



**Michel Labonté**  
Senior Vice-President  
Finance, Technology and Corporate Affairs  
Member of the Executive Committee

June 8, 2005

Mr. John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8

**RECEIVED**

**JUN 14 2005**

Ontario Securities Commission  
SECRETARY'S OFFICE

Dear Mr. Stevenson,

National Bank of Canada supports the establishment and use of a proven internal control model for purposes of providing users of financial information with reasonable assurance as to the integrity of its financial statements. It also understands that a structured and documented control framework will be useful in that it will provide managers with an appropriate tool to effectively manage business risk. Finally, the Bank shares the direction chosen, which involves harmonizing the requirements contained in Multilateral Instruments 52-109 and 52-111 with those contained in sections 302 and 404 of the *Sarbanes-Oxley Act of 2002*.

However, in view of the work done and costs incurred by U.S. and Canadian companies who have complied with sections 302 and 404 of the *Sarbanes-Oxley Act*, we are very concerned by the following:

- The cautious and conservative interpretation by the external auditors of the concepts of materiality and likelihood, in order to protect themselves from potential litigation, is gradually distancing us from the traditional concept of materiality; this point is discussed in greater detail in our responses to questions 5 and 18 of the attached document.
- The process required to achieve compliance with this interpretation by October 31, 2006 is time-consuming and complex; meanwhile, the Instrument will not be approved until the fall of 2005 at the earliest and the work must be carried out concurrently with the work required by the Basel Accord; this point is discussed in greater detail in our responses to questions 15, 16, and 17 of the attached document.
- The guidance in such matters as the scope of work (use of judgement, concepts of risk and top-down approach) and the use of the work of others (in particular, a competent and independent internal audit function) to support certifications is constantly changing; the publication, in response to market pressures, of new PCAOB guidance on May 16, 2005 in order to achieve a better cost/benefit balance will continue to spark extensive discussions before there is a valid consensus; this point is discussed in greater detail in our response to question 5 of the attached document.

**Tour de la Banque Nationale**  
600, rue de La Gauchetière Ouest  
7<sup>e</sup> étage  
Montréal (Québec) H3B 4L2  
**Telephone: (514) 394-8610**  
Fax: (514) 394-6196  
E-mail: michel.labonte@bnc.ca

.../2

We therefore recommend that the application of Multilateral Instrument 52-111, currently scheduled for financial years ending on or after June 30, 2006, be deferred by at least one year, to June 30, 2007, or, preferably, to a date corresponding to 24 months following final approval of the Instrument.

Enclosed are our detailed comments on Proposed Multilateral Instrument 52-111 - Reporting on Internal Control over Financial Reporting.

National Bank of Canada appreciates that the members of the Canadian Securities Administrators plan to take these comments into consideration in deciding whether or not to implement the proposed texts on internal control and financial certification.

Yours truly,



Michel Labonté  
Chairman of the Disclosure Committee

Questions	Responses
<b>Scope of application</b>	
1. Do you agree that the Proposed Internal Control Instrument should apply to all reporting issuers other than investment funds and venture issuers? If not, which issuers do you believe should be subject to the Proposed Internal Control Instrument?	We agree with the scope of application.
2. Do you believe that venture issuers should be subject to different requirements relating to internal control over financial reporting beyond what is required by the Revised Certification Materials? If so, what should be the nature of any different requirements?	No.
<b>Management's assessment of internal control over financial reporting</b>	
3. Should the term "management" be formally defined? If so, what would be an appropriate definition?	No, we do not see the need for a more precise definition of the term "management."
4. If "management" is not defined, is the guidance in the Proposed Internal Control Policy adequate and appropriate?	The guidance is adequate and appropriate and leaves the chief executive officer and chief financial officer some latitude to assess, based on their corporate structure and governance practices, the involvement required of other members of management in order to provide them with the comfort needed to sign off on the certification.
<b>Scope of evaluation</b>	
5. Is the guidance set out in the Proposed Internal Control Policy with respect to the scope of the evaluation of internal control over financial reporting in relation to each of the circumstances set out above adequate and appropriate?	The scope of evaluation as described in the Policy Statement to Multilateral Instrument 52-111 is similar, in many respects, to that described in point 40 of Auditing Standard No. 2 – Internal Control of the PCAOB. It is vague on the concept of significant account and does not include some already highly controversial aspects such as assessing the likelihood of a deficiency, determining the entities to cover and the use of the work of internal audit. In our opinion, this brief description will not make it possible to adequately restrict the scope of the work recommended by the firms of external auditors, which are very cautious and conservative (in order to reduce the risk of litigation) when interpreting the more detailed recommendations of the U.S. oversight board. Important representations have been made to the SEC concerning these interpretations with a view to reducing the adverse effect of these requirements on reporting issuers. On May 16, the PCAOB responded by issuing a Policy

