MSC NOTICE 2003-44

MSC STAFF NOTICE 81-706
TREATMENT OF SALES COMMISSIONS IN THE CALCULATION OF NET ASSET VALUE OF LABOUR SPONSORED INVESTMENT FUNDS

The purpose of this Staff Notice is to set out staff's views on the implications for net asset value calculations for purchases and redemptions of shares (Pricing NAV) by labour sponsored investment funds (LSIFs) of a change in the accounting for sales commissions paid out of an LSIF's assets.

Facts

For the past 10 years LSIFs have been permitted to pay sales commissions out of fund assets. The Commission since 1999 has granted specific exemptive relief from National Instrument 81-105 to this effect.

The practice of many LSIFs has been to record sales commissions paid out of fund assets as an asset (deferred charge) on a fund's statement of net assets and to amortize this amount to retained earnings on a straight line basis over 8 years. The amortization period matches the period for which an investor is required to hold the related shares in order to avoid being required to repay associated tax credits and to avoid paying a redemption fee.

In July 2003 the Accounting Standards Board of the CICA issued a new Handbook Section, Generally Accepted Accounting Principles, Section 1100, effective for financial years beginning on or after October 1, 2003. This Handbook section clarifies the basis on which an entity determines the appropriate accounting for a transaction in the absence of specific recommendations in the CICA Handbook. In particular, the revised definition of generally accepted accounting principles (GAAP) indicates that accounting practices cannot be considered to comply with GAAP by virtue of their use in similar circumstances by a significant number of entities in Canada. In other words, industry practice on its own will not meet the definition of GAAP. LSIFs have relied on industry practice to treat sales commissions as a deferred charge.

The result of this Handbook change is that, for financial years beginning on or after October 1, 2003, the LSIF industry will no longer be able to treat the sales commissions paid by the fund as an asset on their statement of net assets.

Issue

Generally, the calculation of the Pricing NAV has been set out in each LSIF's prospectus. Without being explicitly stated, the Pricing NAV has typically been determined on a basis that is consistent with GAAP. An LSIF that continues, after this accounting change, to calculate its Pricing NAV in accordance with the basis set out in the prospectus will have a Pricing NAV that is different from the net asset value (NAV) determined by reference to the financial statements.

Staff Position

It is intended that proposed National Instrument 81-106 Investment Fund Continuous Disclosure (NI 81-106), which will be published for a second comment period later this year, will require Pricing NAV for all investment funds, including LSIFs, to be calculated in accordance with GAAP. The expected effective date for proposed NI 81-106 is July 1, 2004.

For transitional purposes only, NI 81-106 will propose limited exemptive relief from the proposed requirement to calculate Pricing NAV in accordance with GAAP to LSIFs that cease adding new sales commissions to the existing deferred charge by December 31, 2003. Relief will be limited to allowing Pricing NAV to be determined on the basis that the deferred charge existing at December 31, 2003 will continue to be amortized over its remaining amortization period. It is expected that all other elements of the calculation of the Pricing NAV will be in accordance with GAAP.

The implication of staff's position is that, for a period of up to 8 years, the Pricing NAV for those LSIFs that are granted exemptive relief will differ from the NAV in the financial statements prepared in accordance with GAAP. However, the relief proposed will limit the amount of that difference. LSIFs that follow this transitional method will be required to provide in the notes to their financial statements a reconciliation between the NAV calculated for financial statement purposes and the Pricing NAV.

Staff expect LSIFs to inform existing and new investors of the changes to the accounting for sales commissions paid out of fund assets and the impact of this change on the fund and investors.

Questions regarding this notice may be directed to:

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October 10, 2003