Chartered Accountants of Canada

The Canadian Institute of Chartered Accountants
277 Wellington Street West
Toronto, Ontario
Canada M5V 3H2
Tel: (416) 977-3222
Fax: (416) 977-8585

Comptables agréés du Canada

L'Institut Canadien des Comptables Agréés
277, rue Wellington ouest
Toronto (Ontario)
Canada M5V 3H2
Tél: (416) 977-3222
Fax: (416) 977-8585

August 19, 2002

Five Year Review Committee
c/o Purdy Crawford, Chair
Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Box 50, 1 First Canadian Place
Toronto, Ontario
M5X 1B8

Dear Mr. Crawford:

Re: Ontario Securities Review Advisory Committee
Five-Year Review of Securities Legislation

On behalf of the Canadian Institute of Chartered Accountants, I am pleased to respond to the Committee's recently issued report on the five-year review of Ontario securities legislation. We are generally supportive of the Committee's report and offer specific feedback with respect to a series of recommendations. These comments are put forward keeping in mind that the full nature of changes emanating from the Sarbanes-Oxley Act of 2002 will not be known until the regulations required by the Act are set out, and that these changes may well affect a number of the recommendations set out in the Committee's report.

Recommendation #2: Calls for harmonization of securities regulation across Canada; would provide securities regulators with the power to delegate and would amend securities legislation to provide for mutual recognition.

We support continuing collaboration among Canadian Securities Administrators (CSA) members, as noted in our June 2000 submission. We commend the proposals for harmonization and legislative changes to provide for mutual recognition.

Recommendation #3: Would allow foreign and Canadian companies to prepare financial statements in accordance with U.S. GAAP. Those doing so would be not be required to reconcile to Canadian GAAP beyond a transitional period.

We have serious concerns regarding this proposal, which would permit both foreign and Canadian companies to prepare their financial statements in accordance with U.S. GAAP, with no requirement to reconcile to Canadian GAAP after a transition period.

We believe that the Committee's analysis supporting this recommendation is incomplete in some important respects, and we provide the following observations for consideration:

- We believe the importance of International Accounting Standards has been significantly underestimated. The International Accounting Standards Board (IASB) has achieved world-wide recognition as the central accounting standard setting body in the world – and it is charged with coordinating the efforts of leading national standard setters in the convergence of national standards to one universal set of standards. Major standard setters, including those in the U.S. and Canada, have pledged to work towards this goal.

- In addition to convergence with international standards, the Canadian Accounting Standards Board also counts harmonization with U.S. GAAP – i.e. the elimination of all significant differences – as a fundamental objective. Substantial progress has been made in this regard: recent examples include income taxes, employee future benefits, interim financial statements, earnings per share, business combinations, and foreign currency translation. In addition, current projects are under way to harmonize Canadian GAAP with U.S. standards on accounting for financial instruments and asset impairment.

- At the same time, the Canadian Board reserves the right to adopt an accounting standard which differs from U.S. GAAP where there is clear international agreement as to a superior alternative, or where there are unique Canadian circumstances not recognized by U.S. GAAP. We emphasize that an unavoidable difference with U.S. GAAP will only be accepted in Canadian standards if it is clearly justified. In such instances, disclosure of the nature of these differences and their effects would have information value to users. At the same time, examinations of reconciliations currently provided by many companies indicate that they could be substantially improved. Staff of the Canadian Accounting Standards Board would be willing to work with securities regulators to help develop standards and supporting guidance to improve reconciliations.

- An important part of the basis of the Committee's proposed recommendation is the belief that having to prepare a reconciliation from U.S. GAAP financial statements to Canadian GAAP places an intolerable cost burden on the preparer. We are not aware of any rigorous evidence supporting this belief. Moreover, given that unavoidable differences between U.S. and Canadian GAAP are becoming much reduced,[1] we believe the cost to preparers of determining and presenting the effects of differences with Canadian GAAP is relatively minor. We suggest that additional work needs to be done to validate claims that costs would greatly exceed benefits in this regard.

Recommendation #4: Endorses a move by Canadian regulators and standard setters to International Accounting Standards.

[1] For example, the Committee's Report notes "substantial differences" in accounting for foreign currency translation and inventories. Major differences on foreign currency translation have now been eliminated. With respect to inventories, there never have been any unavoidable differences between U.S. and Canadian GAAP. Canadian GAAP have allowed some alternatives not accepted under U.S. GAAP, but a company could adopt alternatives accepted in Canada that would meet U.S. GAAP. It is interesting to note that a number of Canadian companies registered with the SEC have opted to use Canadian alternatives that they consider superior to U.S. requirements despite having to report the differences in reconciliations to U.S. GAAP required by the SEC.

