



June 6, 2005

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Dear Sir and Madam:

The Committee on Corporate Reporting (“CCR”) and the Issues and Policy Advisory Committee (“IPAC”) of Financial Executives International Canada (FEI Canada) (collectively “the Committees”) are pleased to provide comments on the proposed Multilateral Instrument 52-111 (“MI 52-111”), Reporting on Internal Control over Financial Reporting, and companion policy 52-111CP.

FEI Canada is an all-industry professional association for senior financial executives, with eleven chapters across Canada and approximately 1,700 members. Membership is generally restricted to senior financial officers of medium to large corporations. The following remarks are made on behalf of the Committees and do not necessarily represent the views of FEI Canada or its members. The Committees comprise more than 50 FEI Canada members involved in senior financial and other positions, and in preparing our response, drew on the results of two surveys of our members.

The requirements governing management's certification on the effectiveness of internal controls over financial reporting are of significant interest as they directly impact a large number of our member companies. Our membership will be actively involved in implementing and achieving compliance with any new requirements.

In providing our comments, we are also drawing on the experience of some of our members in complying with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404). Attached to this letter is the result of our fall 2004 survey of inter-listed companies in Canada on the costs associated with achieving compliance with SOX 404. In summary, inter-listed companies were incurring significant internal and external costs to implement and maintain compliance with SOX 404.

Conclusions

The Committees support fully the objectives and much of the regulatory change implemented in recent years to improve the integrity of financial reporting, stronger corporate governance and the recovery of investor confidence. We certainly support the certification by management of internal controls, as long as

that is based on a risk-based, not absolute, approach to the assessment of controls. We also support the approach recommended for implementation, including timeframes and size tests.

However, the Committees strongly disagree with the requirement to have auditors confirm the management certification. We believe the costs of the audit work do not justify the benefits to investors and other stakeholders, and that management and the Boards of companies should decide on the nature and extent of any audit work on the internal control certification that is appropriate in the circumstances. If the audit requirements are left unchanged, we believe many private companies wishing to access public markets for additional capital will be delayed or deterred from going public based on the excessive costs and other issues driven by these requirements. For those companies that are currently public in Canada, we believe the additional audit costs could result in a significant reduction in companies' market capitalization that would be detrimental to current and future shareholder value, so not in their best interests.

Specific Comments

For purposes of providing comments, we solicited comments from the members of both committees on four key questions:

1. Should Canadian companies be required to provide certifications on the effectiveness of internal controls, similar to those required under SOX 404?
2. Should there be a tiered approach to the implementation of the proposed rules based on the size of the company? If so, is market capitalization a good measure?
3. Should there be differing levels of compliance based on a measure such as company size?
4. Should there be a requirement for an audit of management's internal control assertions and report?

Should Canadian companies be required to provide certifications on the effectiveness of internal controls, similar to those required under Sarbanes Oxley?

The Committees agree with the proposed requirement that Canadian companies should provide certifications on the effectiveness of internal controls over financial reporting. All of the inter-listed companies will be reporting effective December 31, 2006. If similar certifications are not required for all Canadian public companies, there is a possibility that the Canadian capital market could become "two-tiered", with those providing certifications perceived to be improved investment opportunities than those companies that do not.

Should there be a phased approach to the implementation of the proposed rules based on the size of the company? If so, is market capitalization a good measure?

There is strong support for the proposal for phased implementation of the proposed rules based on the size of the company. Market capitalization is recognized as an acceptable measure of company size. The Committees believe that there should be revenue thresholds, in addition to market capitalization, in case there are some anomalies in stock prices at the time of implementation.

However, concern was expressed about the ability of the general public to readily determine the market capitalization of a company and therefore understand the applicability of the requirements to companies. Consideration should be given as to how to achieve "transparency" of applicability of the rules under tiered implementation. The OSC should determine how to make the information readily available to investors on a timely basis.

Should there be differing levels of compliance based on a measure such as company size?

Survey participants were divided on this issue. On one hand, it was believed that phased implementation was sufficient recognition of the challenges that smaller companies would face in achieving compliance with the new rules. Alternatively, some felt that smaller companies would face a disproportionate increase in costs to comply and that the requirements should be reduced for smaller companies to reduce compliance costs. As with tiered implementation, disclosure would need to be sufficient to ensure the general public understood what rules applied to each company. Transition rules from one level of compliance to another, as companies expand or contract, would also be required.

Again, our membership placed great emphasis on practical, cost-effective rules, regardless of the company size.

