CEO AND CFO CERTIFICATION

Improving Transparency and Accountability

A Canadian Performance Reporting Board Discussion Brief

The Canadian Institute of Chartered Accountants

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The Canadian Institute
of Chartered Accountants

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CEO AND CFO CERTIFICATION: IMPROVING TRANSPARENCY AND ACCOUNTABILITY

The Canadian Performance Reporting (CPR) Board of the Canadian Institute of Chartered Accountants has published this discussion brief to stimulate discussion and commence a process to develop and communicate a better understanding of the CEO and CFO certifications. The certifications are currently required under the Canadian Securities Administrators' (CSA) Multilateral Instrument 52-109. This discussion brief is based on information available as of August 31, 2004. It is expected that further requirements will be provided by the CSA in an instrument currently under development.

The CPR Board believes MI 52-109 demonstrates the growing importance of the Management's Discussion and Analysis. It takes another step towards a more comprehensive business reporting framework, which integrates financial and non-financial performance measures together with reporting on the effectiveness of controls. This material presents the CPR Board's preliminary views, which are expected to evolve as experience is gained with the certification process and the new reporting requirements.

When reviewing this material, readers should note that the questions included for consideration by CEOs and CFOs are not intended to represent an exhaustive list of items to be addressed, but rather are examples of matters that may be relevant, depending on the circumstances of the issuer. The information contained in this paper does not constitute legal advice. Before making any interpretation of the regulators' intent or the actions required of reporting issuers, readers should refer to MI 52-109.

The CPR Board encourages you to review this discussion brief and submit your feedback. In particular, the Board would appreciate observations about:

- The need for further guidance about making the "fairly present" assessment
- Ways in which this material could be improved to increase its usefulness
- The challenge of assessing disclosure relating to "future prospects" and the period that forward-looking information should address
- The role of the audit committee in the certification process
- The role of the external auditor in the certification process
- The benefit of applying the certification process to entities other than public companies and other reporting issuers (e.g., crown corporations, hospitals, etc.)
- Venture issuers and the certification requirement
- The need for further discussion about Annual Information Form (AIF) disclosures
- The benefit of CICA seminars to further explore issues raised by the certification process and new reporting requirements
- Other issues that the discussion brief omits or does not discuss sufficiently

The Board acknowledges the contributions of Jim Goodfellow, FCA, and Peter Chilibeck, LL.B., in performing the research, conducting interviews with executives that provided valuable insights into the certification process, and in drafting the discussion brief.

Comments and suggestions on the discussion brief should be sent by December 31, 2004 to:

Chris Hicks, CA, Principal
Knowledge Development
The Canadian Institute of Chartered Accountants
277 Wellington Street West
Toronto, Ontario, M5V 3H2

E-mail: chris.hicks@cica.ca
Tel: (416) 204-3233

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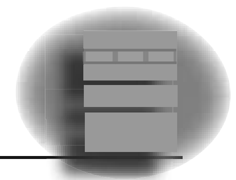


EXECUTIVE SUMMARY

Note: This summary is provided to help orient readers to the way in which this paper is organized. Readers are urged to read the full paper to obtain a more complete understanding of the themes discussed in the summary. The objective of this paper is to provide information that will assist CEOs and CFOs in better understanding the certification requirement, the objectives of transparency and accountability, and to enable them to develop their own practical approaches to the certification process.

Beginning in 2004, CEOs and CFOs of Canadian public companies are required to certify that the financial statements, together with other financial information included in their company's filings "fairly present" in all material respects the financial condition, results of operations and cash flows of the issuer.

The CEO and CFO must also certify that the interim and annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading. This statement is not limited to financial information – it applies to everything in the filings. Therefore, this paragraph in the certificate can have a much broader reach than the "fairly present" assessment.

The certification requirement is being introduced in phases, so companies will need to develop multi-year implementation plans.

The certificates are prescribed and cannot be altered. Because separate personal certificates are required from the CEO *and* the CFO, both executives must lead and actively participate in the process. While CFOs may "quarterback" the process, the CEO must assume overall leadership, make his or her own assessment, and take responsibility for setting the proper "tone at the top."

TRANSPARENCY AND ACCOUNTABILITY

The CPR Board believes that two fundamental principles, which are central to the new regulations and to the functioning of our capital markets, can serve as a guide to CEOs and CFOs in the certification process:

- **Transparency** refers to the degree to which the information contained in the filings being certified by the CEO and CFO enables a reader to reliably assess and interpret the financial condition, results of operations and cash flows of the issuer.

  For the CEO and CFO certification, the "fairly present" assessment and the attestation that the filings do not contain any untrue statement of a material fact or omit to state a material fact is the mechanism used to achieve transparency.

- **Accountability** refers to the public acknowledgement by the CEO and CFO of their responsibility for the completeness, accuracy, timeliness and reliability of the information contained in the filings being certified.

THE "FAIRLY PRESENT" ASSESSMENT

In the first phase, which began in 2004, CEOs and CFOs are required to assess whether the financial statements and the financial information contained in the MD&A in the interim and annual filings, as well as the annual information form in the annual filing, "fairly present" in all material respects the financial condition, results of operations and cash flows of the issuer. This "fairly present" assessment is a judgment of all the financial information contained in the filings and is not restricted to the financial statements' compliance with generally accepted accounting principles (GAAP). The assessment of "financial condition" (a different and more dynamic concept than "financial position" as reflected in the balance sheet) requires consideration of the company's ability to achieve results in the future.

In making their "fairly present" assessment, CEOs and CFOs should consider the disclosure of the non-financial and non-GAAP financial performance measures that they consider critical to understanding their business, comparing their company's performance with others in their industry, and assessing the company's financial condition. It is also essential that any non-financial or non-GAAP financial performance measures be carefully explained and, where appropriate, reconciled to GAAP.

IMPORTANCE OF THE MD&A

The MD&A is central to the "fairly present" assessment of results of operations, cash flows and financial condition. For example, if the CEO and CFO conclude that the financial statements do not by themselves "fairly present" the results of operations, they may decide to provide the appropriate disclosure in the MD&A so the two documents, together, constitute a fair presentation. Similarly, the assessment of financial condition may require enhanced disclosure in the MD&A. Therefore, CEOs and CFOs may need

to reassess the way in which the MD&A is prepared and organized, and the nature of the disclosures provided in it.

DISCLOSURE CONTROLS AND PROCEDURES

In phase two, which begins with financial years ending on or after March 31, 2005, CEOs and CFOs will be required to certify that they have designed disclosure controls and procedures (or caused them to be designed under their supervision) to provide reasonable assurance that material information relating to the issuer and its consolidated subsidiaries, is made known to them. They will also be required to certify that they have evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings, and that they have disclosed their conclusions of that evaluation in the annual MD&A.

Disclosure controls and procedures cover all information required to be disclosed in the interim and annual filings as well as continuous disclosure and other reports required to be filed under provincial and territorial securities legislation or regulation. They include disclosure policies, disclosure committees (where justified by a company's size and complexity) and procedures put in place to ensure that information is brought to management's attention in a timely fashion to enable management to decide if disclosure is required.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Also in phase two, beginning with financial years ending on or after March 31, 2005, CEOs and CFOs will be required to certify that they have designed internal control over financial reporting, or caused it to be designed under their supervision. Under the certification requirement, internal control over financial reporting addresses the reliability of financial reporting and the preparation of financial statements in accordance with the issuer's GAAP. Unlike the certification for disclosure controls and procedures, CEOs and CFOs are not required to certify that they have evaluated the effectiveness of internal control over financial reporting. Nevertheless, such ongoing evaluations would be necessary to conclude on the accuracy and reliability of the financial statements and to identify any need for changes to internal control over financial reporting, which are required to be disclosed under the full certification.

A third phase is expected to require the provision of a formal report on internal control over financial reporting. This requirement is not included in MI 52-109. However, the Canadian Securities Administrators (CSA) are studying the U.S. rules implementing Section 404 of the Sarbanes-Oxley Act and are reported to be developing a proposed instrument to require a report on management's assessment of an issuer's internal control over financial reporting. It is expected that this instrument will likely require some form of auditor attestation.

SUPPORTING PROCESSES

CEOs and CFOs will need to put supporting processes into place, appropriate to the size and complexity of their company, to give them the information and assurances they need to make the statements required in the certificates, and to provide appropriate documentation.

While not required, many larger companies are establishing sub-certification processes, whereby the direct reports to the CEO and CFO provide formal certifications to them on the completeness and accuracy of the financial information pertaining to their areas of responsibility, and the effectiveness of disclosure controls and procedures and internal control over financial reporting.

The new requirements also present opportunities for companies to strengthen and align their risk management programs and to ensure that internal management responsibilities and accountability for financial reporting includes the leaders of business units as well as the finance function.

While supporting processes and documentation are important, the "fairly present" assessment of the financial information contained in the filings and the certification that the annual filings do not contain any untrue statement of a material fact or omit to state a material fact are separate and distinct exercises based on the personal knowledge and judgment of both the CEO and CFO. Meeting these requirements involves much more than just ensuring that subordinates complete a prescribed sub-certification process.

THE AUDIT COMMITTEE AND EXTERNAL AUDITOR

The CEO and CFO certification requirements are directed at management, and do not make reference to either the audit committee or the external auditor. However, given the audit committee's responsibility for reviewing the annual and interim financial statements, MD&A and earnings news releases, the audit committee will likely want reports from the CEO and CFO on their overall approach to the certification process, the issues that were raised, the results of the control evaluations and the conclusions that were reached. Similarly, the external auditor will likely want to understand the conclusions reached by the CEO and CFO and how the certification process, including the control design and evaluation activities, impacts their assessment of internal control and their audit approach.

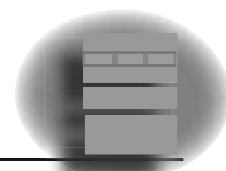
CRITICAL SUCCESS FACTORS

The CPR Board believes that companies should not approach the certification requirement as being just another regulatory compliance exercise. Instead, they should view it as an opportunity to regularly assess and continually improve their processes for public disclosures, and control and risk management. In taking this approach, management can use the certification process to continually strengthen internal accountabilities and run their business better. By contrast, companies that take a mechanistic, compliance-type approach to meeting the certification requirements will not only fail to achieve these additional positive business benefits, but may also end up providing the CEO and CFO with a false sense of security.

How successfully a company achieves these objectives will depend on many factors, including:

- the quality of the leadership provided by the CEO and CFO
- the extent to which other senior operating executives are involved in the process, and
- the commitment to learning from experience, and striving for continual improvement.

1. INTRODUCTION



Since 2002, Canadian companies that are SEC registrants have been required to provide certification under the Sarbanes-Oxley Act. The Canadian Securities Administrators' (CSA) Multilateral Instrument 52-109 expands this certification requirement to all Canadian reporting issuers, except investment funds. MI 52-109 has been adopted by all Canadian jurisdictions (not yet in force in Quebec) except British Columbia.

Companies that comply with the U.S. certification requirements are generally exempt from the Canadian requirements (i.e., certifications prepared for U.S. purposes will satisfy the Canadian requirements) provided that the issuer files the same financial statements and MD&A in both Canada and the United States.

It is important to note that the new Canadian certification requirements do not provide exemptions for venture issuers (typically smaller companies), unlike those provided for certain audit committee requirements for companies listed on the TSX Venture Exchange.

MULTI-PHASE INTRODUCTION

The Canadian CEO and CFO certifications (see Appendix A) will be similar to those required in the United States after implementation of both phases of MI 52-109 and an expected new instrument on internal control over financial reporting. *Figure 1* illustrates the effective dates for a company with a December 31 year-end. (Companies with year-ends other than December 31 should consult MI 52-109 for guidance.)

For companies with a December 31 year-end, the first phase began in the first quarter of 2004 and requires certification that:

- the filings do not contain any untrue statement of a material fact or omit to state a material fact; and
- the financial statements – together with the management's discussion and analysis (MD&A) – "fairly present" the issuer's financial condition, results of operations and cash flows.

The annual certification also covers information in the annual information form (AIF), except for venture issuers, which are not required to file an AIF.

The second phase adds the requirement to provide certification regarding controls. CEOs and CFOs will be required to certify that they have designed (or caused to be designed) and evaluated the effectiveness of disclosure controls and procedures, disclosed in the MD&A their conclusions from that evaluation, and have designed internal control over financial reporting and disclosed in the MD&A any material change in internal control over financial reporting.

Figure 1.

		MI 52-109		Future Instrument
		Phase 1 "Material Fact" and "Fairly Present" Certification (Paragraphs 1-3)	***Phase 2*** Certification of Disclosure Controls and Procedures and Design and Reporting of Changes in Internal Control Over Financial Reporting (Paragraphs 4-5)	***Phase 3*** Report on Internal Control Over Financial Reporting
2004	Interim	✓		
	Annual	✓		
2005	Interim	✓		
	Annual	✓	✓	Yet to be released
2006	Interim	✓	✓	
	Annual	✓	✓	Yet to be released

As of August 2004, details of the third phase had yet to be released. However, the CSA is studying the rules that the U.S. Securities and Exchange Commission adopted to implement Section 404 of the Sarbanes-Oxley Act[1] and is reported to be developing an instrument to require a report on management's assessment of an issuer's internal control over financial reporting. The CSA is also reported to be evaluating the extent to which auditor attestation of such a report should be required.

