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June 16, 2005

Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Office of the Attorney General, Prince Edward Island

Securities Commission of Newfoundland and Labrador
Registrar of Securities, Government of Yukon
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

Attention: John Stevenson, Secretary
Ontario Securities Commission
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Re: Request for comment : PROPOSED MULTILATERAL INSTRUMENT 52-111
AND COMPANION POLICY 52-111CP
REPORTING ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND
PROPOSED REPEAL AND REPLACEMENT OF MULTILATERAL INSTRUMENT 52-109,
FORMS 52-109F1, 52-109FT1, 52-109F2 AND 52-109FT2
AND COMPANION POLICY 52-109CP
CERTIFICATION OF DISCLOSURE IN ISSUERS' ANNUAL AND INTERIM FILINGS

Dear Sir:

Grant Thornton LLP and Raymond Chabot Grant Thornton LLP (we) thank you for the opportunity to comment on the CSA's proposed new instruments and the amendments to existing instruments.

The CSA's proposal essentially follows the model implemented in the United States (U.S.) with two exceptions:

1. a phase-in period for the equivalent of Section 404 requirements of the Sarbanes Oxley Act (the Act) based on the market capitalization of the Reporting Issuer.

2. an exemption from the Section 404 requirements for Venture Issuers and investment companies.

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The CSA's desire to balance the cost of the regulations regarding internal control over financial reporting (internal control) with the associated benefits is admirable. It is also clear that the CSA recognizes the limited and strained availability of resources in the marketplace that could help Reporting Issuers comply with the proposed regulations.

We believe that the following analysis of the results of the U.S. experience and our associated recommendations should be considered before finalizing your approach.

The U.S. model was designed such that management first certified the design effectiveness of internal control. Within 12 months, management further certified the operating effectiveness of internal controls with their annual filings. Management's process and assertions regarding internal control are also subject to an independent audit.

Statistics that accurately or conclusively analyze the U.S. experience probably do not exist. Our support for the following analysis comes from information available on www.complianceweek.com and from first hand experience.

Comment 1 – auditor involvement is key to accurate and complete internal control disclosures

The early U.S. experience indicates that few companies initially realized they had material weakness in internal controls. Therefore, these weaknesses were not disclosed. The number of material weakness disclosures increased through 2004 as auditors began documenting, analyzing and testing internal controls and companies gained increased awareness.

Section 404 of the Act required Issuers to involve their auditor in their process. We believe that this required involvement of the auditor is one of the significant reasons underlying the increased disclosures of material weaknesses in U.S. filings.

Comment 2 – the size of the Reporting Issuer directly impacts the probability that material weaknesses exists

The statistics available on www.complianceweek.com indicate that about 10% of companies have disclosed material weaknesses. We have not been able to obtain statistics by size of the company. However, statistics by audit firm are available and are, perhaps, a rough surrogate.

The percent of clients disclosing material weaknesses for each of the Big 4 firms basically tracks the 10% average. However, the percent of clients disclosing material weaknesses for each of Grant Thornton LLP and BDO Seidman LLP is about 25%. These two firms are primarily focused on auditing entities that are not included in the Fortune 500.

While this analysis has statistical weaknesses, our experience indicates that it is reasonable to conclude that the size of the company is a significant determinant of the frequency of encountering actual material weaknesses in internal control. We raise this point as the majority of Canadian Reporting Issuers are significantly smaller than the average Issuer in the U.S.

From this analysis we raise the following risk that the current proposals may create in Canadian capital markets:

> Absent the involvement of the auditor, the percentage of Canadian Reporting Issuers having actual but undisclosed material weaknesses will be higher than the U.S. experience (cite *Comment 1).*

This risk may be significant in the Canadian context. Due to their smaller size, the proportion of Canadian Reporting Issuers with actual but undisclosed material weaknesses in internal control may in all likelihood be higher than the 10% to 25% cited above under *Comment 2. Transition* and *Venture Issuers* are the Reporting Issuers that are subject to this risk.

This risk is acute for Venture Issuers as the proposed regulations would never subject them to the requirements of 52-111 (i.e., auditor involvement will never be required) and they typically are small entities.

This risk is also significant for the entities classified as *Transition 2* and *Transition 3 issuers.* These Reporting Issuers have a long transition period between management's certification of design effectiveness and management certification and auditor attestation of operating effectiveness of internal controls.

> ***Recommendation 1:*** Management's certification of the operating effectiveness of internal control and the related auditor attestation should closely follow management's certification of the design effectiveness of internal control. The time period between the two requirements should not exceed one year.
>
> This objective could be achieved by allowing all Reporting Issuers to file the *Modified Certificate* (which focuses on design and operating effectiveness of disclosure controls) until they are subject to the requirements proposed under MI 52-111. Venture Issuers will not be subject to MI 52-111 and therefore would only be required to file the *Modified Certificate.*

Comment 3 – there are large Venture Issuers

Venture Issuers are typically small companies. However, the Instrument's definition of Venture Issuers is broader than companies traded on the Venture Exchange. For example, there are large entities that issue public debt, do not have securities traded on an exchange and therefore would be classified as a Venture Issuer.

