September 24, 2003

SUBMISSION TO PARTICIPATING MEMBERS OF THE CANADIAN SECURITIES ASSOCIATION

COMMENTS ON PROPOSED MULTILATERAL INSTRUMENTS 52-108, 52-109, 52-110 AND RELATED POLICIES: AUDITOR OVERSIGHT, CERTIFICATION OF DISLOSURE AND AUDIT COMMITTEES

The members of the *Canadian Council of Chief Executives* (CCCE) head companies involved in every sector of the economy, administering total assets of about $2.1 trillion and with annual revenues of more than $500 billion. The majority of member companies are publicly traded on Canadian markets, and these comments therefore reflect the perspective of major issuers in Canadian capital markets.

In a statement issued in September 2002 entitled *Governance, Values and Competitiveness: A Commitment to Leadership*, the CCCE called for concerted action to improve both the minimum standards and norms of practice in corporate governance in Canada. At the same time, however, we expressed significant concerns with both some of the specific provisions and the rules-based culture reflected in the then recently passed *Sarbanes-Oxley Act* in the United States.

For the many members of the Council whose companies are also active in United States capital markets and therefore directly subject to *Sarbanes-Oxley*, it is critical of course to maintain compatibility between the rules and regulatory systems in the United States and Canada. On the other hand, our central preoccupation as Canadian business leaders is to foster Canada's competitive advantage -- in this case, both in attracting international investors to Canadian markets and in fostering the global growth of Canadian-based enterprises.

For the most part, the three proposed multilateral instruments dealing with auditor oversight, certification of disclosure and audit committees reflect aspects of *Sarbanes-Oxley* that also make sense in the Canadian context. Furthermore, it is evident that in drafting the proposed instruments, Canadian regulators have taken care to adapt United States approaches to some of the specific characteristics of the Canadian market, notably the prevalence of smaller-cap issuers.

With respect to the first instrument, 52-108, dealing with auditor oversight, the Council noted in its statement on governance a year ago that the mandate and structure of the proposed *Canadian Public Accountability Board* (CPAB) had been worked out collaboratively between federal and provincial governments and the Canadian Institute of Chartered Accountants. From an issuer perspective, the major concern going forward is likely to be the efficiency of the proposed oversight body and the extent of the costs that will be assessed to audit firms and passed through to audit clients.

With respect to the second instrument, 52-109, dealing with certification of disclosure in companies' annual and interim filings, the members of the Council made it clear in our statement of September 2002 that while we have always signed off on our companies' statements, *Sarbanes-Oxley* had raised the bar in this respect. We therefore concluded: *"Even though this legislation may not apply to all Canadian companies, we believe that as Canadian chief executives, we should be prepared to offer a comparable certification of our annual and quarterly reports."*

The proposed instrument on certification by chief executive officers and chief financial officers closely mirrors the requirements of section 302 of *Sarbanes-Oxley*. We continue to believe that it is reasonable to require certification both of the accuracy and fairness of our filings and also the informational foundation upon which these representations are based: the design, implementation and performance of internal controls and disclosure controls and procedures.

We do not see as a problem the potential timing gap between some elements of Canadian filings and the eventual CEO/CFO certification. Even if certain information is released before the certification date, both investors and management know that certification will be required and forthcoming, and this should provide sufficient interim assurance of the integrity of the early filings.

We would, however, agree with the proposal not to require certification to cover Form 40 executive compensation disclosure because of the potential either to delay unduly the filing of the annual certificate or for unfairness to officers who might be called upon to certify information before it becomes available. We also agree with the proposal not to require formal interim certification of internal controls and disclosure controls and procedures.

Because the proposed Canadian instrument is clearly comparable to the requirements of *Sarbanes-Oxley*, we agree that there is no need to require duplicate certification. The Council therefore supports the proposed exemption from the requirement to file a separate certification in Canada for issuers that are subject to and comply with section 302 of *Sarbanes-Oxley*. In this respect, we would raise a concern with the proposed transition period, and suggest that the timing for the Canadian certification requirements should be clarified and made consistent with that applicable to foreign private issuers under the new United States requirements.