The phased-in introduction of the new requirements presents CEOs and CFOs with two important considerations.

- First, every company will need to develop an implementation plan that covers all three phases of this requirement. While only a so-called "bare certificate" is required in 2004, companies should nevertheless immediately begin addressing the design and operating effectiveness of their disclosure controls and procedures and internal control over financial reporting to ensure that they are fully prepared for their CEOs and CFOs to certify these controls, as required for financial years ending on or after March 31, 2005.
- Second, the cost of complying with the new requirements will likely be significant. Therefore, the CPR Board believes that companies should consider ways to leverage the investments they will make to comply with the new requirements and processes to more effectively operate their businesses. Companies that utilize the processes implemented to comply with the new requirements to also improve their financial reporting effectiveness will achieve a significant advantage over companies that utilize the new processes solely for compliance.

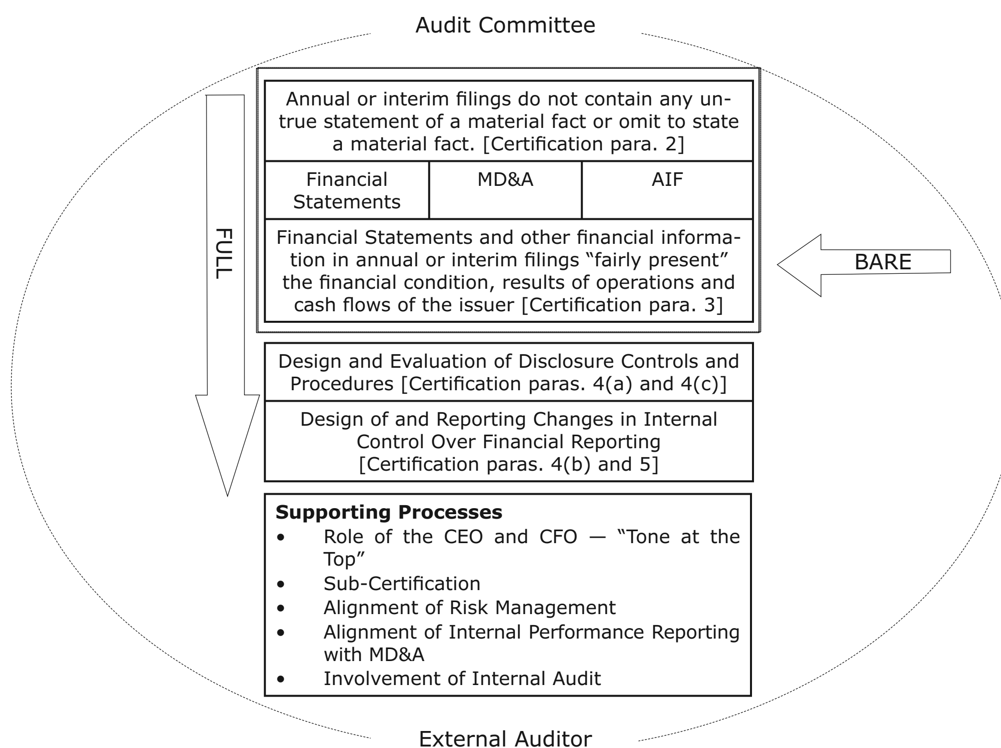
ELEMENTS OF THE CERTIFICATION PROCESS

Figure 2 illustrates the key elements of the new requirements.

The "Material Fact" and "Fairly Present" Assessments: The top element represents the certification that the filings do not contain any untrue statement of a material fact or omit to state a material fact and that the financial statements and the financial information in the MD&A and, where applicable the AIF, constitute a fair presentation. This certification is now required and is discussed in Sections 2 and 3.

Controls: The middle element represents the certifications on the design of disclosure controls and procedures and internal control over financial reporting, the evaluation of effectiveness of disclosure controls and procedures, and the reporting of changes in internal control over financial reporting. This certification will take effect for financial years ending on or after March 31, 2005 and is discussed in Section 4.

Figure 2.



1. Section 404 of the Sarbanes-Oxley Act pertains to Management Assessment of Internal Control, including its evaluation and reporting.

Supporting Processes: The bottom element represents the supporting processes that CEOs and CFOs should put in place to support their certification of disclosure controls and procedures and their reporting on internal control over financial reporting, and to ensure that they have the requisite knowledge to make the "material fact" and "fairly present" assessments. These processes are discussed in Section 5.

Each of these elements is important and involves a unique set of issues. However, all of the elements – the "material fact" and "fairly present" assessments, controls assessments, and supporting processes – must fit together in an integrated manner if the CEO and CFO certification exercise is to achieve its objectives in a cost effective manner.

Governance and audit: Surrounding the three inner elements in this figure are the activities of the audit committee and the external auditor. Although they have no direct role in the certification process, as part of their overall responsibility for governance and the audit of the issuer's financial reporting, they will likely seek information and reports from the CEO and CFO on the certification process. Their roles are discussed in Section 6.

TRANSPARENCY AND ACCOUNTABILITY

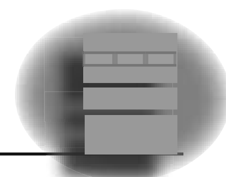
The CPR Board believes that two fundamental principles, which are central to the new regulations and to the functioning of our capital markets, can serve as a guide to CEOs and CFOs in the certification process:

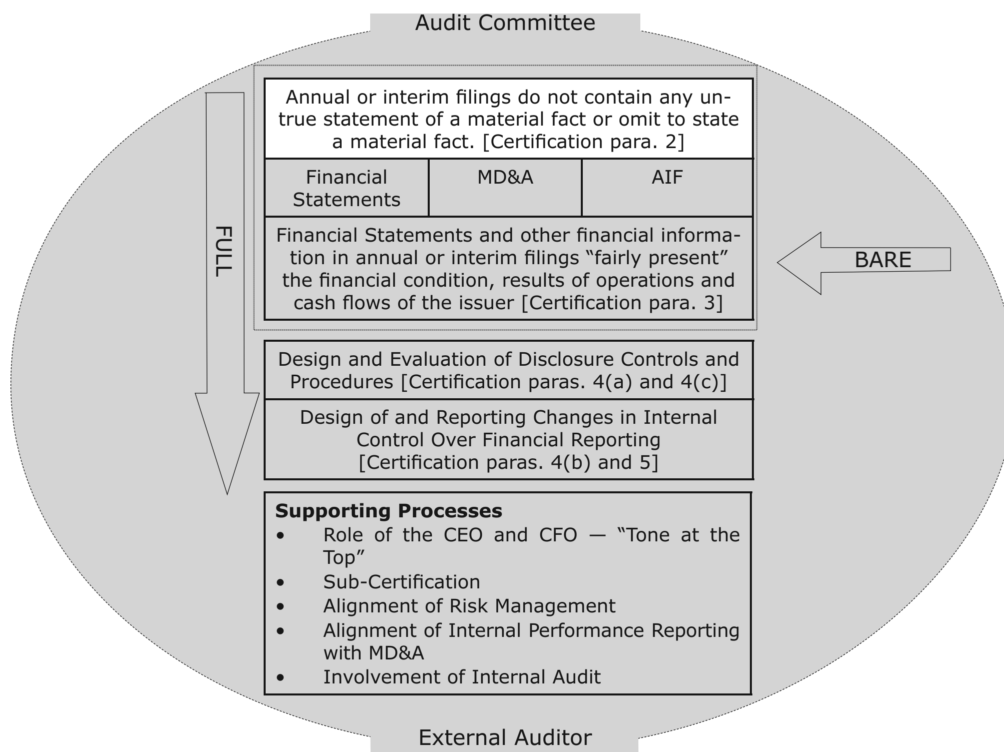
- Transparency refers to the degree to which the information contained in the documents being certified by the CEO and CFO enables a reader to reliably assess and interpret the financial condition, results of operations and cash flows of the issuer. If the information in these documents is lacking, misleading, or presented in a manner that is confusing or not easily understood, then it would not be considered transparent. For the CEO and CFO certification, the "fairly present" and "material fact" assessments are the mechanisms used to achieve transparency.
- **Accountability** refers to the public acknowledgement by the CEO and CFO of their responsibility for the completeness, accuracy and reliability of the information contained in the documents being certified. This accountability will be expanded for financial years ending on or after March 31, 2005, when the requirements for the design and evaluation of disclosure controls and procedures and design and reporting of changes in internal control over financial reporting move the certification beyond documents to control effectiveness, thereby adding an important new dimension to corporate reporting in Canada.

PENALTIES

Securities regulators review issuers' filings, which may lead to questions about the CEO and CFO certification. MI 52-109 does not specify the penalties that may be applied to those found to have provided a false certification. However, Companion Policy 52-109CP does note that such an action would be subject to quasi-criminal, administrative and civil proceedings under existing applicable laws. In addition to the penalties and sanctions contained in corporate and securities statutes and regulations in Canada and the United States, other penalties that could apply to CEOs and CFOs signing false certificates may be found in several new pieces of legislation. The fact that many of these penalties have not yet been applied does not mean they will not be in due course. A more detailed discussion of the Canadian and U.S. pen alties that may be applied is provided in Appendix B.

2. THE "MATERIAL FACT" ASSESSMENT





The second paragraph of the *Certification of Annual Filings* requires the CEO and CFO to state:

> *2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings;*

The second paragraph of the *Certification of Interim Filings* is worded similarly.

The paragraph begins with the phrase "Based on my knowledge…" This raises the issue of what that phrase means, and its implications. Although this phrase may initially seem to limit the information CEOs and CFOs are required to utilize in making their assessments, it may actually imply the need for them to draw upon the very significant pool of information that they would normally possess.

Senior management, and the CEO and CFO in particular, possess a much greater knowledge of the issuer's business, performance, financial condition and future prospects than do analysts, credit rating agencies or investors. The certification process emphasizes that these executives must take into account all their knowledge when determining whether the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated and that the filings "fairly present" the financial condition, results of operations and cash flows (since the third paragraphs of the interim and annual certifications, which pertain to the "fairly present" assessment, also begin with the phrase "Based on my knowledge…").

The knowledge that CEOs and CFOs possess may be grouped into two broad categories:

- **Knowledge about the internal environment.** This includes knowledge of the company's business strategies and plans, financing strategies (including the use of off-balance sheet financing arrangements), current operating performance (including the performance drivers), capabilities (financial and non-financial), and principal business risks and how they are being managed.

CEOs and CFOs also have knowledge about the decisions, choices and judgments made in preparing the financial statements, MD&A and AIF.

- **Knowledge about the external environment.** This includes knowledge of industry and regulatory trends, competitors' strategies and actions, the company's assessments of opportunities and threats, etc. It also includes the information and knowledge that CEOs and CFOs obtain from analyst calls, communications with investors, meetings with creditors, and discussions with rating agencies that indicate how the issuer is being assessed in the investment community, the expectations/concerns for the issuer's financial performance, and the methods that analysts and investors are using to assess the issuer's performance.

Two fundamental transparency questions, and critical issues in the CEO and CFO certification, are:

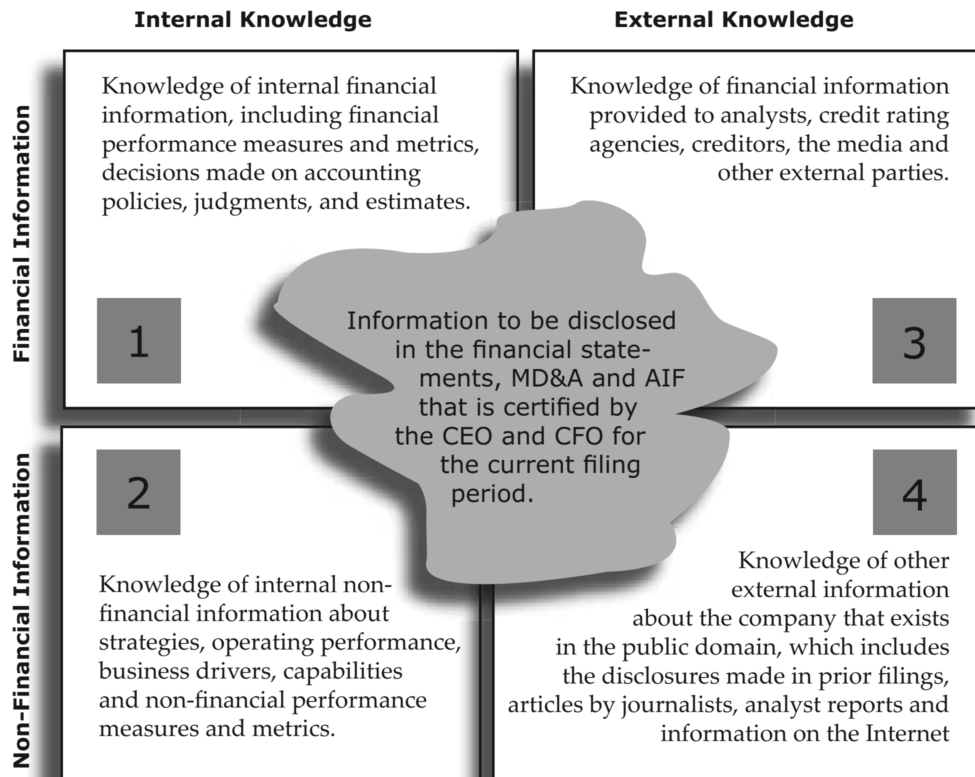
- What information should be made public?
- How should the public information be disclosed and presented in the financial statements, the MD&A, and, where appropriate, in the AIF?

