

1.1.6 CSA Staff Notice 52-318 Audit Committee Follow-up Compliance Review

CSA STAFF NOTICE 52-318

AUDIT COMMITTEE FOLLOW-UP COMPLIANCE REVIEW

As announced in CSA Staff Notice 52-312 that was published on January 13, 2006, staff of the securities regulatory authorities in Alberta, Saskatchewan, Manitoba, Ontario and Québec (the participating jurisdictions) conducted a follow-up review of compliance with the provisions of Multilateral Instrument 52-110 *Audit Committees* (the Instrument). The follow-up review was necessitated by the inadequate level of compliance with the Instrument that was communicated in CSA Staff Notice 52-312. This notice outlines the results of our follow-up review.

The Instrument

The Instrument came into force on March 30, 2004 in every jurisdiction in Canada except British Columbia and Québec. In Québec, it came into force on June 30, 2005. The Instrument applies to all reporting issuers with limited exceptions.

The Instrument prescribes three broad sets of requirements:

- all members of the audit committee must be independent and financially literate (venture issuers, as that term is defined in the Instrument, are exempt from these requirements);
- an audit committee must have all of the responsibilities prescribed by the Instrument which should be set out in its charter; and
- a reporting issuer must include certain disclosure in its AIF, management information circular or MD&A.

The Review Program

We selected a sample of 25 issuers for review where a participating jurisdiction was the issuer's principal regulator. Our selection criteria included the size of the issuer's market capitalization, its industry sector, and its listing status. Our sample included 15 TSX listed issuers (TSX issuers) and 10 venture issuers.

Our review focused on each issuer's compliance with the Instrument's requirements related to audit committee composition and responsibilities. In conducting our review, we examined:

- the responsibilities of the audit committee;
- all direct or indirect relationships that each audit committee member had with the issuer;
- the basis upon which each audit committee member was determined to be independent or non-independent;
- the relevant education and experience of each audit committee member;
- the basis upon which each audit committee member was determined to be financially literate; and
- any exemptions that the issuer relied on in connection with the independence or financial literacy of an audit committee member.

Results

Audit Committee Responsibilities

Overall, the audit committees of 18 issuers (72% of issuers reviewed) had all of the responsibilities prescribed by the Instrument. This included 10 TSX issuers (67% of TSX issuers reviewed) and 8 venture issuers (80% of venture issuers reviewed).

Our review identified several instances where an issuer's audit committee was not assigned one or more of the responsibilities prescribed by the Instrument. The non-compliance related to a range of different responsibilities as set out below:

Responsibility	Section Number in Instrument	Number of Instances of Non-Compliance
Oversee work of external auditor	s. 2.3(3)	6
Review and approve issuer's hiring policies for partners and employees of issuer's current and former external auditors	s. 2.3(8)	4
Pre-approve non-audit services to be provided by external auditor	s. 2.3(4)	3
Establish procedures for handling complaints and employee concerns regarding accounting or auditing matters	s. 2.3(7)	3
Review issuer's financial statements, MD&A and annual and interim earnings press releases prior to their release	s. 2.3(5)	2
Recommend to board the external auditor to be nominated and their compensation	s. 2.3(2)	1

For each of the seven issuers where we identified instances of non-compliance, we accepted an undertaking from the issuer to address the deficiencies within a specified period of time prior to its next annual meeting.

Audit Committee Member Independence

All of the TSX issuers reviewed had audit committees comprised solely of independent directors.

While venture issuers are not required to comply with the audit committee independence requirements of the Instrument on the basis of the exemption included in Part 6, six venture issuers (60% of venture issuers reviewed) had audit committees comprised solely of independent directors.

Each of the four venture issuers that did not have fully independent audit committees had one member who was not independent. In each instance, the member was an employee or executive officer of the issuer which is a deemed material relationship under s. 1.4(3)(a). In two of those instances the individual was the issuer's president and CEO, in one instance the individual was the issuer's CFO, and in one instance the individual was an employee of the issuer.

Audit Committee Member Financial Literacy

We did not find any instances where an issuer determined that an audit committee member was not financially literate. This finding is particularly noteworthy for venture issuers as they are not required to comply with the audit committee financial literacy requirements of the Instrument on the basis of the exemption included in Part 6.

In a few instances, however, the assertion by an issuer of the financial literacy of an audit committee member was the subject of further scrutiny in our review. In these instances, we found that, although an audit committee member was ultimately determined to be financially literate, the matter had not been carefully considered by the issuer prior to our enquiry.

Issuers are reminded that the financial literacy of each director should be carefully assessed prior to that individual's appointment to the audit committee. The assessment should generally be supportable on the basis of the individual's relevant education and/or experience.

Future Reviews

All of the TSX issuers reviewed complied with the Instrument's audit committee composition requirements. However, we are concerned about the number of instances identified in our review where the audit committees of both TSX issuers and venture issuers were not assigned all of the responsibilities prescribed by the Instrument. We therefore intend to review issuers' compliance with the Instrument selectively as part of our ongoing continuous disclosure review program.

Questions

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