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June 30, 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

c/o John Stevenson, Secretary
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– and –

Anne-Marie Beaudoin, Directrice du secretariat
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Dear Sirs/Mesdames:

Request for Comments regarding Proposed Multilateral Instrument 52-111 and Companion Policy 52-111CP Reporting on Internal Control Over Financial Reporting (the "Instrument") 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

We are submitting this letter to you in response to the Request for Comments published at (2005) 28 OSCB 1277. Our responses to the specific questions asked in the Request for Comments appear first, followed by our other comments on the proposed Instrument. Terms which are defined in the Request for Comments or Instrument are used similarly in this letter.

The point which we feel is most important in the discussion about the proposed Instrument is what it does not yet address, but which we feel it should. Like its U.S. counterpart, the Instrument does not provide guidance as to the purpose of requiring internal control over financial reporting, and the expectation of the regulators as to how that purpose is to be achieved. The SEC and PCAOB have now issued guidance to SEC registrants and, more importantly, their auditors on these points, based on the first year's experience of SEC registrants with SOX 404.[1]

The SEC Report states:

> "An overall purpose of internal control over financial reporting is to foster the preparation of reliable financial statements. Reliable financial statements must be materially accurate. Therefore, a central purpose of the assessment of internal control over financial reporting is to identify material weaknesses that have, as indicated by their very definition, more than a remote likelihood of leading to a material misstatement in the financial statements. While identifying control deficiencies and significant deficiencies represents an important component of management's assessment, the overall focus of internal control reporting should be on those items that could result in material errors in the financial statements."

It advises that "staff believes that management should use a top-down, risk-based approach in determining significant accounts and related significant processes and relevant assertions" and further states:

> "Indeed, an assessment of internal control that is too formulaic and/or so detailed as to not allow for a focus on risk may not fulfill the underlying purpose of the

[1] Division of Corporate Finance, Office of the Chief Accountant, U.S. Securities and Exchange Commission "Staff Statement on Management's Report on Internal Control Over Financial Reporting" (May 16, 2005); Public Company Accounting Oversight Board Release 2005 – 009 "Policy Statement Regarding Implementation of Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*" (May 16, 2005).

> requirements. The desired approach should devote resources to the areas of greatest risk and avoid giving all significant accounts and related controls equal attention without regard to risk."

We encourage the CSA to take this opportunity to leverage from the U.S. experience and amend the Instrument and Companion Policy to explicitly require a similar approach by management and auditors in discharging the internal control reporting and internal control audit requirements of the Instrument.

As noted below, we also think that, instead of the phased implementation approach adopted by the Instrument, there is merit to limiting the application of the Instrument to Canada's largest issuers and, based on experience with their compliance with the Instrument, considering whether to amend the Instrument to apply to smaller issuers.

Specific Requests for Comment

1. While there may be value to applying the provisions of the proposed Instrument to Canada's largest reporting issuers, we doubt whether the benefit of extending the requirement to smaller reporting issuers will exceed the cost of compliance. We therefore agree with excluding venture issuers from its application.

2. The requirements for venture issuers set out in the Revised Certification Materials are appropriate.

3. No definition of management is needed. We would note that no such definition has ever been provided in connection with the term "management's discussion and analysis".

4. The guidance is satisfactory.

5. Additional guidance with respect to the scope of the evaluation of internal control over financial reporting where the controlled entity is also subject to CEO/CFO certification and a management report on internal control, would be desirable.

6. No comment.

7. No comment.

8. Additional guidance, in the Instrument itself, respecting the type of evidence which must be maintained would be helpful. For example, the obligation should be to maintain evidence <u>sufficient</u> to provide reasonable support for

management's assessment, not <u>all</u> evidence that provides reasonable support for management's assessment.

9. If there is going to be an obligation to maintain the evidence, the nature of the obligation should be <u>to take reasonable steps</u> to maintain the evidence. Additional changes should be made to the Instrument and to the guidance provided. The issuer is not guaranteeing that all evidence is to be maintained since evidence may be lost due to force majeure or accident. Nor should it be necessary that any more evidence than what is sufficient to provide reasonable support should be maintained.

10. Provided that the evidence is limited to what is sufficient to provide reasonable support and the obligation is to take reasonable steps to maintain it, the period of time provided is reasonable.

11. It is appropriate to include disclosure of 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.

12. Management should be able to reasonably rely on assessments with respect to subsidiaries that are subject to similar obligations with respect to internal control certification and/or reporting without having to duplicate review of the subsidiary's systems. Disclosure of these circumstances should be required.

13. The exemptions are appropriate.

14. Issuers that are subsidiary entities should also be exempt from the proposed Instrument if they meet the requirements set out in Section 1.2(e) of Multilateral Instrument 52-110.

15. As noted above, we doubt whether the value of implementing the Instrument with respect to reporting issuers other than the largest Canadian reporting issuers exceeds the cost. We would suggest that rather than phasing in implementation, the Instrument be restricted to Canada's largest issuers. Following completion of a year, the CSA could then examine such issuers' experience with the implementation of the Instrument and, with the benefit of more information relating to costs, make a more informed decision as to whether to amend the Instrument so that it would apply to smaller issuers.

