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New Brunswick Securities Commission
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Re: Response to Proposed Multilateral Instrument 52-111 and Companion Policy 52-111CP

We are writing in response to the request for public comment made by the members of the Canadian Securities Administrators (the CSA). We are pleased to provide our comments on what we deem to be a very important proposal for the Canadian Capital Markets.

While we have a number of specific comments and issues for the CSA to consider, we emphasize at the outset our strong support for the introduction of mandatory reporting on internal control over financial reporting with auditor attestation for TSX registrants.

Our response includes a discussion on several areas that we consider important. We have included in Appendix 1 a table that sets out our responses to the specific questions included in your request for comments.

The Need For Reporting on Internal Control over Financial Reporting

In our view, formalized reporting on internal control over financial reporting will, in the longer term, produce substantial benefits to reporting issuers and investors and enhance the credibility of Canada's Capital Markets. We also believe that a decision to not adopt formal reporting on internal control over financial reporting with auditor attestation could create negative and unfair perceptions by investors, rating agencies and foreign regulators about the quality of management and governance in Canadian companies.

We commend the CSA for their efforts to estimate and assess both the benefits and the costs associated with implementing these proposals. We support the CSA's efforts to estimate and assess the highly intangible social benefits that would result from the adoption of these proposals as set forth in the report "The Cost and Benefits of Management Reporting and Auditor Attestation on Internal Controls over Financial Reporting" prepared by Charles River Associates Canada Ltd. While this analysis of the potential benefits is highly subjective, we believe that the approach used by Charles River Associates is reasonable and their conclusions are supportable. Estimating the benefits is, in our view, not only useful, but necessary. A decision to not estimate the benefits because of the estimation difficulty would give undue prominence to the cost side of the equation, which of course is much easier to accumulate or estimate.

We believe that the benefits associated with these new disclosure and reporting requirements will in the long term exceed the costs involved – recognizing that, while these costs would likely decline following the initial implementation, these costs are, and will be, significant. The detailed comments which follow are intended to help the CSA refine and improve these proposals, and should not be interpreted as any indication of our lack of support for the overall thrust of these proposals.

We are providing a copy of our response to the Canadian Institute of Chartered Accountants, as a number of our comments relate to the Auditing Standards, which while not formally included in this proposal, are central to many of the issues contained therein.

Expectation Gap Regarding Material Weakness Disclosures

In our view it is the disclosure of material weaknesses in internal control and management's remediation plans or alternatively disclosure of the absence of material weaknesses that provides important information for investors.

Under the CSA proposals, if material weaknesses or deficiencies are discovered by management or the external auditors of TSX issuers, then disclosure of such weaknesses will be required and this information will be available to investors in making investment decisions. We believe that this is an important and significant enhancement in corporate reporting.

We are concerned that this principle has not been extended to TSX-V issuers to require them to also disclose material weaknesses in internal control over financial reporting at least to the extent that management is aware of known material weaknesses in internal control over financial reporting.

Canada's Capital Markets, together with other Capital Markets across the globe, now essentially operate as an online real-time continuous disclosure system. If our markets are to operate efficiently, then reporting issuers must provide, and be perceived to provide, timely, accurate and reliable information to investors. Investors must have confidence in both the information disclosed and the accounting and disclosure systems that produce this information. Providing investors with a greater degree of assurance about the effectiveness of disclosure controls and internal control over financial reporting will, in our view, enhance investor confidence in our Capital Markets.

At the present time, investors and shareholders are not provided with sufficient information to enable them to assess or monitor the quality of internal controls in the companies in which they invest or plan to invest. They cannot distinguish between companies who place a high priority on internal control over financial reporting, and are prepared to make the related investments, and those companies who have material weaknesses and inadequate remediation plans. A failure to disclose the existence of material weaknesses in internal control over financial reporting increases the risks for investors with respect to any investment decision that is based on financial information produced by the systems containing such weaknesses.

