

## **CSA Staff Notice 52-325 Certification Compliance Review**

### **Purpose**

This notice outlines the results of a recent review conducted by staff of the Canadian Securities Administrators (staff or we) of compliance with the provisions of National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (Certification Instrument or NI 52-109).

NI 52-109 came into force on December 15, 2008, at which time Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* (MI 52-109) was repealed. The purpose of the Certification Instrument is to improve the quality and reliability of reporting issuers' annual and interim disclosure. We believe that this, in turn, will help to maintain and enhance investors' confidence in the integrity of our capital markets. See Appendix A of this notice for a summary of the most significant changes from MI 52-109 to NI 52-109.

### **Executive Summary**

Of the total reporting issuers reviewed, 38% appeared to substantively comply with the requirements of NI 52-109 such that no action was required. However, of the remaining 62% of issuers reviewed, we identified some level of non-compliance with the provisions of the Certification Instrument. For 30% of reporting issuers reviewed, the filings were so deficient that the issuers were required to refile their annual MD&A and/or certificates. For 32% of the issuers reviewed, we required the issuers to make prospective changes in future filings. Staff expects that issuers' compliance with NI 52-109 will improve as issuers become more familiar with the requirements. Meanwhile, we will continue to monitor compliance with these requirements closely.

### **Review program**

We selected a sample of 198 non-venture issuers and 53 venture issuers with a December 31, 2008 year-end.

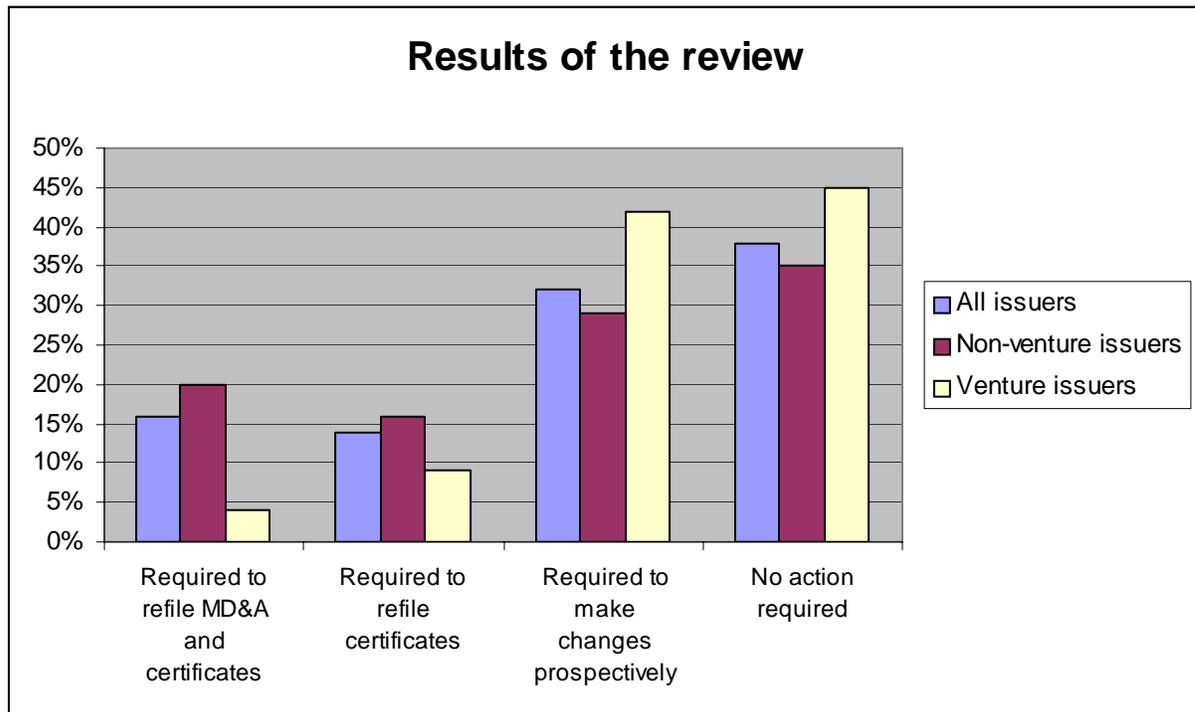
Our review focused on the following questions:

- Did the certifying officers and issuer use the correct form of certificate for their circumstance?
- Did the issuer's annual management discussion and analysis (MD&A) include disclosure that corresponds to the representations contained in the certificates?

