



Implications of Proposed National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings

In March of 2006, the Canadian Securities Administrators (CSA) announced that they would not proceed with Multilateral Instrument 52-111, *Reporting on Internal Control over Financial Reporting* (MI 52-111) which proposed an internal control audit opinion on management's assessment of the effectiveness of internal control over financial reporting (ICFR). At the same time, the CSA warned reporting issuers (Issuers) that the decision to forgo MI 52-111 was not a signal that internal controls were unimportant as they also announced plans to amend Multilateral Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings* (MI 52-109) to expand the CEO/CFO certification requirements to include design and effectiveness of ICFR requirements for all Issuers, including venture issuers.

On March 31, 2007, the CSA released the details of its proposed new approach for additional provisions relating to ICFR which, if adopted, will take effect June 30, 2008. The key elements of the proposed National Instrument 52-109 *Certification of Disclosure in an Issuers' Annual and Interim Filings* (Proposed NI 52-109 or Proposed Instrument) are that:

- it replaces the current MI 52-109;
- there is no requirement for external auditor attestation;
- all Issuers, including venture issuers, are required to evaluate the design and effectiveness of both Disclosure Controls & Procedures (DC&P) and ICFR;
- Issuers must follow documentation requirements for ICFR;
- there is increased disclosure in the Management Discussion and Analysis (MD&A) regarding DC&P and ICFR;
- they have introduced the concept of a "reportable deficiency";
- reportable deficiencies, which could relate to either weaknesses in design or effectiveness of ICFR, must be disclosed in the MD&A along with a description of the deficiency and plans to remediate;
- venture issuers (and only venture issuers) may indicate why reported deficiencies cannot be reasonably remediated;
- there are permissible exclusions for the reporting on ICFR for: i) proportionately consolidated entities; ii) variable interest entities; and iii) acquisitions within 90 days of period end, assuming certain disclosure requirements are met;
- there is a requirement to re-file certificates if the financial statements, MD&A or Annual Information Form are re-filed; and
- interim certificates have the same requirements as the annual certificates except for the evaluation of effectiveness of DC&P and ICFR.

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Reportable Deficiencies

Perhaps the most significant change reflected in the Proposed Instrument is the introduction of the concept of a reportable deficiency. Understanding the definition of a reportable deficiency is crucial, as they must be disclosed in the MD&A. Proposed NI 52-109 defines a reportable deficiency as follows:

“reportable deficiency” means a deficiency, or combination of deficiencies, in the design or operation of one or more controls that would cause a reasonable person to doubt that the design or operation of internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Issuer’s GAAP.

Implications:

- It will take some time for the industry to adjust to this definition and arrive at some consistency as to its application.
- Companion Policy to Proposed NI 52-109 (Proposed NI 52-109CP) indicates that “there must be no material misstatement in the annual or interim financials”; thus the definition of reportable deficiency is at least at the same threshold as a material weakness (used by Sarbanes Oxley section 404 (SOX 404)) and could possibly be less.
- Reportable deficiencies relate only to ICFR; thus it appears that it is acceptable for an Issuer to conclude that weaknesses in DC&P exist without further disclosure in the MD&A, provided those weaknesses do not relate to ICFR.

Proposed Changes to Full Certificate Disclosures

A comparison of the full annual certificate disclosure requirements under the current and proposed rules is provided in Appendix A. The more significant changes to certificate disclosures include:

- a statement identifying the control framework the certifying officers used to design the Issuer’s ICFR or a statement that they did not use a framework, as applicable.

Implications:

- Proposed NI 52-109 does not require certifying officers to design ICFR using a control framework or to evaluate the effectiveness of ICFR against a control framework. However, the use of a control framework (a recognized set of internal controls expected in an organization) is best practice. Certifying officers would likely find it useful to refer to a control framework when designing or evaluating the effectiveness of ICFR in order to ensure they have considered all relevant aspects of internal control.
- Most Issuers refer to the *Internal Control - Integrated Framework* (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework has become the de facto internal control framework due to its reference in the Sarbanes Oxley Act. While other suitable frameworks exist, there are significant resources and publications available on the COSO Framework and external expertise is easiest to find with respect to the COSO Framework.
- NI 52-109CP includes a discussion with respect to a ‘Top-down’ approach to documenting and evaluating ICFR. The CICA has several publications in their series entitled *Internal Control: The Next Wave of Certification* that provides guidance to management on how the Top-down approach might be implemented.
- COSO has also issued *COSO - Guidance for Smaller Public Companies* which small issuers may find useful.