As external auditors, we have always been troubled in client situations where weaknesses in internal control necessitate conducting a substantive audit approach. In these circumstances, the external auditor would be expected to comply with the communication requirements set forth in the CICA Handbook (for example the requirements in Sections 5135, 5136, 5141, 4143, 5220 and 5751) and to provide senior management and the audit committee with an assessment of those weaknesses in internal control over financial reporting that have come to the auditors' attention. The investors, however, would only be provided with the unqualified opinion on the financial statements.

In our view this situation creates two problems. First, investors are not informed about any material weaknesses in internal control which were identified in the annual audit, which could impact the integrity and reliability of financial information in quarterly reporting and timely disclosure releases. Second, this practice creates an "expectation gap" between what investors may expect the external auditor to do and provide and the information presently made available to them as investors concerning material weaknesses in internal control over financial reporting. Many may still believe that an unqualified auditor's report on the financial statements extends to the systems that produce this information as well as the financial statements – which is clearly not the case. The CSA proposals expand and make more explicit the auditor's responsibilities for internal control over financial reporting and would, in our view, reduce this expectation gap.

Auditor Attestation

In our view, auditor attestation is necessary to ensure effective and consistent evaluations across reporting issuers.

The report "The Cost and Benefits of Management Reporting and Auditor Attestation on Internal Controls over Financial Reporting" prepared by Charles River Associates Canada Ltd. states on page 59.

> *Eliminating the cost of auditor attestation would reduce compliance costs on the order of 50% for the same quality level of internal controls. However, absent auditor attestation, there may be considerable variation in the extent to which issuers document, test, and improve their internal controls. As a result, the information value to investors of management reports on internal controls may be significantly diminished.*

We agree with the above assessment. Auditor attestation, at least to the extent proposed in MI52-111, is required, in our view, to ensure effective and consistent evaluations across reporting issuers. Without auditor attestation we seriously doubt whether those issuers that are required to complete an evaluation of internal control over financial reporting will do so consistently or devote the level of effort, diligence and discipline necessary to report information on internal controls of value to investors and thereby enhance the credibility of Canada's capital markets.

In 1992, the Accounting Standards Board issued CICA Handbook Accounting Guideline 7, "The Management Report" which states in part in Paragraph .03 that "The Accounting Standards Board is of the opinion that, when an entity's annual financial statements are distributed widely, a management report should be presented". Pursuant to Paragraph

.06 the management report is to acknowledge management's responsibility for various matters including "the development of internal controls over the financial reporting process designed to provide reasonable assurance that relevant and reliable financial information is produced". Presently the external auditor is not required to provide any assurance on this management report.

In our view, the management report required by Accounting Guideline 7 has become a perfunctory piece of disclosure, is not subjected to any formal audit requirement (other than the limited audit procedure pursuant to CICA Handbook Section 7500.23) or governance review and is not supported by any standardized or consistent assessment or evaluation of internal controls to support the statements made in such reports.

The following two examples of actual disclosures made by public companies in these management reports illustrate that the disclosures, currently made in response to Accounting Guideline 7, are very general in nature, relate to the design of internal control systems and provide little if any information on whether these systems of internal control are operating effectively or not.

> *The Company maintains systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and the Company's assets are appropriately accounted for and adequately safeguarded.*

> *Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or unauthorized use and financial records are properly maintained to provide reliable information for preparation of financial statements.*

We are not aware of any company that disclosed material weaknesses in internal control in these management reports.

We also fully support the proposal that the participating audit firm that prepares the auditor's report on the financial statements must be the same as the participating audit firm who prepares the audit report on internal control over financial reporting. We also agree that the participating audit firm must plan and coordinate their processes of documenting and testing the internal control over financial reporting to support both their opinions on internal control over financial reporting and their opinion on the financial statements.

Auditing Standards

We note that the proposal calls for the external auditor to perform his or her work in accordance with standards to be established by the Canadian Institute of Chartered Accountants (CICA). As a result, we are providing the CICA Auditing Standard Board with a copy of our response to these proposals.