- Was the MD&A disclosure consistent with the guidance in the Companion Policy to NI 52-109 (52-109CP)?
- Were the annual certificates dated and filed on the correct date?
- If the issuer refiled its annual financial statements, annual MD&A or Annual Information Form (AIF), did the issuer also file Form 52-109F1R – *Certification of refiled annual filings* (Form 52-109F1R)?
- Were the annual certificates filed in the exact wording prescribed by the required form without any amendments?

### Results of the review

The table below summarizes the results of the review. In some cases, issuers did not comply with more than one provision of the Certification Instrument.



We characterized the level of non-compliance into three categories (refiling of MD&A and certificates, refiling of certificates and prospective changes) based upon the nature and severity of the deficiencies identified.

For 30% of reporting issuers reviewed, the filings were so deficient that the issuers were required to refile their annual MD&A and/or certificates. This was the situation for 36% of non-venture issuers and 13% of venture issuers reviewed. The majority of the refilings related to:

- conclusions about the effectiveness of disclosure controls and procedures (DC&P) and internal control over financial reporting (ICFR) in the annual MD&A, and
- significant amendments to the wording prescribed by the certificates.

Prospective changes were required for 32% of reporting issuers reviewed to correct some aspect of their compliance with the Certification Instrument provisions going forward. A significant number of these commitments related to:

- amendments to the wording prescribed by the certificate, and
- the use of incorrect dates.

The results of the review are described in greater detail below. We encourage certifying officers and issuers to use this notice and to thoroughly review the Certification Instrument and 52-109CP in order to fully comply with the certification requirements.

### **A – Refiling of MD&A and certificates**

As a result of our review, we recommended that 20% of non-venture issuers and 4% of venture issuers reviewed refile their MD&A and certificates due to the following deficiencies.

#### ***Issuers did not fully disclose their conclusions about the effectiveness of DC&P and ICFR in their MD&A***

In accordance with the representations in subparagraphs 6(a) and (b)(i) of Form 52-109F1 – *Certification of annual filings full certificate* (Form 52-109F1), the annual MD&A must disclose the certifying officers’ conclusions about the effectiveness of the issuer’s DC&P and ICFR.

Eleven percent of non-venture issuers did not disclose in their annual MD&A the certifying officers’ conclusions about the effectiveness of DC&P or the ICFR. Four percent of venture issuers reviewed, that elected to file Form 52-109F1, also did not disclose these conclusions. This includes issuers that did not disclose conclusions about the effectiveness of both the design and operation of DC&P or ICFR. Guidance on evaluating operating effectiveness of DC&P and ICFR can be found in Part 7 of 52-109CP.

#### ***Issuers qualified their conclusions about the effectiveness of DC&P and/or ICFR***

As discussed in Parts 9.5 and 10.1 of 52-109CP, certifying officers may not qualify their assessment by stating that the issuer’s DC&P and ICFR are effective, subject to certain qualifications or exceptions, unless the qualification pertains to one of the scope limitations explicitly permitted by section 3.3 of the Certification Instrument.

Eleven percent of non-venture issuers reviewed qualified their conclusions about the effectiveness of DC&P and ICFR. While some of these issuers concluded that DC&P and ICFR were effective, they also disclosed a “weakness”, “design challenge” or “deficiency,” (collectively, a limitation), such as lack of segregation of duties or a lack of knowledgeable accounting staff in technically complex areas. This type of disclosure is potentially confusing

to readers of the annual MD&A because it is difficult to discern if such a description constitutes a material weakness relating to ICFR or a weakness in DC&P that is significant.