- if applicable, the Issuer must disclose in its annual MD&A, for any reportable deficiency relating to design of ICFR that existed at the financial year end:
 - a description of the reportable deficiency;
 - a description of the remediation plan to address the reportable deficiency; and
 - the completion date or expected completion date of the remediation plan.

Or alternatively, only for venture issuers:

- if applicable, if a venture issuer cannot reasonably remediate a reportable deficiency relating to design of ICFR, it must disclose in its annual MD&A:
 - a description of the reportable deficiency;
 - why the venture issuer cannot reasonably remediate the reporting deficiency;
 - the risks the venture issuer faces relating to the reportable deficiency; and
 - whether the venture issuer has mitigated those risks and if so, how.

Implications:

- Proposed Form 52-109F1 requires disclosure of any reportable deficiencies relating to the operation of the Issuer's ICFR. Therefore, the scope of the ICFR evaluation must be sufficient to identify any such reportable deficiencies.
- All known reportable deficiencies in ICFR must be disclosed. It is not sufficient to disclose just the 'Top 5'.
- For venture issuers only, it is acceptable to not actively remediate known ICFR design weaknesses.
- Non-venture issuers may apply to securities regulators in order to obtain exemptions similar to those provided to venture issuers.

- if applicable, the Issuer must disclose in its annual MD&A:

- (a) the fact that the Issuer's certifying officer(s) have limited the scope of its design of DC&P and ICFR to exclude controls, policies and procedures of:
 - (i) a proportionately consolidated entity in which the Issuer has an interest;
 - (ii) a variable interest entity in which the Issuer has an interest; or
 - (iii) a business that the Issuer acquired not more than 90 days before the Issuer's financial year end; and.
- (b) summary financial information of the proportionately consolidated entity, variable interest entity or business that the Issuer acquired that has been proportionately consolidated or consolidated in the Issuer's financial statements.

Implications:

- There are provisions in Proposed NI 52-109 to file a different certificate for reverse takeover situations occurring within 90 days of year end. This certificate, called *Form 52-109F1 - IPO/RTO*, also permits certifying officers to exclude certain portions of their ICFR.
- These are the only conditions that the Issuer can exclude from the scope of its ICFR evaluation without seeking specific approvals from the securities regulators.
- If the scope of the certification has been limited, Issuers are required to disclose summary information on the entities that have been excluded from the scope.
- The current rules under MI 52-109 are silent with respect to limitations on scope. Issuers should consult their securities lawyer or seek approvals from securities regulators before implementing scope limitations on the design of DC&P and ICFR until the Proposed Instrument comes into effect.

- The Issuer's certifying officer(s) must:
 - (a) evaluate, or cause to be evaluated under its supervision, the effectiveness of the Issuer's DC&P at the financial year end, and the Issuer must disclose in its annual MD&A its conclusions about the effectiveness of DC&P at the financial year end based on such evaluation; and
 - (b) evaluate, or cause to be evaluated under its supervision, the effectiveness of the Issuer's ICFR at the financial year end, and the Issuer must disclose in its annual MD&A:
 - (i) its conclusions about the effectiveness of ICFR at the financial year end based on such evaluation;
 - (ii) a description of the process the Issuer used to evaluate the effectiveness of ICFR;
 - (iii) a description of any reportable deficiencies relating to operation existing at the financial year end; and
 - (iv) the Issuer's plans, if any, to remediate any such reportable deficiencies relating to operation.

Implications:

- The Proposed Instrument does not explicitly require the certifying officers to provide a description of the process used to evaluate the effectiveness of DC&P nor deficiencies and remediation plans, if applicable. The CSA has requested these disclosures through staff comments in the past. Issuers should watch for clarifications in the future as to whether this is still an expectation of the CSA.

- Reporting to the Issuer's external auditor and board of directors or audit committee: The Issuer's certifying officer(s) must disclose, based on their most recent evaluation of ICFR, to the Issuer's external auditor, the board of directors and the audit committee of the board of directors any fraud that involves management or other employees who have a significant role in the Issuer's ICFR.

Implications:

- Fraud refers to an intentional act by one or more individuals involving the use of deception to obtain an unjust or illegal advantage.
- There are two types of fraud to consider:
 - (i) intentional misstatements resulting from fraudulent financial reporting, including omissions of amounts or disclosures in financial statements, to deceive financial statement users; and
 - (ii) misappropriation of assets.
- Proposed NI 52-109CP discusses that fraud could be perpetrated by third parties. It is unclear if the Issuer needs to report fraud committed by third parties in order to be in compliance with the Proposed Instrument. Issuers should consider doing so if they find themselves in this situation. Issuers should also be aware that they might have requirements to report all frauds they are aware of, including those committed by third parties, under other securities regulations.

