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Public Sector CEO/CFO Certification.

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Background: What is CEO/CFO Certification?

Certification Background

CEO/CFO CERTIFICATION REQUIREMENTS – PRIVATE SECTOR

- As a result of several business failures in the U.S., requirements for CEO/CFO Certification (“Certification”) on internal controls over financial reporting were established. Similar requirements have been established in Canada.
- The certification regulations require CEOs and CFOs to personally certify that, among other things:
 - the Company’s annual and interim filings **do not contain any misrepresentations** or omit to state any material facts;
 - the financial statements and other financial information in the annual and interim filings **fairly present** the financial condition, results of operations and cash flows for the relevant time period;
 - the Company has **designed disclosure controls and procedures and evaluated the effectiveness** of such disclosure controls and procedures;
 - the Company has **designed internal controls** over financial reporting, **evaluated their effectiveness**, and disclosed any “material weaknesses”; and,
 - the Company has **disclosed material changes in internal controls** over financial reporting.

Objectives include:

- **Restoring public trust** and confidence in public securities markets;
- **Improving corporate governance** and promoting ethical business practices;
- Enhancing **transparency and completeness** of financial statements and disclosures;
- **Ensuring that company executives are aware** of material information emanating from a well-controlled environment;
- **Holding company management accountable for material information** that is filed with the regulators and released to investors; and,
- Achieving new levels of **corporate excellence**.

Certification Background

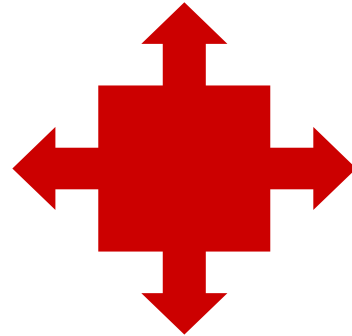
FOUR MAJOR AREAS OF IMPACT

Impact on Audit Committees

- Responsibilities, Independence, Financial Literacy, AC Financial Expert

Impact on Auditors

- Regulation of Audit Firms
- New Independence Standards



Impact on Management

- Continuous Disclosure Obligations
- CEO/CFO Certification
- Internal Control Reporting

Penalties

- Larger fines and jail terms
- Disgorgement
- More commitment to enforcement
- Civil liability for disclosures in secondary markets

Certification Background

SCOPE OF CERTIFICATION

- The controls subject to assessment include:
 - Controls over **initiating, authorizing, recording, processing and reporting** significant accounts and disclosures and related assertions included in the financial statements;
 - Controls related to the initiation and processing of **non-routine and non-systematic transactions**, such as accounts involving judgments and estimates;
 - Controls related to the **selection and application of appropriate accounting policies** that are in accordance with the issuer's GAAP;
 - **Anti-fraud** programs and controls;
 - Controls, including **information technology general controls**, on which other controls are dependent;
 - Controls over the **period-end financial reporting process**, including controls related to journal entries; and
 - **Controls that have a pervasive impact** such as those within the control environment.

Certification Background

HOW CERTIFICATION IS DIFFERENT FROM EXTERNAL/INTERNAL AUDIT

- **Certification is a management-owned process:**
 - For most organizations, while **management may be confident** in their financial reporting and related internal controls, they often have **no documented evidence and have done no assessment** of the design and/or operating effectiveness of their internal controls.
 - In today's environment, **solely relying on the results of audits is seen as inadequate ownership by management** for the organization's internal controls.
 - Certification represents an on-going compliance monitoring program that is **owned by management (not auditors)** which is focused on ensuring that internal controls over financial reporting are operating as intended.
 - It provides management with documented evidence of the appropriateness of the design and operating effectiveness of the organization's internal controls over financial reporting.

Background: Certification in the Public Sector



Control Focus at Canadian Federal Government Level

BACKGROUND

- Origins of the issue:
 - Private sector business failures and regulatory response;
 - Government scandals and increased visibility of Auditor General comments;
 - A new environment (don't just sign representations lightly anymore); and,
 - “Restoring Trust and Accountability” theme.
- Converging ‘control-based’ requirements as a result of:
 - TBS Crown corporation governance review (exploring a certification regime) – February 2005; Renewed interest in 2007 and Guidance is currently being developed.
 - New Internal Audit Policy (renewed focus on risk and controls), effective April 2006;
 - Departmental F/S audit requirement (requirement for control reliance);
 - MAF assessments (expected practices and controls); and,
 - Draft Financial Management Policy Framework – expected to be implemented ‘soon’.