16. Phased-in implementation allows more junior issues to piggyback off the experience realized by more senior issuers, but only to the extent that they postpone taking action. Smaller issuers may face criticism or pressure to comply before the phased in deadline – which is inappropriate if there is a possibility that

a cost/benefit analysis will result in an indefinite postponement of the delayed compliance date. Moreover, as issuers are already facing difficulties in sourcing personnel to assist with internal control review and assessment it would help ease the pressure to limit application of the Instrument to just the largest issuers. These concerns can be addressed by limiting the application of the Instrument to Canada's largest issuers as noted above.

17. We are not aware of any additional costs or benefits, but do note the considerable concern being voiced to the SEC concerning the burdens which issuers feel SOX 404 is imposing upon them.

18. We agree with (d). As noted previously, however, we believe that the Instrument should only be made applicable to the largest reporting issuers.

19. We generally agree with the assessment of the alternatives; however, as noted above, we feel that more limited scope of application is not as problematic as suggested and offers some practical benefits. The CSA could always, based on an assessment of experience with the Instrument as it applies to more senior issuers, determine later whether to extend the application of the Instrument to more junior issuers and then amend the Instrument.

20. We are not aware of any other alternatives to those set out in the Request for Comments.

21. It is not appropriate to require a refiling of the annual certificates by the venture issuer because of the gap in time. Although the AIF is filed with respect to a financial year, it should take into account subsequent events. The certificate will also bear a later date. The annual financial statements and MD&A, however, since they have already been filed, will not have been so updated. It may be difficult to still conclude that the financial statements and MD&A "fairly present" matters without taking into account events subsequent to the year end.

22. Yes, the gap is problematic as noted above.

23. The expectation that management will have sufficient access to a subsidiary to evaluate the issuer's internal control over a financial reporting in the subsidiary will not be true in all cases, especially where the subsidiary is itself a public company. In such circumstances, the degree of control by management of the parent is constrained by prohibitions against participation by representatives of the parent on the subsidiary's audit committee and constraints on representation by the parent's management or the board of directors of the subsidiary to the extent the subsidiary complies with Multilateral Policy 58-201.

Other Comments

- The definition of "material weakness" proposed by the CICA is too low a threshold. Casting the test as "more than a remote likelihood" will result in matters being treated as material weaknesses even though a reasonable person would think that the risk of a misstatement occurring is not material.

- We suggest that the value of plain vanilla non-convertible, non-participating preferred shares be excluded from the calculation of "market capitalization of equity securities" in section 1.3 since these are equivalent to subordinated debt.

- Subsection 2.5(1)(f) – the subsection seems to permit disclosure in the internal control report of any limitations in management's assessment only to the extent the limitations relate to a joint venture or variable interest entity. Management should be able to disclose any limitations in its assessment, regardless of the reasons.

- Section 2.6 – the board of directors should be able to delegate approval of the internal control report to the audit committee.

- Section 5.1 – NI 51-102 requires delivery to persons who request delivery pursuant to a request form. However, issuers also have the alternative of voluntarily sending annual financial statements to all securityholders, in which event the requirement to send annual financial statements does not apply. Thus, it is not clear what is meant in Section 5.1 when it states that an issuer must send an internal control report when the issuer "must" send its annual financial statements and MD&A under NI 51-102. Also, under Section 4.6 of NI 51-102, issuers are required to send financial statements to anybody who requests them except where the financial statements were filed more than two years before the issuer received the request. For issuers that are required to send financial statements in respect of a year in which they did not prepare an internal control report (because they were not required to) Section 5.1 should clarify that it is not necessary to prepare such a report. There are circumstances where an issuer may be required to send annual financial statements as part of another continuance disclosure document, such as an information circular prepared in connection with a special meeting to approve a transaction. It is not clear whether Section 5.1 is intended to require that the report be provided in those circumstances as well; presumably it should not. Perhaps rephrase Section 5.1 as follows:

  > "When an issuer sends its annual financial statements and annual MD&A for a financial year to a person pursuant to Section 4.6 of NI 51-102 it must also send to the person or

> company, concurrently and without charge, a copy of its internal control report and internal control audit report, if any, prepared for that financial year."

- Section 6.1(1) should be rephrased as "an issuer required to file internal control reports and internal control audit reports under this Instrument may file them in French or in English".

- Section 6.1(3) – it is not clear what obligation this is intended to impose upon an issuer.

- The reference in Section 3.1(1) of the Companion Policy that participating audit firms may assist management in documenting internal control over financial reporting without compromising their independence is a welcome and helpful clarification.

- Part 6 of the Companion Policy – there is a discussion about the liability of officers for misrepresentations that may be contained in an internal control report and of audit firms with respect to internal control audit reports. It would be helpful, however, also to reference the potential exposure of directors with respect to the internal control report and, possibly, the issuer.

We are pleased to have had an opportunity to comment on the proposals contained in this Request for Comment. If you have any questions or comments, please do not hesitate to contact Andrew MacDougall at (416) 862-4732.

Yours very truly,

OSLER, HOSKIN & HARCOURT LLP
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