Documentation to Support Design

The current rules under MI 52-109 do not specify documentation requirements for the Issuer to support its conclusions. Proposed NI 52-109 does address the extent and form of documentation to support the certifying officer's disclosures for both DC&P and ICFR. Proposed NI 52-109 indicates that generally the following elements related to design should be documented.

<p>Elements of the Control Environment</p> <ul style="list-style-type: none"> • Tone at the top • Organizational structure of the Issuer – the lines of authority and responsibility or the nature of informal reporting relationships as applicable • Management's philosophy and operating style – in particular with respect to identifying and managing risks • Integrity, ethics, and competence of personnel • External influences that affect the Issuer's operations - these could include business practices, regulatory supervision, and legislative requirements • Human resources policies and procedures - hiring, training, supervision, compensation and evaluation practices that affect its employees' attitudes towards controls 	
<p>Design of DC&P (the processes that ensure information is brought to the attention of the certifying officers, in a timely manner to enable them to determine if disclosure is required)</p> <ul style="list-style-type: none"> • Communications to employees of the Issuer's disclosure obligations, including the purpose of disclosure and DC&P and deadlines for specific filings and other disclosure • Assignment of roles, responsibilities and authorizations relating to disclosure • Guidance on how authorized individuals should assess and document the materiality of information or events for disclosure purposes • A policy on how the Issuer will receive, document, evaluate and respond to complaints or concerns received from internal or external sources regarding financial reporting or other disclosure issues 	<p>Design of ICFR</p> <ul style="list-style-type: none"> • The Issuer's ongoing risk assessment process • How significant transactions, and significant classes of transactions, are initiated, authorized, recorded, processed and reported • The flow of transactions to identify when and how material misstatements or omissions could occur due to error or fraud • A description of the controls over relevant assertions related to all significant accounts and disclosures in the financial statements • A description of the controls designed to prevent or detect fraud, including who performs the controls and, if applicable, how duties are segregated • A description of the controls over period-end financial reporting processes • A description of the controls over safeguarding of assets

Implications:

- The elements of the Control Environment apply equally to DC&P and ICFR.
- The extent of documentation will vary depending on the size and complexity of the Issuer's DC&P and ICFR. The documentation might take many forms (e.g., paper documents, electronic, or other media) and could be presented in a number of different ways (e.g., policy manuals, process models, flowcharts, job descriptions, documents, internal memoranda, forms, etc). The extent and form of documentation is a matter of judgment as long as the above elements are incorporated and their organization and relationship to the above elements are reasonably clear.
- Proposed NI 52-109CP indicates that the above elements should generally be included. If an element is truly not applicable, it need not be addressed; however this situation is expected to be rare.
- The documentation of these elements is expected to be in writing.
- The amount of time needed to document these elements should not be underestimated. If Issuers do not have sufficient documentation to currently support their assessments, they should not delay in generating this documentation as the CSA is currently expecting this level of documentation.

Documentation to Support Operating Effectiveness

- Proposed NI 52-109CP indicates that certifying officers can use a variety of tools to perform their DC&P and ICFR evaluations. These tools include:
 - (a) certifying officers' daily interaction with the control systems;
 - (b) walkthroughs;
 - (c) interviews of individuals who are involved with the relevant controls;
 - (d) observation of procedures and processes, including adherence to corporate policies;
 - (e) reperformance; and
 - (f) review of documentation that provides evidence that controls, policies or procedures have been performed.

The nature, timing and extent of evaluation procedures necessary for certifying officers to obtain reasonable support for the effective operation of a component of DC&P or ICFR depends on the level of risk the component of DC&P or ICFR is designed to address.

- Proposed NI 52-109CP indicates that to provide reasonable support for a DC&P or ICFR evaluation, the certifying officers should generally document the following:
 - (a) a description of the process the certifying officers used to evaluate DC&P or ICFR;
 - (b) how the certifying officers determined the extent of testing of the components of DC&P or ICFR;
 - (c) a description of, and results from applying, the evaluation tools discussed above; and
 - (d) the certifying officers' conclusions about the following:
 - (i) the effectiveness of DC&P or ICFR, as applicable; and
 - (ii) whether a reportable deficiency in ICFR relating to operation existed as at the end of the period.