Figure 3 illustrates the interrelationship of the CEO's and CFO's internal and external sources of knowledge. The centre of the figure represents the information and disclosures to be made in the filings covered by the CEO and CFO certification. The choice of information to be added to the public disclosures is affected by the content and activities in each of the four surrounding areas, each of which requires disclosure decisions by the company.

In Quadrant 1, the CEO and CFO must assess whether the financial information, and critical decisions made in the preparation of this information, are fairly presented in the financial statements, the MD&A, and, in the case of annual certificates, the AIF, and that the filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated. In this quadrant, Generally Accepted Accounting Principles (GAAP) play an important, but not exclusive, role.

In Quadrant 2, the focus is on the non-financial information disclosed in the MD&A and AIF. The CEO and CFO must assess whether this information (e.g., information on strategies and key performance drivers and metrics) will enable the reader to understand and appraise both historical financial results and future prospects. In making this determination, the CEO and CFO must assess the appropriateness and organization of the non-financial information to be disclosed. Disclosing a large volume of information in a disorganized manner may create an "information overload," which would defeat the objectives of transparency by making it difficult for readers to determine what is most important and relevant to their needs. By contrast, providing too little information

Figure 3



would also result in a disclosure that was not transparent.

Quadrants 3 and 4 represent the knowledge the CEO and CFO develop from interactions with analysts, credit rating agencies and others (Quadrant 3) and the public at large (Quadrant 4). The knowledge obtained in Quadrants 3 and 4 helps the CEO and CFO understand the concerns and information needs of investors and readers, in turn affecting their assessment of the nature and extent of financial and non-financial information disclosed (Quadrants 1 and 2). The CEO and CFO should assess whether the information in the financial statements, MD&A and AIF is consistent with information that has already been disclosed to analysts or previously disclosed to the public, or adequate explanations provided, thereby helping to minimize the risk of selective disclosure.

THE PRIVATE/PUBLIC DISCLOSURE BOUNDARY

The effective functioning of our capital markets requires full disclosure of all material information on a timely basis. The determination of what information is to be made public (beyond the regulatory minimums), and what is to be kept private is a judgment that is dynamic and changes over time (for this reason, the public disclosure area illustrated in Figure 3 is presented as a free format). The decisions that determine the private/public disclosure boundary have long been recognized as a critical reporting issue. The CEO/CFO certifications emphasize the importance of these decisions and attach the accountability for them with the CEO and CFO.

Many factors influence the decisions CEOs and CFOs make in managing the private/public disclosure boundary. These include the requirements specified for financial statements, the MD&A, AIF and other continuous disclosure regulations, and the disclosure policies enacted by the TSX and TSX Venture Exchanges requiring the timely disclosure of "material information," which include both material facts and material changes relating to the company.

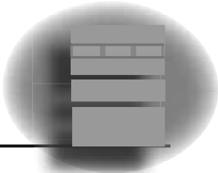
On the other hand, management will also want to protect against unnecessarily releasing information that may create a competitive disadvantage for the issuer. Other issues for management to consider include whether or not to disclose matters in their early stages where there is insufficiently robust information to provide useful disclosure, and whether disclosing a matter that is not required to be reported would possibly give an advantage to future investors at the expense of current investors. There is also the possibility that disclosing too great a volume of information will confuse rather than enlighten the reader. MI 52-109 does not provide guidance on any of these matters. Instead, the CEO and CFO are required to make their own judgments, based on their knowledge, as to whether the financial information presented in the filing is complete (i.e., appropriate choices have been made about what information is made public or kept private), accurate and constitutes a fair presentation.

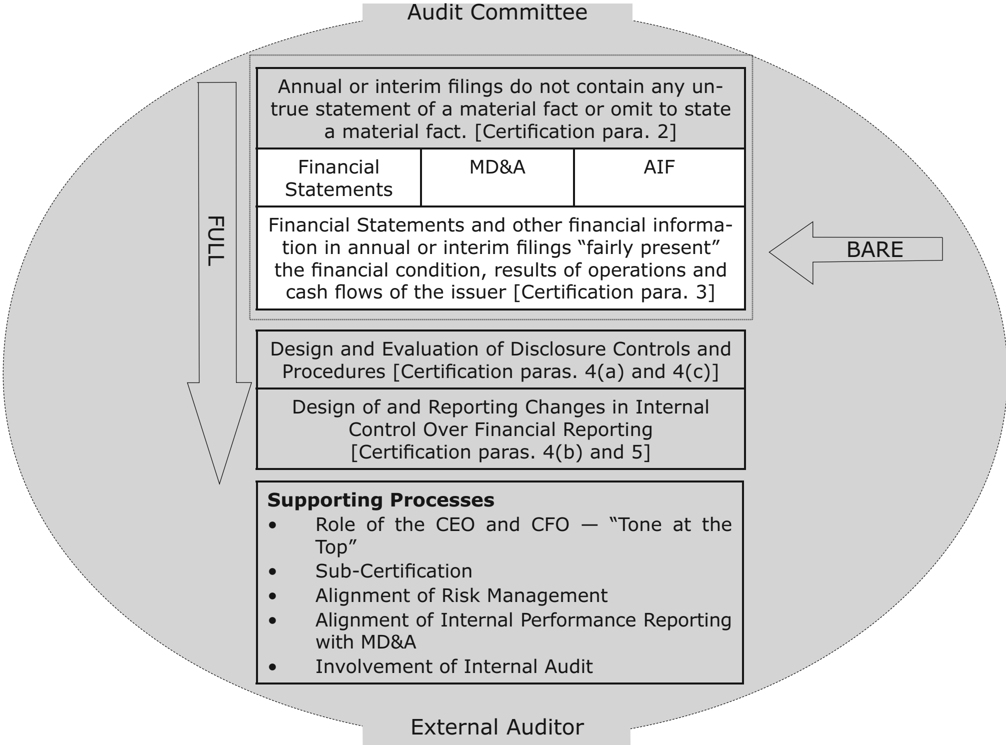
Another important consideration is that the Canadian continuous disclosure regime differs from that of the United States. MI 52-109 provides an exemption for SEC registrants that file their U.S. certificates with Canadian securities regulatory authorities, provided that the issuer files the same financial statements and MD&A in both Canada and the United States. However, these issuers should be aware that they remain subject to the Canadian continuous disclosure regime. While their SEC certificates may satisfy the requirements of MI 52-109, these companies should ensure that their disclosure policies and procedures address all of the disclosure regimes to which the company is subject.

Finally, consideration should be given to how technology and the Internet influence transparency and the sharing of information. In their book *The Naked Corporation: How the Age of Transparency Will Revolutionize Business*, Don Tapscott and David Ticoll suggest we are entering an extraordinary age of transparency where businesses must rethink the private/public disclosure boundary and make themselves clearly visible to shareholders, customers, employees, partners and society. Tapscott and Ticoll believe that financial data, grievances, internal memos, environmental disasters, product weaknesses, protests, scandals, and policies – good news and bad – can often be found on the Internet by anyone who knows where to look, which could make concerns about disclosure creating competitive disadvantage a moot point.

In the next section, which discusses the "fairly present" assessment, some sample questions are provided that may assist CEOs and CFOs in ensuring that their issuer's filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated.

3. THE “FAIRLY PRESENT” ASSESSMENT





The third paragraph of the *Certification of Annual Filings* requires the CEO and CFO to state:

> *3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings;*

The third paragraph of the *Certification of Interim Filings* is worded similarly.

Under the certification requirement, the financial information contained in the filings (financial statements, MD&A, and, in annual filings, the AIF and referenced documents) must be assessed both individually and in the aggregate to determine whether, as a whole, they “fairly present” in all material respects the issuer’s financial condition, results of operations, and cash flows. As discussed in the previous section of this paper, CEOs and CFOs are also required to certify that these filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated.

Accordingly, this suggests a multi-step approach to making these assessments:

i) ensuring the financial statements are in compliance with GAAP

ii) ensuring the MD&A is properly presented

iii) satisfying the requirements for the AIF (and referenced documents) in the annual filing, and

iv) standing back and assessing whether the reporting package as a whole “fairly presents” the financial condition, results of operations and cash flows, in addition to concluding that the filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated.

FINANCIAL STATEMENTS

The standards for the preparation of the financial statements are defined by GAAP. The *CICA Accounting Handbook* sets forth the primary sources of GAAP, which include the italicized and non-italicized sec-

tions of the *Handbook*, Accounting Guidelines, and EIC Abstracts. The *Handbook* recognizes that no rule of general application can be phrased to suit every circumstance or combination of circumstances. Matters may arise that are not specifically addressed in the primary sources of GAAP or where additional guidance is needed to apply a primary source. In these instances, management may need to refer to other sources of GAAP, which are described in the Handbook. However, management should adopt accounting policies and disclosures that are consistent with the primary sources of GAAP, and exercise their professional judgment in applying the concepts set forth in the Financial Statement Concepts Section of the *Handbook*.

In making their assessments of the financial statements, CEOs and CFOs should focus not just on whether GAAP have been properly applied, but also on the key decisions and judgments made in this process and the overall quality of the financial statements.

CEOs and CFOs may wish to consider the following questions in making their “fairly present” and “material fact” assessments. (Please note: this is not an exhaustive or complete list of issues that may be addressed. Instead, the questions are merely a starting point for items of consideration.)

1. Are the accounting principles used for major transactions, arrangements or events in the period the “most appropriate” in the circumstances, or would they likely be viewed as less preferable – or, perhaps, borderline acceptable practices – that were selected to achieve a particular objective?
2. Is the materiality threshold used in the preparation of the financial statements reasonable? What errors were detected by management or the auditors in the preparation process, but not included in the financial statements because they were considered immaterial?
3. Does the accounting treatment and related disclosure for major transactions, arrangements or events in the period reflect their economic substance and portray their economic reality? If not, have the financial statements been corrected in accordance with GAAP and has additional interpretative disclosure been included, as necessary, in the MD&A?
4. What is the degree of conservatism in the more significant accounting judgments and estimates, revenue recognition criteria, etc.? Has the degree of conservatism changed from prior periods?
5. Do the accounting estimates and judgments made in preparing the financial statements reflect any trends or biases that would consistently overstate or understate key amounts?
6. What is the quality of the assets recorded on the balance sheet? What asset impairment assessments have been made or considered in the period?
7. What revisions to estimates were made in the period? How significant is the impact of such revisions on earnings? How do reported earnings compare with reported cash flows? What is the impact of “one time” gains and losses on earnings in the period? How does this compare with prior periods? What is the overall “quality” of earnings (i.e., how conservative are the estimates and judgments in computing the earnings)?
8. Is the presentation of liabilities, together with the disclosure of commitments and contingencies, presented in a manner that is clear, informative, and communicates the financial risks involved?
9. Has the external auditor completed an audit or review of the financial statements? What are the auditor’s findings and observations?
10. Are there any potential liabilities, commitments or contractual arrangements that are not included in the financial statements or notes thereto? If not, why not?

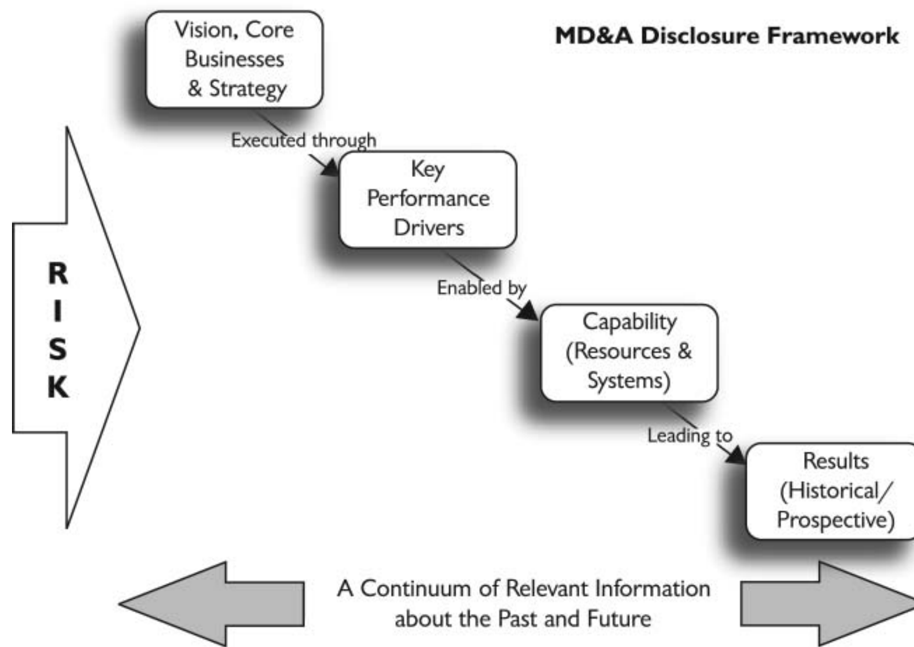
MANAGEMENT’S DISCUSSION AND ANALYSIS

The MD&A is a key element of the financial reporting package in both the interim and annual filings and, therefore, is a critical component of the filings being certified. The requirements for preparing a MD&A, and the specific items to be included in it, are set out by the Canadian securities regulators. In addition, the CICA has published *Management’s Discussion and Analysis – Guidance on Preparation and Disclosure*, which provides disclosure principles and recommended practices for the MD&A, and guidance to help issuers prepare a meaningful and informative MD&A. *Figure 4* illustrates the disclosure framework developed and recommended by the CICA’s CPR Board.

