (i) Specific item tests, whereby the auditor examines individual items which he or she considers should be examined because of their size, nature or method of recording (CICA Handbook Section 5300.13);
 - (ii) Representative item tests, whereby the auditor's objective is to examine an unbiased selection of items (Section 5300.13).

The determination of an appropriate sample on a representative basis may be made using either statistical or non-statistical methods (CICA Handbook Section 5300.15).

In determining the extent of the tests appropriate in sub-sections (i), (ii), (iii) and (iv) of (a) below, the Dealer Member's Auditor should consider the adequacy of the system of internal control and the level of materiality appropriate in the circumstances so that in the auditor's professional judgment the risk of not detecting a material misstatement, whether individually or in the aggregate is reduced to an appropriately low level (e.g. in relation to the estimated risk adjusted capital and early warning reserves).

The Dealer Member's Auditor shall:

- (a) As of the audit date:
 - (i) Compare ledger accounts with the trial balances obtained from the general and subsidiary ledgers and prove the subsidiary ledger totals with their respective control accounts (see Rule 300.4 below re Electronic Data Processing);
 - (ii) Account for, by physical examination and comparison with the books and records, all securities, including those held in safekeeping or in segregation, currencies and other like assets on hand, in vault or otherwise in the physical possession of the Dealer Member. Where the nature and size of a Dealer Member's operation is such that there are employees who are independent of those employees who handle or record securities, such independent employees may undertake all or a portion of the count and examination under the Dealer Member's Auditor's supervision. The Dealer Member's Auditor should test count and compare with the independent employees' counts and the security position records, sufficient securities so as to be satisfied that the entire count was materially correct. The Dealer Member's Auditor must maintain control over these assets until the physical examination has been completed;

- (iii) On a test basis, verify securities in transfer and in transit between offices of the Dealer Member;
- (iv) Review the balancing of all security positions and open commodity and option contracts. Review the reconciliation of all mutual funds, brokers, dealers and clearing accounts. Where a position or account is not in balance according to the records (after adjustment to the physical count), ascertain that an adequate provision has been made in accordance with the Notes and Instructions for out of balance positions embodied in Statement B of the Joint Regulatory Financial Questionnaire and Report for any potential loss;
- (v) Review bank reconciliations. After allowing at least ten business days to elapse, obtain bank statements, cancelled cheques and all other debit and credit memos directly from the banks and by appropriate audit procedures substantiate on a test basis the reconciliations with the ledger control accounts as of the audit date;
- (vi) Ensure that all custodial agreements are in place for securities lodged with acceptable locations. In addition, for locations classified as other foreign securities locations, the Auditor must obtain evidence, on an annual basis of the approval of such locations as documented in the minutes of the board of directors and/or other duly constituted board committee meetings of the Dealer Member;
- (vii) Obtain written confirmation with respect to the following:
 - (1) Bank balances and other deposits including hypothecated securities;
 - (2) Money, security positions and open commodity and option contracts including deposits with clearing houses and like organizations and money and security positions with mutual fund companies;
 - (3) Money and securities loaned or borrowed (including subordinated loans) together with details of collateral received or pledged, if any;
 - (4) Accounts of or with brokers or dealers representing regular, joint and contractual commitment positions including money and/or security positions and open commodity and option contracts;
 - (5) Accounts of directors and officers or partners, including money and/or security positions and open commodity and option contracts;
 - (6) Accounts of clients, employees and shareholders, including money and/or security positions and open commodity and option contracts;
 - (7) Guarantees in cases where required to margin (protect) accounts guaranteed either during or as at the end of the year subject to audit;
 - (8) Statements from the Dealer Member's lawyers as to the status of lawsuits and other legal matters pending which, if possible, should include an estimate of the extent of the liabilities so disclosed;
 - (9) All other accounts which in the opinion of the Dealer Member's Auditor should be confirmed;

