

**COMPANION POLICY 52-110CP
TO MULTILATERAL INSTRUMENT 52-110
AUDIT COMMITTEES**

**Part One
General**

- 1.1 Purpose** – Multilateral Instrument 52-110 *Audit Committees* (the Instrument) is a rule in each of Québec, Alberta, Manitoba, Ontario, Nova Scotia and Newfoundland and Labrador, a Commission regulation in Saskatchewan, a policy in New Brunswick, Prince Edward Island and the Yukon Territory, and a code in the Northwest Territories and Nunavut. We, the securities regulatory authorities in each of the foregoing jurisdictions (the Jurisdictions), have implemented the Instrument to encourage reporting issuers to establish and maintain strong, effective and independent audit committees. We believe that such audit committees enhance the quality of financial disclosure made by reporting issuers, and ultimately foster increased investor confidence in Canada’s capital markets.

This companion policy (the Policy) provides information regarding the interpretation and application of the Instrument.

- 1.2 Application to Non-Corporate Entities** – The Instrument applies to all reporting issuers other than investment funds, issuers of asset-backed securities, designated foreign issuers and certain subsidiary entities of reporting issuers. Consequently, the Instrument applies to issuers that are both corporate and non-corporate entities. Where the Instrument or this Policy refers to a particular corporate characteristic, such as a board of directors, the reference should be read to also include any equivalent characteristic of a non-corporate entity.

**Part Two
The Role of the Audit Committee**

- 2.1 The Role of the Audit Committee.** An audit committee is a committee of a board of directors to which the board delegates its responsibility for oversight of the financial reporting process. Traditionally, the audit committee has performed a number of roles, including
- helping directors meet their responsibilities,
 - providing better communication between directors and the external auditors,
 - enhancing the independence of the external auditors,
 - increasing the credibility and objectivity of financial reports, and
 - strengthening the role of the directors by facilitating in depth discussions among directors, management and external auditors.

The Instrument requires that the audit committee also be responsible for managing, on behalf of the shareholders, the relationship between the issuer and the external auditors. In particular, it provides that an audit committee must have responsibility for:

- (i) overseeing the work of the external auditors engaged for the purpose of preparing or issuing an audit report or related work; and
- (ii) recommending to the board of directors the nomination and compensation of the external auditors.

Although under corporate law an issuer's external auditors are responsible to the shareholders, in practice, shareholders have often been too dispersed to effectively exercise meaningful oversight of the external auditors. As a result, management has typically assumed this oversight role. However, the auditing process may be compromised if the external auditors view their main responsibility as serving management rather than the shareholders. By assigning these responsibilities to an independent audit committee, the Instrument ensures that the external audit will be conducted independently of the issuer's management.

2.2 Review of Financial Statements by Parent's Audit Committee. Subsection 2.3(5) of the Instrument provides that an audit committee must review financial statements, MD&A and earnings press releases before the issuer publicly discloses this information. Where a subsidiary entity is also subject to the Instrument, we believe that the parent company's audit committee can perform the review function for the subsidiary entity with respect to this information.

2.3 Public Disclosure of Financial Information. Issuers are reminded that, in our view, the extraction of information from financial statements that have not previously been reviewed by the audit committee and the release of that information into the marketplace is inconsistent with the issuer's obligation to have its audit committee review the financial statements. See also National Policy 51-201 *Disclosure Standards*.

Part Three Independence

3.1 Meaning of Independence. The Instrument generally requires every member of an audit committee to be independent. Subsection 1.4(1) of the Instrument defines independence to mean the absence of any direct or indirect material relationship between the director and the issuer. In our view, this relationship may include commercial, charitable, industrial, banking, consulting, legal, accounting or familial relationships. However, only those relationships which could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgement should be considered material relationships within the meaning of section 1.4.

Subsection 1.4(3) of the Instrument sets out a list of persons that we believe have a relationship with an issuer that would reasonably interfere with the exercise of the person's independent judgement. Consequently, these persons are not considered independent for the purposes of the Instrument and are therefore precluded from serving on the issuer's audit committee. Directors and

their counsel should therefore consider the nature of the relationships outlined in subsection 1.4(3) as guidance in applying the general independence test set out in subsection 1.4(1).

