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Canada's Securities Regulators Release New Proposals on Internal Controls

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Canada's securities regulators have released new proposals on CEO and CFO certifications and related management discussion and analysis (MD&A) disclosure. The proposals, which have been published for a 60-day comment period, pertain to issuers' "internal control over financial reporting" (ICFR) and "disclosure controls and procedures" (DC&P) under Multilateral Instrument 52-109. The proposed certifications and related MD&A disclosure would apply to annual and interim filings of all reporting issuers (except investment funds) for periods ending on or after December 15, 2008.

This bulletin describes the key aspects of the certification and related MD&A proposals, including the main changes to the regulators' March 2007 proposals, which were withdrawn for reconsideration following extensive comment from market participants.

Evaluation of ICFR

As under the March 2007 proposals, these new proposals require CEOs and CFOs to certify annually that they have

- evaluated, or caused to be evaluated under their supervision, the effectiveness of the issuer's ICFR; and
- disclosed in the annual MD&A their conclusions about the effectiveness of the issuer's ICFR.

CEOs and CFOs would also have to certify annually that they have disclosed to the issuer's auditors and either the board of directors or the audit committee any fraud involving management or other employees with a significant role in ICFR.

MD&A Disclosure of Material Weaknesses

If there is a material weakness in the design or operation of ICFR, the CEO and CFO would have to certify (quarterly for design weaknesses, but only annually for operational weaknesses) that the issuer's MD&A discloses

- a description of the material weakness;
- the impact of the material weakness on the issuer's financial reporting and ICFR; and

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- the issuer's current plans, if any, or any actions already undertaken for remediating the material weakness (actual remediation would not be mandatory).

A "material weakness" is defined as "a deficiency, or a combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the reporting issuer's annual or interim financial statements will not be prevented or detected on a timely basis." This is the same as the U.S. definition. The concept of "reportable deficiencies" in the March 2007 proposals has been dropped.

Scope Limitations

In designing DC&P and ICFR, issuers would be permitted to exclude proportionately consolidated entities, variable interest entities and businesses acquired not more than 365 days before the end of the financial period to which the certificate relates (this compares with a 90-day period in the March 2007 proposals). Issuers would have to disclose any exclusions in MD&A and provide summary financial information for the excluded entities.

Venture Issuer Basic Certificate

Under the proposals, the certificates filed by venture issuers would not have to refer to DC&P or ICFR, and venture issuers would not have to make the related MD&A disclosures. Instead, venture issuers' certificates would include a note to readers explaining how the certificates differ from those of non-venture issuers.

Control Framework

Non-venture issuers must use a control framework to design their ICFR. This requirement differs from the March 2007 proposals, which did not mandate the use of a control framework. The framework must be a suitable one that has been established using due process procedures, including the broad distribution of the framework for public comment. These are the same criteria as set out in the U.S. rules for selecting a control framework. Like the SEC, Canadian regulators have not mandated the use of any particular control framework. The proposals refer to the following frameworks commonly in use:

- *Risk Management and Governance: Guidance on Control* (COCO Framework), published by The Canadian Institute of Chartered Accountants;
- *Internal Control – Integrated Framework* (COSO Framework), published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO); and
- *Guidance on Internal Control* (Turnbull Guidance), published by The Institute of Chartered Accountants in England and Wales.¹

¹ Smaller issuers can also refer to *Internal Control over Financial Reporting: Guidance for Smaller Public Companies* published by COSO, which provides guidance to smaller public companies on the implementation of the COSO Framework.

Certifications Following an IPO, a Reverse Takeover or Ceasing to be a Venture Issuer

A CEO's and CFO's first certification filed after an IPO, a reverse takeover or ceasing to be a venture issuer may omit all references to ICFR and DC&P. Instead, this initial certification would have to include a note to readers explaining how the certificate differs from a regular certificate.

Cross-Border Issuers

As under existing rules, cross-border issuers that comply with the SEC's certification and internal control requirements would not have to comply with the Canadian rules. In lieu of filing the Canadian certifications, these issuers would be able to file their SEC certifications, management's report on internal control and the related auditor's attestation with Canadian regulators.

Companion Policy Guidance

The proposed new Companion Policy provides guidance on, among other things,

- fair presentation, financial condition and reliability of financial reporting;
- design of ICFR and DC&P and evaluation of their operating effectiveness;
- use of a service organization or specialist for ICFR;
- material weaknesses in ICFR;
- significant weaknesses in DC&P;
- the role of the board and audit committee;
- business acquisitions and certain long-term investments;
- venture issuer basic certificates and certificates for new reporting issuers; and
- certification of revised or restated annual or interim filings. **1**