Compliance with the confirmation requirements shall be deemed to have been made if positive requests for confirmation have been mailed by the Dealer Member's Auditor in an envelope bearing the Auditor's return address. The Dealer Member's Auditor has the option to send out second requests similarly mailed to those not replying to the initial request. Appropriate alternative

verification procedures must be used to obtain relevant and reliable audit evidence where second requests are not sent out or replies to second requests have not been received. For accounts mentioned in (4), (6) and (7) above, the Dealer Member's Auditor shall (i) select specific accounts for positive confirmation based on (a) their size (all accounts with equity exceeding a certain monetary amount, with such amount being related to the level of materiality) and (b) other characteristics such as accounts in dispute, accounts that are significantly undermargined, nominee accounts, and accounts that would require significant margin during the year or as at year-end without the existence of an effective guarantee, and (ii) select a representative sample from all other accounts of sufficient extent to provide reasonable assurance that a material error, if it exists, will be detected. For accounts in (4), (6) and (7) above that are not confirmed positively, the Dealer Member's Auditor shall mail statements with a request that any differences be reported directly to the auditor. Clients' accounts without any balance whatsoever and those closed since the last audit date shall also be confirmed on a test basis using either positive or negative confirmation procedures, the extent to be governed by the adequacy of the system of internal control;

Where a reply to a positive confirmation request for a guarantee in (7) above has not been received, the guarantee shall not be accepted for margin purposes in respect of the account guaranteed unless and until a written form of confirmation of the guarantee has been received by the Dealer Member's Auditor (or by the Dealer Member if subsequent to the filing of the Joint Regulatory Financial Questionnaire and Report), or a new guarantee agreement is signed by the customer. If a guarantor responds to a positive or negative confirmation disputing the validity of the guarantee or the extent of the guarantee, such guarantee shall not be accepted for margin purposes until the dispute is resolved and the confirmation of the guarantee is provided in acceptable form. In addition to the confirmation procedures, the Dealer Member's Auditor should review a sample of guarantee agreements to ensure duly executed and completed agreements exist and such agreements comply with the minimum requirements of Rule 100.15(h);

- (viii) Subject the statements in Part I and Schedules in Part II to audit tests and/or other auditing procedures to determine that the margin and capital requirements, which are used in the determination of the excess (deficiency) of risk adjusted capital are calculated in accordance with the [Rules](#) in all material respects in relation to the financial statements taken as a whole;
- (ix) Obtain a letter of representation from the senior officers of the Dealer Member with respect to the fairness of the financial statements including among other things the existence of contingent assets, liabilities and commitments.
- (b) Check on a test basis that the Dealer Member's procedures are such that securities held for safekeeping are described on both statements rendered to the client and on the Dealer Member's security position record as being so held;
- (c) Complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Segregation of Securities in the Joint Regulatory Financial Questionnaire & Report.

300.3. In addition, the Dealer Member's Auditor shall:

- (a) Complete and report on the results of applying the prescribed procedures contained in the Report on Compliance for Insurance in the Joint Regulatory Financial Questionnaire & Report;
 - (b) Report whether the Exchange seats operated by the Dealer Member are owned outright and free of any encumbrance; and
 - (c) Report on any subsequent events, to date of filing, which have had a material adverse effect on the excess (deficiency) of risk adjusted capital.
- 300.4. The Dealer Member's Auditors' review of the accounting system, the internal accounting control and procedures for safeguarding securities prescribed in the above Audit Requirements should encompass any in-house or service bureau EDP operations. (This may include reliance on CICA Handbook Section 5900 report "Opinions on Control Procedures at a Service Organization). As a result of such review and evaluation the Dealer Member's Auditor may be able to reduce the extent of detailed checking of clients and other account statements to trial balances and security position records.
- 300.5. Copies of the Form 1 and all audit working papers shall be retained by the Dealer Member's Auditor for 6 years. The two most recent years shall be kept in a readily accessible location. All working papers shall be made available for review by the Corporation and the Canadian Investor Protection Fund.
- 300.6. If the Dealer Member's Auditor observes during the regular conduct of his or her audit any material breach of the [Rules](#) pertaining to the calculation of the Dealer Member's financial position, handling and custody of securities and maintenance of adequate records he or she shall make a report to the Corporation.