Should there be a requirement for an audit of management's internal control assertions and report?

Management should provide its certificates and no audit should be required, although management should be permitted to elect to have its certifications audited. The Committees acknowledge that this could result in a “two-tiered” capital market as noted above, as the inter-listed companies are subject to audit. However, since the inter-listed companies tend to be large, capital intensive industries, we believe the nature of the investment decisions may be different in any event. As such, the differing requirements do not cause us concern.

The Committees believe that, if an audit is required, the only management assertions subject to audit should be those related to entity-level controls, and perhaps controls over the financial reporting and close process. It is the Committees' view that the “tone at the top” drives business decisions, actions and processes. Testing and auditing detailed controls over transactions is virtually useless if the entity-level controls are not effective and senior management does not espouse ethical behaviour in the conduct of the corporation's business. We disagree with the statement in the request for comments that “it would reduce the ability of issuers and auditors to learn from the experience of issuers and auditors complying with SOX 404 rules”. In fact, we believe it would demonstrate that we have learned from that experience and the procedures implemented for SOX 404 purposes could be applied similarly but on a narrower scope of controls.

Experience in the United States indicates that the involvement of the external auditor has created costs far in excess of value received. As well, timely and direct communication between external auditor and management has been impaired, as the external auditor struggles to comply with PCAOB guidance.

If regulators determine that an audit of management's assertions over all internal controls is required, strong views were expressed that implementing the Canadian requirements must be more practical and provide for a better cost/benefit relationship than is the case in the United States. The Committees believe that the regulators must provide high-level implementation guidance that makes reference to a risk-based audit approach, combined with a review of entity-level controls. This then will guide the auditing standard-setters in developing their standards and likely would avoid the transaction-based, overly detailed approaches to documentation, management testing and auditing that have arisen from U.S. guidance. In our view, this would have a significant impact on the ongoing audit costs. Although the CICA will solicit comments on proposed guidance, we believe it is extremely important for the regulators to provide overall direction as to the extent of management testing and audit work that are to be performed.



In closing, the Committees support a phased implementation of practical requirements to assess internal controls over financial reporting. Achieving compliance with these requirements should remain the accountability of management. We would be pleased to meet with you if you wish to discuss our views further.

Yours very truly,

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Costs of Internal Control Certification in Canada



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The following opinion is based on research undertaken by the members of the Issues and Policy Advisory Committee (IPAC) of Financial Executives International Canada. The remarks represent the views of the IPAC and are not necessarily the views of Financial Executives International Canada or its members.

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Introduction

Two years after SOX 404 became law in the United States, studies are beginning to reveal the costs of internal control certification to US corporate filers. In Canada, we anticipate that companies listed on Canadian exchanges that will be subject to the new OSC ruling respecting management reporting and auditor attestation to the design and effectiveness of internal controls (MI 52-111) will be faced with similar costs.

In order to obtain information on the potential costs of implementing MI 52-111, Financial Executives International Canada, and its National Strategic Partner, Russell Investment Group, conducted a survey of inter-listed companies in Canada. It is our hope that the information collected in this survey will help us shed some light on the potential costs to Canadian listed companies that are now preparing to report on the design and effectiveness of their internal controls. The following are the key results obtained from the survey. All values are stated in Canadian dollars, unless otherwise noted.

Survey Methodology

Between September and November of 2004, FEI Canada distributed copies of the survey to roughly 5500 CFOs and other senior level financial executives in companies across Canada. Only those companies that were listed in both Canada and the United States were eligible to complete the survey. Ninety three responses were received, almost half (46) of which were from large companies with annual revenues greater than \$200 million. Seventeen were received by companies with revenues between \$100 million and \$200 million, 16 were received from companies with revenues of between \$25 million and \$100 million and 14 were from companies with revenues between \$5 million and \$25 million.

Sample Data

Highlights

Over one third the companies responding to our survey were more than 50% through the SOX 404 process. The majority of respondents answering the survey had a senior finance role.

As expected, the majority of respondents were from Ontario, reflecting the general distribution of inter-listed companies in Canada. Over half of the Ontario respondents, or 23 of these companies, had revenues greater than \$200 million. Of the companies responding, 35 or 37.6% were more than halfway through the SOX 404 certification process. Twenty four of these companies, or more than half of the large companies responding to our survey, had annual revenues greater than \$200 million. Twenty nine companies in the sample were between 1% and 25% complete and 3 were 100% complete. Of the companies that have completed the certification process, all were in the large company category with revenues greater than \$200

million. Out of 93 respondents, 2 were Presidents or CEOs and 59 held the position of VP or CFO. The remainder were controllers and directors.