Control Focus at Canadian Federal Government Level

PROPOSED INTERNAL CONTROL POLICY

- New Financial Management Policy Framework:
 - Supports the Government’s direction to strengthen financial management across the public service;
 - Supports the re-establishment of the Office of the Comptroller General;
 - Translates the CFO Model into policy terms; and
 - 5 Core Financial Management Policies (one focusing on internal control).
- Policy on Internal Control (Draft)
 - Deputy Head responsible for “extended” risk management and the system of internal control;
 - CFO responsible for “core” risk responsibilities related to financial systems, records, reporting and financial controls, including all financial controls in programs; and
 - ADMs responsible for “core” risk responsibilities related to program systems, records, reporting, and for the implementation and operation of financial controls.

Control Focus at Canadian Federal Government Level

DRAFT POLICY On INTERNAL CONTROL (CONT'D)

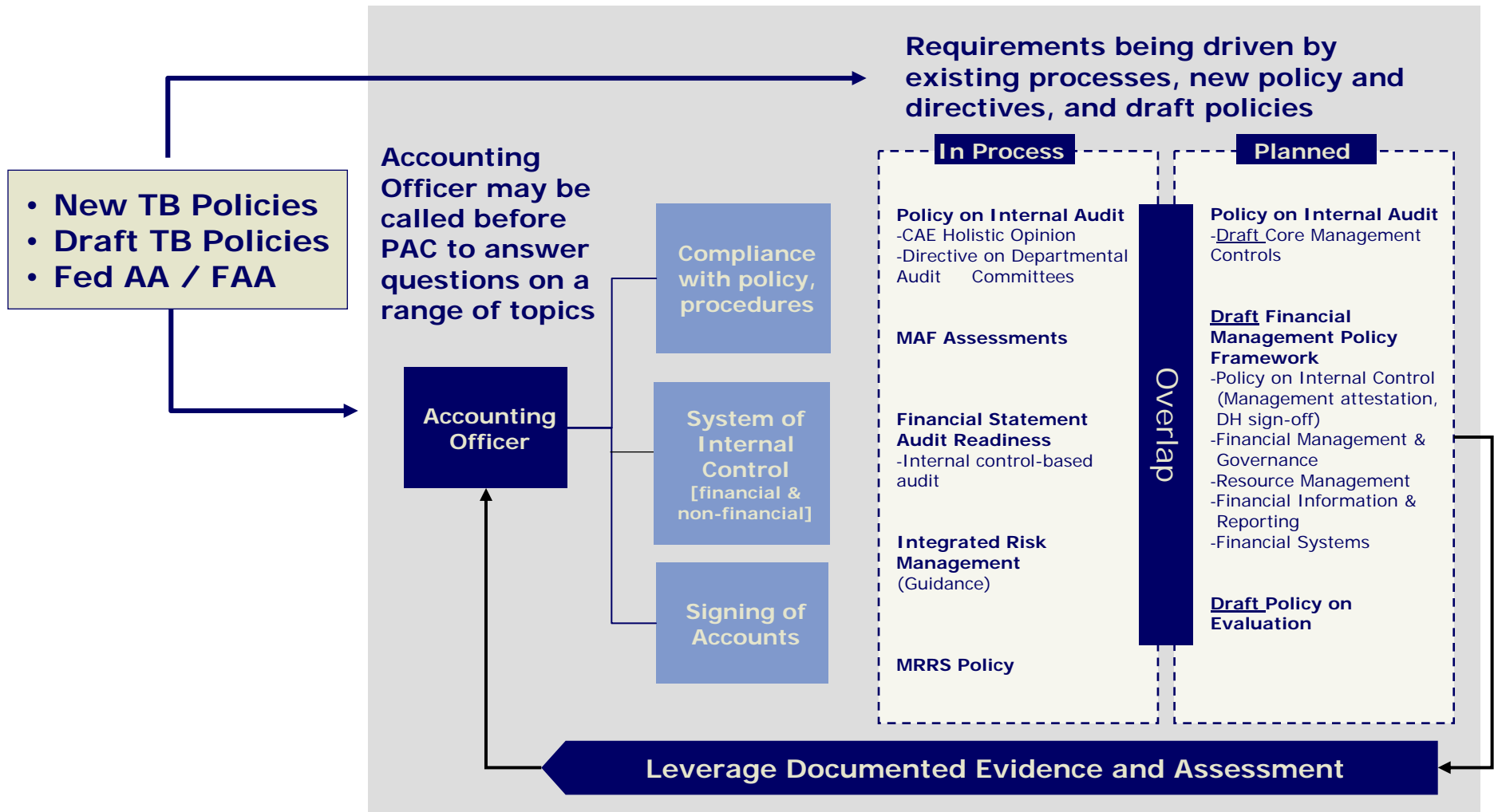
- Deputy Head as the Accounting Officer will provide an annual Statement on Internal Control (SIC):
 - Confirmation that the effectiveness of the system of internal control has been reviewed, including controls over financial reporting;
 - Confirmation that the results of the effectiveness review have been discussed by the Deputy Head with the Audit Committee; and
 - Necessary actions have been or are being taken to remedy significant failings or weaknesses with respect to internal control.
- Deputy Head will obtain assurances and evidence to support SIC via:
 - **Audit Committee** – Review of risk management and management control framework matters;
 - **Chief Audit Executive** – Various internal audits and annual opinion on effectiveness and adequacy of risk management, control, and governance;
 - **Chief Financial Officer** – *CFO Statement of Internal Control* for financial controls and internal controls over financial reporting; and
 - **ADMs** – Stewardship Representations (SIC-like) for all controls within their purview.
- Comptroller General will provide Treasury Board with a Government-wide Statement on Internal Controls.