We strongly support the Committee's recommendation encouraging a move by both Canadian regulators and standard setters to International Accounting Standards. As indicated above, convergence with international accounting standards is a fundamental objective of the Canadian Accounting Standards Board.

Recommendation #12: Proposes a reduction of minimum initial comment periods (for rules, period would be reduced from 90 to 60 days, and for policies, from 60 to 30 days).

We are concerned that the proposed reduction in the periods for public comment may deter members of the public who would otherwise make an effort to comment. This would be a particular concern in the absence of more extensive pre-release procedures. We have observed cases where problems have occurred after the release of new rules where appropriate field-testing was not completed before the release of proposals.

Recommendation #13: Proposes the republication for comment of proposed rules and policy statements considered to be material.

We support this proposal in principle, but we are concerned about the possibility that significant changes in proposed rules could be introduced without re-exposure.

Recommendation #14: Proposes a reduction of the period for ministerial approval from 60 to 30 days.

We agree with this recommendation to streamline the rulemaking process, given that there is appropriate notification and briefings of the Minister's staff by the Commission.

Recommendation #34: Proposes harmonization by the CSA of continuous disclosure requirements and the creation of a minimum level of continuous disclosure requirements applicable to all reporting issuers. Also calls for the creation of a statutory civil liability regime for continuous disclosure across Canada.

We applaud these proposals. We are pleased to learn that the CSA has developed a proposed continuous disclosure rule that has been exposed for public comment

As we noted in our previous submission to the Committee, we believe that statutory civil liability, coupled with effective surveillance and punitive action by regulatory authorities, is necessary to ensure satisfactory operation of the continuous disclosure system.

Recommendation #35: Calls for the creation of a statutory civil liability regime for continuous disclosure as proposed by the CSA, urging the Ontario government to adopt this regime along with the governments of other CSA jurisdictions.

We support the CSA model legislation, which provides for a new civil right of action for misrepresentations in documents and public statements and for failures to disclose material

changes when required under securities legislation. In this regime, the CSA makes two significant recommendations that we strongly endorse:

1. The imposition of full proportionate liability for breaches of continuous disclosure requirements under securities law, except where breaches are caused by fraudulent or dishonest behaviour, in which case joint and several liability would apply; and
2. that liability of defendants be capped at certain specified amounts.

Under the proposed regime, defendants in such actions would be liable only in proportion to their degree of responsibility. However, where a defendant knowingly authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure, the defendant would be jointly and severally liable.

The CSA further recommends in its proposed regime that the liability of defendants in such actions (which defendants could include the responsible issuer corporation, its directors and officers and experts) should be limited to certain specified amounts. For an expert, liability would be limited to the greater of (i) $1 million, and (ii) the revenue that the expert and its affiliates earned from the responsible issuer and its affiliates during the twelve months prior to the misrepresentation. The liability cap would take into account any damages previously awarded against the defendant, or settlement paid by the defendant in any other similar actions regarding the same misrepresentation or failure to make timely disclosure brought in another Canadian jurisdiction. However, where the plaintiff proves that the person or company knowingly authorized, permitted or acquiesced in or knowingly influenced the making of the misrepresentation or the failure to make timely disclosure, the limitation on liability would not be available.

However, the proposed CSA regime would apply only to secondary market disclosure. We strongly believe that proportionate liability should apply to all financial claims – whether arising under the primary or secondary markets. This position finds support in a package of proposals issued by the British Columbia Securities Commission in February 2002, which calls for a regime of proportionate liability to apply to claims arising from misrepresentations in an offering document or the issuer's continuous disclosure record. Moreover, although the 1998 report of the Standing Senate Committee on Banking, Trade and Commerce on auditor liability endorsed modified proportionate liability in respect of federal corporations and financial institutions legislation, we believe that the Committee's rationale for reform applies equally to provincial securities legislation.

Therefore, while endorsing the CSA proposal for secondary market disclosure, we believe that its modified proportionate liability proposal should also apply to primary market activity (prospectus, takeover bid and similar liabilities) covered by provincial securities legislation and would urge you to expand your recommendation in this regard.

Recommendation #45: Recommends a reduction in the periods for filing annual and interim financial statements (annual statements reduced from 120 to 90 days after the fiscal year end; and quarterly statements from 60 to 45 days after the end of the quarter).

We support this proposal, which would provide more timely information to investors.

Recommendation #46: Would require quarterly financial statements to be reviewed by the issuer's external auditor.

Capital markets place a great deal of importance on quarterly financial information released by companies. Consequently, we support the recommendation because it would improve the quality of interim reporting, and would result in timely recognition and resolution of accounting problems that have in the past frequently been deferred until the annual financial statements are prepared and audited.

Recommendation #47: Would require press releases containing financial or earnings information to be filed on SEDAR.

We support this proposal, which would increase the accessibility to the public of significant financial information.

