

1.1.4 CSA Notice 52-313 - Status of Proposed MI 52-111 Reporting on Internal Control over Financial Reporting and Proposed Amended and Restated MI 52-109 Certification of Disclosure in Issuers' Annual and Interim Findings

CANADIAN SECURITIES ADMINISTRATORS NOTICE 52-313

**STATUS OF
PROPOSED MULTILATERAL INSTRUMENT 52-111
REPORTING ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

AND

**PROPOSED AMENDED AND RESTATED MULTILATERAL INSTRUMENT 52-109
CERTIFICATION OF DISCLOSURE IN ISSUERS' ANNUAL AND INTERIM FILINGS**

Purpose of this notice

The securities regulatory authorities in all Canadian jurisdictions are issuing this notice to update market participants on the status of our deliberations on proposed internal control reporting requirements.

After extensive review and consultation and in view of the delays and the debate underway in the US over the rules implementing section 404 of the *Sarbanes-Oxley Act of 2002* (the Sox 404 Rules), we have determined not to proceed with proposed Multilateral Instrument 52-111 *Reporting on Internal Control over Financial Reporting* (Proposed MI 52-111).

As more fully discussed below, we propose to expand Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (MI 52-109) to include the following additional provisions in respect of internal control over financial reporting:

- The CEO and CFO of a reporting issuer, or persons performing similar functions, will be required to certify in their annual certificates that they have evaluated the effectiveness of the issuer's internal control over financial reporting as of the end of the financial year and caused the issuer to disclose in its annual MD&A their conclusions about the effectiveness of internal control over financial reporting as of the end of the financial year based on such evaluation.
- The issuer will not be required to obtain from its auditor an internal control audit opinion concerning management's assessment of the effectiveness of internal control over financial reporting.
- These requirements will apply to all reporting issuers, other than investment funds, in all Canadian jurisdictions.
- The *earliest* that these requirements will apply is in respect of financial years ending on or after December 31, 2007.

Background

On February 4, 2005, the securities regulatory authorities in every Canadian jurisdiction, other than British Columbia, published for comment Proposed MI 52-111 and a proposed amended and restated version of MI 52-109.

Proposed MI 52-111, as it was published for comment, was substantially similar to the requirements of the Sox 404 Rules. Under Proposed MI 52-111, management of an issuer would have been required to evaluate the effectiveness of the issuer's internal control over financial reporting, as at the end of the issuer's financial year, against a suitable control framework. In addition, the issuer would have been required to file the following with the securities regulatory authorities:

- a report of management on its assessment of the effectiveness of the issuer's internal control over financial reporting, including a statement as to whether the issuer's internal control over financial reporting is effective; and
- a report of the issuer's auditor prepared in accordance with the CICA's auditing standard for internal control audit engagements.

The British Columbia Securities Commission did not publish Proposed MI 52-111 for comment; however, it published and sought comment on its views on internal control reporting requirements under BCN 2005/08 *BCSC Comments on Proposed Multilateral Instrument 52-111*.

The comment period on Proposed MI 52-111 and the proposed amended and restated MI 52-109 expired on June 30, 2005. We received and reviewed 64 comment letters on Proposed MI 52-111 and the amended and restated MI 52-109 and five comment letters on the British Columbia Securities Commission's request for comment. We also actively solicited feedback on Proposed MI 52-111 through discussion forums held in Vancouver, Calgary and Toronto and consultation with a wide range of

stakeholders, including reporting issuers, audit firms and legal advisers to reporting issuers, internal control consultants and investor groups. In addition, we closely monitored ongoing developments in the US surrounding the Sox 404 Rules and the related internal control auditing standard.

Proposed internal control reporting requirements

What will we require?

After careful consideration of the feedback received and recent developments internationally, particularly in the US, we propose to expand MI 52-109 to include the internal control reporting requirements discussed below.

- The CEO and CFO of a reporting issuer, or persons performing similar functions, will be required to certify in their annual certificates that they have evaluated the effectiveness of the issuer's internal control over financial reporting as of the end of the financial year. They will also be required to certify that, based on their evaluation, they have caused the issuer to disclose in its annual MD&A their conclusions about the effectiveness of internal control over financial reporting as of the end of the financial year.
- As noted above, the issuer's annual MD&A will include disclosure regarding its internal control over financial reporting. This disclosure will include a description of the process for evaluating the effectiveness of the issuer's internal control over financial reporting and the conclusions about the effectiveness of internal control over financial reporting as of the end of the financial year.

