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Re: Comments

Thank you for the opportunity to submit the following comments on Multilateral Instrument 52-111 and 52-111cp.

In 1991, William A. Bradshaw, FCA and I wrote a report for the Canadian Institute of Chartered Accountants titled *Assessing Management Control: a systems approach*.

It began with the following ten questions:

1. The organization knows what is important, what re its values, its strengths and its weaknesses.
2. It recognizes that external and internal changes are taking place all the time and this means that control procedures must also change.
3. It is continually identifying key variables or vital signs and is monitoring these on a real time basis.
4. Mistakes, errors and problems are reported and investigated to determine what can be learned.
5. Open Communication is seen as important, everyone knows that the only real mistake is a cover-up.
6. There is recognition that detailed rules and procedures can result in people looking for ways to beat the system.
7. There is a belief that widespread understanding and agreement on objectives is one of the most effective ways to achieve cohesion and control.
8. There is a recognition of the importance of knowledge and judgement required by people at all levels.
9. There is a recognition of the importance of designing systems that reflect trust rather than suspicion.
10. Planning is seen as an ongoing process; the organization is prepared to change plans as soon as they are prepared.

All these questions dealt with control, of which internal control of financial reporting was one aspect. They were consistent with the principles-based approach that has been in use

in Canada and were at a high enough level of abstraction to be of appropriate concern to upper management. The control environment is what is important here, and if that is healthy, deficiencies and material misstatements should be obvious and rare. We recommended the use of models from systems thinking; in particular Stafford Beer's Viable System Model, but also process models such as self-assessment and simulations. These approaches concern the organization as a whole and assume, usually correctly, that if one part of the organization is out of synch with the others that it will be transparent. The current approach seems to touch only partially on some of these questions and does not address others at all.

While it is necessary that the Ontario (and other provincial) Securities Commissions bring their directives in line with Section 404 of Sarbanes-Oxley, it would be a mistake to believe that compliance with its requirements for internal control over financial reporting will address the big picture adequately, or indeed, prevent the deceptions that characterized recent scandals. But, the big picture is really what the job of the Board, CEO and upper management is about and what they should be addressing. Although it is true that many organizations needed to update their understanding of and compliance with reporting requirements, that is not the full extent of the problem. Organizations that approach the need to review and give assurances on compliance broadly are likely to realize more benefits if they regard it as an opportunity to review their whole control environment and perhaps redesign it to meet their needs more effectively.

For an organization, control is about achieving objectives and internal control of financial reporting is one key aspect. That aspect has traditionally been the province of the CFO and his or her staff. It deals primarily with the present and immediate past. Its projections into the future are difficult to substantiate and enquiry is the only effective way to obtain that information. It is unfortunate that enquiry is referred to only briefly as in 'Enquiry alone, however, will not generally provide an adequate basis for management's assessment.' (52-111cp 2.3 part 3). Enquiry, as we found in a research study for the C.I.C.A., (*Audit Enquiry: seeking more reliable evidence from audit enquiry*, 2000) can be a reliable source of audit evidence if it is done in a comprehensive and rigorous manner. While the statement of one individual on one occasion might not be reliable, consistency and coherence in the statements of several independent individuals or of the one individual over time becomes more reliable.

I am concerned that the letter and spirit of these new requirements bring management's attention down to too low a level of detail. Few executives can be effective evaluators of internal control if the emphasis is on control procedures.

Anyone who is not a computer expert, and some that are, would blanch at offering a guarantee about an information technology system they did not know intimately. It should be noted that 'information technology general controls (52-111-cp, 2.3 part e) and 'control over procedures used to enter transaction totals...' (part f) are items on which management can only take the word of associates. They will be dependent, as they were before, on the integrity and competence of the people who report to them.

Another area of concern is that organizations could pull back from pursuing opportunities where international activities and foreign currency transactions could be more difficult to evaluate.

Finally, everyone agrees that culture and tone at the top are very important. Indeed, if organizations have that right, there is little likelihood that they will run into trouble with material misstatements. Yet, there is little in the way of help and guidance there. If the management were able to answer yes to most of the questions they would probably be in pretty good shape. While it is not possible to deliver prescriptions, there are several factors that might be considered. Transparency is one. Establishing a reward and compensation system that is fair and does not encourage people to manipulate short term results to obtain their bonuses is another. Listening to what everyone in the organization has to say (see *The Wisdom of Crowds* by James Surowiecki, Abacus, 2004) is a third.

I hope these comments will be useful and would be happy to speak further about them.

Respectfully submitted,

Allenna Leonard