Control Focus at Canadian Federal Government Level

CROWN CORPORATION CERTIFICATION IN CANADA

- The Treasury Board of Canada Secretariat (TBS) undertook a comprehensive assessment of the governance of Crown corporations in 2004 and produced a report to Parliament entitled *Review of the Governance Framework for Canada's Crown Corporations* in February 2005.
- The review identified 31 measures for improving the governance of Crown corporations. Under the context of "Reporting – Making Transparency and Accountability Come to Life", TBS's review addressed certification for Crown corporations and stated the following:
 - **"Measure #24: In principle, the government supports the use of a certification regime adapted to the reality of public institutions. The Treasury Board of Canada Secretariat will examine, in consultation with Crown corporations, the development of a certification regime that would be applicable to all Crown corporations."**
- TBS is currently exploring how the certification regime will move forward. Their current efforts are focused on developing guidance for Federal Crowns corporations.

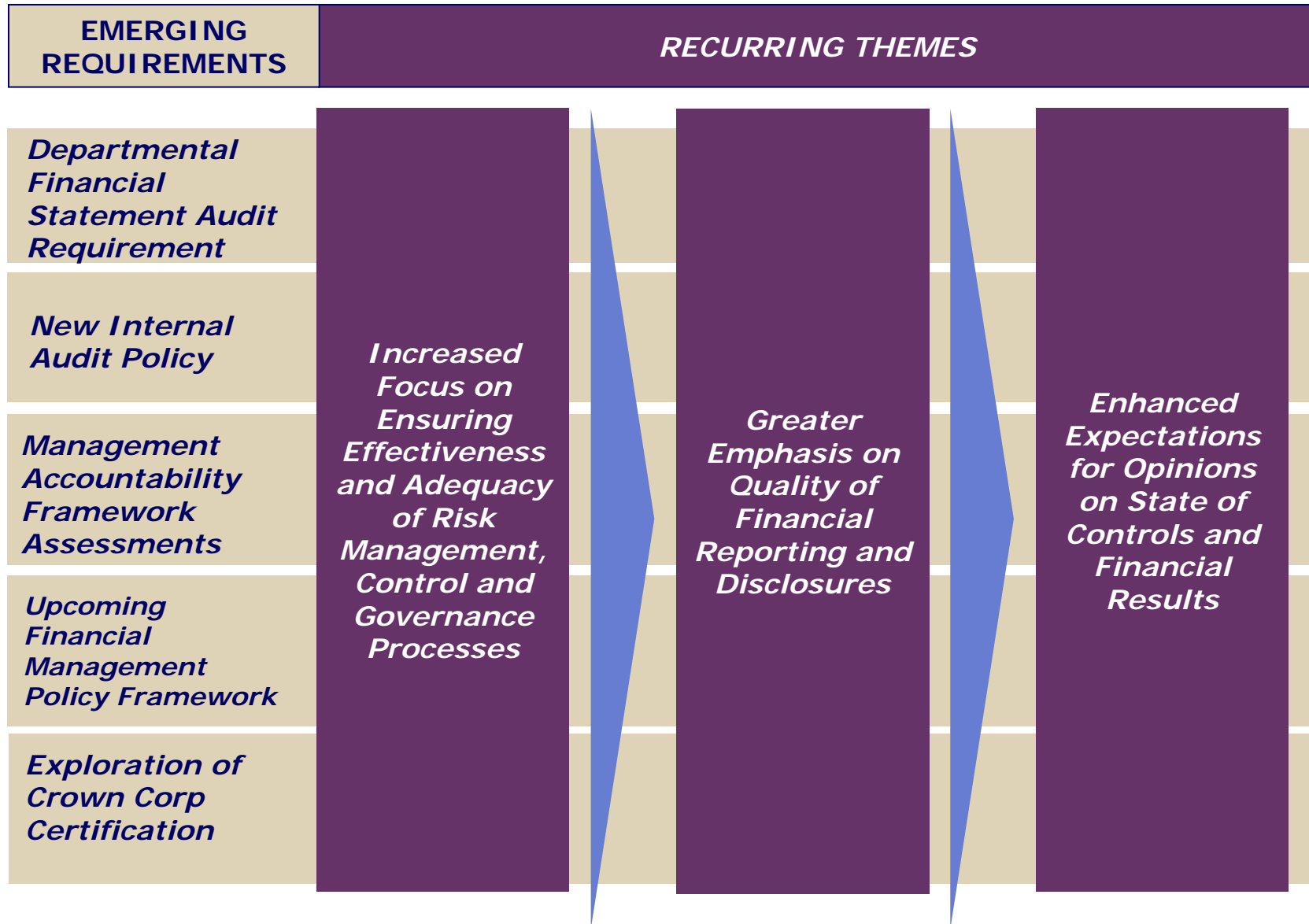
For Departments....a view of the 'Lay of the Land'



Although the requirements have been introduced as separate initiatives, there are recurring themes

Control Focus at Canadian Federal Government Level

RECURRING THEMES



Recurring Themes Observed

- Almost all organizations have internal controls in place and many would say that they are comfortable and confident that they are appropriate and operating effectively.
- In today's environment, solely relying on the results of external and internal audits is seen as inadequate ownership by management for the organization's internal controls.
- Demonstrating an effective control environment by Management requires:
 - Documentation of the organization's controls; and,
 - Visibility into the effectiveness of control activities.

U.S. Federal Government Internal Control Requirements

- In light of the new internal control requirements for publicly-traded companies, in December 2004, the Office of Management and Budget of the United States Federal Government issued revised requirements to its 24 largest federal government agencies related to management's responsibility for internal control.
- The stated purpose of the revised requirements was to improve the accountability and effectiveness of federal programs and operations by establishing, assessing, correcting and reporting on internal control.
- The revised requirements, effective in fiscal year 2006, defined management's responsibility related to internal control, the process for assessing internal control effectiveness, internal control standards, and new specific requirements for conducting management's assessment of the effectiveness of internal control over financial reporting.
- The U.S. federal government requirements are extremely similar to private sector certification requirements (except that an independent audit on management's certification is not required).

