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Comptables généraux accrédités

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September 24, 2003

Ontario Securities Commission
Cadillac Fairview Tower
Suite 800, Box 55
20 Queen Street West
Toronto, Ontario
M5H 3S8

Attention: John Stevenson, Secretary

Quebec Securities Commission
800 Square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, QC H4Z 1G3

Attention: Denise Brousseau

Re: Proposed Multilateral Instruments 52-108 – 52-109 – 52-110

We take pleasure in enclosing, for consideration by the securities regulatory authorities, the comments of the Certified General Accountants Association of Canada on the above-mentioned Proposed Instruments.

The events of recent years have obliged regulators and governments to address the significant crisis in confidence. If Canada is to compete globally, it needs to assure investors that the standards and rules that govern our markets are as robust here as anywhere else in the world. This must be done without unduly penalizing the vibrancy of our economy or ignoring the specificities of its make-up. CGA-Canada welcomes these Proposed Instruments. We trust that these comments will prove valuable in your deliberations.

Please advise if we could provide further information on the subject.

Yours truly,

Anthony Ariganello, CGA
President and Chief Operating Officer

Enclosure

CGA-Canada Response to Proposed Multilateral Instrument 52-108 – Auditor Oversight

The Certified General Accountants Association of Canada has reviewed the Proposed Multilateral Instrument 52-108 entitled ***Auditor Oversight*** and is pleased to provide these comments for your consideration. The purpose of the Proposed Instrument is to "contribute to public confidence in the integrity of financial reports of reporting issues by promoting high quality, independent auditing." The goal is laudable and CGA-Canada welcomes the initiative.

The notion of an independent oversight board was re-affirmed with the establishment of the Public Company Auditing Oversight Board created as a result of the passage of *Sarbanes-Oxley Act of 2002*. We submit, however, that in the hastiness to create such an organization in Canada, the result was an organization that is fundamentally flawed. Only a change to By-law 1 will enable its proper functioning and enable the CPAB to fulfill the role that it was created to do – that is, independent oversight of public company audits.

Specifically, CGA-Canada questions a number of issues that have been raised in other for a These are:

- Increased transparency and public accountability;
- Independence of the accounting and audit professions;
- Participation of all stakeholders in the governance as well as the design and implementation of inspection programs; and
- The ability of provincial CGA organizations to supervise the inspection and oversight of CGA firms.

On this last point, may we remind the regulators that the Supreme Court of Canada has made it clear that any subordinate legislation (which includes rules, regulations and policies) cannot be inconsistent with other Acts of Parliament or provincial legislation. CGA associations are clearly mandated through their respective legislation to set the standards of entry into public practice, continuing registration as well as the review and discipline of their members. They accomplish this in the public interest.

In response to your specific questions, we are pleased to provide the following commentary.

- Issue – participation of public accounting firms in foreign jurisdictions in CPAB Oversight Program

CGA-Canada believes that firms located in jurisdictions outside of Canada and performing audits of publicly listed entities in Canada should be subject to the same rules and regulations of Canadian firms. This is an issue of fair competition. However, the CPAB may wish to enter into reciprocal agreements with organizations in foreign jurisdictions that are able to demonstrate adequate independent oversight of public audits.

- Issue – disclosure where a public accounting firm has failed to address deficiencies

We believe that five days may not be a sufficient period of time for notification of all clients in a large firm. Such deficiencies should be disclosed when a firm has failed to address defects within the period prescribed by the CPAB. Moreover, CGA-Canada believes that CPAB decision-making must be transparent. It is in the public interest for information about participating audit firms be a matter of the public record.

CGA-Canada Response to Proposed Multilateral Instrument 52-109 – Certification of Disclosure

The Certified General Accountants Association of Canada has reviewed the Proposed Multilateral Instrument 52-109 [MLI 52-109] entitled ***Certification of Disclosure in Companies' Annual and Interim Filings,*** and we are pleased to provide these comments. CGA-Canada supports the objective implicit in the document, namely that investors can rely on the disclosures made in published financial statements. Moreover, any initiative intended to restore confidence in published financial statements is to be applauded.

Our support for the Proposed Instrument is driven by two main principled-based considerations, namely that Chief Executive Officers and Chief Financial Investors are ultimately the individuals who must be held accountable for the information they provide to investors and readers. Certification of disclosure by executive management provides a new level of assurance to investors. Implementing this requirement in tandem with other initiatives such as the proposed reforms to penalties currently before Parliament, ensures that investors may rely on the quality of financial information presented in statements.

Some stakeholders have argued that executive management provide some form of assurance on the information that underlies financial statements and that the new provisions contained in *Sarbanes-Oxley Act of 2002* are simply symbolic. We disagree. It is unlikely that CEOs and CFOs will take this responsibility lightly. This brings us to our second consideration.