The CSA describes the MD&A’s purpose in the general instructions for Form 51-102F1:

> *MD&A is a narrative explanation, through the eyes of management, of how your company performed during the period covered by the financial statements, and of your company’s financial condition and future prospects. MD&A complements and supplements your financial statements, but does not form part of your financial statements.*
>
> *Your objective when preparing the MD&A should be to improve your company’s overall financial disclosure*

Figure 4



by giving a balanced discussion of your company's results of operations and financial condition including, without limitation, such considerations as liquidity and capital resources – openly reporting bad news as well as good news. Your MD&A should

- *help current and prospective investors understand what the financial statements show and do not show;*
- *discuss material information that may not be fully reflected in the financial statements, such as contingent liabilities, defaults under debt, off-balance sheet financing arrangements, or other contractual obligations;*
- *discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future; and*
- *provide information about the quality, and potential variability, of your company's earnings and cash flow, to assist investors in determining if past performance is indicative of future performance.*

Since the MD&A complements and supplements the financial statements, it can be very important in resolving disclosure issues. For example, if the CEO and CFO felt the financial statements alone would not yield a fair presentation for the purposes of the certificate, then the MD&A would be the logical place to provide the additional disclosures and necessary explanations so the two documents, together, would constitute a fair presentation. The MD&A is also the place where management can explain the factors that impacted operating results and cash flows and how these results related to the company's strategies and objectives, thereby enabling the reader to better understand both historical performance and future prospects.

The consideration of materiality is as important when deciding on MD&A disclosures as it is in preparing financial statements and related notes. Information is material if its omission or misstatement could influence a reasonable investor's decision to buy, hold or sell securities in the company. This test applies to qualitative information, as well as financial and other quantitative information, both historical and prospective in nature. Further, consideration should be given to individual items of information that, in themselves, may not be material but could become so when viewed in the context of other disclosures, or as elements in the larger picture.

The following questions focus on issues for CEOs and CFOs to consider when making their "material fact" and "fairly present" assessments in relation to the MD&A.

1. What is the involvement of the finance organization and operating executives, both at the corporate level and in the business units, in preparing or reviewing the MD&A?
2. Does the MD&A comply with regulatory requirements? Does it follow the guidance produced by the CICA?
3. Has the MD&A been reviewed by the external auditor and/or legal counsel? What are their ob-

servations?

4. How was materiality determined for deciding what information, both qualitative and quantitative, and both prospective and historical, was to be disclosed in the MD&A? What were the materiality "close calls" and on what basis were they resolved?
5. Are important performance drivers that are not recognized as accounting assets (e.g., research and internally developed intellectual property, etc.) adequately explained in the MD&A? Have the relevance and importance of non-financial performance measures included in the MD&A been satisfactorily explained and related to the reported financial performance?
6. Does the MD&A include industry-based or other non-GAAP financial performance measures? Are these performance measures clearly defined and reconciled to the financial statements?
7. Does the MD&A effectively communicate the composition of recognized earnings (e.g., contribution of business units), the impact of external trends (e.g., changes in interest rates or foreign exchange rates), the historical perspective (e.g., comparison with prior periods) and future prospects (e.g., comparison against strategic objectives)?
8. Are the principal business risks that are disclosed and discussed in the MD&A consistent with those that have been identified in strategic planning activities/reports and operations reviews? How are the disclosure and discussion of financial risks (e.g., off-balance sheet financing arrangements and liquidity disclosures) in the MD&A related to the disclosures in the financial statements?
9. Is the MD&A written in clear, plain language? Does it present with candour and without exaggeration a fair and balanced picture, including "bad news" as well as "good news"? Does the MD&A have a marketing or promotional bias?
10. Does the MD&A provide a complete, integrated and balanced view of the company's historical results, future prospects, and financial condition explaining the "why" behind performance and prospects?

ANNUAL INFORMATION FORM (AIF)

The annual certification also covers the AIF and all information incorporated into it by reference. The above suggestions on MD&A also apply to items in the AIF that are not included in the MD&A. Please note that in *Management's Discussion and Analysis – Guidance on Preparation and Disclosure*, the CICA suggests that certain information (for example risk and rating disclosures) called for in the AIF should also be addressed in the MD&A.

Canadian issuers should be aware that the continuous disclosure regime in Canada is broader than that of the United States and, to the extent that continuous disclosures are incorporated into the AIF, they will be subject to certification.

Issuers may wish to consider the timing of their various filings. Because the annual certification applies to all annual filings, it would be filed with the last document to be filed. Typically, this would be the AIF, since the financial statements and MD&A are usually filed first. However, some audit committees may prefer that the CEO's and CFO's certificates be completed prior to the filing of the financial statements and MD&A. In such a situation, one solution would be to accelerate the AIF so that all annual filings and the certificates are filed concurrently.

FINANCIAL CONDITION

CEOs and CFOs should understand the emphasis placed on the term "financial condition" and the subtle, but important, distinction between this term and the concept of "financial position," which is reflected in the balance sheet.

There is no generally accepted definition of the term "financial condition" and MI 52-109 does not attempt to provide one. However, Companion Policy, 52-109CP emphasizes that "financial condition" is broader than "financial position" and that it encompasses a number of qualitative and quantitative factors.

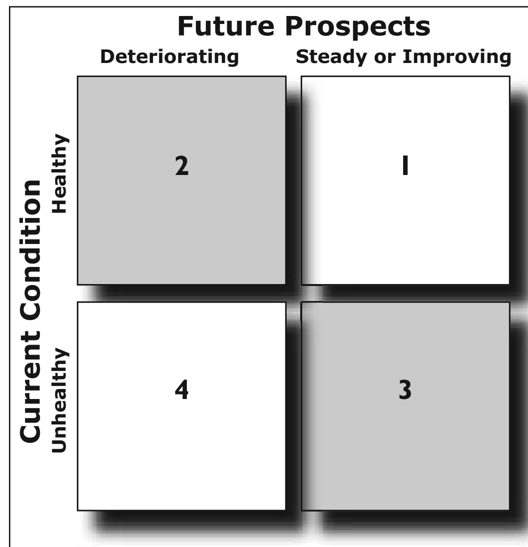
Financial statements are prepared on the assumption that the entity is a going concern – in other words, that it will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the normal course of operations. An assessment of financial condition involves assessing the disclosure relating to factors that could impact the entity's ability to continue to operate as a going concern, either now or in the foreseeable future.

In this regard, it might be useful to consider an entity's financial condition as falling into one of four broad categories, as illustrated in *Figure 5*.

Quadrant 1 represents companies that are healthy, generating positive earnings and cash flows and, barring unforeseen catastrophes, are likely to remain so. Reporting on financial condition is not usually a problem in this quadrant.

Quadrant 2 represents companies that are currently healthy, but deteriorating. In this quadrant, there are often concerns about a discussion of "negative trends" or information that could unnecessarily upset the market. The CEO and CFO should, therefore, stand back and carefully assess the disclosures to en-

Figure 5.



sure that all relevant information is disclosed (e.g., the factors causing the deterioration in financial condition, the implications, and what management is doing about them). It should be noted that, in situations where a company's financial condition deteriorates quickly and significantly, regulators and litigants often carefully analyze the disclosures provided in the periods preceding the decline to assess whether adequate disclosure was made of the risks and threats to the company's financial condition.

Quadrant 3 represents entities that are currently in a weak financial condition, but whose situation is improving. In this quadrant, the CEO and CFO should ensure that the "good news" is not overstated and that there is a balanced presentation of the progress made in improving the financial condition, the prospects for the future, and the related risks.

Quadrant 4 represents entities that have a very weak financial condition that is deteriorating further, with the result that these companies often have a high risk of becoming insolvent. In this quadrant, the challenge is one of organizing and presenting the "bad news" in the most informative manner.

Companion Policy 52-109CP acknowledges that it would be difficult to enumerate a comprehensive list of factors that could impact the assessment of financial condition, but does offer the following for consideration:

- liquidity
- solvency
- capital resources
- overall financial health of the issuer's business
- current and future considerations, events, risks, or uncertainties that might impact the financial health of the issuer's business.

Naturally, many other factors could also impact financial condition. These include:

- capital adequacy
- quality of assets (including the time and effort to realize their value in terms of cash flow)
- quality of intangibles and brands that are not normally recognized as assets for accounting purposes
- insurance coverage and the extent of self-insurance
- available lines of credit and credit facilities that are not fully utilized
- guarantees, contingencies, adequacy of provisions for all liabilities, customer commitments and backlog, and
- adequacy of cash flow from operations to fund operating and capital expenditures, etc.

In particular, attention should be directed to the disclosure of any arrangements that involve "triggers" – i.e., terms or conditions that could have an instant impact on financial condition.

Financial condition is a more dynamic concept than financial position. For example, the overall health of the issuer's business is determined not only by the issuer's resources and obligations at a point in time, but also by the opportunities and risks that might impact its financial health and its ability to bear unexpected losses. Perhaps financial condition may best be thought of as describing an entity's financial fitness – its ability to manage the risks it faces and execute its planned strategies.

A point-in-time assessment of financial position involves adding up all of the assets and the liabilities presented on the balance sheet and assessing factors such as asset coverage and capital adequacy. However, it should be remembered that accounting is based on "point estimates" for many asset values, provisions for impairments, warranties and other liabilities. In assessing financial condition, the CEO and CFO should address the range and variability of accounts that are based on accounting estimates as well as the recorded amount.

For example, how would the financial condition be affected if the major accounting estimates and the forecasted cash flow from operations were all realized at the adverse end of their predicted ranges? Because information relating to the variability of accounting estimates is not normally disclosed, readers have limited ability to factor this type of analysis into their decision-making. (The *CICA Handbook* identifies two areas for measurement uncertainty disclosure: 1) the nature of a measurement uncertainty that is material, and 2) the extent of a measurement uncer-

tainty that is material when it is reasonably possible that the recognized amount could change by a material amount in the near term.) As a result, the CEO and CFO should assess, based on their knowledge, whether this type of information should be presented – especially when it is possible that scenarios of this sort could happen – and, if so, whether it would have a significant impact on financial condition.

Implicit in considering an entity's financial condition is an assessment of the impact of current and future conditions. To do this, CEOs and CFOs will be required to assess the trends and issues presented primarily in the MD&A, and whether they will either strengthen or weaken the company's financial condition. For example, the effect of an appreciation of the Canadian dollar against the U.S. dollar on an importer or exporter could have a short-term impact (i.e., a positive or negative impact on profits and cash flows) and a long-term impact (i.e., how a sustained appreciation of the Canadian dollar would change the competitive dynamics of the company's industry and its future prospects).

There is no prescription for the way that matters affecting financial condition should be assessed – this is left to the judgment of the CEO and CFO. However, it would seem reasonable to consider both the magnitude of the impact of potential trends and future events on the entity's financial condition and the likelihood of their occurrence.

In the final analysis, CEOs and CFOs must address two fundamental issues in assessing financial condition:

1. Are all the detailed disclosures of factors that affect financial condition appropriately presented in the financial statements, MD&A, and, for annual filings, the AIF?
2. Does the MD&A explicitly draw the reader's attention to the major factors that determine financial condition and present management's overall assessment of financial position and condition?

OVERALL ASSESSMENT OF FAIR PRESENTATION

For the purposes of the CEO and CFO certification, the financial statements and other financial information included in the MD&A and AIF must meet a standard of overall material completeness, accuracy and presentation that is broader than the financial reporting requirements under GAAP.

Companion Policy 52-109CP states that the "fairly present" representation is not qualified by the phrase "in accordance with generally accepted accounting principles." This was apparently done to prevent management from relying entirely upon compliance with GAAP, since GAAP could not be expected to include all the components of an overall fair presentation. Because the "fairly present" assessment applies to financial information in the financial statements, MD&A and AIF, some financial information included in this assessment is not covered by GAAP.

The "fairly present" element of the certification focuses on the financial statements and other financial information. The regulators do not define financial information, and some of the information in the filings is clearly non-financial (for example, the names of directors in the AIF). For this reason, there is some uncertainly about what information is covered by the "fairly present" assessment. However, given that the stated objective of the certificates is to improve the quality of reporting issuers' disclosure, and the fact that it is not possible to qualify the report because non-financial information is required to be included for fair presentation, it may not be unreasonable to interpret the term "financial information" broadly. Therefore, unless and until the regulators state otherwise, the CPR Board suggests that "financial information" may be considered to include all the information necessary to "fairly present" the financial condition, results of operations and cash flows, including, where appropriate, key performance drivers, capabilities and resources, and the effect of identified risks, etc.