We believe that it is very important for the Auditing and Assurance Standards Board to balance two competing priorities, namely the need for harmonization of Canadian auditing standards with those set forth by the Public Company Accounting Oversight Board (PCAOB) in the United States and the unique implementation challenges occasioned by the realities of the Canadian marketplace. Our concern is the prescriptive manner in which the United States standards issued by the PCAOB are being written and applied in practice. We believe that cost effective implementation requires the auditor to exercise considerable judgment. We believe that this point was raised by several commentators at the SEC Public Forum in early April this year. We therefore encourage the Auditing and Assurance Standards Board, in consultation with the PCAOB whenever possible, to provide for and encourage the use of professional judgment and that prescriptive rules and tests are presented as guidance to support the exercise of professional judgment and not as a substitute therefore.

Further, we would suggest that the Auditing and Assurance Standards Board initiate a project to revise Generally Accepted Auditing Standards so as to functionally integrate, update and streamline the existing standards for reporting on internal control, reporting on annual financial statements, and interim reviews of quarterly financial reports. The objective would be to produce a single, integrated set of auditing standards that would enable the profession to perform a more cost effective "integrated audit" which will support multiple opinions and/or reports that meet the needs of the audit committee, board of directors and investors. In this review, the Auditing and Assurance Standards Board should include an assessment of the auditors' association and involvement with disclosure controls, the CEO/CFO certification process and the Management Discussion and Analysis (MD&A) and integrate these items into the integrated audit in a meaningful and practical manner. In the material that follows in this letter, we identify several areas of overlap where integrated guidance would, in our view, serve the public interest.

Integration of Multilateral Instrument ("MI") 52-109 and MI 52-111

We view the internal control over financial reporting proposals as being highly integrated with the requirements for CEO/CFO Certification and to a lesser extent the disclosure requirements for the MD&A. The integration of these two instruments (MI52-109 and MI52-111) presents a particular communication challenge for the Canadian Securities Administrators.

We agree with the position put forward in section 2.1 of MI52-109 that all reporting issuers, irrespective of any listing exchange must have disclosure controls and procedures and internal control over financial reporting. We suggest, however, that the adjective "effective" be inserted before "disclosure controls" to indicate that it is not acceptable to just design effective disclosure controls and internal controls, they must be operationally effective.

We urge the CSA to address the consequence for companies who are found not to have effective disclosure controls and internal control over financial reporting. We note that in the United States, SEC registrants may be subjected to severe penalties if they are found to not have effective internal controls. Also in the United States the establishment of effective internal control and other "due diligence" procedures can serve to reduce the sentences imposed by the courts on companies who are convicted of certain offences. We believe that in Canada the requirement for having effective disclosure controls and internal control over financial reporting is not as clear and that the penalties are not nearly as severe. The CSA needs to ensure that there are substantive and meaningful penalties for not maintaining effective disclosure controls and internal control over financial reporting.

We note that the evaluation of disclosure controls does not require a separate report, but states that the CEO and the CFO certify they have evaluated disclosure controls and that they have disclosed in the annual MD&A their conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings. With respect to internal control over financial reporting, management of issuers listed on the TSX must issue a separate report on the results of their evaluation. Management must disclose in the annual MD&A, and not in the internal control report, any change in the issuer's internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

The end result is that information on an issuer's disclosure and internal control is provided to investors in multiple documents – the CEO and CFO certificates, the MD&A and the management report on internal control. We suggest that the CICA's Corporate Performance Reporting Board, in consultation with the CSA, develop guidance for a

separate section of the MD&A dealing with the various disclosures related to both disclosure control and internal controls over financial reporting. This additional guidance when presented in the MD&A could help investors understand the various documents that contain control related information and help the reader understand management's assessment of these control matters, the results of the various evaluations and management's actions and plans to correct any identified deficiencies and material weaknesses. In this regard, we believe it is very important for management to not only disclose material weaknesses in either disclosure controls or internal control over financial reporting but to also disclose their actions and plans to correct these deficiencies. We believe the MD&A is the best place to provide such disclosures.