It is the responsibility of CEOs and CFOs to ensure the proper internal controls and procedures to ensure the integrity of financial information. The simple fact is that financial statement may not always present fairly the financial situation of an enterprise at any one point in time. MLI 52-109 demands that the signatory attest to the fact that for annual fillings "… the annual financial statements together with the other financial information included in the annual filings present fairly in all material respects the financial condition, the results of operations and cash flows of the issue…". We assume that the "other financial information" provided will overcome any shortcomings in the GAAP-based financial statements.

Certified General Accountants are self-regulated professionals. They are educated and trained to maintain a high standard of competence. The review and discipline process assures the Canadian public they can rely on the high professionalism of our 58,000 members and students. Our members adhere to professional standards and a strict Code of Ethical Principles and Rules of Conduct. Unfortunately, events

of the recent few years demand extreme measures. These are necessary steps to restore confidence in capital markets.

Following are comments on the specific "requests for comments."

- Issue: Do you agree that the proposed one-year transition period is appropriate?

  Yes, CGA-Canada agrees, subject to our comments below, that the one-year transitional period should be sufficient.

- Issue: Do you think that there is reason to differentiate between smaller and larger issuers? For example, is there any reason to exclude representations 4 through 6 with regard to smaller issuers?

  Yes, CGA-Canada believes there is reason to differentiate between smaller and larger issuers. One of the conceptual underpinnings of the audit is the need to reduce agency costs. Because of the separation of ownership and management, agency theory predicts that information asymmetry will work against the owners. The audit is one tool to reduce that gap. Similarly, the representations required of the CEO and the CFO are further limits on the potential for information imbalance.

  In a large firm, it is reasonable to impose these demands. It is less reasonable to demand that a smaller firm comply, especially if the operation is limited in terms of personnel and/or activities. Typically, the need for the required controls is less in such firms; moreover, the cost of documenting and implementing rigorous controls may exceed any benefits derived from their implementation. In addition, smaller firms tend to rely more on their external auditors for guidance regarding internal controls. Given that the CICA *Handbook* requires that the auditor examine internal controls, it should be sufficient for the purposes of the Instrument.

  The one insolvable problem we foresee is the determination of the threshold for this exclusion.

- Issue: If the AIF and annual financial statements and MD&A are not all filed at the same time, there will be a gap between the time that the earliest of those documents is filed and the time the annual certificate is filed. Is this timing gap problematic?

  CGA-Canada suggests that as long as the gap is not excessive (perhaps no more than 45 days), the lag should be acceptable. Given the additional work required for compliance, it is not unreasonable to expect that many entities will choose to file over a period of time.

- Issue: Do you agree with the approach proposed for interim evaluation of internal controls and disclosure controls and procedures?

  CGA-Canada notes that the Proposed Instrument does not require quarterly evaluation of the effectiveness of the issuer's disclosure controls and procedures and internal controls as it does for the annual filings. The Instrument acknowledges that the decision is based on a cost/benefit trade-off. We support the Instrument's approach.

- Issue: Do you think that the exemption in section 4.1, as currently drafted, will have the effect of discouraging issuers that prepare their financial statements in accordance with U.S. GAAP from preparing and filing Canadian GAAP financial statements?

  One of the underlying concepts of capital market theory is that any action that reduces transaction costs also reduces the cost of capital. Having to prepare two sets of financial statements is a cost that many capital market participants would rather not face. In the absence of any other information, the likelihood companies would choose to limit their statements to those prepared using US GAAP seems positive. However, if these entities are Canadian corporations, they must file income tax returns based on *Canadian* GAAP. Thus, they will be compelled to prepare (or at least derive) Canadian GAAP based statements to satisfy the Canada Customs and Revenue Agency (assuming that CCRA does not change its policies and accept US-based GAAP for purposes of the *Income Tax Act*). It should also be noted that the number of corporations that would likely avail themselves of the opportunity to prepare only one set of (US-based) financial statements is few, and this issue may not be one to worry about.

- Issue: Should we formally define: (i) internal controls and (ii) disclosure controls and procedures? If so, what should the appropriate definitions be?

  CGA-Canada does not believe that a single definition for internal controls and/or disclosure controls and procedures would be appropriate, or even possible. There is simply no comparison between a simplified system used by, for instance, a venture capitalist and an ERP system employed by a multi-national corporation. We agree with the comments expressed in the Companion Policy 52-109CP: "In our view, these considerations are best left to management's judgement based on various factors that may be particular to their issuer, including its size and the nature of its business."

CGA-Canada Response to Proposed Multilateral Instrument 52-110

The Certified General Accountants Association of Canada has reviewed the Proposed Multilateral Instrument 52-110 [MLI 52-110] entitled ***Audit Committees,*** and we are pleased to provide these comments. CGA-Canada supports the implementation of MLI 52-110 to strengthen the role of the audit committee (when one already exists) or require the establishment of one (where none exists) in order to restore investor confidence in financial reports. The Association views this initiative as a positive step towards alleviating the harm done by corporate failures in the United States.