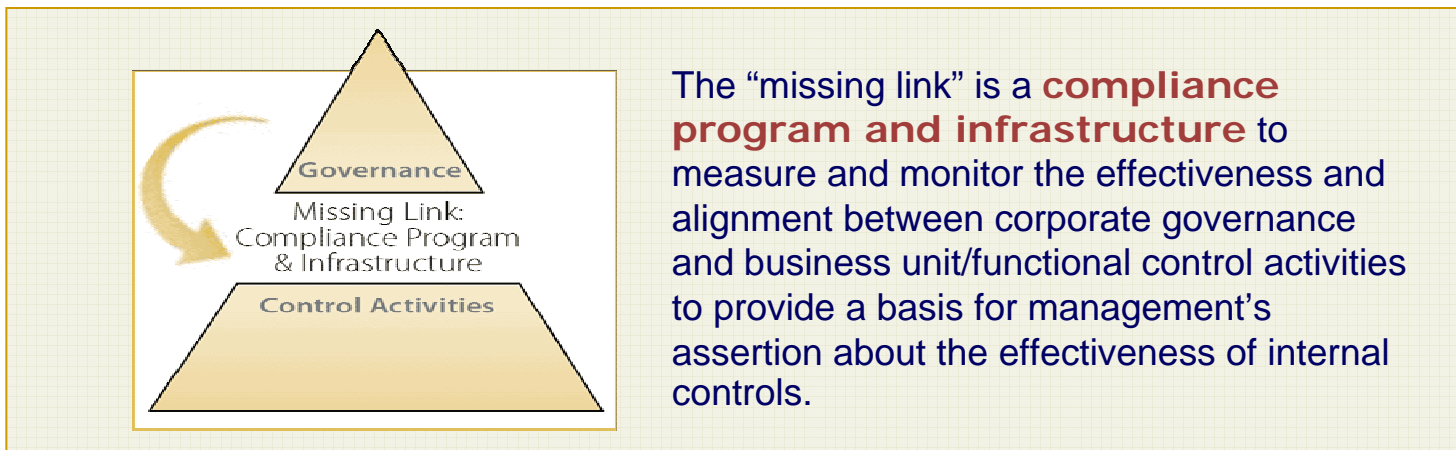


A How-To Guide: An Approach to CEO/CFO Certification

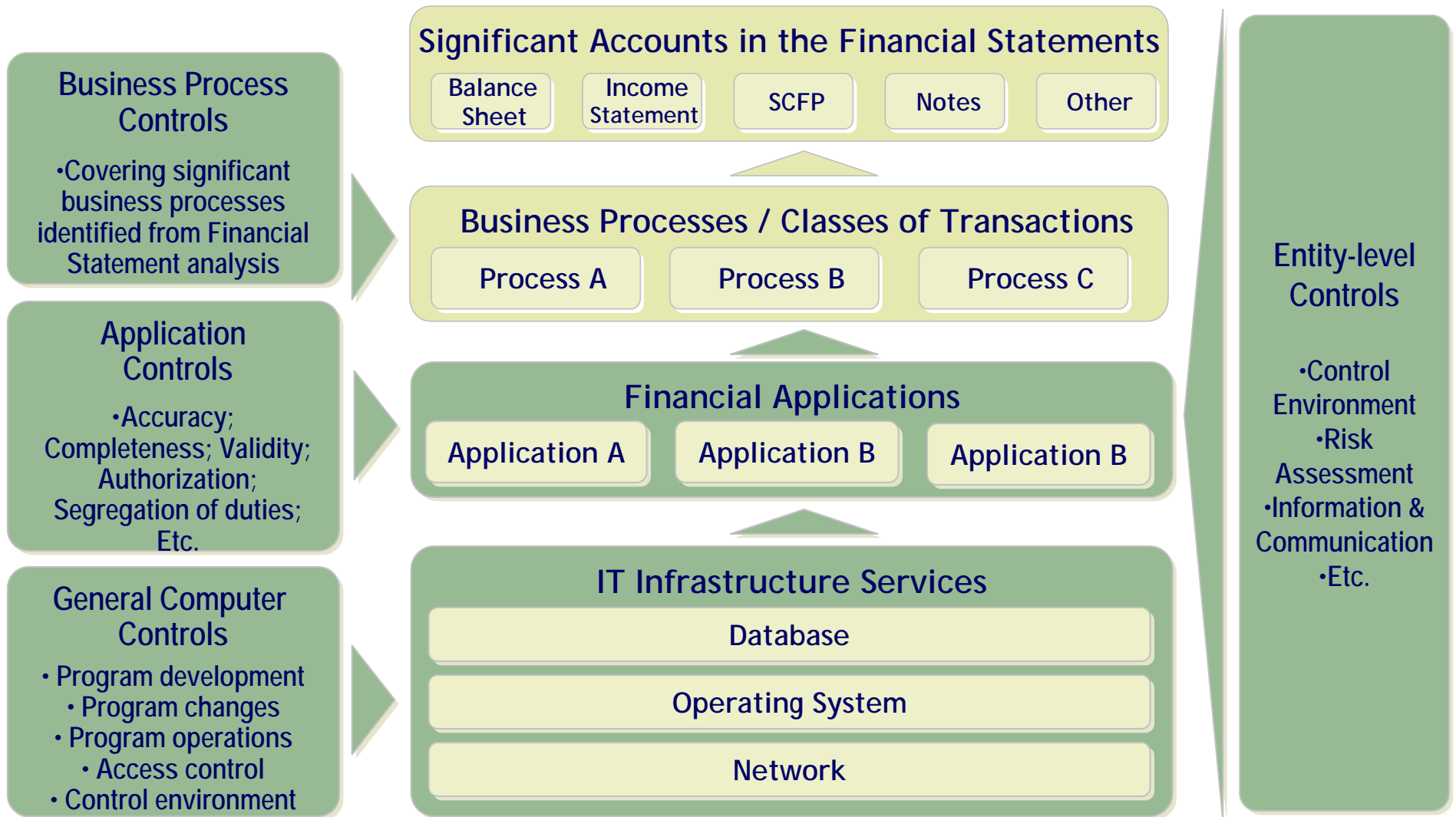
Certification Background

CERTIFICATION - LINKING SENIOR MANAGEMENT/ GOVERNANCE TO CONTROL ACTIVITIES

- Almost all organizations have internal controls over financial reporting in place; and many would say that they are comfortable and confident that the controls are appropriate and operating effectively.
- The effectiveness of senior management's oversight of the internal control structure is typically hindered because there is inadequate:
 - Linkage between senior management's governance activities and the organization's control activities;
 - Documentation of the organization's control framework (i.e. the control activities that are in place); and,
 - Visibility into the effectiveness of control activities.