Implications:

- Although inquiry and observation alone might provide an adequate basis for an evaluation of an individual control with a lower risk, they will not provide an adequate basis for the evaluation as a whole.
- The certifying officers' daily interaction could provide an adequate basis for the certifying officers' evaluation of DC&P or ICFR if the operation of controls, policies and procedures is centralized and involves a limited number of personnel. Reasonable support of such daily interaction would include memoranda, e-mails and instructions or directions from the certifying officers to other employees.
- The use of inquiry and observation and the certifying officer's daily interaction are certainly efficient methods to evaluate the DC&P and ICFR; however, Issuers should be aware that the exclusive use of these two methods will be seen as insufficient to support the assertion that a proper evaluation has been performed.

Implications:

- The certificate itself only requires a description of the process used to evaluate ICFR. However, the Companion Policy indicates that the description should include DC&P.
- Normally the extent of testing is associated with the risk of the control in question. Thus a risk assessment needs to be performed to determine the likelihood of a material misstatement arising should the control not function as designed.
- In a top-down risk-based approach, certain low risk controls which are associated with strong control environment controls may not need to be tested at all.
- The amount of time needed to document these elements should not be underestimated.

Proposed Changes to Interim Certificate Disclosures

The CSA has expanded the full interim certificate to include representations relating to the design of DC&P and ICFR that are also included in the full annual certificate, as described above.

Implications:

- Documentation supporting the certifying officers' design of DC&P and ICFR is required for each quarter since the interim certificates require the certifying officers to report on design. Therefore it will be important for Issuers to retain documentation supporting the design of controls at various points in time. This might be accomplished by indicating on each document the time period that it is relevant for or copying all the documentation supporting the design of controls for each quarter.
- Proposed NI 52-109 does not specify how long documentation supporting design should be retained.
- Documentation supporting operating effectiveness is required on an annual basis.

Re-filings

New certificate forms will apply when an Issuer re-files its annual or interim financial statements, annual or interim MD&A or AIF. New certificate forms will also need to be filed when a venture issuer voluntarily files an AIF after it has filed its annual financial statements and MD&A.

Implications:

- If a venture issuer voluntarily files an AIF after it has filed its annual financial statements and MD&A, a separate annual certificate must also be filed. In order to reduce the risk that this requirement is not adhered to, the best practice would be to file the AIF at the same time as filing the annual financial statements & MD&A.
- If an Issuer re-files its annual financial statements, annual MD&A or AIF for a financial year, it must file a separate annual certificate for that financial year in Proposed Form 52-109F1R on the date that it re-files the annual financial statements, annual MD&A or AIF, as the case may be.
- If an Issuer re-files its interim financial statements or interim MD&A for an interim period, it must file a separate interim certificate for that interim period in Proposed Form 52-109F2R on the date that it re-files the interim financial statements or interim MD&A, as the case may be.
- A re-filed certificate must include all the paragraphs included in the certificate originally filed with the exception of the first paragraph.
- Since Proposed NI 52-109 applies for financial years beginning on or after March 31, 2005 (see next paragraph), it appears that re-filing certificates would be needed for any financial years beginning on or after this date.
- Depending on the cause of the re-filing, it is unlikely that the CSA will accept conclusions that the design and effectiveness of DC&P and ICFR provide reasonable assurance that the financials and filings are free from a material misstatement.

Applicability

The applicability of Proposed NI 52-109 is to all reporting issuers, including venture issuers, other than issuers of investment funds. There are exemptions for Issuers who are in compliance with SOX 302 and 404.

The proposed effective date is June 30 2008; however it is applicable to fiscal years ending on or after March 31, 2005.

Implications:

- Although the proposed effective date is June 30, 2008, the Proposed Instrument does indicate it is applicable for fiscal years ending on or after March 31, 2005. Since the current rules require Issuers to certify the design of ICFR for fiscal years ending after June 29th, 2006, it appears as though the CSA is expecting that the documentation requirements contained in the Proposed Instrument are currently being followed. Thus it would be prudent to document the design of ICFR in accordance with the Proposed Instrument.

External Auditor Involvement

Proposed NI 52-109 does not require the external auditor to provide an opinion on ICFR or on the CEO/CFO certifications. However, the external auditor is associated with the information in the MD&A and therefore with the MD&A disclosures regarding ICFR changes and weaknesses. The external auditor is required to read the MD&A to assess whether it is consistent with their knowledge, including knowledge about ICFR that was obtained in conducting their audit of the financial statements to which the MD&A relates.

