

# CEO AND CFO CERTIFICATION IN CANADA

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# Regaining Investor Confidence

## Chronology of Events

|                   |  |
|-------------------|--|
| 2001/2002         | Large financial reporting governance scandals  |
| July 30, 2002     | Sarbanes-Oxley Act ("SOX") signed into law in U.S.   |
| January 16, 2004  | Canadian Securities Administrators (CSA) issue multi-lateral instruments (effective March 30, 2004) – 52 - 108, 109, 110 |
| November 26, 2004 | Proposal to amend 52 – 109   |
| February 4, 2005  | Proposal to implement 52-111 & to amend 52 -109  |
| May 16, 2005      | SEC & PCAOB issue guidance on compliance emphasizing risk based approach and importance of control environment           |
| July 29, 2005     | Proposal to delay implementation of 52-111   |
| March 10, 2006    | Proposal to not proceed with 52-111 and move some components into 52-109   |

# Regaining Investor Confidence

## Canadian Rules

- **Key elements:**

- Audit Committees ( MI 52-110)
- Internal Control Certifications (MI 52-109/111)
- New oversight body for external audit firms (MI 52-108)

# Regaining Investor Confidence in the Capital Markets

## Serious Stuff

- Penalty for CEOs and CFOs giving false certificates – per OSC
- Fine of \$5 million and imprisonment for 5 years less a day
- Disgorgement of bonuses

# Auditor Oversight – MI 52-108

- ❑ Canadian Public Accountability Board (CPAB) new oversight body for external audit firms
- ❑ Requires a *reporting issuer* to hire a “participating accounting firm” i.e.
  - a firm that has entered into a participation agreement with CPAB and
  - the firm is in compliance with any restrictions or sanctions imposed by the CPAB

# Audit Committee Requirements – MI 52-110

## **Disclosures (AIF)**

- Charter, composition, financial literacy
- Policies concerning fees paid for non-audit services performed by the external auditor
- Rejected recommendations by full Board

## **Authorities**

- Engage independent counsel or advisors
- External auditors directly report to audit committee

# Audit Committee Requirements – MI 52-110

## **Composition**

- Independent
- Financially literate
- At least three people

## **Responsibilities**

- Direct oversight of external audit
- Review of external financial disclosures
- Process for anonymous concerns (whistle blower)
- Pre-approval of other services by external auditors
- Policy on hiring of staff from external audit firm

## Annual and Quarterly Certifications

CEO, CFO must certify five items:

1. Reviewed the filings
2. Filings do not contain any untrue statements of material fact or omit to state a material fact
3. Financial statements together with other financial information fairly presents in all material respects the financial condition, results of operations, and cash flows of company

# Current MI 52-109

CEO, CFO must certify five items (cont'd):

4. Responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting,
  - a) Designed such disclosure controls to provide reasonable assurance that material information is made known to CEO, CFO
  - b) Designed such internal controls over financial reporting to provide reasonable assurance regarding reliability of financial reporting and preparation of financial statements in accordance with GAAP
5. Disclosed in MD&A any change in internal controls over financial reporting that occurred in recent interim period that has materially affected financial reporting

# Current MI 52-109

**Annually**, the same 5 points, except item 4 has an item

- c) Evaluated the effectiveness of the disclosure controls and procedures as of the end of the period and disclosed in the annual MD&A conclusions about the effectiveness of disclosure controls and procedures

# Expected MI 52-109

**Annually**, the same 5 points, except item 4 has an item

- d) Evaluated the effectiveness of the internal controls over financial reporting as of the end of the period and disclosed in the annual MD&A the process for control evaluation and conclusions about the effectiveness of internal controls over financial reporting

# Fair Presentation?

- ❑ In view of CSA, fair presentation includes but not limited to:
  - selection of appropriate accounting policies
  - proper application of appropriate accounting policies
  - disclosure of financial information that is informative and reasonably reflects underlying transactions, and
  - includes additional disclosure necessary to provide investors with materially accurate and complete picture of financial condition, results of operations and cash flows

# What is Financial Condition?

- ❑ Financial condition is not defined, CSA suggests that one would consider items such as:
  - liquidity, solvency, capital resources
  - overall financial health of the company
  - current and future considerations, events, risks or uncertainties that might impact financial health of company

# What are Disclosure Controls and Procedures?

## Disclosure controls and procedures:

- ❑ controls and other procedures designed to provide reasonable assurance that information to be disclosed in filings or other reports filed is recorded, processed, summarized and reported within time periods specified in securities legislation
- ❑ controls and procedures designed to ensure that information required to be disclosed in filings or other reports filed is accumulated and communicated to CEO and CFO to allow timely decisions regarding required disclosure