If issuers elect to discuss a limitation in their annual MD&A that is not a material weakness relating to their ICFR or a weakness in DC&P that is significant, the discussion should avoid any ambiguity about the nature of the limitation. The MD&A should clearly disclose if the limitation constitutes a material weakness relating to ICFR or a weakness in DC&P that is significant. Guidance on assessing the significance of deficiencies in ICFR can be found in Part 9 of 52-109CP.

Some issuers concluded that DC&P and ICFR were effective because they had procedures for addressing the limitation. In some cases, an issuer's discussion did not clarify if a material weakness relating to ICFR or a weakness in DC&P that is significant existed after implementing the procedures. A reader could infer that although there was a material weakness relating to ICFR or a weakness in DC&P that was significant, it was fully addressed at the reporting date due to the implementation of the procedures. If the control deficiencies were fully addressed, the limitation would not exist at the financial reporting date.

Several issuers confused the concepts of "mitigating procedures" and "compensating controls". As discussed in subsection 9.1(3) of 52-109CP, a mitigating procedure may help to reduce, but does not eliminate, the financial reporting risk that the deficient ICFR component failed to address. Certifying officers and issuers should not imply that a mitigating procedure eliminates a material weakness and should not conclude that ICFR and DC&P are effective. In contrast to a mitigating procedure, a compensating control fully addresses a material weakness and allows certifying officers to conclude that ICFR and DC&P are effective. In the case of a compensating control, the material weakness relating to ICFR or the weakness in DC&P that is significant is fully addressed and there is no associated reporting obligation.

As discussed in section 6.11 of 52-109CP, the lack of segregation of duties is a significant ICFR challenge. An issuer may address this challenge through additional involvement by its audit committee or board of directors. This involvement could represent either a mitigating procedure or a compensating control, depending on the nature of procedures performed by the directors, the volume of transactions and the complexity of the business. Staff believes that the threshold is high for the additional involvement of the audit committee or board of directors to constitute a compensating control, rather than a mitigating procedure. If the issuer has implemented only a mitigating procedure, it should identify the lack of segregation of duties as a material weakness and conclude that ICFR is not effective. Further, section 10.3 of 52-109CP states that if the certifying officers identify a material weakness in the issuer's ICFR, this will almost always represent a weakness that is significant in the issuer's DC&P.

### ***Issuers limited the scope of design of DC&P and ICFR***

In accordance with section 3.3(2) of NI 52-109, an issuer that limits its scope of DC&P or ICFR design to exclude controls, policies and procedures of a proportionately consolidated entity, a variable interest entity or a business acquired not more than 365 days before the end of the financial period to which the certificates relate must disclose in its MD&A the limitation

and provide summary financial information about these entities. Guidance on meaningful summary financial information is included in section 13.3 and section 14.2 of 52-109CP.

Two percent of the non-venture issuers reviewed, that relied on a scope limitation, failed to disclose in their MD&A summary financial information. In addition, one non-venture issuer did not disclose in its MD&A the fact that it had limited the scope of its design of DC&P and ICFR.

## **B – Refiling of certificates**

Staff recommended that 16% of non-venture issuers and 9% of venture issuers reviewed refile their certificates due to the following deficiencies.

### ***Significant amendments to the wording of the form***

In accordance with sections 4.1 and 5.1 of NI 52-109, issuers are required to file the annual and interim certificates in the exact wording prescribed by the required form. This includes the form number and the form title.

Six percent of non-venture issuers reviewed made significant amendments to the wording prescribed by the required form.

The most common amendments were:

- omitting paragraphs;
- removing paragraph 5.2 on ICFR material weakness relating to design, paragraph 5.3 on limitation of scope of design and subparagraph 6(b)(ii) on ICFR material weakness relating to operation when they did not apply;
- reporting changes in ICFR for a shorter period than the issuer’s interim period by inserting the incorrect date in paragraph 7, and
- adding text.