Annual Sales Revenues (C\$)	Number of Respondents
5-25 million	14
25-50 million	9
50-75 million	2
75-100 million	5
100-150 million	10
150-200 million	7
> 200 million	46
Total	93

Province	Number of Respondents
Alberta	19
British Columbia	12
Manitoba	2
Nova Scotia	4
Ontario	42
Quebec	12
Saskatchewan	1
Other	1
Total	93

Percent Completion	
1 - 25 %	29
25% - 49%	31.2
50% - 74%	17
75% - 99%	15
100%	3

Survey Results

How many internal person hours do you expect to need to comply with section 404/Management Report on Internal Controls (SOX 404)?

Highlights

43.5% of large inter-listed companies in Canada expect that it will require over 10,000 person hours to comply with SOX 404. With the exception of one company with revenues between \$50 million and \$75 million, all medium and small companies in our survey indicated that they would anticipate requiring less than 5000 internal person hours to comply with SOX 404.

The number of internal person hours that companies anticipated needing to comply with section 404/Management Report on Internal Controls is correlated to company size. Of the 46 companies with revenues greater than \$200 million, 20, or roughly 43%, reported that they would require over 10,000 internal person hours to comply. Sixteen fell into the 10,000 to 50,000 person hour category, and 4 expected requiring over 50,000 person hours.

Twenty two, or 48%, of large companies' respondents fell into the 1000 to 10,000 person hours category. Twelve of these companies, or 26% of all large companies, fell into the 5,000 to 10,000 person hours category. With the exception of one company with revenues between \$50 million and \$75 million, all medium and small companies in our survey indicated that they would anticipate requiring less than 5000 internal person hours to comply with SOX 404.

At what level of the organization were most of these resources deployed?

The companies in our survey were asked what sort of resources were required (i.e. Manager, supervisory, administrative, senior management, data entry, auditor, CFO and IT) in their SOX 404 certification efforts. Management resources were cited most often by the respondents, with 89% of respondents indicating that resources were deployed at this level. This compares to 37% that indicated that they were deployed at the supervisory level and 9% that indicated that resources were deployed at the administrative level. Companies were allowed to have multiple choices.

How many external person hours do you expect to pay for to comply with Section 404/Management Report on Internal Controls (SOX 404)?

Highlights

The number of external person hours that will be hired to comply with SOX 404 varies according to company size. Almost all companies in the survey will be hiring external consultants during the first year of their SOX 404 certification process. Roughly half of the large companies surveyed expect to pay for more than 2500 external person hours. Relatively more mid-sized companies reported lower external person hour requirements than companies with revenues below \$50 million and over \$150 million.

With respect to additional external person hours required, 25% of all companies fell into the 1000 to 2500 person hours category. This compares to 40% of companies in the \$100 million to \$150 million revenue range, and 50% of companies in the \$50 million to \$75 million revenue range.

In terms of paying for additional external person hours, over 10% of the larger companies in the survey fell into the 10,000 to 50,000 person hours range. One company expected to pay for more than 50,000 external person hours. Almost all of the companies in the survey indicated that they would be hiring external consultants during the first year of their compliance effort. Again this varies according to size of company. Almost 78% of companies in the \$25 million to \$50 million revenue range expect to be hiring external consultants, compared to 71.4% in the \$150 million to \$200 million range, 60% in the \$75 million to \$100 million revenue range and 54.3% of those with revenues over \$200 million.

What is your estimated cost, in thousands, for external consulting, software, and other vendor charges (excluding auditor fees) to comply with section 404?

Highlights

74% of respondents estimated that they would spend more than \$50,000 for external consulting, software, and other vendor charges to comply with Section 404, excluding Auditor's fees for attestation. Medium sized companies can expect to pay more than large companies, in both relative and absolute terms.

Almost 43% of companies with revenues between \$150 million and \$200 million fell into the \$500,000 to \$1 million range in terms of paying for external consulting, software and external vendor charges, whereas only 15.2% of larger companies expected their costs to be this high. Thirty percent of companies with revenues between \$100 million and \$150 million fell into the \$250,000 to \$500,000 category, compared to 26.1% in larger companies.

What is the additional audit fee you expect to pay for the public auditor attestation report required by Section 404 (SOX 404)?

Highlights

In terms of increases in audit fees for Section 404, results for large companies are mixed. One in five large companies expect to pay between \$25,000 and \$50,000 and 17.4% expect to pay between \$50,000 and \$100,000. This compares with 8 companies that expect to pay over \$1 million.