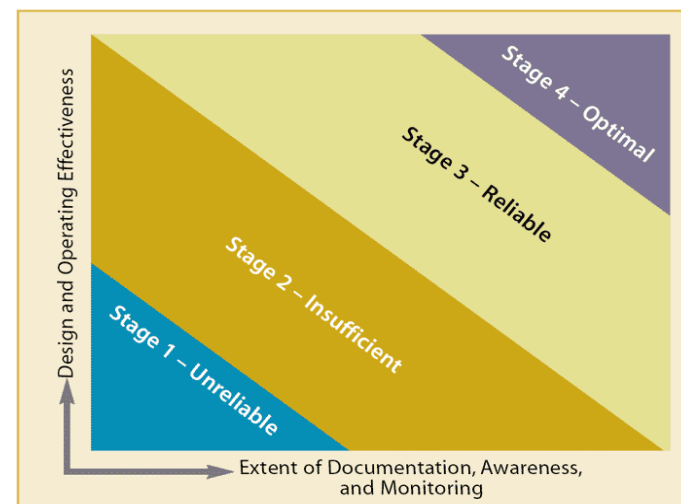


Starting Point – Decomposing Financial Statements



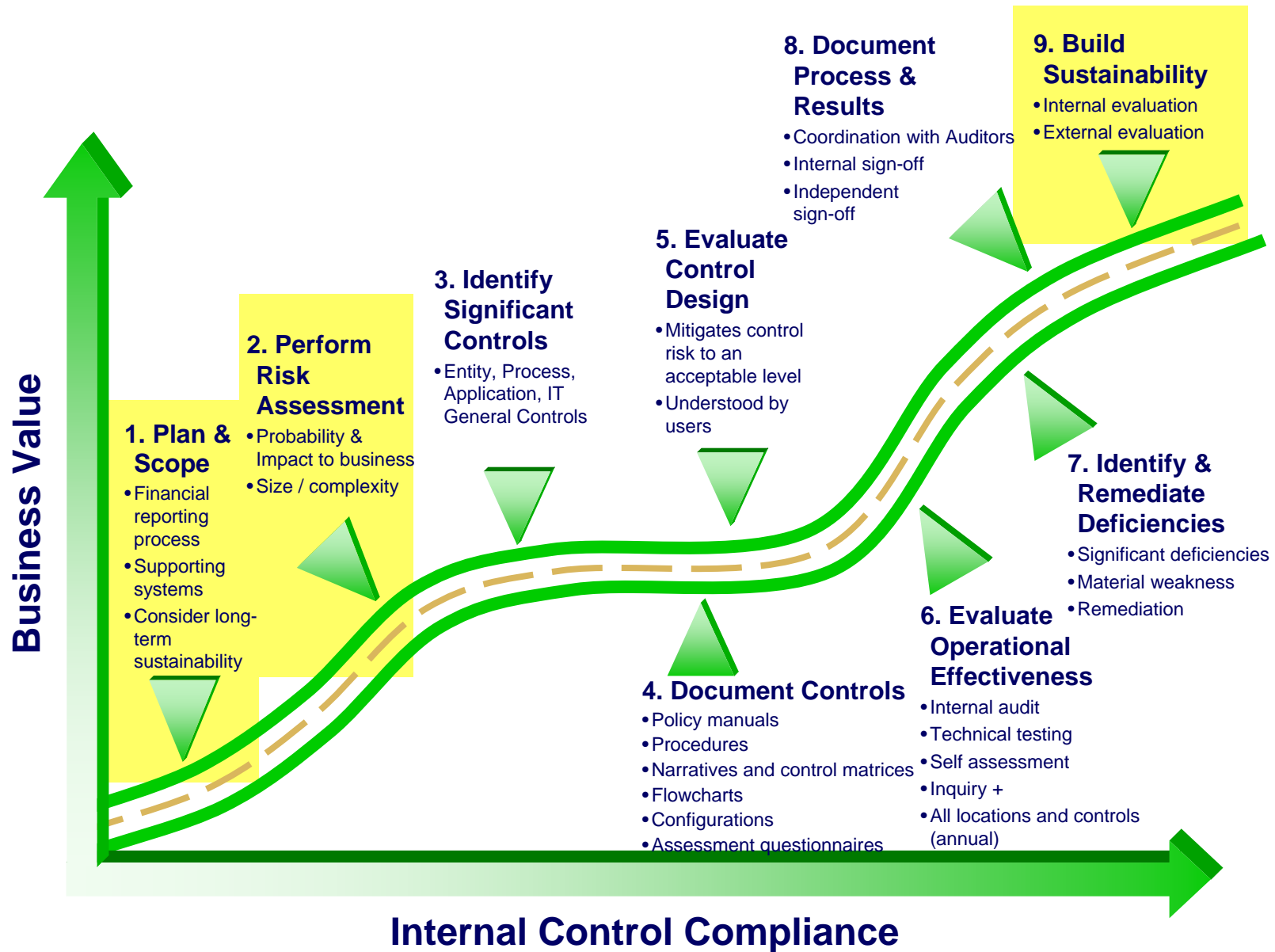
Documentation – Internal Control Reliability Model

- **Documentation** of controls, related policies/procedures, certification approach and certification work performed is a critical requirement for certification



	Stage 1 – Unreliable	Stage 2 – Insufficient	Stage 3 – Reliable	Stage 4 – Optimal
Characteristics	<ul style="list-style-type: none"> • Controls and related policies and procedures are not in place and documented. • A disclosure creation process does not exist. • Employees are not aware of their responsibility for control activities. • The operating effectiveness of control activities is not evaluated on a regular basis. • Control deficiencies are not identified. 	<ul style="list-style-type: none"> • Controls and related policies and procedures are in place but not fully documented. • A disclosure creation process is in place but not fully documented. • Employees may not be aware of their responsibility for control activities. • The operating effectiveness of control activities is not adequately evaluated on a regular basis and the process is not fully documented. • Control deficiencies may be identified but are not remediated in a timely manner. 	<ul style="list-style-type: none"> • Controls and related policies and procedures are in place and adequately documented. • A disclosure creation process is in place and adequately documented. • Employees are aware of their responsibility for controls activities. • The operating effectiveness of control activities is evaluated on a periodic basis (e.g., quarterly) and the process is adequately documented. • Control deficiencies are identified and remediated in a timely manner. 	<ul style="list-style-type: none"> • Meets all of the characteristics of Stage 3. • An enterprise-wide control and risk management program exists such that controls and procedures are documented and continuously reevaluated to reflect major process or organizational changes. • A self-assessment process is used to evaluate the design and effectiveness of controls. • Technology is leveraged to document processes, control objectives and activities, identify gaps, and evaluate the effectiveness of controls.
Implications	<ul style="list-style-type: none"> • Insufficient documentation to support management's certification and assertion. • Level of effort to document, test, and remediate controls is significant. 	<ul style="list-style-type: none"> • Insufficient documentation to support management's certification and assertion. • Level of effort to document, test, and remediate controls is significant. 	<ul style="list-style-type: none"> • Sufficient documentation to support management's certification and assertion. • Level of effort to document, test, and remediate controls may be significant depending on the company's circumstances. 	<ul style="list-style-type: none"> • Implications of Stage 3. • Improved decision-making because of high-quality, timely information. • Efficient use of internal resources. • Real-time monitoring.