Recommendation #48: Recommends that the GAAP exemption available to banks and insurance companies be removed. Alternatively, the exemption should be restricted to situations where there is demonstrable prudential concern in order to contain or prevent solvency risk. Also recommends that GAAP override relating to bank holding companies be reconsidered.

We support the recommendations that the GAAP exemption available to banks and insurance companies in subsection 2(3) of the Regulation to the Act be removed and that the GAAP override relating to bank holding companies should be reconsidered. In this regard, we attach our submission to the House of Commons Standing Committee on Finance on Bill C-8 for your information.

It is our belief that external stakeholders are not best served by financial statements that depart from GAAP. Global accounting standard setters are striving to remove differences between national standards in order to facilitate comparability and the efficiency of global capital markets. Providing a national regulator with the ability to override those standards is counter to this objective. It is not necessary to override GAAP, because financial institution regulators can obtain the additional or adjusted financial information they need to make decisions on capital adequacy through requiring separate reports to them.

Recommendation #49: Would give the Commission rulemaking authority to prescribe requirements relating to the functioning and responsibilities of audit committees of reporting issuers and encourages similar powers for other CSA jurisdictions. Also urges CSA to work together to establish standards for audit committees.

We believe that the Saucier Report recommendations may result in an improvement in audit committee practices that would eliminate the need for regulatory intervention. However, its recommendations were issued less than one year ago and have yet to be fully implemented. Accordingly, it is too early to assess whether these recommendations will lead to the behaviour change that was a major objective of the report.

We note that the July 2002 Interim Report of the UK Coordinating Group on Audit and Accounting Issues made recommendations to strengthen the Combined Code and also recommended that the UK Government consider underpinning the role and responsibilities of audit committees in company law. However, in doing so, it indicated that there are wider considerations that require very careful thought.

The CICA and the Institute of Corporate Directors are hosting a forum of business leaders in September 2002 titled *Canadian Audit Committees — A Call to Leadership*. This event, which will result in a report on its outcome, is designed to clarify best practices for audit committees and the role of audit committees in ensuring confidence in Canadian capital markets. It will also provide input to regulators as necessary on any changes required to ensure audit committees function most effectively. We will communicate to you the outcome of this conference in case you choose to consider it in drawing up the final report, and recognize that regulators may need to take action should private sector initiatives not keep pace with developments in other jurisdictions.

Recommendation #50: Urges the Commission to pro-actively monitor developments in the U.S. relating to auditor independence and to consider what reforms are necessary in Canada.

We agree with the need to monitor U.S. developments relating to auditor independence. This issue has been under examination for some time by the CICA Public Interest and Integrity Committee (PIIC), which, as part of its mandate to pursue harmonized world-class standards, is developing new rules of conduct for auditor independence. These rules, which will be as consistent as possible with existing U.S. and international standards, will be circulated for public comment later this summer, for adoption by the CA profession in 2003. The PIIC will continue to actively monitor proposed changes to international independence standards, particularly in the U.S., where SEC requirements will change in response to the Sarbanes-Oxley Act of 2002 ("the Act"). The full nature and extent of the changes in the U.S. will not be known until the SEC sets out the regulations required by the Act. As and when such standards change, the PIIC will propose modifications, as appropriate to the Canadian independence standards.

Recommendation #51: Recommends that the Commission adopt amendments to proxy disclosure rules to require public companies to disclose expenditures for audit and non-audit consulting services.

We support this proposal in principle; however, we believe the matter should be dealt with in the context of the various matters being considered in relation to Recommendation 50, not in isolation.

We note the reference in the discussion material supporting the recommendations to adopting proxy disclosure rules similar to those in the United States. We understand that experience with the application of those rules has led to a belief by many that the categorization in the proxy rules is inappropriate. For example, the fees associated with an auditor's work on a prospectus would not be considered audit related, despite the fact that it involves audit and assurance work that can only be completed by the auditor. Also, there are types of services where it is not clear how the fees should be categorized. It is important that disclosure reflect the nature of the services and that it be consistent from company to company. Consequently, if such rules are to be proposed, we suggest that the Commission study the experience with the U.S. rules and consult with Canadian preparers and auditors of financial statements as part of the process of developing such proposals.

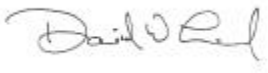
Recommendation #81: Would amend Act to include a prohibition on making a statement, written or oral, that a person or company knows or ought reasonably to know, is a misrepresentation.

We support this proposal, which we believe is a necessary concomitant of the proposal for a statutory civil liability regime for continuous reporting.

* * *

We hope that the above input is useful and would be pleased to provide further information with respect to these comments. We appreciate the opportunity to respond to the Committee's report, and ask that these comments be taken into account in finalizing its recommendations.

Yours sincerely,



David W. Smith
President & CEO

DWS/sd