The additional audit fee that companies expected to pay for the public auditors attestation report required by Section 404, varied widely, with estimations of between \$3,000 and \$7.5 million. The largest number of medium sized companies (40%) fell into the \$50,000 to \$100,000 category. However, many larger companies in the survey said that they expected a much lower increase in fees due to SOX 404. Thirty percent of companies whose revenues were between \$100 million and \$150 million fell into the \$5,000 to \$10,000 category. Forty three percent of companies with revenues between \$150 million and \$200 million fell into the \$10,000 to \$50,000 range. One company, the largest in our sample, reported an estimated increase in auditor fees of \$7.5 million.

The accuracy of these cost estimates, as previous FEI US studies have shown, is likely to be dependent on the percent completion of the SOX 404 certification process. We know that US estimates changed over time, as companies progressed in their certification process. In this particular study of inter-listed companies, over one third of companies were 50% into the process. Thirty five of the 93 companies, or roughly 38%, had completed over 50% of the SOX 404 certification process. Seven of these were large companies reporting expected cost increases of between \$500,000 and \$7.5 million. Two indicated that they expected to pay an additional \$1 million and one expected to pay an additional \$7.5 million. Future surveys will be conducted that will show actual costs incurred at the end of years one and two of the SOX 404 certification process.

What percentage is this fee of your total annual financial statement audit fee?

Highlights

When asked what the SOX 404 audit would cost as a percentage of their current audit fees, over one quarter, or 27 of the companies surveyed, fell into the 25% to 50% range. Seventeen percent, or 16 respondents, fell into the 50% and 74% range. Eleven companies in the sample expected the SOX 404 audit cost to total 100% of their current financial statement audit fees.

Of the 46 large companies in the sample, 14, or 30.4%, fell into the 25% to 50% category. This compares to six or 43% of the smaller companies with revenues between 5 million and 25 million that fell into this category. Six of the 46 large companies fell into the 1% to 25% category. Nine or 19% fell into the 50% to 75% category and four large companies expected audit fees to double.

What percentage of your processes are you documenting to comply with SOX 404?

Highlights

76% of respondents indicated that they would be documenting over 75% of their processes to comply with SOX 404. Fifteen of 93 companies, or 16.1%, indicated that they would be documenting 100% of their processes.

Of the large companies in our sample, 71.7 % will be documenting over 75% of their process. This compares to 64.2% of companies with revenues in between \$5 million and \$25 million, 77.8% of companies in the \$25 million to \$50 million revenue range, 50% of companies in the \$50 million to \$75 million revenue range, and 90 % in the \$100 million to \$150 million revenue range. All companies that were in the \$75 million to \$100 million revenue range, as well as all companies in \$150 to \$200 million revenue range, plan on documenting 100% of their processes.

What percentage of your documented processes do you expect your external auditor to actually test?

Highlights

While over three quarters of our survey respondents indicated that they would be documenting more than 75% of their processes, only 43% indicated that they expect their auditors to test more than 75% of their processes.

To what extent do you see your control processes change?

Highlights

75% of survey respondents reported that they expected their control processes to change somewhat due to SOX 404 certification. This compares with 19.4% that thought their processes would change significantly and 5.4% that reported there would be no change at all.

Relatively more small companies thought that their control process would change in a significant way than large companies. Four out of 14 companies with between \$5 million and \$25 million in revenue, or 28.6%, indicated that they foresaw a significant change in their control processes. This compares to 17.4% of large companies that held this view.

What cost impacts do you anticipate as a result of a change in your control processes?

Highlights

Of the companies responding to our survey, 23.7% indicated that they expected costs of staffing to be impacted as a result of a change in their control process. Similarly, 30.1% indicated that information technology (IT) costs would be impacted.

Staffing and information technology (IT) were the two most frequently cited categories in terms of anticipated cost impacts. Large company results were consistent with the overall results. In companies with over \$200 million in revenues, 28.3% indicated that staff costs would be impacted and 32.6% indicated that IT costs would be impacted. IT systems was the most frequently cited category, relative to other categories like IT software, administrative costs, or staffing and human resources costs. Thirty three percent of all respondents indicated that none of their outsourced processes would be affected by the internal control assessment. The result for large companies is virtually identical to the overall group. However, half of smaller companies with revenues in the \$5 million to \$25 million dollar range thought that none of their outsourced processes would be affected. Twenty three percent of all survey respondents simply did not know.