# What are Internal Controls over Financial Reporting?

## Internal controls over financial reporting:

- ❑ processes designed and effected by Board, management, other staff to provide reasonable assurance regarding reliability of financial reporting and preparation of financial statements for external purposes in accordance with GAAP and includes:
  - Records maintained that accurately and fairly reflect transactions and dispositions of assets
  - Transactions are properly recorded to permit preparation of financial statements in accordance with GAAP
  - Receipts and expenditures are authorized by management and directors
  - Prevent or timely detection of unauthorized acquisition, use or disposition of assets

# Transition Period – Current 52 - 109

Provision for transition period:

- Certificates required for years beginning on or after January 1, 2004
- However phase in requires a “bare” vs. modified vs. full certificate
- Bare = only certify first 3 statements
- Modified = excludes internal control over financial reporting (ICFR)

Using December 31, 2005 year end:

- File bare annual certificate for December 31, 2004
- File bare interims for March 31, 2005, June 30, 2005, Sept. 30, 2005
- Modified annual certificate for December 31, 2005
- Modified interims for March 31, 2006, June 30, 2006, Sept. 30, 2006
- First full annual for December 31, 2006
- Full interims for 2007
- Thereafter ... tbd.

# A Recap

## What to certify and when

| Certify as to   | Bare Interim | Full Interim | Bare Annual | Full Annual |
|---|--------------|--------------|-------------|-------------|
| Reviewed the filing   | ✓            | ✓            | ✓           | ✓           |
| No untrue statements and no omissions of material fact      | ✓            | ✓            | ✓           | ✓           |
| Presents fairly financial condition, operations, cash flows | ✓            | ✓            | ✓           | ✓           |
| Designed disclosure controls and procedures                 |              | ✓            |             | ✓           |
| Designed controls over financial reporting                  |              | ✓            |             | ✓           |
| Evaluated effectiveness of disclosure controls              |              |              |             | ✓           |
| Disclosed changes in internal controls in interim period    |              | ✓            |             | ✓           |

# MI 52-109 (Modified – IN/OUT)

CEO, CFO must certify five items (cont'd):

4. **Responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting, and have:**
  - a) **Designed such disclosure controls to provide reasonable assurance that material information is made known to CEO, CFO**
  - b) **Designed such internal controls over financial reporting to provide reasonable assurance regarding reliability of financial reporting and preparation of financial statements in accordance with GAAP**
  - c) **Evaluated the effectiveness of the disclosure controls and procedures as of the end of the period and disclosed in the annual MD&A conclusions about the effectiveness of disclosure controls and procedures**
5. **Disclosed in interim MD&A any change in internal controls over financial reporting that occurred in recent interim period that has or may materially affected financial reporting**

# A Recap (Current Law: 52-109)

What to certify and when

| Certify as to   | Bare Interim | Full Interim | Bare Annual | Full Annual |
|---|--------------|--------------|-------------|-------------|
| Reviewed the filing   | √            | √            | √           | √           |
| No untrue statements and no omissions of material fact      | √            | √            | √           | √           |
| Presents fairly financial condition, operations, cash flows | √            | √            | √           | √           |
| Designed disclosure controls and procedures                 |              | √            |             | √           |
| Designed controls over financial reporting                  |              | √            |             | √           |
| Evaluated effectiveness of disclosure controls              |              |              |             | √           |
| Disclosed changes in internal controls in interim period    |              | √            |             | √           |

# Proposed MI 52-111

- MI 52-111 had required:
  - CEO/CFO to issue a report that provides management's assessment of effectiveness of internal controls over financial reporting using a suitable control framework and disclosing all material weaknesses;
  - Board of Directors to approve report before it is filed;
  - Opinion on management's assessment program and conclusions from external auditors; and
  - Maintenance of evidence of management's documentation & evaluation of internal control effectiveness
- Effective dates depended on Market Capitalization over 20 days ending June 30, 2005

# Proposed MI 52-111 Effective Dates

- MC > \$500 million
- MC: \$250 – 500 million
- MC: \$75 – 250 million
- MC: < \$75 million
- Years ending after June 29, 2006
- June 29, 2007
- June 29, 2008
- June 29, 2009

MC = Market  
Capitalization @  
June 30, 2005

# Proposed MI 52-109 Issues

- No Reference to/use of a Framework
- No Auditor attestation
- No Exemptions
- Bill 198 civil liability

# Other Control Certification Issues

- More costly proportionally for smaller companies
- Value perceived to be low
- Large drain on internal employees

# What will help?

- COSO Guidance for Smaller Public Companies
- PCAOB, SEC, CSA and Consultants' learnings from SOX
- Top-down risk based approach

# COSO's Guidance

- Control Principles based
- Generic examples & techniques
- Documentation guidance
- Lessons learned
- Risk focus



# COSO's Guidance - Emphasis

- Control environment extremely important
- Holistic risk approach/systemic review
- Audit Committee
- Software/templates
- Benefits



# Conclusions

- 2006 requirements are onerous
- Control environment critical
- Risk focus
- Lots to document but KIS
- Costs relatively high but match risk
- Benefits exist – opportunity to improve
- Light at the end of the tunnel

# Questions