	<p>Statement providing guidance to external auditors so that they can better plan the work required to implement Auditing Standard No. 2. The impact of this guidance on the scope of work and the use of the work of others has yet to be evaluated and will be the subject of extensive discussions. In an environment where the Bank relies on a competent and independent internal audit function, the outcome of those discussions could significantly alter our implementation strategies. In short, we are concerned that Canadian issuers will face the same difficulties if an effort is not made to more precisely define the concepts of materiality, scope of work, and use of the work of the internal audit function to support certifications.</p> <p>Finally, in the banking industry, where assets are very important, the single concept of materiality, calculated using a percentage of pre-tax net earnings, results in a coverage in excess of 80% for all balance sheet items and a coverage in excess of 99% for 75% of items. In our opinion, this coverage is excessive. This is a direct consequence of the lack of precision in the description of the scope of evaluation and the conservative stance adopted by the firms of external auditors.</p>
<b>Suitable control framework</b>	
6. Are there any other control frameworks that should be identified in the Proposed Internal Control Policy as satisfying the criteria for a suitable control framework?	Yes. As the required controls include IT controls, it would appropriate for the Instrument to identify suitable IT control frameworks (e.g., COBIT).
7. Are there any specific aspects of the identified control frameworks on which additional guidance is required to assist in their application by issuers that have limited formal structures for internal control over financial reporting?	Certain bodies have established a correspondence between the COBIT and COSO models in order to identify IT aspects pertinent to financial data. The draft instrument should make reference to the documents the financial market authorities deem pertinent.
<b>Evidence</b>	
8. Is the guidance in the Proposed Internal Control Policy regarding the content of the evidence adequate and appropriate?	Yes.
9. Are the requirements in the Proposed Internal Control Instrument regarding the manner in which the evidence must be maintained adequate and appropriate? Is the guidance in the Proposed Internal Control Policy regarding the manner in which the evidence may be	Yes.

maintained adequate and appropriate?	
10. Is the requirement in the Proposed Internal Control Instrument on the period of time during which the evidence must be maintained adequate and appropriate?	Yes.
<b>Internal control report</b>	
11. Is it appropriate to require disclosure of any limitations in management's assessment of the effectiveness of an issuer's internal control over financial reporting extending into a joint venture, VIE or acquired business? If not, are there alternative ways of providing transparency with respect to any limitations in management's assessment?	<p>To the extent that the data relating to such businesses are material in the Bank's consolidated balance sheet and there are actual limitations in management's assessment of the effectiveness of internal control in those businesses, we feel that disclosure of any limitations in the assessment is justified. However, this requirement must take the materiality of the entities concerned into account.</p> <p>Lastly, if the acquired business enjoyed exemption privileges, the acquirer should retain those privileges.</p>
12. Are there any other circumstances under which management may reasonably limit its assessment? Should disclosure of these circumstances be required?	If an entity acquires or merges with a business not previously subject to this instrument, limiting the assessment should be permitted for a minimum of two years as of the acquisition or merger date, i.e., the time required to integrate the business and to review and improve its processes in order to subsequently document and assess its controls.
<b>Exemptions</b>	
13. Are the exemptions from the Proposed Internal Control Instrument appropriate?	We agree with the exemptions provided for under the Instrument.
14. Are there any other classes of issuers that should be exempt from the Proposed Internal Control Instrument?	Idem question 13
<b>Effective date and transition</b>	
15. Is the phased-in implementation of the Proposed Internal Control Instrument appropriate?	<p>The phased-in implementation of the instrument is commendable and gives non-venture issuers with a lower market capitalization reasonable time to comply. However, several factors lead us to conclude that the deadline of June 30, 2006 (for non-venture issuers with a market capitalization of more than \$500 million) is too ambitious. These factors are:</p> <ul style="list-style-type: none"> <li>• the late date on which the Instrument will be adopted (fall 2005 at the earliest);</li> <li>• the fact that the compliance date in the U.S. market has been deferred from July 2005 to July 2006 for foreign issuers, demonstrating that they are</li> </ul>