### ***No material weakness or scope limitation***

In accordance with the instruction included in the required form, the certifying officers and the issuer must insert paragraph 5.2, subparagraph 6(b)(ii) and paragraph 5.3 in the certificates only if they are applicable. If they are not applicable, they must insert “N/A”.

Eleven percent of non-venture issuers reviewed:

- incorrectly referred, by the inclusion of paragraph 5.2 and/or subparagraph 6(b)(ii) in their certificates, to the existence of a material weakness relating to ICFR when one did not exist, or
- incorrectly referred, by the inclusion of paragraph 5.3 in their certificates, to a limitation in the scope of the design of DC&P and ICFR when no scope limitation was required.

### ***Refiled financial statements, MD&A or AIF***

In accordance with Part 6 of NI 51-109, if an issuer refiles its financial statements, MD&A or AIF, it must file separate certificates for the period in Form 52-109F1R for refiled annual filings or Form 52-109F2R - *Certification of refiled interim filings* for refiled interim filings.

Two percent of non-venture issuers reviewed did not refile certificates when they filed amended financial statements or MD&A.

### ***AIF filed subsequently***

In accordance with subsection 4.1(2) of NI 52-109, a reporting issuer must file its certificates on the later of the dates on which it files its AIF (if it is required to file an AIF), or files its annual financial statements and annual MD&A. A non-venture issuer that chooses to file annual certificates at the date of the filing of its annual financial statements and annual MD&A must refile the annual certificates if the AIF is subsequently filed.

In addition, if a venture issuer voluntarily files an AIF for a financial year after it has filed its annual financial statements, annual MD&A and annual certificates for the financial year, the venture issuer must file separate annual certificates on the same date that it files its AIF (Form 52-109F1-AIF – *Certification of Annual Filings in Connection with Voluntarily Filed AIF*). This is in accordance with subsection 4.1(3) of NI 52-109.

Two percent of non-venture issuers reviewed and 4% of venture issuers reviewed did not refile certificates when they filed an AIF subsequent to filing their financial statements and MD&A.

### ***Note to reader***

The note to reader is an integral part of the Form 52-109FV1 – *Certification of annual filings - venture issuer basic certificate* (Form 52-109FV1). It clarifies the responsibility of certifying officers and discloses that inherent limitations on the ability of certifying officers of a venture issuer to design and implement on a cost-effective basis DC&P and ICFR may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

Five percent of venture issuers reviewed did not include the “Note to reader” in their Form 52-109FV1.

## C – Prospective changes to the certificates and/or the MD&A

Twenty-nine percent of non-venture issuers and 42% of venture issuers were required to make prospective changes in the following areas.

- **Amendments to wording on forms.** Certifying officers and issuers were advised not to make any amendment to the wording prescribed by the required form even if they considered those amendments to be minor. In most of these instances, certifying officers and issuers did not include the paragraph titles, the title of the form or the form number. Some certifying officers of non-venture issuers removed “if any” after “AIF” from paragraph 1 of the annual certificates and some venture issuers removed the reference to “the AIF” in the same paragraph. None of these alterations are permitted.
- **Date in paragraph 7 of the certificates.** When certifying officers certify that the issuer disclosed in its annual MD&A any change in the issuer’s ICFR that occurred during the period, they must insert the date immediately following the end of the period in respect of which the issuer made its most recent interim or annual filing, as applicable. This date would generally be October 1, 2008 for issuers with December 31, 2008 year-end. We note that many certifying officers inserted January 1, 2008.
- **Certificate date.** Some certifying officers did not date the certificates the same date that the certificates were filed. In accordance with section 7.1 of NI 52-109, a certifying officer must date a certificate filed under NI 52-109 the same date the certificate is filed.
- **Filing date of certificates.** Some issuers did not file the certificates concurrently with the filing of their AIF or financial statements and MD&A, whichever is later. Certifying officers and issuers were advised that in accordance with subsections 4.1(2) and 5.1(2) of NI 52-109, they are required to file their certificates on the later of the dates on which they file their AIF (if they are required to file an AIF) or their annual financial statements and annual MD&A. Interim certificates must be filed on the same date the interim financial statements and interim MD&A are filed.
- **Venture issuer disclosure.** Some venture issuers discussed DC&P or ICFR in the MD&A but did not include cautionary language. In accordance with section 15.3 of 52-109CP, if a venture issuer and its certifying officers file Form 52-109FV1 or Form 52-109FV2 – *Certification off interim filings - venture issuer basic certificate* and chooses to discuss the design or operation of one or more components of their ICFR and DC&P in the MD&A or other regulatory filings, they should consider disclosing in the same document that:
  - (a) the venture issuer is not required to certify the design and evaluation of its DC&P and ICFR and has not completed such an evaluation, and
  - (b) inherent limitations on the ability of the certifying officers to design and implement on a cost-effective basis DC&P and ICFR for the issuer may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