Finally, we agree with the proposal to allow smaller issuers to design controls and procedures that are appropriate to the size and complexity of their businesses. This outcomes approach is both more practical and imposes a tougher standard: it is the results rather than the processes that count.

Moving to 52-110, dealing with audit committees, the Council also is on record as supporting the direct reporting relationship of external auditors to the audit committee of the board. We are less certain that the proposed instrument goes far enough in adapting the requirements of *Sarbanes-Oxley* to "certain realities of the Canadian marketplace", notably the high number of junior and controlled issuers.

Our principal reservation is with respect to the definition or degree of independence required of members of the audit committee in companies with controlling shareholders. For widely held companies, it is clearly appropriate to require that all members of the audit committee be independent of management. For many controlled companies, however, major shareholders continue to be involved in management either directly or through family members.

We understand the need to protect the interests of minority shareholders in such situations and are on record as supporting a requirement that a majority of the audit committee should be independent of management. It still seems reasonable, however, to suggest that a major or controlling shareholder has an urgent and compelling interest in ensuring strong oversight of financial reporting and should not be prohibited from participation in the audit committee.

The proposed instrument does a better job of meeting the needs of junior companies, notably with respect to both the definition and "comply or explain" approach to the appointment of "audit committee financial experts". The proposed approach is similar to that adopted in the United States, but provides additional flexibility for smaller issuers.

In particular, we support the idea of defining both "audit committee financial expert" and the concept of "financial literacy" as relative to the complexity of an individual issuer's affairs. This is a realistic approach that should enable smaller issuers to recruit the degree of expertise they need at an affordable cost.

Furthermore, while the exemption for venture issuers will enable smaller-cap companies to bypass both the independence and financial literacy requirements for their audit committees, the requirement to disclose their practices, fees and reliance on this exemption will provide a powerful incentive to upgrade their audit committees as quickly as possible.

On the whole, therefore, the three proposed instruments and related policies appear to capture the most positive elements of *Sarbanes-Oxley* while learning from the early experience in implementation in the United States and adapting its practices to the unique characteristics of the Canadian market.

In addition to offering comments on the specific instruments, the Council would like to reinforce a broader concern with the regulation of Canada's capital markets. We note in particular that the British Columbia Securities Commission is not at this time intending to adopt the latter two instruments as it proceeds with a significantly different approach to the reform of securities regulation.

The Council has considerable sympathy with the principles underlying the B.C. Model, especially with its desire to simplify and streamline regulatory processes and make greater use of sound principles rather than narrow rules.

Both the British Columbia approach and the one reflected in the proposed instruments have merits. What the Council cannot accept is a sharp divergence between Canadian jurisdictions, one that would make securities regulation even more complicated, fragmented and costly for issuers than it is today.

We recognize that the debate within Canada reflects a broader global discussion about competing approaches to capital market issues, including accounting standards as well as securities regulation. This continuing competition of ideas is healthy, but the Council believes that Canada must be able to offer a coherent position within this global discussion.

Furthermore, our capital markets are simply too small to allow huge disparities between jurisdictions in Canada. We have supported the Canadian Securities Administrators (CSA) in their efforts to develop Uniform Securities Legislation (USL) for Canada. Provincial governments for their part have made a commitment to proceeding with a passport system that would enable issuers to deal with a single regulator instead of thirteen.

What neither the USL proposal nor a passport system can provide, however, is any means of resolving an impasse. An acceptable system of regulation must be able to reach resolution on contentious issues in order to move forward with necessary reforms on a timely and consistent basis across the country.

In our view, therefore, if the members of the CSA are not able to bridge their differences and reach consensus on a compatible approach involving all jurisdictions, they will provide an additional compelling reason to move quickly beyond the planned passport model toward a single Canadian regulator.

Thank you for this opportunity to offer comments on the issues raised by the proposed instruments, which we hope will contribute effectively to reinforcing investor confidence in Canada's capital markets.