Much of what is included in MLI 52-110 is based on the US *Sarbanes-Oxley Act of 2002* and SEC/NYSE requirements – requirements that took effect this year. As noted in the Request for Comments, the integration of the capital markets in North America calls for a common response. While we concur with the notion, CGA-Canada wonders if a one-year transitional period might not be worth considering. As the US regulations are only now coming into force, there might be merit in assessing the effectiveness of these rules in achieving the desired goal before implementing them in Canada. However, if the Proposed Instrument is to be effective for 2004, we support the decision to provide relief to junior public issuers, especially as they form the bulk of Canada's public enterprises.

Following are comments on specific issues.

- 1.3 — Meaning of Affiliated Entity …

  As written, sub-section 1.3(1)(b) is an example of an incomplete definition. To be effective, a definition must unambiguously establish the criteria that enable users to operationalize the definition. That is, a definition must be clearly establish an "if this, then that" framework. Reading the clause as one "sentence," we get "For the purposes of this Instrument, a person or company is considered to be an affiliated entity of another person or company if the person or company is both a director and an employee of an affiliated entity, or an executive officer, general partner or managing member of an affiliated entity." This is incomplete: sub-section 1.3(1)(b) defines an affiliated person or company by reference to an affiliated person or company. On the other hand, sub-section 1.3(1)(a) leaves no doubt as to what constitutes an affiliated entity in the circumstances described in that sub-section.

  Similarly, sub-section 1.3(2) is extremely difficult to follow because of the use of the term "another" in the main clause, but the words "that other" or "the other" are employed in the subsidiary clauses. Perhaps it may be easier to define control (such as is done under generally accepted accounting principles) and then state that a subsidiary is an entity subject to control.

- 1.4 — Meaning of Independence

  While the Association agrees in principle with the goals of the section, we wonder whether Canada's unique circumstances have been adequately considered. As mentioned, the Request for Comments acknowledges the large number of Canadian public junior issuers. However, the Request for Comments appears to have overlooked the fact that many of these junior issuers are *family businesses.* While the Proposed Instrument exempts what it calls "venture issuers" from the need to have an independent audit committee, there appears to be a gap in that some family businesses may not qualify as venture issuers.

  It is almost certain that in a closely held business, one or more family members will sit on the Board of Directors, and it is equally likely that at least one family member will (want to) sit on the audit committee. Given the nature of these family businesses, CGA-Canada doubts that they will be willing to comply with the requirement if they are not considered venture issuers. The very nature of family businesses almost requires that a family member sit on the audit committee. Accordingly, we suggest some relief be provided for closely held enterprises that are not venture issuers.

- 2.3 – Audit Committee Responsibilities

  Sub-section (8) may be lead to confusion. The Association assumes it refers to situations where the issuer offers employment to a person who is or was an employee of the current or former external auditors. However, one could read the clause as requiring the issuer to get involved in the hiring policies of the external auditors. The potential could be eliminated if the words "offers of employment to" were inserted between "regarding" and "employees."

- 3.1 – Composition

  Sub-section 3.1(1) specifies that the audit committee must be composed of at least three members. While the Association generally agrees, we wonder whether this will place an undue burden on small public (not venture) issuers. While we cannot cite extensive empirical literature, we suggest that the size of the issuer should be considered when stipulating the minimum size of the audit committee. Perhaps a size threshold could be used where issuers at a to be determined level of total assets would require a minimum of three members; others may reduce that number to two.

  Sub-section 3.1(4) requires that every audit committee member be "financially literate." CGA-Canada concurs with this requirement. However, we note that there is no requirement for the audit committee to have a member who is designated as the "financial expert." While a case can be made that there is indirect pressure to comply – Form 52-110F1 demands disclosure of the identity of the audit committee

financial expert, or failing that there is one, the reasons why the committee does not have one – the Association would prefer to see an explicit requirement for such a member on the audit committee. Moreover, we would recommend that *all* audit committees – even those firms exempt from the requirements of section 3 – have an audit committee member who can be considered a financial expert.

- 5.1 — Required Disclosure

  Item 1 of both Form 52-110F1 and 52-110F2 requires the disclosure of the audit committee's charter. While the Association supports the intent, we suspect that providing the full text of the charter may not be the most effective means of communicating the objectives and goals of the audit committee. We suggest that the disclosure be amended to require a *summary* of the audit committee's mandate. Almost by definition, audit committee mandates are lengthy, detailed documents, and they will likely become even longer in order to implement the requirements of this Proposed Instrument. Moreover, the language of the mandate will differ from firm to firm. Given that the goal is to provide information that is useful to investors for decision-making purposes, a summary will enable readers to focus on a succinct statement of what the audit committee was expected to do.