While measurement of benefits is subjective, many people feel that formal reporting on the effectiveness of internal control does add value and plays an important role in protecting the public interest.[1]

> ***Recommendation 2:*** in the interest of protecting the public, present and future large cap Venture Issuers should be subject to the requirements of proposed MI 52-111. Companies would require time to establish the systems, processes and documentation that are necessary to comply with the regulations. Therefore, in the year subsequent to meeting the large cap criteria, it would be appropriate to require in their next annual filings management certification of design effectiveness of internal control only. Management certification of operating effectiveness of internal control and the related auditor attestation would follow in the year subsequent to the certification of design effectiveness.

Appendix 1 contains feedback on the specific questions contained in the CSA's Request for Comment.

Questions on these comments may be directed to the undersigned.

Yours truly,

Richard L Wood, C.A.
National Auditing Standards Partner
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[1] For example, at the recent C.I.C.A. / Institute of Corporate Directors Policy Forum about 90% of the participants expressed at least some agreement with the two following statements "securities regulators are proposing that management and auditors of TSX listed companies provide readers of financial statements with formal reports on the effectiveness of internal control over financial reporting. These new formal internal control reports will: (1) improve the quality and reliability of corporate financial disclosures and (2) be useful to investors in Canada's capital markets.

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Appendix 1
Feedback on Specific Questions

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?

   No – see Comment 3

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 – see Comment 3

3. Should the term "management" be formally defined? If so, what would be an appropriate definition?

   No – we agree with the CSA's position

4. If "management" is not defined, is the guidance in the Proposed Internal Control Policy adequate and appropriate?

   Yes

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?

   Yes

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?

   No- we are not aware of any additional established frameworks

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?

   Prior to the requirements of the Sarbanes Oxley Act there was little consistency in applying control frameworks. This situation was particularly true in the application of internal control frameworks to meet the specific objectives of internal control over financial reporting. Significant guidance has been published in the U.S. and more guidance is anticipated. As this is both a complex and judgmental subject, companies and auditors would also welcome additional guidance.

   That said, the question refers to "issuers that have limited formal structures". It should be stated that to achieve the objectives of internal control formal structures are a basic requirement. Issuers that have limited formal structures likely will not be able to achieve design or operating effectiveness of internal control. This will be the situation for a lot of Venture Issuers. As discussed in comment 2, having Venture Issuers certify on the design of internal controls with no requirement to certify on effectiveness may prove to be misleading based on the US experience. As implied in recommendation 1, we recommend that Venture issuers, if provided an exemption on effectiveness certification of internal controls, also be

provided an exemption on design certification on internal controls.

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 maintained adequate and appropriate?

   Yes

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

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?

    Yes

12. Are there any other circumstances under which management may reasonably limit its assessment? Should disclosure of these circumstances be required?

    No

13. Are the exemptions from the Proposed Internal Control Instrument appropriate?

    Yes

14. Are there any other classes of issuers that should be exempt from the Proposed Internal Control Instrument?

    No

15. Is the phased-in implementation of the Proposed Internal Control Instrument appropriate?

    No – see comments 1 and 2.

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?

    No – see comments 1 and 2.

    In our experience, the total cost of implementing the systems necessary to comply with the regulations can be divided into two roughly equal parts. Part one involves documentation, design analysis and remediation (akin to design effectiveness). Part two involves testing, remediation and re-testing (akin to operating effectiveness).

The proposed phased-in period causes all Reporting Issuers to complete "part one" for their 2006 filing. Therefore, the proposal requires all Reporting Issuers to compete for scarce resources in the market place at the same time.

We believe the approach put forward in recommendation 1 would address this concern.

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?

    We have nothing to add to those identified.

18. Do you believe that the benefits (both quantifiable and unquantifiable) justify the costs of compliance (both quantifiable and unquantifiable) for:
    a. issuers with a market capitalization of less than $75 million?
    b. issuers with a market capitalization of $75 million or more but less than $250 million?
    c. issuers with a market capitalization of $250 million or more but less than $500 million?
    d. issuers with a market capitalization of greater than $500 million?
    e. all issuers?

    Why?

    We believe that making improvements and monitoring internal control will yield benefits to all businesses. We encourage the exercise of caution in attempting to measure the cost-benefit of the proposed regulations. The U.S. experience is the only benchmark. When examining the U.S. experience many environmental conditions need to be considered as part of the analysis including: (a) existing weaknesses in corporate practice (b) the cost effect of non-negotiable deadlines (c) time crunch caused by underestimating the size of the projects and the delays in making appropriate plans and taking timely actions (d) unclear expectations of management and auditors [a lot of the guidance did not get published until late in the year] (e) one time cost investments [e.g., documentation of systems] and (f) the scarcity of expertise. It will likely be two more years before there is sufficient stability in Issuer's and auditor's processes that would enable a fair assessment.

19. Do you agree with our assessment of the identified alternatives?

    Yes – however, please refer to recommendations 1 and 2.

20. What other alternatives, if any, would achieve the objectives identified above?

    Yes – however, please refer to recommendations 1 and 2.