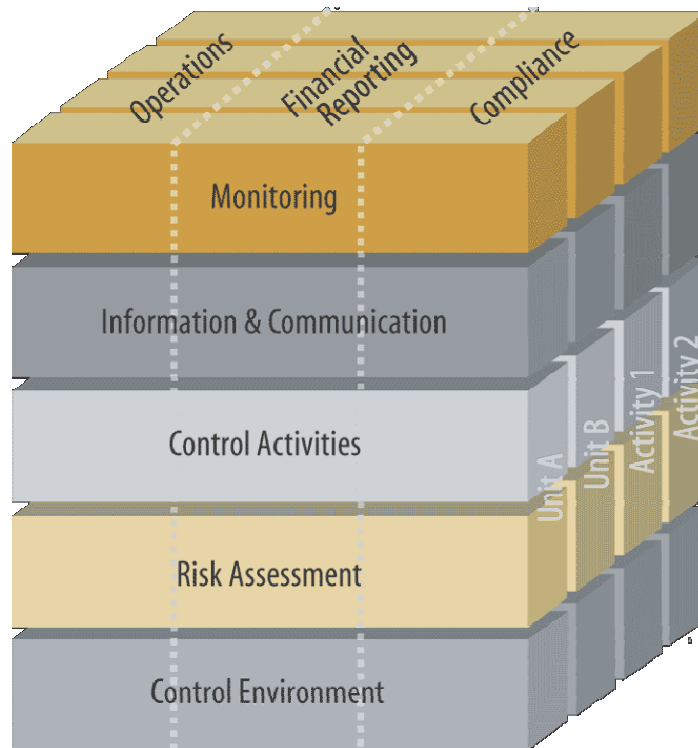
Summary Certification Readiness Roadmap



Select a Suitable Internal Control Framework

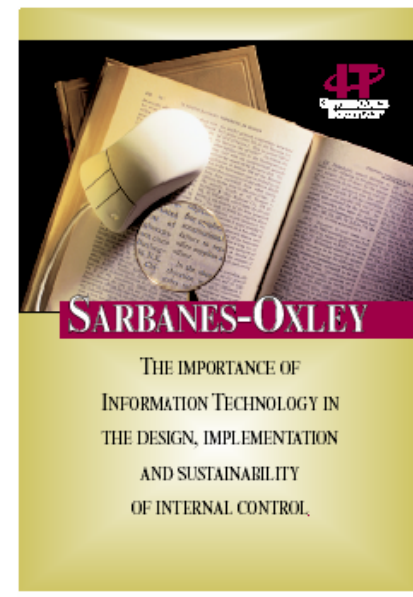
COSO FRAMEWORK

- The de facto standard for most organizations undertaking certification programs has been the COSO control framework.



COBIT – A MODEL FOR GENERAL COMPUTER CONTROLS

- The IT Governance Institute has recently published “updated” guidance for IT professionals on how to address Sarbanes-Oxley from an IT perspective using COBIT.



A How-To Guide: Lessons Learned



Lessons Learned

- A few hazards that should be recognized on the compliance journey include:
 - Jumping in quickly to document processes without a plan;
 - Shallow and narrow approaches;
 - Aversion to undertaking risk assessment;
 - Mergers, Acquisitions & Subsidiaries - Clashing cultures;
 - Not involving/addressing IT adequately;
 - Inadequate attention to outsourced service providers;
 - Lack of senior management and Board buy-in/engagement;
 - Inadequate project management support;
 - Insufficient involvement of external auditors; and,
 - Inadequate consideration of long-term sustainability.

Questions



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