The certificate also includes a statement that the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading. This statement is not limited to financial information. It applies to *everything* in the filings. Therefore, this clause in the certificates can have a much broader reach than the "fairly present" certification.

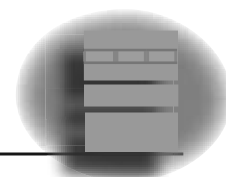
At its simplest, the "fairly present" assessment requires the CEO and CFO to stand back and ask: "Do the filings provide an accurate, faithful representation of the company's economic reality and performance?" In short, "Do they tell it like it is?" The certification is a check in the process, not an end unto itself.

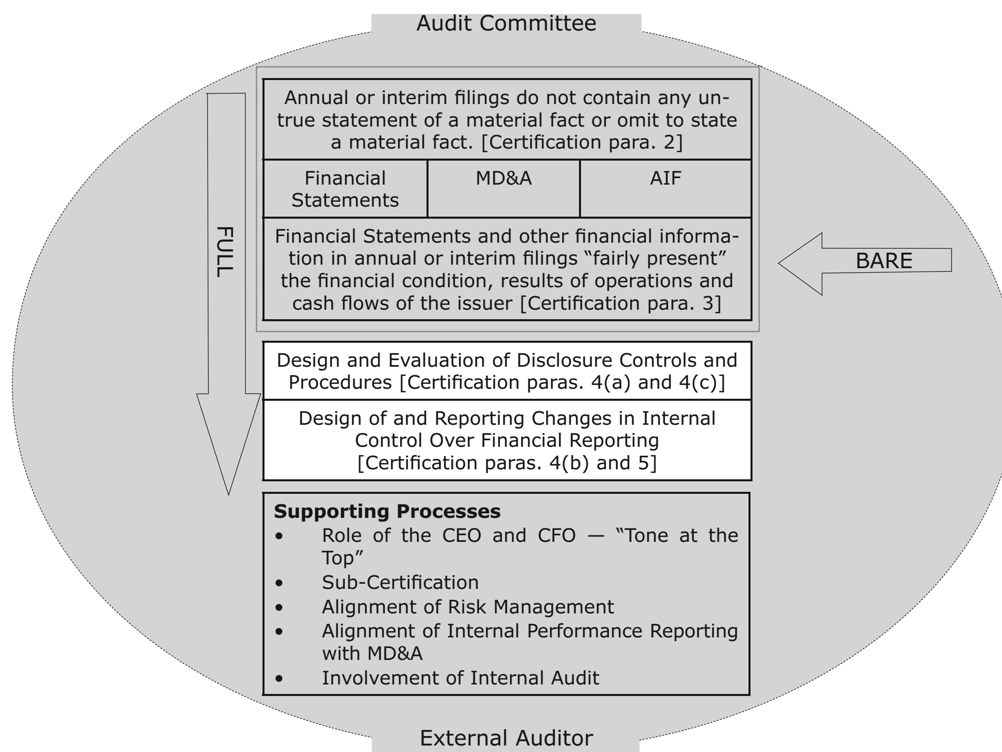
After the CEO and CFO have assessed the presentation in the financial statements, MD&A, and, where applicable, the AIF, they must make their overall assessments of fair presentation. The following questions may help them in making this assessment:

1. Does the presentation of financial information in the financial statements, MD&A, and the AIF in the case of annual certificates, reflect the CEO's and CFO's knowledge of the company's strategies, operations, relationships, industry dynamics and issues that face it?

2. Do the MD&A, and AIF in the case of annual certificate, together with the financial statements, provide the necessary information to enable readers to reach an informed judgment about the company's historical financial results, financial condition and future prospects?
3. Have all the important issues raised by analysts, rating agencies etc., been addressed in the filings, thereby reducing the possibility of future selective disclosures?
4. Are decisions to withhold the disclosure of information because of perceived "competitive disadvantages" reasonable and appropriate?
5. Do the financial statements, MD&A and AIF identify all the significant problems and risks known to management, or is there a risk that overly technical interpretations of the disclosure rules and/or GAAP have reduced transparency in this regard?
6. Is the amount of information being disclosed so great that readers are likely to be overwhelmed with insignificant details, thereby obscuring important information? Is the reader's attention drawn to the most important matters?
7. Has every effort been made to present disclosures using simple, plain language so an average investor will more easily understand the issuer's reported performance and financial condition?

4. THE CONTROLS ASSESSMENT





Beginning in financial years ending on or after March 31, 2005, CEOs and CFOs will be required to expand their certification with respect to "disclosure controls and procedures" and "internal control over financial reporting," as indicated below for annual filings:

4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:

a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;

b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and

c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD&A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and

5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

A similar requirement applies to interim filings, except for the evaluation of the effectiveness of disclosure controls and procedures and related disclosure, which is limited to the annual filing.

DISCLOSURE CONTROLS AND PROCEDURES

The focus of this control certification is on “disclosure controls and procedures” which MI 52-109 defines as:

> *…controls and other procedures of an issuer that are designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under provincial and territorial securities legislation is recorded, processed, summarized and reported within the time periods specified in the provincial and territorial securities legislation and include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under provincial and territorial securities legislation is accumulated and communicated to the issuer's management, including its chief executive officers and chief financial officers (or persons who perform similar functions to a chief executive officer or a chief financial officer), as appropriate to allow timely decisions regarding required disclosure.*

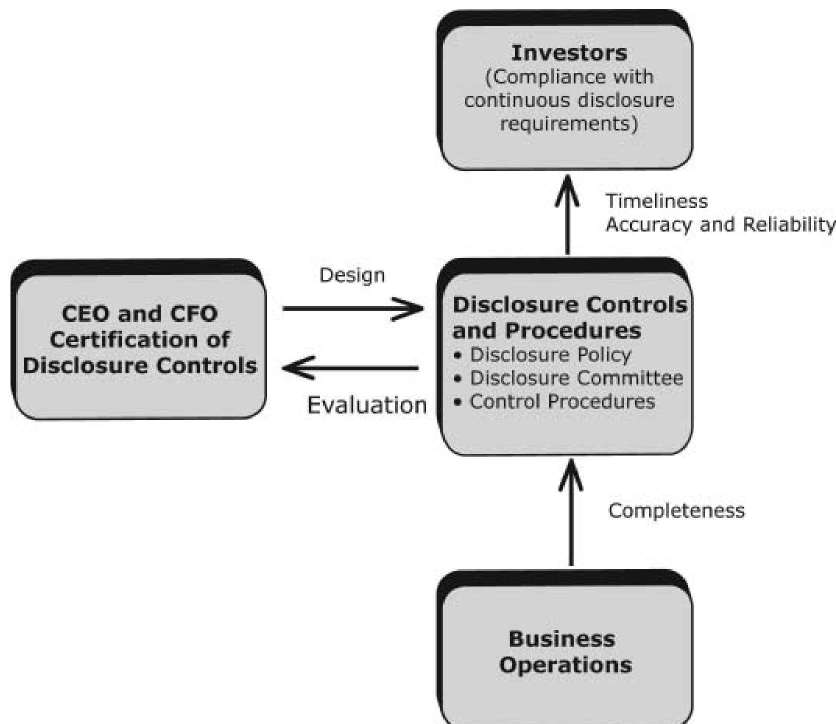
There are two main components to this definition. The first is that disclosure controls and procedures include controls over the external communication of information contained in all reports filed or submitted under provincial and territorial securities legislation within the specified time periods. This would include controls over information contained in the interim and annual filings, as well as controls that ensure that the issuer meets all continuous disclosure requirements including material change reports, business acquisition reports, information circulars, etc.

The second component is that disclosure controls and procedures also cover the internal communication to the CEO and CFO of information that may need to be disclosed, particularly within the time period covered by the filings. While the “material fact” and “fairly present” assessments and certification are designed to ensure the quality of information contained in the filings, the controls certification is designed to ensure that all material information is communicated to the CEO and CFO and is filed within the appropriate time periods.

The certification of disclosure controls and procedures will be a key element of the certification process when it is fully implemented, and CEOs and CFOs will need to think carefully about what they must do in order to make these statements in their certificates. As discussed below, the foundation of effective disclosure controls and procedures is a current and comprehensive disclosure policy. Within the disclosure policy's framework, the disclosure committee should oversee and document the procedures designed to ensure that the policy is understood, implemented and monitored, and CEOs and CFOs should ensure that such a policy is implemented and evaluated accordingly.

Figure 6 illustrates the relationship between disclosure controls and procedures and the company's reporting to investors and between the controls and

Figure 6.



their certification by the CEO and CFO.

DISCLOSURE POLICY

The foundation for effective disclosure controls and procedures is a well-written continuous disclosure policy. National Policy Statement 51-201 on Disclosure Standards recommends that issuers develop a written corporate disclosure policy to provide a process for disclosure and to promote an understanding of the legal requirements among directors, officers and employees. This policy should be reviewed and approved by the board of directors and widely distributed to officers and employees.

Such a policy will better enable reporting issuers to:

- minimize the risk of selective disclosure
- ensure that all disclosures made by the issuer to its investors or the investment community are accurate, complete and "fairly present" the company's financial condition, results of operations and cash flows in all material respects, and
- ensure that disclosures are made within the time periods specified by applicable laws, regulations and stock exchange requirements.

Guidance on developing a continuous disclosure policy can be found in the Canadian Investor Relations Institute Model Disclosure Policy (www.ciri.org).

DISCLOSURE COMMITTEE

National Policy Statement 51-201 recommends that issuers:

> *Establish a committee of company personnel or assign a senior officer to be responsible for:*
>
> *a) developing and implementing your disclosure policy*
>
> *b) monitoring the effectiveness of and compliance with your disclosure policy*
>
> *c) educating your directors, officers and certain employees about disclosure issues and your disclosure policy*
>
> *d) reviewing and authorizing disclosure (including electronic, written and oral disclosure) in advance of its public release, and*
>
> *e) monitoring your Web site.*

While the new Canadian certification requirements do not require issuers to establish a "disclosure committee," such a committee is recommended under the U.S. certification requirements.

Based on the interviews conducted when researching this paper, larger companies are establishing or using existing disclosure committees to assist the CEO and CFO in meeting their certification requirements and to ensure that the company's continuous disclosure policy is implemented effectively. (The membership of the disclosure committee may include the Corporate Controller, General Counsel, Head of Internal Audit and Head of Investor Relations, with one of these individuals serving as the committee's chair.)

In smaller companies, where the CEO and CFO are sufficiently active in all aspects of the business, a separate disclosure committee may not be necessary.

In discharging its duties, the disclosure committee should have access to all books, records, facilities and personnel – including the opportunity to consult with the external auditor and the audit committee. When necessary, the disclosure committee should also have the ability to obtain advice of outside legal and financial advisors in order to fulfill its responsibilities.

A sample mandate for a disclosure committee is provided in Appendix C.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

For financial years ending on or after March 31, 2005, the CEO and CFO will be required to certify that they have:

> *…evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD&A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation.*

In the annual certification, there is a difference between paragraph 4 (a), pertaining to the design of disclosure controls and procedures, and paragraph 4(c), which is quoted above. Paragraph 4 (a) requires the CEO and CFO to certify that disclosure controls and procedures have been designed "*to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared.*" This reflects the second component of the definition of disclosure controls and procedures, regarding internal communication to enable timely decisions to be made by the CEO and CFO as to whether external disclosures are required. Paragraph 4 (a) does not require the CEO and CFO to certify that disclosure controls and procedures have been designed to provide reasonable assurance that the information required to be disclosed by the issuer in its annual and interim filings, or other reports that it files or submits under provincial and territorial securities legislation, is recorded, processed, summarized and reported within the time periods specified in the provincial and territorial securities legislation.

By contrast, paragraph 4 (c) does not differentiate between the internal communication and external reporting aspects of disclosure controls and procedures. As a result, one may conclude that the certification of the evaluation of the effectiveness of disclosure controls and procedures pertains to both features. Therefore, in conducting their evaluation of disclosure controls and procedures, it would seem prudent for CEOs and CFOs to also consider the overall design of the disclosure controls and procedures, including the external reporting aspects, notwithstanding the fact that paragraph 4 (a) only requires certification of the internal communication component.

The specific process that a CEO and CFO utilize to evaluate disclosure controls and procedures for their annual certification will depend upon the circumstances of the company. However, all such evaluations should include an assessment of the design of the company's disclosure controls and procedures, including the company's disclosure policy, disclosure committee and the control procedures established to implement the disclosure policy. The evaluation should include an assessment as to whether the disclosure controls and procedures are operating effectively as of the end of the period covered by the annual filings.

