

J. C. Smith

June 28, 2005

Alberta Securities Commission  
4<sup>th</sup> Floor, 300-5<sup>th</sup> Avenue S.W.  
Calgary, Alberta  
T2P 3C4

Attention: Kari Horn  
Acting General Counsel

Dear Ms. Horn:

Re: Proposed MI 52-111

I was inspired by your presentation at the ASC Chief Accountant's Conference last week to comment on the proposed rules which would require Canadian companies to follow internal control reporting standards similar to the US Sarbanes-Oxley rule 404 ("SOX").

My letter is based on long experience gathered in the accounting and financial area, including:

- I am a long time Chartered Accountant who also delivers continuing education programs to CA's in Western Canada on topics including corporate governance.
- I have acted as CFO of a large Canadian issuer and am currently the part time CFO of a very small venture exchange issuer.
- I manage the funds of my family, whose income today and in the future will come primarily from investments.
- I act as a director (and audit committee chair) of five Canadian public companies, two of which are listed on the TSX, two on the Venture exchange and one whose application for listing on the Venture exchange is pending.

I have always felt, and continue to feel, that the SOX internal control legislation is deeply flawed. If we review the corporate reporting scandals in the US and Canada over the last several years, a common theme of these issuers has been widespread management collusion in schemes to present financial reporting in a fashion which benefited the issuer and obscured the truth of non-routine transactions. The focus of SOX 404 has become routine transactions, which are seldom the cause of material financial mis-statements. Despite the recent Scrusby decision, it seems to me that the certification process provides securities regulators with a sound statute on which to base a prosecution of any parties involved in any future incidents similar to those of the last few years.

However, I realize that the whole SOX process is intended to bolster investor confidence that had reached an alarming low after the Enron case became public. While I, as an

3839-10 Street S.W., Calgary, Alberta, T2T 3J2  
Phone: (403) 617-4472 Fax (403) 287-2764  
Email: smithjc@shaw.ca

J. C. Smith

investor, take little comfort from SOX 404, many less informed investors may take comfort in the regulations. Therefore, I would agree that it may be necessary for Canadian regulators to recognize the US trends and implement a response, particularly for issuers whose investors market includes significant numbers of investors in the United States.

My request is that this response recognize the major differences between Canadian and US issuers and that most Canadian issuers that seek substantial investment from the US are inter-listed in the US and will, from 2006 onward, be required to meet SOX 404 in their reporting.

Virtually all Canadian issuers are small companies by US standards. The exemption of Venture exchange issuers from 52-111 is a good start to recognizing this critical difference. However, the exemption needs to be extended further because the control frameworks contemplated under SOX 404 simply are not applicable to the majority of Canadian issuers. For example, an oil and gas company with 10,000 BOE/d of production would probably generate about \$70-80 million in annual funds flow (before working capital changes) and be valued at \$200-400 million in today's market. However, that company would probably have a total financial staff of 8-12 people, which is insufficient to introduce any formal framework such as COSO. In fact, the company can probably afford only one person with any experience in financial reporting and may rely on its auditors as an essential part of its control process through the experience they can bring to the reporting process.

I would respectfully submit that Canadian securities regulators consider the following changes to the principles underlying the proposed 52-111 rules:

- The full internal control reporting requirements would only be applicable to the largest Canadian issuers – probably only those to be included in the first year of the proposed implementation schedule.
- The implementation schedule be deferred by at least one year to permit companies sufficient time to complete the significant amount of work required to comply with 52-111. I have spoken at length with senior officials from US and Canadian issuers that are subject to SOX 404 and their experience suggests that there is insufficient time now to implement the internal controls rules by the end of next year. In addition, there are not enough qualified accounting people available at the present time to finalize the SOX 404 compliance for foreign issuers and to assist with compliance with similar domestic regulations at the same time.
- The rules be written in a manner that requires (not just encourages) auditors to consider the comments of the PCAOB and its staff issued on May 16 of this year. Unless the consideration of risk and integration of the control audit with the regular audit are mandated to auditors, auditors will continue to follow the path which exposes them to the lowest legal risk – audit everything.
- Smaller companies that are exempt from the 52-111 requirements still be required to certify internal control over financial reporting. The possible legal ramifications of making such certifications without appropriate due diligence should encourage signing authorities of these companies to ensure that their internal control processes are appropriate for the scale and scope of their operations.

3839-10 Street S.W., Calgary, Alberta, T2T 3J2  
Phone: (403) 617-4472 Fax (403) 287-2764  
Email: smithjc@shaw.ca

J. C. Smith

It may also be useful to provide educational opportunities for CEOs and CFOs of the smaller companies to develop a better understanding of risk areas in financial reporting and the types of controls that represent accepted practice to minimize such risks.

As noted earlier, I recognize that a Canadian internal control response to bolster market confidence is appropriate. I only ask that we develop a response that recognizes the types of issuers we have in Canada and does not impose an undue burden on those companies.

Yours truly,

3839-10 Street S.W., Calgary, Alberta, T2T 3J2  
Phone: (403) 617-4472 Fax (403) 287-2764  
Email: [smithjc@shaw.ca](mailto:smithjc@shaw.ca)