Responsibilities of the CEO and CFO

We support the CSA proposal that the CEO and CFO should both sign off on the design and evaluation of both disclosure controls and internal control over financial reporting. We also agree that the operational effectiveness of these controls should be evaluated on an annual basis, and not on a quarterly basis. We note that the Instrument does not define "management". We believe that the CEO and CFO need to take responsibility, individually and jointly, for the management report on internal control over financial reporting as they are required to do for the evaluation of disclosure controls. The CEO and CFO (or persons performing similar functions to a chief executive officer or chief financial officer), should be able to determine the other members of management that should be involved in the process of preparing the management report on internal control over financial reporting, but they should not be able to delegate or avoid the overall responsibility for the report or its content.

As stated earlier, the management reporting on internal control over financial reporting is highly integrated with the CEO/CFO Certification process, which requires separate certificates to be signed by the CEO and CFO. We also note that the responsibility for certifying on the design of internal control over financial reporting must be performed by the CEO and CFO. However, when it comes to the evaluation, MI 52-111 is not as clear and seems to suggest that the term management could be someone other than the CEO and CFO. In our view, this introduces an unnecessary level of confusion into the document. In practical terms, it seems clear to us that it is the CEO and CFO who must provide the management report on the evaluation. As a result, we suggest that the final standard make it clear that the CEO and CFO are responsible for the design of, the evaluation of and the reporting on internal control over financial reporting and they therefore should sign the management report on internal control over financial reporting.

The Need for Guidance for Management

At the present time, the guidance with respect to management's evaluation and testing of internal control over financial reporting stems primarily from the standards issued by the PCAOB in the United States. In other words, it is auditing standards and guidance that is providing the direction for management with respect to their evaluation and reporting on internal control over financial reporting.

We are strongly of the view that guidance should be developed to assist management in the design, evaluation and reporting of internal control. We believe this guidance should be developed by the Canadian Institute of Chartered Accountants, be developed in a way such that it can evolve and grow as we gain experience, and provide examples of management reporting on internal controls. In other words, it should not be prescriptive rules.

This guidance should address both disclosure controls and internal control over financial reporting. The guidance should also deal with the use of the CoCo framework. In our view the CoCo framework contains a number of desirable elements that should be emphasized. Consideration should be given to providing guidance as to how to integrate the CoCo elements and the COSO control framework. The lack of guidance with respect to the design and evaluation of disclosure controls is, in our view, even more acute and requires attention.

We also believe that the guidance for management should include the requirement for a "scope" paragraph in the management report on internal control over financial reporting that describes the nature and extent of their assessment of internal control over financial reporting and the types of procedures performed to evaluate and test internal controls.

Without such a "scope" paragraph in the management report supported by meaningful standards and guidance for management, we fear that the nature and extent of management's work on evaluating and testing internal control over financial reporting will be driven by the auditing standards and the work of the external auditor. This, unfortunately in our view, has contributed to date to a "bottom up" focus rather than a "top down" risk based focus. We believe this has been the source of much of the confusion and costs that have been incurred in the initial round of assessments in the United States.

Recognition that there can and may well be differences in the scope of the work performed by management and the auditor should also be noted in the guidance (and that management teams may wish to consider audit efficiencies and costs in determining the nature, timing, and extent of their testing; and the competency and objectivity of client personnel responsible to the conduct of the testing of controls).

The Need For A Meaningful Risk Assessment

Many commentators on the approach taken to compliance with Section 404 in the United States have observed that the application of the US standards in the first year of application did not differentiate sufficiently between areas of high risk and low risk, and that there was not enough emphasis placed on entity-level or company level controls. We support these observations and believe that these deficiencies should be addressed in the MI 52-111. We think this would increase the benefit for both companies and investors since it would ensure that control testing is biased towards the areas of greater risk.

To achieve this objective, we believe that both management and the external auditors must be able to exercise professional judgment in determining the scope of the evaluation and the nature and depth of testing of controls. We believe the current standards in the United States have been, to date, too frequently implemented in a prescriptive manner and that this tends to discourage the exercise of professional judgment. While we take some comfort in the recent guidance issued by the PCAOB and the SEC encouraging the use of more judgment in the application of the rules, we note that the announcements do not constitute a change in any of the "rules" and believe that more can be achieved. There is no reason why we cannot accomplish this in Canada.