The issuer will not be required to obtain from its auditor an internal control audit opinion concerning management's assessment of the effectiveness of internal control over financial reporting.

The board of directors and its audit committee, in consultation with management, may choose to consider whether they wish to engage the issuer's auditor to assist in discharging their respective responsibilities for (i) the issuer's internal control systems and (ii) review and approval of the issuer's annual MD&A. However, engagement of the auditor will not be a requirement under MI 52-109.

The proposed internal control reporting requirements discussed above do not diminish the existing obligations of the issuer's auditor under generally accepted auditing standards to (i) understand the issuer's internal controls relevant to the audit of the issuer's financial statements and (ii) read materials with which the auditor is deemed to be associated, such as the issuer's MD&A, assess whether they are inconsistent with their knowledge and take appropriate action if they are aware of any material misstatements of fact or, if applicable, misrepresentations.

What are we trying to achieve with these internal control reporting requirements?

The objectives of the proposed internal control reporting requirements are to improve the quality, reliability and transparency of financial reporting. We believe the proposed additional internal control reporting requirements will increase management's focus on, and accountability for, the quality of internal control over financial reporting. This will contribute towards achieving our objectives while balancing the costs and benefits associated with the internal control reporting requirements.

We intend to monitor implementation of the proposed approach and to evaluate the extent to which it has been effective in achieving our objectives. CSA staff will review the disclosure in the MD&A regarding internal control over financial reporting, together with the related certifications, as part of our continuous disclosure reviews. We may enquire into the procedures that support the disclosure and certifications, particularly where the continuous disclosure filings contain material misstatements or apparent errors.

Based on the results of this monitoring and in light of experience in Canada and internationally, we will consider in the future whether a requirement for auditor involvement with the evaluation of the effectiveness of an issuer's internal control over financial reporting would contribute in a cost-effective manner to further improving the quality and consistency of disclosure to investors.

To whom will these internal control reporting requirements apply?

We propose that the additional internal control reporting requirements apply to all reporting issuers, other than investment funds. This is consistent with the current scope of application of MI 52-109.

We do not propose to distinguish between non-venture issuers and venture issuers, with the result that issuers will have to comply with the additional internal control reporting requirements regardless of where their securities may be listed or quoted. This proposal recognizes that internal control over financial reporting is important for all reporting issuers, regardless of their size or listing.

When will these internal control reporting requirements apply?

We believe the process of evaluating the effectiveness of internal control over financial reporting will be a significant undertaking for many issuers. Therefore, we intend to allow significant lead time for issuers to plan and implement efficiently the activities required to support the additional certifications and disclosure relating to internal control over financial reporting. The *earliest* that these requirements will apply is in respect of financial years ending on or after December 31, 2007. We propose a single implementation date for all issuers.

Will the requirement for CEOs and CFOs to certify that they have designed internal control over financial reporting and caused the disclosure of certain changes in internal control over financial reporting be deferred?

Currently under MI 52-109, beginning with financial years ending on or after June 30, 2006, CEOs and CFOs, or persons performing similar functions, are required to certify that they have designed internal control over financial reporting and caused certain changes in internal control over financial reporting to be disclosed in the issuer's MD&A. The implementation of these requirements will not be deferred even though we propose to implement the requirement to certify the evaluation of the effectiveness of internal control over financial reporting at a later date.

Will the additional internal control reporting requirements affect the requirement for CEOs and CFOs to evaluate the effectiveness of disclosure controls and procedures?

No. CEOs and CFOs, or persons performing similar functions, are required to certify that they have evaluated the effectiveness of disclosure controls and procedures as of the end of the financial year for financial years ended or ending on or after March 31, 2005. Please refer to our responses to comments in respect of amendments to MI 52-109 set out in our notice dated April 1, 2005 for guidance on how to implement this requirement.

Project plan

The foregoing is a high-level summary of our proposed internal control reporting requirements. We intend to seek public comment on the proposed requirements, together with other amendments to MI 52-109 previously published for comment in February 2005. Accordingly, we will publish an amended and restated MI 52-109 for comment later this year.

Withdrawal of notices

We have determined that the following notices are no longer required and they are therefore withdrawn in all Canadian jurisdictions in which they were published:

- Canadian Securities Administrators Staff Notice 52-308 *Status of Proposed Instrument regarding Reporting on Internal Control over Financial Reporting*; and
- Canadian Securities Administrators Notice 52-310 *Regarding Proposed Timing of Proposed Multilateral Instrument 52-111 and Companion Policy 52-111CP Reporting on Internal Control over Financial Reporting*.

Questions

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