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The Corporate Governance Landscape In Canada

The Sarbanes-Oxley Act started a revolution in corporate governance. Here's an overview of corporate governance in Canada

The Sarbanes-Oxley Act (SOX) was signed into law in the United States in July 2002. Since then, SOX has had a significant and lasting impact on corporate directors, CEOs, CFOs and auditors. The Canadian version of SOX has been introduced through various separate yet interrelated instruments and pieces of legislation over the past several years, making it a challenge for stakeholders to keep abreast of the regulatory requirements. To help directors, executives and companies understand what's required of them, Deloitte provides an overview of the CEO/CFO certification requirements in Canada.

The corporate governance revolution began in the United States with one piece of legislation — the Sarbanes-Oxley Act of 2002. Canadian regulatory reforms have been introduced in a piecemeal fashion through separate instruments and legislation, issued at different times, and by different regulatory or legislative bodies. (For a list, see A selection of Canadian rulings released since 2004.)

This regulatory environment presents a challenge for directors, auditors and executives of Canadian companies, as each set of rules and requirements cannot be assessed independently of the others. Canadian reporting issuers must view each of the pronouncements in a holistic manner, since the responsibilities outlined in one instrument impact those prescribed under another.

The three dimensions of capital market reform in Canada

In Canada, capital market regulation is influenced by the public, the securities regulators, the institutional shareholders and the business community. There are two conflicting pressures: the need to harmonize with the United States, as interlisted companies account for approximately 60 percent of Canada's total market capitalization, and the need to be responsive to our small cap and controlled company environment. In Canada, the vast majority of companies in terms of numbers account for 40 percent of market capitalization.

There are three dimensions of capital market reform in Canada:

- **Financial reporting** — including auditor oversight, requirements for audit committees, and requirements regarding CEO/CFO certification of interim and annual filings,
- **Governance disclosures** — including the board's oversight of management, and
- **Civil liability legislation** — which came into effect on January 1, 2006 and has resulted in increased risk for corporate directors.

These changes have far-reaching implications for all those involved in improving corporate governance. For instance, auditors and audit committees must be more rigorous in reviewing and disclosing their company's financials. CEOs and CFOs must personally certify that they have designed and overseen appropriate disclosure controls and procedures (DC&P); for 2006 annual certificates, they will also have to certify as to the design of internal controls over financial reporting (ICFR). And civil liability legislation has increased the risk that corporate

directors face when they assume a seat at the boardroom table. Read about the impact of capital market reform on directors, CEOs, CFOs, auditors and Canadian capital markets.

The CSA's Certification 'Flight Plan'

The Canadian Securities Administrators (CSA) first issued Multilateral Instrument 52-109, Certification of issuers' annual and interim filings, in January 2004. The instrument introduced the certification process for Canadian "reporting issuers." The certification process consists of four phases, delineated in The CSA's Revised Certification Flight Plan, a colour-coded graph that outlines what is required of each phase and when it comes into effect. The accompanying Annual certificate for CEOs and CFOs outlines what they are required to certify.

The **first phase** (represented in green boxes on the CSA's Revised Flight Plan), required the CEO and the CFO to separately certify on the "content" of their quarterly and annual regulatory filings. This certification, which started in 2004, included statements that, to the best of their knowledge, there were no material misstatements or omissions and that the financial information fairly presented, with no reference to GAAP, the results of operations, cash flows and financial condition of the issuer.

The **second phase** (represented in orange) began in 2005, when the annual certificates were expanded to include a certification that the CEO and CFO had designed disclosure controls and procedures (DC&P) and evaluated their effectiveness to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to them by others within those entities. This certification indicates that the CEO and CFO have instituted controls that ensure their knowledge is complete.

The **third phase** of the certification (represented by the top two purple boxes) will occur in the annual certificates for 2006, when the CEO and the CFO will be required to state that they have designed internal control over financial reporting (ICFR) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

The **fourth phase** of the certification process (represented by the final purple box) has not yet been finalized, and will come into effect at the earliest for year-ends ending on or after December 31, 2007. The fourth phase will require CEOs and CFOs of reporting issuers to evaluate the operating effectiveness of internal control over financial reporting (ICFR) on an annual basis. This certification process is intended to apply to all Canadian reporting issuers, including venture issuers.

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