Our experience to date suggests that the first year application of the US requirements and related auditing standards often resulted in a "bottom up" approach to the documentation and testing of internal controls that does not necessarily direct management or the external auditors' attention and allocation of resources to the areas of greatest risk. We believe that the management guidance recommended above should include an explicit requirement that management perform a meaningful assessment, regardless of the control framework utilized in their assessment, of inherent risk (i.e., the risk of a material error occurring before management considers the effectiveness of controls) for both disclosure controls and internal control over financial reporting before the evaluation of control design and the testing of the operational effectiveness of controls is performed.

In our view, the nature and extent of an evaluation of internal control (that done by both management and the external auditor) should be based on this assessment of inherent risk so that the majority of the testing performed is focused on controls over specific risks or high risk areas. This would help align the level of effort in testing internal control with the areas of greatest importance. We believe that application of the US standards may have resulted in too much work being done testing internal control in areas where there are no specific risks or the risk of a material error occurring is assessed as being low.

Areas of high inherent risk areas would normally include the recording of transactions or events that are not subjected to a formal structured process such as manual journal entries, non-routine and non-systematic transactions, and accounting estimates which require a great degree of judgment in their determination.

Materiality and Classification of Control Deficiencies

The concept of a "material weakness" in internal control over financial reporting plays a central role in the theoretical underpinnings of these proposals. The CSA proposal states that a "material weakness" has the meaning ascribed to it in the proposed CICA Standard, which in turn states:

> *"Material weakness" means a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected."*

The CICA definition is identical to the US definition and incorporates the three part framework for assessing control deficiencies and weaknesses set forth in PCAOB Auditing Standard No. 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements".

We point out two critical elements of this definition. First, it does not change the definition of what is material to the financial statements.

Second, any internal control failure, irrespective of whether it results from a failure in control design or operation, is considered to be a control deficiency.

We note that control deficiencies can be inconsequential, significant or material. Control deficiencies are considered to be significant deficiencies if they would result in "more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected." Significant control deficiencies must be reported to the registrant's audit committee but not disclosed. Material weaknesses must be reported to the audit committee and disclosed.

While we support this three part conceptual framework for analyzing and reporting control deficiencies, the underlying practices for categorizing deficiencies are complex, detailed, difficult to apply, and are challenging to explain to audit committees and other directors. We use this as an illustration of an area where there ultimately is a need for greater use of professional judgment and a potential example of where the detailed US

guidance for the categorization of deficiencies will benefit from experience in application and a maturing in understanding amongst management and auditors; and an area where Canada can benefit, in terms of audit efficiency, from the United States experience.

Role of the Board and the Audit Committee

MI 52-111 proposes that the management report on internal control over financial reporting be reviewed and approved by the board of directors, and there is no mention of the role of the audit committee. In our view, this introduces an unnecessary level of confusion. While it is the responsibility of the board to approve all disclosure documents, we believe the practical approach for most companies is to have the audit committee review the management report on internal control over financial reporting and propose it to the board for approval. This approach would be consistent with the audit committee's role in its review of the financial statements and MD&A (which will now contain information related to disclosure controls and internal control over financial reporting). Alternatively, if it was the specific intent of the CSA to have the boards of directors review and approve the management report (as is the case with financial statements pursuant to MI 52-110), and presumably to consider the effectiveness of the audit committee as an element of internal control as part of its consideration, we believe it would be desirable to indicate that intention and the reason therefor more directly. Should the CSA ultimately determine that the audit committee should review the reporting on internal control over financial reporting; a corollary amendment to MI 52-108 would be required to include this within the responsibilities of the audit committee.

Regardless of the above determination and on a broader note, we suggest the CSA also take this opportunity to clarify the role of the audit committee and board of directors in the CEO/CFO Certification process. Since Multilateral Instrument 52-110 requires the audit committee to review and approve the financial statements, MD&A and earnings press release before they are issued, we believe audit committees have a vital interest in the CEO/CFO Certification process. We think it is important for audit committees to be informed by the CEO and CFO of the procedures they have put in place to support their certifications and of course their conclusions. We suggest that the CSA consider a separate section on board and audit committee oversight responsibilities with respect to both the CEO/CFO Certification process and management reporting on internal control over financial reporting.