The following questions may help CEOs and CFOs in identifying issues to be addressed in this evaluation process:

1. Has the company's disclosure policy been kept current? Has the policy been communicated to directors, officers and employees so they understand what is expected of them? Does the policy reflect the disclosure and filing requirements of all applicable capital market jurisdictions in which the company operates?
2. Has the authority, responsibility and accountability for the various forms of disclosure and reporting (e.g., timely disclosure releases, financial reporting, MD&A, etc.) been clearly defined so the appropriate people make the decisions and actions to prepare, review, approve, publicly disclose and file information with regulatory authorities?
3. Have the significant internal and external disclosure risks (i.e., risks of incomplete or inaccurate disclosure or the failure to disclose/file within prescribed time periods) been identified, assessed and addressed in the disclosure policy, disclosure committee mandate and the disclosure controls and procedures?
4. What evidence is there to suggest that directors, officers and employees adhere to the continuous disclosure policy in their day-to-day activities? Have there been instances of non-compliance with the disclosure policies? What actions were taken?
5. Do the people responsible for the preparation and filing of public disclosure documents have the necessary knowledge, skills and tools to discharge their responsibilities? Are these people supported by others with the necessary knowledge, skills and tools to discharge their responsibilities for capturing, summarizing and reporting information to them?
6. Is there any evidence to suggest that sufficient and relevant information is not being identified and communicated in a timely manner to the appropriate people, including the CEO and CFO?
7. Is the disclosure committee effective in practice? Does it challenge the completeness and quality of disclosures? Is there a healthy tension between the disclosure committee and the CEO and CFO?
8. Have appropriate disclosure controls and procedures been designed to ensure effective implementation of the disclosure policy throughout the company? Do these disclosure controls and procedures take into consideration internal and external disclosure risks?
9. Are decisions and actions relating to public disclosure and filing of documents in different geographic locations and jurisdictions effectively coordinated and monitored for consistency and quality?
10. Does management monitor the external and internal environment to obtain information that may indicate a need to re-evaluate the company's continuous disclosure policy, the disclosure committee's mandate and activities, and the design of disclosure controls and procedures?
11. Have any communications been received from securities regulators, investment analysts, credit rating agencies or the external auditor that may suggest that the company's disclosures, and the related controls and procedures, are inadequate? If so, what actions were taken in response?

INTERNAL CONTROL OVER FINANCIAL REPORTING

The full certificates that are effective for financial years ending on or after March 31, 2005 also require the CEO and CFO to acknowledge responsibility for establishing and maintaining internal control over financial reporting, which is defined as:

> *…a process designed by, or under the supervision of, the issuer's chief executive officers and chief financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management*

and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP and includes those policies and procedures that:

> *a) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer,*
>
> *b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the issuer's GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer, and*
>
> *c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial statements*

When the definitions of "disclosure controls and procedures" and "internal control over financial reporting" are viewed in isolation, it would seem that internal control over financial reporting is encompassed by disclosure controls and procedures. However, Companion Policy 52-109CP states that, "*While there is a substantial overlap between the definition of disclosure controls and procedures and internal control over financial reporting, there are both some elements of disclosure controls and procedures that are not subsumed within the definition of internal control over financial reporting and some elements of internal control over financial reporting that are not subsumed within the definition of disclosure controls and procedures.*" This discussion brief may serve as a catalyst in arriving at a final conclusion about this issue.

The certificates set out different responsibilities in respect of disclosure controls and procedures and internal control over financial reporting. The certification of internal control over financial reporting is restricted to the design of such controls and the reporting of changes to them. (Unlike the requirement for disclosure controls and procedures, an evaluation of the effectiveness of internal control over financial reporting is not required.) The CPR Board advises CEOs and CFOs to carefully consider the interrelationship between disclosure controls and procedures and internal control over financial reporting, particularly in areas of overlap.

The evaluation required by MI 52-109 differs from Section 404 of Sarbanes-Oxley in several respects. However, the CSA has stated that it is developing, as a separate initiative, a proposed instrument that will require a report on management's assessment of an issuer's internal control over financial reporting (i.e., a Canadian equivalent to Section 404 of Sarbanes-Oxley). This initiative is likely to include a requirement for the evaluation and disclosure of management's conclusions about the effectiveness of internal control over financial reporting, and a representation regarding disclosure of significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting and the prevention and detection of fraud. The CSA is reported to be evaluating the extent to which auditor attestation of a management report on internal control over financial reporting should be required.

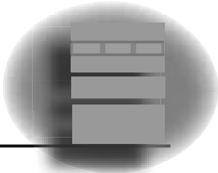
While Canadian reporting issuers await these proposed rules, CEOs and CFOs should note that under MI 52-109, beginning in financial years ending on or after March 31, 2005, they will be required to certify that they have:

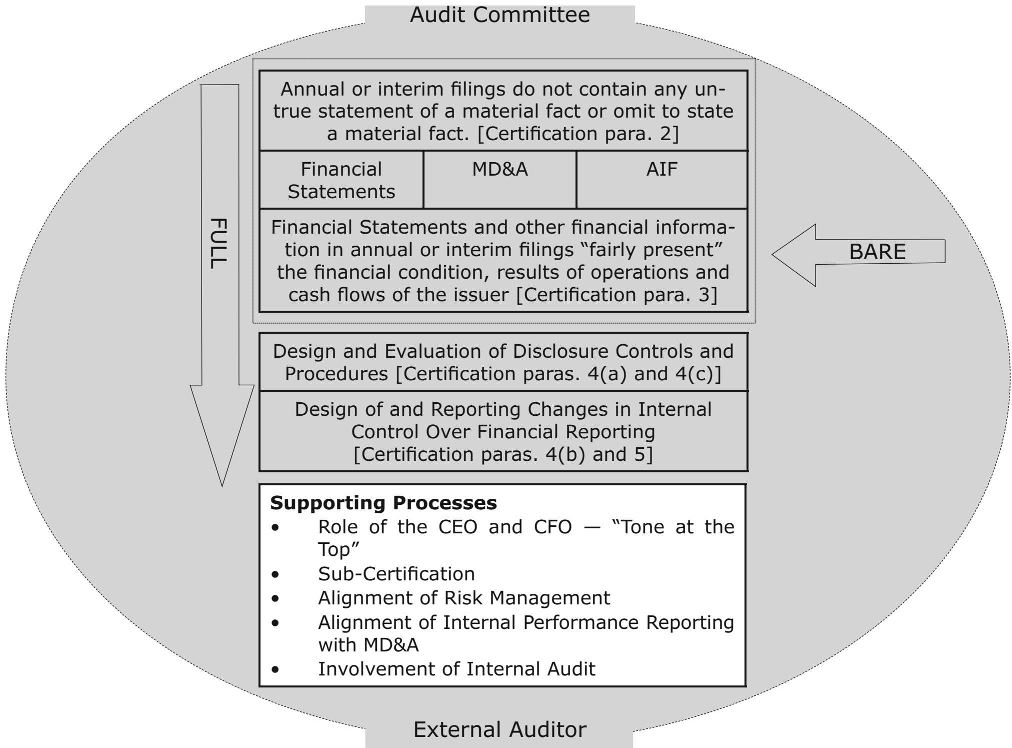
- Designed internal control over financial reporting, or caused it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP (paragraph 4b); and
- Caused the issuer to disclose in the MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting (paragraph 5)

The certification requirements for internal control over financial reporting do not require a formal evaluation and testing of all elements of the operating effectiveness of internal control. It would seem reasonable, however, that to support their design certification, the CEO and CFO should perform an assessment as to whether the design of internal control over financial reporting, at least at the entity level, is adequate to support the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

Similarly, the CEO and CFO must be able to support their certification in paragraph 5 that the disclosures in the interim and annual MD&A of any "material" change in the issuer's internal control over financial reporting are completed and fairly presented. This will likely require CEOs and CFOs to implement some form of system to track and report all "material" changes in internal control over financial reporting.

5. SUPPORTING PROCESSES





CEOs and CFOs will need to ensure that the appropriate systems and processes are in place to support their certification. These would include the accounting systems and disclosure processes, as discussed in the previous section dealing with controls. However, our research indicates other issues that the CEO and CFO should address to ensure they have the appropriate support for their annual and interim certifications. These supporting processes are discussed in this section.

The need for supporting processes varies with the size and complexity of the organization. Larger, more complex and/or geographically dispersed organizations will likely need more formal supporting processes than smaller ones in which the CEO and CFO are more actively involved in day-to-day operations. However, certain supporting elements will be applicable to all organizations, and one of these is the CEO and CFO's responsibility for setting the proper "tone at the top".

ROLE OF THE CEO AND CFO – TONE AT THE TOP

Successfully implementing the new requirements will require leadership and a coordinated set of actions and activities from the CEO, CFO, corporate counsel and the senior executives in both finance and the business units. All of these parties must agree on the objective of ensuring that the issuer's reporting is transparent and of high quality. Without such a commitment – and without a detailed understanding of the certification requirements – it is unlikely that the organization will achieve an effective certification process, a circumstance that would expose the CEO, CFO and the audit committee to a variety of risks.

As with most things in corporate life, the CEO's leadership is critical to this process. CEOs have two broad choices: step up to the plate, set the right tone, create the right expectations and provide the requisite leadership, or abdicate/delegate the responsibility to the CFO, taking an "I'll sign, when you sign" approach.

Because a separate personal certificate is required from the CEO, the regulators clearly expect CEOs to take an active role in the process. Canadian and U.S. regulators both want CEOs, as the issuer's senior executive and leader, to make their own assessments based on their knowledge of the business and its strategies, risks and operating performance. CEOs are responsible for setting the proper "tone at the top" for their companies. Being actively involved in this process and providing it with the requisite lead-

ership is one way to achieve that tone.

The regulators require CFOs to provide a certificate because the certification includes financial disclosures, disclosure controls and procedures, and internal control over financial reporting. CFOs must meet the demands of their external stewardship responsibilities and support both the business and the CEO (to whom they report directly). The certification process adds an explicit public accountability for CFOs. Accordingly, many CFOs may find the new requirements a catalyst for re-evaluating and reassessing their priorities and responsibilities.

While each has a certificate to sign, CEOs and CFOs must work together as a team in the certification process. CFOs are likely to be called upon to "quarterback" the certification process, while CEOs will be better positioned to stand back and make an overall assessment of the financial and non-financial information compiled and presented in the filings in relation to the company's strategies, competitive landscape, opportunities and risks.

Before they can sign their certifications, CEOs and CFOs must first be able to answer two fundamental questions:

1. Am I satisfied that all material information has been brought to my attention?
2. Based on what I know, is the financial information in the annual or interim filings "fairly presented" in all material respects?

The certification requirement points to the need for an "accountability framework" comprised of three key items: (i) policies, (ii) processes and controls, and (iii) people. Without clear policies, it is difficult to establish control or accountability. In addition, it takes processes and people to implement these policies, including providing the necessary training and education for those involved in implementing the policies. The certification provides CEOs and CFOs with an opportunity to review their policies, processes and controls, and people with respect to the preparation and reporting of the financial and non-financial information included in the filings and for the completeness and accuracy of that information, which is communicated up the line to the CEO and CFO.

Implications for "New" CEOs and CFOs

Of the many tasks facing new CEOs and CFOs upon taking office, one of the most significant and critical is to prepare for certifying their company's filings. Once in office, new CEOs and CFOs will be required to provide certification for the entire reporting period; therefore, the need to prepare themselves for certification will become more urgent the closer a new officer's appointment is to the issuer's filing date.

Beginning with the annual certificate for financial years ending on or after March 31, 2005, CEOs and CFOs will be required to certify that they have designed disclosure controls and procedures, and internal control over financial reporting. However, most companies will already have designed and implemented such controls and procedures prior to the arrival of a new CEO or new CFO.

According to Companion Policy 52-109CP, in order to meet the "have designed" criterion, new CEOs and CFOs are to review all such existing controls and procedures that were put into place by the company prior to their appointment. If, during this review, a new CEO or new CFO identifies aspects of those existing controls and procedures that require modification, they are responsible for designing (or supervising the design of) such modifications.

SUB-CERTIFICATION

CEOs and CFOs should ensure that they have documentary evidence to support their "material fact" and "fairly present" assessments, and, eventually, to support their design and evaluation of disclosure controls and procedures and internal control over financial reporting. Our interviews suggest that most larger companies are establishing a sub-certification process, whereby the direct reports to the CEO and CFO provide formal certifications to the CEO and CFO on the:

- completeness and accuracy of the financial information pertaining to their area of responsibility
- effectiveness of disclosure controls and procedures, and
- design of internal control over financial reporting.

Obtaining sub-certifications from business unit and finance executives is not required by regulation. However, a sub-certification process would be useful when the CEO and CFO are separated from the units that conduct business operations and process accounting transactions. (Such a separation may occur as a result of geography, business diversification or organizational size.) In these situations, the CEO and CFO must place a significant reliance on representations and reports from subordinates. (In smaller companies, where the CEO and CFO are often directly involved in the business operations, there may be less need for reliance on reports and a formal sub-certification process.)

CEOs and CFOs should be aware that the signing of sub-certifications by junior officers and managers is not a substitute for their own diligence and knowledge. Nor are sub-certifications a substitute for ensuring that the company has effective disclosure controls and procedures. However, if designed properly,

a sub-certification process can add discipline to the disclosure process, positively reinforce the need for effective disclosure controls and procedures and help sustain a corporate culture that places high value on accurate and timely public disclosures. An effective sub-certification process can also form the backbone of an accountability system for financial reporting.

To achieve effective accountability from subordinates, the sub-certifications should be tailored to each individual's area of personal knowledge and organizational responsibility. The people signing the sub-certifications should understand the company's disclosure policies and objectives, and the applicable accounting policies. Sub-certifications may also be more effective if they are designed to affirm specific facts or accounting practices relevant to the contents of the financial statements and MD&A rather than broad generalizations. Our interviews clearly suggest that one size does not fit all, and the sub-certifications may need to be specifically designed to fit the company's particular business, organizational structure, and regulatory environment.