## **D – No action required**

No action was taken with 35% of non-venture issuers and 45% of venture issuers reviewed. In these cases, the issuer either fully complied with the Certification Instrument, or the level of non-compliance was insignificant.

### **Next steps**

We will continue to review compliance with the Certification Instrument as part of our ongoing compliance reviews and our continuous disclosure review program. We will take action when deficiencies are identified.

September 11, 2009

## For more information

For more information, contact any of the following people:

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<p>Bob Bouchard Director, Corporate Finance Manitoba Securities Commission 204-945-2555 <a href="mailto:bob.bouchard@gov.mb.ca">bob.bouchard@gov.mb.ca</a></p> <p>Patrick Weeks Analyst, Corporate Finance Manitoba Securities Commission 204-945-3326 <a href="mailto:patrick.weeks@gov.mb.ca">patrick.weeks@gov.mb.ca</a></p>	<p>Jeff Harriman Securities Analyst New Brunswick Securities Commission 506-643-7856 <a href="mailto:jeff.harriman@nbsc-cvmnb.ca">jeff.harriman@nbsc-cvmnb.ca</a></p>

## **Appendix A**

### **Certification Instrument**

On December 15, 2008, the Certification Instrument came into force and MI 52-109 was repealed. The most significant changes introduced by NI 52-109 are set out below.

#### **Non-venture issuers**

##### *Full Annual Certificate*

A representation has been added to this certificate to the effect that the certifying officers have evaluated, or have caused to be evaluated under their supervision, the effectiveness of the issuer's ICFR at the financial year-end and that the issuer has disclosed in its annual MD&A the certifying officers' conclusions about the effectiveness of ICFR at the financial year-end based on their evaluation.

##### *Design of DC&P and ICFR*

Non-venture issuers:

- are required to use a control framework in the design of ICFR
- may limit the scope of their design of DC&P and ICFR to exclude controls, policies and procedures of a proportionately consolidated entity or variable interest entity in which the issuer has an interest or a business that the issuer acquired not more than 365 days before the end of the financial period to which the certificate relates
- must disclose in their MD&A any scope limitation in the design of DC&P and ICFR and provide summary financial information about the proportionately consolidated entity, variable interest entity or acquired business that has been proportionately consolidated or consolidated in the issuer's financial statements

##### *Material weakness in design or operation of ICFR*

If the certifying officers of a non-venture issuer determine that a material weakness relating to either the design or operation of ICFR exists at the end of the period covered by the annual or interim filings, the issuer must disclose the following in its annual or interim MD&A:

- a description of each material weakness
- the impact of the material weakness on the issuer's financial reporting and its ICFR, and
- any plans or any actions undertaken for remediating the material weakness

#### **Venture issuers**

##### *Venture Issuer Basic Certificate*

There is a new form of certificate for venture issuers. It does not include representations relating to the establishment and maintenance of DC&P and ICFR.