Controls in Small ("Small Cap") Issuers

We recognize, however, that the control issues in small cap companies are very different from those in large cap companies. In some cases we suspect control in small cap companies is actually superior, but it is often not subjected to the same level of documentation and formality that exists in large cap companies. For this reason we support the continued study of controls in small cap organizations and encourage the utilization of the guidance under development in the United States at this time (which guidance we understand may not result in an alternative COSO framework for smaller organizations but rather in the identification of control techniques that might be appropriate to achieve the objectives of the COSO control framework in smaller organizations). While we support the benefits of using this US material, we also believe that Canadian small cap companies are both more numerous and smaller that those in the United States. In fact, Canada has a higher incidence of 'micro caps' and therefore, we think the guidance being developed in the United States may not fully address the Canadian situation.

The current proposals require management of all reporting issuers (large cap and small cap) to certify on the design of disclosure controls and internal control over financial reporting, and to certify that they have evaluated disclosure controls. The proposals also require management of all issuers to disclose material changes to internal control over financial reporting. Since financial statements are documents that are required to be filed with securities regulators, many key internal controls over financial reporting are subsumed in the definition of disclosure controls. As a result management in small cap issuers will be required to consider the design and evaluate internal control over financial reporting at least to the extent required in order to certify to disclosure controls and to report material changes in internal control over financial reporting. What is proposed is that the results of management's evaluation and /or the related work on internal control completed in conjunction with the audit of the financial statements would not be made public and therefore any material weaknesses identified in management's evaluation, or by the external auditors, would also not be made public. While we presently agree with the less rigorous governance requirements for small cap issuers, we do not believe that there should be a difference when it comes to disclosures of material weaknesses known to management, the external auditors or the directors. We think this sets a dangerous precedent.

Proposed Exemptions for Venture Issuers

The Proposed MI 52-111 continues a trend started in previous Multilateral Instruments (e.g., MI52-110) which provides for exemptions for issuers listed on the venture exchange.

In MI 52-110, venture issuers are allowed to have directors on their audit committees that do not meet the standards of independence and financial literacy required of audit committees listed on the TSX. In MI 52-111, venture issuers are exempted from a requirement that management evaluate and publicly report on internal control over financial reporting and for auditor attestation related to internal control over financial reporting.

The CSA appears to be adopting a dual standard regulatory policy with respect to securities regulation in Canada. It would appear that the CSA's intent is for reporting issuers listed on the Toronto Stock Exchange to operate at close to North American, or world-class standards. We fully support this notion and believe that it is in the public interest. Reporting issuers on the venture exchange, however, would be permitted to operate at a lower standard, with reduced level of governance and oversight, reduced external auditor involvement and reduced disclosure for investors. As noted above we have serious concerns with this philosophy and approach to regulatory policy, especially with respect to the disclosure of material weaknesses and fraud known to management.

While we agree that the burden imposed on small cap companies needs to be carefully considered and that every effort needs to be made to reduce such cost burdens, we do not agree that there should be different disclosure standards depending on the size of the company or whether the company is listed on the TSX or the TSX-V. We would prefer the staggered implementation approach utilized elsewhere in MI 52-111 which provides for staggered implementation for the disclosure of material weakness and fraud by TSX-V listed issuers, thereby providing small cap companies more time to prepare for new disclosure requirements.

Presently there is no specific requirement that all Canadian issuers disclose known material weaknesses in internal control over financial reporting. The proposed MI 52-111 would bring the requirements to disclose material weaknesses into play for TSX issuers. Present regulations do not specifically require the disclosure of known material weaknesses in internal control over financial reporting by TSX-V issuers.

The Corporate Governance Guidelines and Disclosure

While we strongly support the proposed management report on internal control, the disclosure of material weaknesses in internal control and auditor attestation, we wish to briefly discuss a potential conflict in the application of MI 52-111 that, we believe, could create some implementation issues and ultimately have a negative impact on the effectiveness of these proposals to prevent or detect the overriding of internal controls or other fraudulent or improper actions involving the CEO and his or her direct reports.