To be effective, the sub-certification process must be recognized as being more than a documentation or form-signing exercise. To achieve this objective, the sub-certification process should:

1. Include a review of how the senior business and finance leaders of each business unit ensure the effective implementation of and respect for the company's continuous disclosure policy, financial reporting policies and risk management policies.
2. Be integrated with the management reporting and accountability structures through which senior management monitors performance and manages the business and financial risks.
3. Ensure that the people involved in the sub-certification process understand its purpose and their responsibilities.
4. Support a culture of openness and trust that enables people to raise issues or questions without a fear of criticism or reprisal.

In assessing the quality and reliability of a sub-certification, the CEO and CFO should have face-to-face discussions with the sub-certifiers that include an in-depth review of matters such as:

a) whether the disclosures related to the sub-certifier's areas of responsibility are accurate, complete and consistent with the sub-certifier's knowledge of his or her business unit/staff function
b) whether all material items and factors affecting the financial results for the fiscal period have been disclosed
c) whether all material risks been appropriately disclosed
d) whether material trends in the industry segment, general economic conditions, etc. have been factored in
e) understanding the areas of accounting that required the most significant judgment and estimates
f) any items they considered disclosing but did not
g) whether there was anything they did not understand
h) any significant/material items reported for the period that could affect the integrity of financial reporting or the disclosure documents
i) any concerns regarding staffing (including quantity, turnover, and quality/skill level/experience/training) or time available for the exercise
j) any concerns regarding access to information, and the responsiveness of the people with the information
k) any concerns regarding the underlying accounting or control processes applied in the preparation of the financial information and disclosures, including their effectiveness, or the processes to escalate potentially disclosable items to senior management, and
l) whether any problems occurred, and, if so, how serious were they, what were the causes, and have steps been taken to avoid a repetition.

According to those interviewed for this paper, one of the most useful benefits of a well designed sub-certification process is the opportunity it provides for the CEO and CFO to engage, in a meaningful manner, the business unit leaders in the financial reporting process, which helps them better understand the importance of risk management and effective control and, in so doing, helps them run their business units more effectively.

For example, one of the issuers interviewed for this paper reported holding quarterly face-to-face meetings between the corporate CEO and CFO and each business unit's leader and CFO. These meetings give the corporate executives an opportunity to ensure that the business unit's leader and CFO had read the disclosures and sub-certificates from their unit, and to discuss with them the judgments they had made. Higher levels of accountability are achieved through face-to-face meetings than through an entirely paper-based process – in addition to the ancillary benefits of having such meetings among the company's key

leaders. Regardless of whether the business unit's CFO reports on a "dotted" or "solid" line basis to the business unit's head or corporate CFO, a good sub-certification process helps reinforce the business unit CFO's direct accountability to the corporate CEO and CFO.

Notwithstanding these opportunities and potential benefits, most companies will need to address some important behavioural and cultural issues when implementing a sub-certification process. For example, CFOs commented that middle-level managers and executives could become very anxious, and perhaps threatened, by the requirement to sign sub-certifications, especially if their purpose has not been clearly explained. Therefore, CEOs and CFOs must evaluate the effect that sub-certifications could have on morale, corporate culture, and the practical ability of delegating responsibility appropriately within the officer group. CEOs and CFOs must also decide what they will do if an officer refuses to provide such a certification, and how they will determine whether this refusal results from a lack of co-operation with the process or is a red flag that indicates the existence of a substantive hidden problem.

Finally, in addition to separate business unit and finance function sub-certifications, the disclosure committee should provide its own report or certification to the CEO and CFO prior to the filing of their certificates on:

a) the committee's compliance with its policies and discharge of the responsibilities assigned to it, and
b) the committee's conclusions and recommendations resulting from its evaluation of the effectiveness of the disclosure controls and procedures.

ALIGNMENT OF RISK MANAGEMENT

In the interviews conducted for this paper, executives noted the importance of aligning the sub-certification process with the risk management process to ensure that a focus is placed on principal business risks. CEOs and CFOs should stress that a thorough identification and analysis of relevant risks is necessary to achieve accurate and timely disclosure and form a basis for managing and controlling those risks.

CEOs and CFOs must assess the principal business risks that could impair financial condition and the way in which those risks are being managed or mitigated. A disclosure about principal business risks that doesn't also provide information about management's appetite for risk, tolerance thresholds and approach to risk management could be just as misleading as a failure to disclose those risks. (In other words, the actual threat to an issuer's financial condition depends on both the potential impact of an identified business risk and the actions being taken to mitigate that risk).

Many companies are in the process of developing enterprise-wide risk management objectives and operational procedures, which provide information on principal business risks and how they are being mitigated. For example, several financial institutions have developed highly formal systems, while smaller companies typically have very informal systems that are dependent on the CEO's and CFO's active involvement in the business.

It is important to note that financial condition is impacted not just by operational and financial risks, but also by strategic risks.

A well-designed risk management program should provide the CEO and CFO with valuable information and assurance about the likelihood and magnitude of the risks that could impact a company's financial condition. Similarly, investors and analysts also require information about the risks facing the company, and how they are assessed and managed, in order for them to assess the company's financial condition. If a company's financial condition is to be fairly presented, the financial statements and MD&A must inform the reader about the core business activities – providing information not just on historical financial results, but also on how these business activities create value for shareholders. The disclosure should provide information about the way that management has identified principal business risks and assessed their potential impact, and also provide information on the procedures management has implemented to manage those risks efficiently at the individual and the aggregate level. This risk management information is best presented in the MD&A and should complement the information on financial risks presented in the financial statements.

ALIGNMENT OF INTERNAL PERFORMANCE REPORTING WITH MD&A

CEOs and CFOs should view the "material fact" and "fairly present" assessments as an opportunity to more closely link the financial statements and MD&A, better align the performance measures used to manage the business with its external reporting, and develop an improved form of business reporting that integrates both financial and non-financial performance measures, as well as historical results, with future prospects.

CEOs and CFOs consider certain non-financial and non-GAAP financial performance measures to be critical to understanding their business, comparing their company's performance with others in their industry and assessing the company's financial condi-

tion. However, it is essential that any non-financial or non-GAAP financial performance measures be carefully explained and, where appropriate, reconciled to GAAP.

The effective integration of non-financial and non-GAAP financial performance measures must occur at two levels. First, it must occur at the external reporting level between the financial statements and the MD&A and, second, between external reporting and internal reporting. If this integration is accomplished effectively, the organization will have taken a significant step towards a more effective business reporting process.

ROLE OF INTERNAL AUDIT

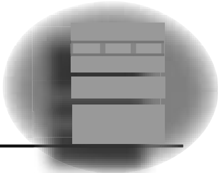
Many CEOs and CFOs will look to their internal audit function for assistance in developing their supporting processes or evaluating the effectiveness of disclosure controls and procedures. If so, the critical issue to address is the extent to which internal audit's participation in such activities could compromise its organizational independence, which, in turn, could affect the ability of the audit committee and the external auditor to rely on internal audit's work or reports.

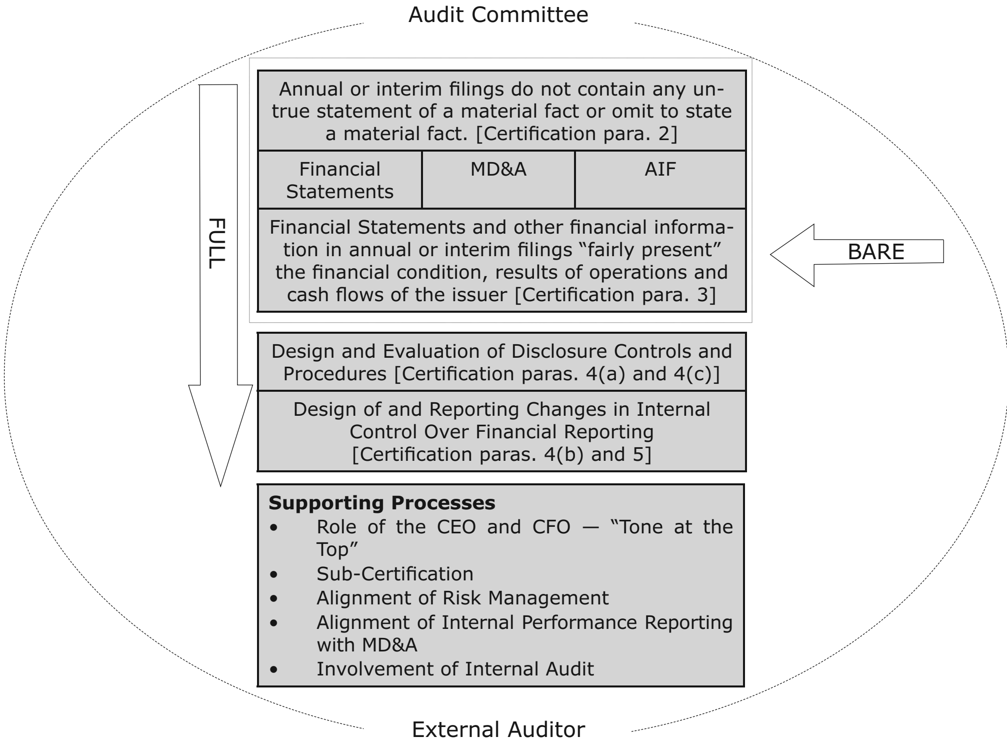
For example, some CEOs and CFOs may ask the internal audit function to help train employees about how to assess, modify or create the systems and processes needed to support the CEO and CFO certifications. They may also ask internal audit to help in organizing and documenting the policies, procedures and forms involved in the certification process. Given their skill sets, providing any of this assistance may be appropriate for the internal audit function. However, once the support systems are in place, operating management must take over as the "owner" of the systems that support the certification process. If such a transfer of ownership does not occur and the internal audit function becomes responsible for the certification process, this would likely compromise its organizational independence, making it difficult for internal audit to have the objectivity necessary to effectively evaluate or test the effectiveness of the certification process.

Another instance in which internal audit's organization independence must be protected occurs where the head of the internal audit function sits on the company's disclosure committee. Certainly, there are advantages to having the internal auditor participate on such a committee. With his or her professional expertise, the internal auditor would be able to pose challenging questions while also sharing professional knowledge with the other committee members. The internal auditor's participation on the committee would also help the internal audit function in assessing the disclosure committee's effectiveness since the internal auditor would be a first-hand observer of the committee's operations, the quality of its meetings, and the thoroughness of the questions raised by the committee and the answers provided to it. However, the internal auditor should not be allowed to become an overly dominant member of the disclosure committee, or to take on a leadership role, such as becoming its chair, because that would make it difficult for the internal audit function to be objective in assessing the committee's effectiveness. Therefore, a solution being adopted by some companies is to have the head of internal audit serve only as an ex-officio member of the disclosure committee.

Internal audit can also play an important role in evaluating and testing the overall effectiveness of disclosure controls and procedures and reporting their findings and conclusions to management, the audit committee and the external auditor. The effectiveness of disclosure controls and procedures can be evaluated and tested using established auditing methods, such as a risk-based approach that focuses the internal auditor's activities on the disclosure issues that present the greatest risk for the company and the certifying officers. Once again, however, the internal auditor's credibility in evaluating and testing disclosure controls and procedures will be determined, to a large degree, by the internal audit function's organizational independence with respect to the nature and extent of its involvement in the certification process.

6. AUDIT COMMITTEE AND EXTERNAL AUDITOR





The CEO and CFO certification requirements are directed at management, and do not make reference to the audit committee or the external auditor. Nevertheless, they present implications for both of them.

ROLE OF THE AUDIT COMMITTEE

Multilateral Instrument 52-110 on Audit Committees requires audit committees to review the annual and interim financial statements, MD&A and earnings news releases, but not the AIF. In the interviews conducted for this paper, most companies reported that their audit committee has questioned the CEO and CFO about their overall approach to the certification process, the issues that were raised and the conclusions that were reached.

Audit committees that wish to learn about the approach to certification may consider asking – and CEOs and CFOs should expect to answer – questions such as:

1. What supporting processes have the CEO and CFO put in place as part of the certification process? Do they cover all business units and corporate functions? Do they include business/operating executives as well as finance executives?
2. What criteria do the CEO and CFO use to assess fair presentation?
3. What guidance is provided to business unit managers, particularly on the assessment of fair presentation and communicating material information to the CEO and CFO?
4. Do the CEO and CFO meet with business executives and finance executives to review issues relating to certification? Do they have a standard list of questions? Have the questions changed from prior periods, and if so how?
5. If the company has a disclosure committee, what has it communicated to the CEO and CFO? What are the committee's processes, and the results of its work?
6. What issues arose in the sub-certification process? How were they resolved?
7. Were there any "early stage" or other issues that were not disclosed because of a lack of sufficiently robust information to provide a useful disclosure?
8. How and by whom is the MD&A assembled and written?
9. Should the company file concurrently its finan-

cial statements, MD&A, AIF and the CEO and CFO certificates?

10. How have the CEO and CFO approached the design and documentation of disclosure controls and procedures and internal control over financial reporting?
11. Has a team been put in place to lead this process – with or without assistance of outside advisors?
12. Are the internal and external auditors involved in an appropriate manner?