	<p>facing major compliance challenges;</p> <ul style="list-style-type: none"> <li>• the scope of the work to be performed in a context where materiality and the level of risk are strongly influenced by highly cautious and conservative external auditors;</li> <li>• expected changes concerning the scope of the work to be performed, in light of the American experience, post mortems and current pressures on the U.S. capital markets;</li> <li>• the effect on the business (in our particular case, a federally chartered bank) of carrying out this work simultaneously with the work required by the Basel Accord;</li> <li>• the need for the business to continue operating.</li> </ul> <p>We strongly recommend that the deadline be extended by at least one year, to June 30, 2007, and preferably to a date corresponding to 24 months following adoption of the Instrument.</p>
<p>16. Does the phased-in implementation adequately address the concerns regarding the cost and limited availability of appropriate expertise within reporting issuers and among external advisors and auditors? If not, how can these concerns be addressed?</p>	<p>The costs of implementing this instrument are related more to the scope of the work to be performed than to the time required to complete the work (see response to question 5). Nonetheless, spreading the work out over time results in lower costs by reducing the need for overtime and the substantial use of external consultants, to the extent that they are available. It also alleviates, without eliminating it altogether, the problem of there being a limited pool of expertise available. The effect of these advantages is far less pronounced for businesses required to comply by June 30, 2006. Consequently, by deferring the deadline to June 30, 2007 or, preferably, 24 months following adoption of the Instrument, we could achieve several objectives:</p> <ul style="list-style-type: none"> <li>• benefit better from the American experience by correcting already identified errors and more effectively targeting the level of documentation and assessment of the scope of work;</li> <li>• improve the quality of information produced;</li> <li>• reduce implementation costs;</li> <li>• alleviate the problem of there being a limited pool of expertise available.</li> </ul>

<b>Anticipated costs and benefits</b>	
<p>17. Are there any costs or benefits associated with the Proposed Internal Control Materials that have not been identified in the Internal Control CBA? If so, what are they?</p>	<p>The following advantage is omitted from the study: The creation of structured risk and control documentation should reduce the risk related to the turnover rate and facilitate staff succession and training.</p> <p>The study also does not mention the following disadvantage: In the banking sector, the combined effect of the work required by Multilateral Instrument 52-111 on internal control, that required by the OSFI for purposes of compliance and the activities related to the new Basel Accord may take away from the time management would normally devote to strategic sales and business development. Therefore, in addition to the costs associated with compliance, there is an opportunity cost related to the potential loss of revenues and the postponement of investments in areas such as technology.</p>
<p>18. Do you believe that the benefits (both quantifiable and unquantifiable) justify the costs of compliance (both quantifiable and unquantifiable) for:</p> <p>(a) issuers with a market capitalization of less than \$75 million?</p> <p>(b) issuers with a market capitalization of \$75 million or more but less than \$250 million?</p> <p>(c) issuers with a market capitalization of \$250 million or more but less than \$500 million?</p> <p>(d) issuers with a market capitalization of greater than \$500 million?</p> <p>(e) all issuers?</p> <p>Why?</p>	<p>We believe that the benefits will justify the costs of compliance if, and only if, the draft texts on internal control are applied in an effective and responsible manner in order to maintain a reasonable cost/benefit ratio and to enable a realistic assessment of risks that takes into account the commercial and business imperatives of the issuer.</p>
<b>Alternatives considered</b>	
<p>19. Do you agree with our assessment of the identified alternatives?</p>	<p>Yes, we agree with your assessment.</p>
<p>20. What other alternatives, if any, would achieve the objectives identified above?</p>	<p>We generally agree that we should harmonize our approach with U.S regulations in order to keep methodology development and implementation costs to a minimum. Moreover, harmonization will put Canadian companies on an equal footing with their American counterparts.</p>
<b>Refile document</b>	
<p>21. Is it necessary or appropriate to require a venture issuer to refile its annual certificates for</p>	<p>Does not apply in our case.</p>

a financial year when it voluntarily files an AIF for that financial year after it has filed its annual financial statements, annual MD&A and annual certificates for that financial year?	
22 . Since the AIF may be voluntarily filed several months after the issuer's annual financial statements and annual MD&A, there may be a significant gap between the time that the annual financial statements and annual MD&A are filed and the time that the annual certificates are refiled. Is this timing gap problematic?	Does not apply in our case.
23. Is the guidance regarding the treatment of underlying entities set out in the Revised Certification Policy adequate and appropriate?	The guidance provided is clear.