Many, if not most, of the accounting scandals in the past few years have involved the CEO and one or more of his or her direct reports – quite often the CFO. These executives are, of course, the persons who are given the primary responsibility for the design of the company's disclosure controls and internal controls and must often make important accounting and disclosure decisions. The CEO and CFO must sign the certificates required by 52-109 that publicly acknowledges this responsibility.

The management report on internal control over financial reporting, with the attestation of the external auditor, will provide investors with reasonable assurance that the CEO, CFO and top management have put in place appropriate internal controls, and that these controls are operating effectively. Setting an appropriate "tone at the top" and designing effective entity level controls are a key component of an effectual internal control system, but by themselves they are not entirely sufficient to prevent, or control, the behavior of an unethical CEO or CFO who is intent on manipulating the accounting system and financial reporting for his or her personal gain.

The CSA has recently issued National Policy 58-201: Corporate Governance Guidelines and National Instrument 58-101: Disclosure of Corporate Governance Practices, that set forth important governance practices, which together with the proposed requirements of MI 52-111 and MI 52-109 will, in our view, constitute a reasonable regulatory framework setting forth the governance and management responsibilities, and the distinction between the two. We believe that NP 58-202 and NP 58-101 set forth the proper guidelines and expectations for the board of directors on key issues like defining the responsibilities of the CEO, the need for the board to satisfy itself as to the integrity of the CEO and other executive officers, the responsibilities and composition of the compensation committee, the need for a code of business conduct and ethics, and the need for the CEO and other executive officers to create a culture of integrity throughout the organization.

It is the board of directors, and its committees like the audit committee, who are the only persons capable of exercising any degree of control over the CEO. It is important for preparers, investors and auditors to understand that the board and audit committee have governance and oversight responsibilities for disclosure controls and internal controls, but conceptually they are not part of the internal control system (i.e., the separation of governance and management means the audit committee cannot be part of a control system that it is responsible for overseeing). We believe that this distinction needs to be emphasized more in MI 52-111.

Our point is one of emphasis and monitoring compliance. The matters addressed in NP 58 201 must be in place if internal control systems are to operate effectively and the objectives of MI 52-111 are to be achieved. Similarly, the design and evaluation of disclosure controls and internal controls contained in MI 52-109 and MI 52-111 are needed to ensure that the appropriate operating controls are working properly and can be relied on.

While we congratulate the CSA for putting all these various elements in place, we point out what we believe is an important communication challenge. In our view, it is important for the CSA to communicate the linkage and interrelationships of these various policies and instruments so that boards of directors, management and external auditors can understand the interrelationships and interdependencies, and ensure that all components are implemented in a cost effective manner.

It is also important for the CSA to effectively monitor compliance with NP 52-201 and NI 52-101 by reporting issuers.

The Need For A National Securities Regulator

We conclude with a comment on the process followed in Canada for setting these rules. We are becoming increasingly concerned about the fragmented nature of this process and the fact that uniform agreement cannot be obtained by the provincial and territorial securities regulators. Every rule-making initiative seems to involve new sets of compromises, exemptions and conflict among the provincial securities regulators. In our view, this reinforces the call that has come from many quarters, and many high profile commissions, that Canada needs a national securities regulator to set national policies that focus on the interests of the country.

We join in what we believe is an increasing chorus of business leaders urging the CSA members and federal government to put their individual interests and agendas aside and focus on the overall needs of the Canadian Capital Markets and their credibility in the global marketplace. We are a small country, with a very small proportion of the global market capitalization. Canadian needs for capital far exceed our domestic supply. Adopting a philosophy of differential disclosure and governance standards, or a multiple jurisdictional system for securities regulation in Canada, will not, in our view, enhance the attractiveness or credibility of the Canadian Capital Markets or our ability to effectively regulate our own markets.

Should you wish to discuss this response to your request for comments please contact either James L. Goodfellow at 416-601-6418 or Brian J. Reinke at 416-601-5757.