It is likely that the external auditor will enquire of management as to their conclusions related to DC&P and ICFR as the external auditor does have a responsibility to take into account risks of material misstatement in the performance of the audit. This is true even if the weaknesses, if any, were corrected during the year.

Implications:

- Should the Issuer refuse to provide their external auditor with their conclusions, then the auditor may consider including a scope limitation to their audit report since management does have a responsibility to disclose all known weaknesses.

It is also likely that the external auditor will request the Issuer's supporting documentation since the external auditor must evaluate the design of controls relevant to the financial statement audit and determine whether they have been implemented. The external auditor may also determine it is efficient and effective to rely on the operating effectiveness of identified controls to support their audit opinion.

Implications:

- Issuers may find that providing well organized, clear documentation supporting the design of their internal controls may reduce the disruptions by the external auditor asking questions in this regard and may also result in savings in audit fees.
- The external auditor may not be associated with false or misleading statements in the MD&A. So while the external auditor does not have a responsibility to provide an opinion on ICFR or the certifying officer's certificates, if it is apparent to the external auditor that the Issuer has not produced sufficient documentation to support their conclusions, the external auditor must take issue if this fact is not disclosed in the MD&A.

In order to be in compliance with Generally Accepted Audit Standards the external auditor must perform, at a minimum, walkthrough procedures to confirm that controls have been placed in operation in their performance of their financial statement audit. The external auditor may conclude that controls are not properly designed or are not operating effectively as a result of their audit.

Implications:

- The external auditor may not be associated with false or misleading statements in the MD&A. If, as a result of the external auditor's own procedures, it is determined that reportable deficiencies exist, the external auditor must take issue if these deficiencies are not disclosed in the Issuer's MD&A.

Commenting on the Proposed NI 52-109

We encourage Issuers to make written submissions with respect to any concerns they may have on Proposed NI 52-109. Submissions must be received by the CSA by June 28, 2007. Please address submissions to:

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APPENDIX A – COMPARISON OF FULL ANNUAL CERTIFICATES

Current Requirements	Proposed Requirements
Certificate Disclosures require the Certifying Officers to state:	
Review: ➤ They have reviewed the annual filings.	Review: ➤ They have reviewed the annual filings.
No Misrepresentations: ➤ Based on their knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact.	No Misrepresentations: ➤ Based on their knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact.
Fair Presentation: ➤ Based on their knowledge, the annual financial statements and filings present fairly in all material respects.	Fair Presentation: ➤ Based on their knowledge, the annual financial statements and filings present fairly in all material respects.
Responsibility: ➤ They are responsible for DC&P and ICFR.	Responsibility: ➤ They are responsible for DC&P and ICFR.
Design: ➤ They have caused to be designed appropriate DC&P. ➤ They have caused to be designed appropriate ICFR.	Design: ➤ They have caused to be designed appropriate DC&P. ➤ They have caused to be designed appropriate ICFR.
	Control Framework: ➤ The control framework used to design ICFR or state that no control framework was used in the MD&A.
	Design Reportable Deficiencies (if applicable): ➤ They have caused the Issuer to include in the MD&A: a) ICFR Design (available to any Issuer): i) a description of the reportable deficiency; ii) the remediation plan to address; and iii) the expected completion date; b) ICFR Design (available to venture issuers only): i) a description of the reportable deficiency; ii) why the deficiency cannot reasonably be remediated; iii) the associated risks and iv) any mitigation thereof.
	Limitation on Scope (if applicable): ➤ They have caused the Issuer to disclose in the MD&A if ICFR controls excluded any of: i) proportionately consolidated entities; ii) variable interest entities; or iii) acquisitions within 90 days of period end.
Evaluation: ➤ They have evaluated the effectiveness of DC&P and disclosed in the MD&A their conclusions regarding effectiveness.	Evaluation: ➤ They have evaluated the effectiveness of DC&P and disclosed in the MD&A their conclusions regarding effectiveness; ➤ They have evaluated the effectiveness of ICFR and disclosed in the MD&A their conclusions on effectiveness and a description of the process used to evaluate; ➤ If applicable, a description of any reportable deficiencies related to ICFR and the Issuer's plans, if any, to remediate.
Changes in ICFR: ➤ They have caused the Issuer to disclose material changes in ICFR that occurred in the most recent interim period.	Changes in ICFR: ➤ They have caused the Issuer to disclose material changes in ICFR that occurred in the most recent interim period.
	Disclosure of Fraud: ➤ They have disclosed to the Issuer's external auditor and board of directors or audit committee any fraud that involves management or other employees who have a significant role in the Issuer's ICFR.