INVOLVEMENT OF THE EXTERNAL AUDITOR

The external auditor does not have a direct role in the CEO/CFO certifications. Notwithstanding that, in arriving at his or her conclusion about the financial statements, it seems likely that the auditor would discuss with the CEO and CFO the rationale they used in making their "material fact" and "fairly present" assessments, the processes undertaken to provide the certifications, and any issues that arose with respect to the financial statements and how those matters were resolved.

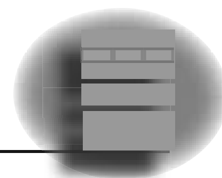
The external auditor is engaged by the audit committee to express a conclusion about the financial statements, and the audit committee may enquire about the auditor's assessment of the process followed by the CEO and CFO in preparing to sign their certifications and the conclusions that they reached. In that event, the auditor may wish to explain his or her responsibilities are to conduct an audit in accordance with generally accepted auditing standards. By comparison, the CEO and CFO certifications relate to the fair presentation of all financial information in the filings, without reference to GAAP, and are based on the more in-depth knowledge of management. It is likely that the enquiries and other procedures the auditor performed in conducting the audit would relate to only some aspects of the CEO and CFO certification process.

The audit committee and/or the CEO and CFO may request the auditor's advice or assistance in some aspect of the certification process. If so, the auditor should carefully review the CA profession's rules of professional conduct. Such an engagement would require the pre-approval of the audit committee and a determination by the auditor that the engagement would not impair the auditor's independence. In making this determination, the auditor will consider a number of factors, including, for example, the impact of the proposed engagement on the auditor's reliance on management representations for audit purposes. The auditor will want to ensure that these representations are truly those of management and that the auditor is not merely relying on his or her own advice.

The questions that an audit committee might ask the CEO and CFO, set out above, may also be relevant for auditors to ask. In addition, auditors may wish to consider the following questions:

1. Have the CEO and CFO certificates been signed in respect of the period covered by the auditor's engagement (either interim reviews or annual audit)?
2. Did the process identify any weaknesses in either disclosure controls and procedures or internal control over financial reporting? If so, what has management done to correct these deficiencies and what impact would these weaknesses have on the interim or annual financial statements?
3. Did the process detect any fraud or other illegal acts?
4. Did the process result in any revisions to the financial statements?
5. Did the process identify any errors in the financial statements that were not adjusted because they were not material?
6. Have the CEO and CFO communicated the results of their "material fact" and "fairly present" assessments and the process followed in reaching their assessments to the audit committee? What was the audit committee's reaction?
7. Are there any areas where the CEO and CFO concluded that, because the financial statements did not "fairly present" the company's financial condition, that additional material needed to be added to the MD&A? Is this the appropriate way of addressing this issue?
8. What process was followed in the review of the MD&A, particularly the disclosures described in sections. 4(c) and 5 of the full certificate?

7. CONCLUSION



The purpose of the certification process is to enhance investor confidence through improving the transparency of disclosure and holding key executives accountable for the accuracy and completeness of financial reporting and related controls.

CRITICAL SUCCESS FACTORS

The interviews with Canadian executives indicate that the degree to which the certification process will achieve these objectives depends on many factors, including:

- the quality of the leadership provided by the CEO and CFO
- the extent to which other senior operating executives are involved in the process, and
- the commitment to learn from experience, and strive for continual improvement.

Leadership

Of the above factors, perhaps the most determinative is the attitude and leadership – the "tone at the top" – provided by the CEO and CFO. If these executives embrace the certification process as an opportunity to improve the way in which they run their business and as an important part of the disclosure process, then the process will likely have a very positive and significant impact. On the other hand, CEOs and CFOs who communicate through their words and actions that they consider the process to be yet another "compliance" exercise, which is not otherwise important, will likely see significantly fewer benefits.

The certification process certainly presents additional liabilities and risks for CEOs and CFOs who do not discharge their responsibilities in an effective manner. However, while concerns about liability, sanctions and penalties are important, our research indicates that they should not be over-emphasized. As one interviewee cautioned "legal concerns should not drive the process." The focus of the certification process should be on transparency and substance, rather than on "form" or mechanistic compliance. In fact, CEOs and CFOs who adopt a "tick the box" type approach that produces well documented files full of sub-certifications, but with little challenge to the substance or exercise of judgment, may actually have a process that produces a false sense of security.

Involvement of Senior Executives

A well-designed certification process can provide the significant additional benefit of more meaningfully involving senior operating executives from outside the finance function in the company's financial reporting process. Fully realizing this benefit, however, will take time and effort on the part of the CEO and CFO. They must educate their executives on all matters related to certification, including the objectives of the certification process, the key requirements in financial reporting, the MD&A and continuous disclosure, the information required for the process, the way in which executives should work with the finance staff, and the obligations on the executives if they have questions, issues or concerns.

Striving for Continual Improvement

The approach taken to planning the process, learning from experience and striving for continual improvement will be the final key determinant to success. Implementing the certification requirement is a multi-year exercise that begins with the "fairly present" assessment, then introduces disclosure controls and procedures, and will likely conclude with management reporting on internal controls (including auditor attestation). Management must develop a long-term plan to ensure that these elements are addressed in an orderly and effective manner.

Perhaps more important, however, is the need to ensure that the plan is built on a continual improvement philosophy. Many of our interviewees noted that the process they first introduced is not the same as the one they now follow. CEOs and CFOs must monitor the effectiveness of the certification process, seek feedback from all those involved, learn from the experience, and continually improve the process.

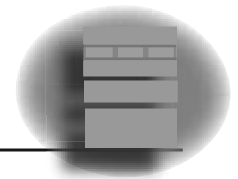
TRANSPARENCY AND FAIR PRESENTATION

The objective of the many new requirements that now apply to Canadian public companies, including the certification process, is to create a greater transparency of important financial information between that which is found in management reports, board submissions and databases within the company, and the information disclosed by the company in its filings. While an improvement in the quality of information disclosures is certainly laudable, a complete transparency of information is not likely to ever be achieved, nor should it.

If a company were fully transparent, all of its internal information would be visible to those outside the company. Rather than being a benefit to investors, such a situation would almost certainly overwhelm them with such a volume of information that it would be difficult, if not impossible, for them to digest the information, let alone determine which items were relevant to their needs and which were not.

Because of that, and despite the popular current emphasis being placed on the concept of transparency, a better way to think of the objectives of the new requirements, including the CEO and CFO certification, is in terms of fair presentation. One way to do so may be in terms of an analogy to a museum or art gallery in which a limited number of items are on display to the public at a given time. If the artifacts and other objects placed on display are fully representative of the items that remain in storage or are otherwise not available for viewing, then the public galleries may be considered to "fairly present" the contents of the museum's entire collection. If, however, the artifacts on display to the public were of a significantly greater or lesser quality than those that remain out of sight, then the public galleries would not provide a fair presentation of the collection.

Appendix A: CERTIFICATES



Form 52-109F1 - Certification of Annual Filings

I, <identify the certifying officer, the issuer, and his or her position at the issuer>, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings) of **<identify issuer>** (the issuer) for the period ending **<state the relevant date>**;
2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings;
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;
   b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
   c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD&A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and
5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: __________

________________________________[Signature] [Title]

Form 52-109FT1 - Certification of Annual Filings during Transition Period

I, <identify the certifying officer, the issuer, and his or her position at the issuer>, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings) of **<identify issuer>** (the issuer) for the period ending **<state the relevant date>**;
2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings; and
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings.

Date: __________

______________________________[Signature] [Title]

Form 52-109F2 - Certification of Interim Filings

I <identify the certifying officer, the issuer, and his or her position at the issuer>, certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings) of **<identify the issuer>**, (the issuer) for the interim period ending **<state the relevant date>**;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings;
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings;
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the interim filings are being prepared; and
   b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
5. I have caused the issuer to disclose in the interim MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: __________

______________________________[Signature] [Title]

Form 52-109FT2 - Certification of Interim Filings during Transition Period

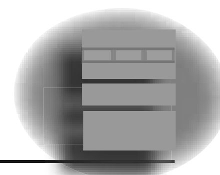
I <identify the certifying officer, the issuer, and his or her position at the issuer>, certify that:

1. I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings) of **<identify the issuer>**, (the issuer) for the interim period ending **<state the relevant date>**;
2. Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
3. Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

Date: __________

______________________________[Signature] [Title]

Appendix B:
PENALTIES, SANCTIONS, DISGORGEMENT AND LEGAL LIABILITY



MI 52-109 does not specify the penalties that could be applied to those found to have provided a false certification. However, such an action would be subject to quasi-criminal, administrative and civil proceedings under existing applicable laws.

CANADIAN PENALTIES

By way of example, in Ontario, Bill 198 (introduced in 2002) made several amendments to the Securities Act (Ontario). Since April 2003, penalties for violating the Securities Act have been increased to a maximum fine of $5 million, and maximum prison time to five years less a day. (s. 122(1)) If trading following the filing of a certificate could be characterized as "insider trading," then the maximum fine would be the greater of triple the "profit" made (or loss avoided) and $ 5 million. (s. 122(4))

The Ontario Securities Commission now also has the power to levy administrative penalties up to $1 million for each failure to comply; to order the "disgorgement" of any amounts obtained as a result of the non-compliance; to prohibit a person from acting as officer or director; etc. (s. 127(1)). The fact that some of these remedies have not been utilized to date does not mean they will not be in appropriate circumstances.

If, after a certificate was filed pursuant to MI 52-109, major stock option gains were realized and those amounts were determined to be based on a certificate proven to be wrong (i.e. the certified results fueled the stock price appreciation that yielded the option profits) then "disgorgement" and a fine of the greater of $5 million and triple the profit might ensue. In addition, income tax might still be payable on the stock option profit, without an offsetting deduction for the disgorgement and fines.

Other amendments to the Securities Act (Ontario) currently awaiting passage provide for civil rights of action in favour of secondary market participants. (ss. 138.1 – 138.14) While the certificate will not be considered a "core document" under these provisions, it can still attract liability. The proposed amendments dispense with the common law requirement to show reliance or causation on the statements made (i.e. a lower standard for a plaintiff than is found under U.S. Rule 10b-5 which requires "*scienter*" – a mental state embracing intent to deceive, manipulate or defraud), and provide liability limits for officers up to 50% of total compensation for the prior year (annual cash compensation, plus pension benefits, stock option value, etc.).

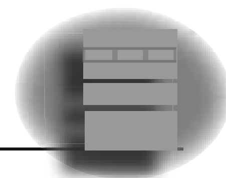
U.S. PENALTIES

The U.S. Sarbanes-Oxley Act of 2002 provides that if the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirements, the CEO and CFO shall reimburse the issuer for any bonus or other incentive-based or equity-based compensation received by them in the year following the issuance or filing of the relevant document, together with any profit on the sale of stock during that period. (S. 304)

Further, certifying any statement knowing of non-compliance is subject to increased criminal penalties up to US$1 million and imprisonment up to 10 years; "willfully" certifying any statement knowing of non-compliance is subject to penalties up to US$5 million and imprisonment up to 20 years. (S. 906)

Sarbanes-Oxley also lowers the threshold for barring individuals from acting as a director or an officer of any issuer from "substantial unfitness" to "unfitness" (i.e. "if the conduct of that person demonstrates unfitness to serve…"). (S. 305)

Appendix C: SAMPLE MANDATE FOR DISCLOSURE COMMITTEE



1. To review, on an ongoing basis, the issuer's continuous disclosure policy to ensure that it addresses the issuer's principal business risks, changes in operations or structure, and facilitates compliance with applicable legislative and regulatory reporting requirements.
2. To design a set of "disclosure controls and procedures" to provide reasonable assurance that:
   a) the continuous disclosure policy is effectively implemented across all business units and corporate functions; and
   b) information of a material nature is accumulated and communicated to senior management, including the CEO and CFO, to allow timely decisions on required disclosures.
3. To review prior to issuance or submission to the audit committee or board of directors:
   a) annual and interim filings, management information circulars, material change reports, annual information forms, and any other information filed with securities regulators;
   b) news releases containing financial information, earnings guidance, information about material acquisitions or dispositions, or other information material to investors; and
   c) presentations and reports containing financial information broadly disseminated to analysts, creditors and investors, including financial information displayed on the issuer's website.
4. To direct and supervise an annual or interim evaluation of the effectiveness of the issuer's disclosure controls and procedures, unless this evaluation is performed by another group such as the internal audit department. (The U.S. requirements call for a quarterly evaluation of disclosure controls and procedures, whereas in phase two the Canadian requirements will require an annual evaluation of disclosure controls and procedures.)
5. To ensure that policies and guidance related to corporate disclosure and financial reporting are developed and issued, and that communication of matters affecting disclosure and financial reporting efficiently flows down, across and up the organization.
6. To assist the CEO and CFO in monitoring and evaluating the integrity, ethical values and competence of the company's officers and employees in accordance with the policies and direction provided by the issuer's board of directors and its audit committee.
7. To bring to the attention of the CEO and CFO, all relevant information with respect to the committee's activities, the annual or interim filings, and the evaluation of the effectiveness of the issuer's disclosure controls and procedures.