Yours truly,

cc. Mr. David Smith, FCA
President and CEO
Canadian Institute of Chartered Accountants

Appendix 1 Response to Specific Questions

In your request for public comment you specifically requested that we consider several questions. Our comments regarding each of the questions are as follows:

Question	Response
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?	Yes --
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?	Yes, Venture issuers would, in our view, have to complete a more limited evaluation of their internal control over financial reporting in order to complete their evaluation of disclosure controls. In our view all issuers should be required to disclose known material weaknesses in their internal control over financial reporting. In our view all issuers should be required to disclose any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting. See also sections titled "Auditing Standards", and "Control in Small ("Small CAP") Cap Issuers" in our detailed letter.
3. Should the term "management" be formally defined? If so, what would be an appropriate definition?	Yes, see section titled "Responsibilities of the CEO and CFO" in our detailed letter.
4. If "management" is not defined, is the guidance in the Proposed Internal Control Policy adequate and appropriate?	No
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?	No, we believe more guidance for management is needed. See also sections titled "The Need for Guidance for Management" and "The Need For A Meaningful Risk Assessment" in our detailed letter.
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 suggest that the CICA "integrate" the Canadian COCO framework with the US COSO framework. See section titled "The Need for Guidance for Management" in our detailed letter.
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?	Yes. See our response to question 6 above. We believe further guidance concerning entity level controls, risk assessment and the application to small cap companies would be desirable. See sections titled "The Need for a Guidance for Management", "The Need For A Meaningful Risk Assessment", and

Question	Response
	"Control in Small Cap Issuers" in our detailed letter.
8. Is the guidance in the Proposed Internal Control Policy regarding the content of the evidence adequate and appropriate?	No. See our response to question 7 above.
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?	There are likely rare circumstances stemming, for example, from complex governance structures or potential legal requirements. In such circumstances we recommend disclosure of (1) the circumstances giving rise to the scope limitation, (2) the governance/controls in place and (3) the significance/ materiality of the excluded businesses should be required.
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 - The position of non share capital reporting issuers should be clarified.
15. Is the phased-in implementation of the Proposed Internal Control Instrument appropriate?	Yes However, the position of non share capital reporting issuers should be clarified.
16. Does the phased-in implementation adequately address the concerns regarding the cost and limited availability of appropriate expertise within reporting the issuers and among external advisors and auditors? If not, how can these concerns be addressed?	Yes
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?	Not aware of any.
18. Do you believe that the benefits (both quantifiable and unquantifiable) justify the costs of compliance (both quantifiable and unquantifiable) for:	Yes for all categories. See section titled "The Need For Reporting on Internal Control over Financial Reporting" of our detailed letter.

Question	Response
(a) issuers with a market capitalization of less than $75 million? (b) issuers with a market capitalization of $75 million or more but les 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?	It is important that TSX issuers be seen to and in fact adhere to world class governance and reporting standards.
19. Do you agree with our assessment of the identified alternatives?	Yes, we believe the CSA's proposal is the preferred alternative. See section "The Need For Reporting on Internal Control over Financial Reporting" of our detailed letter
20. What other alternatives, if any, would achieve the objectives identified above?	We support the proposed alternative. Given the objective of improving the reputation of the Canadian market more generally, we believe that disclosure of additional control related information including disclosure of remediation plans should be considered. Disclosure by venture issuers of known material weaknesses in internal control over financial reporting and of any known fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal control over financial reporting is consistent with this overriding objective and should, in our view, be required.
21. Is it necessary or appropriate to require a venture issuer to refile its annual certificates for 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?	We believe that the refiling of annual certificates would be appropriate and would serve to confirm that there have been no material changes to the related financial statements and annual MD&A.
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?	We believe that the AIF should clearly set forth any material changes to the information presented in the related financial statements and annual MD&A. Assuming this is the case the proposed certificates would be appropriate and desirable as the "annual filings" referred to in the certificates should collectively be "certifiable" using the proposed certificate wording.
23. Is the guidance regarding the treatment of underlying entities set out in the Revised Certification Policy adequate and appropriate?	Generally the guidance is adequate and appropriate. In practice the phrase "all reasonable steps" is open to interpretation. We believe that the guidance would be less open to interpretation if "all reasonable steps" included a requirement for evidence of a formal request (and desirably of a denial of access).