3.2 Safe Harbour – Subsection 1.3(1) of the Instrument provides, in part, that a person or company is an affiliated entity of another entity if the person or company controls the other entity. Subsection 1.3(4), however, provides that a person will not be considered to be an affiliated entity of an issuer if the person:

- (a) owns, directly or indirectly, ten per cent or less of any class of voting equity securities of the issuer; and
- (b) is not an executive officer of the issuer.

Subsection 1.3(4) is intended only to identify those persons who are not considered affiliated entities of an issuer. The provision is not intended to suggest that a person who owns more than ten percent of an issuer's voting equity securities is automatically an affiliated entity of the issuer. Instead, a person who owns more than ten percent of an issuer's voting equity securities should examine all relevant facts and circumstances to determine if he or she is an affiliated entity within the meaning of subsection 1.3(1).

Part Four Audit Committee Financial Experts

4.1 Definition of Audit Committee Financial Expert.

- (1) Subsection (a) of the definition of audit committee financial expert requires the individual to have an understanding of financial statements and the accounting principles used by the issuer to prepare its financial statements. Where an issuer prepares its financial statements in accordance with Canadian GAAP, the audit committee financial expert must therefore have an understanding of Canadian GAAP. However, in our view, an individual needs a detailed understanding of only those principles of Canadian GAAP which might reasonably be applicable to the issuer in question. For example, an individual would not be required to have a detailed understanding of the Canadian GAAP treatment of complex derivatives transactions if the issuer in question would not reasonably be involved in such transactions.
- (2) Clause (c) of the definition of audit committee financial expert allows an individual to meet the definition as a consequence of the active supervision of persons engaged in the specified conduct. The phrase active supervision means more than the mere existence of a traditional hierarchical reporting relationship between supervisor and those being supervised. A person engaged in active supervision participates in, and contributes to, the process of addressing (albeit at a supervisory level) the same general types of issues regarding preparation, auditing, analysis or evaluation of financial statements as those addressed by the person or persons being supervised. The supervisor should also have experience

that has contributed to the general expertise necessary to prepare, audit, analyze or evaluate financial statements that is at least comparable to the general expertise of those being supervised. An executive officer should not be presumed to qualify. An executive officer with considerable operations involvement, but little financial or accounting involvement, likely would not be exercising the necessary active supervision. Active participation in, and contribution to, the process, albeit at a supervisory level, of addressing financial and accounting issues that demonstrate a general expertise in the area would be necessary.

- (3) In addition to determining that a person possesses an adequate degree of knowledge and experience to qualify as an audit committee financial expert, an issuer should also ensure that the candidate embodies the highest standards of personal and professional integrity. In this regard, an issuer should consider any disciplinary actions to which a potential expert is, or has been, subject in determining whether that person would be a suitable audit committee financial expert.

4.2 Liability of Audit Committee Financial Expert.

- (1) The primary benefit of having an audit committee financial expert serve on an issuer's audit committee is that the person, with his or her enhanced level of financial sophistication or expertise, can serve as a resource for the audit committee as a whole in carrying out its functions. The role of the audit committee financial expert is therefore to assist the audit committee in overseeing the audit process, not to audit the issuer.

The Instrument requires an issuer to disclose whether or not an audit committee financial expert is serving on its audit committee. In our view, the mere designation or identification of a person as an audit committee financial expert in compliance with the disclosure obligation does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification. Conversely, the designation or identification of a person as an audit committee financial expert does not affect the duties, obligations or liability of any other member of the audit committee or board of directors. The purpose of the disclosure requirement is to encourage issuers to appoint audit committee financial experts to their audit committees. As a result, we believe that it would adversely affect the operation of the audit committee and its vital role in our financial reporting and public disclosure system, and systems of corporate governance more generally, if courts were to conclude that the designation and public identification of an audit committee financial expert affected such person's duties, obligations or liability as an audit committee member or board member. We believe that it would be adverse to the interests of investors and to the operation of markets and therefore would not be in the public interest, if the designation and identification affected the duties, obligations or liabilities to which any member of the issuer's audit committee or board is subject.

- (2) A person who is designated or identified as an audit committee financial expert is not deemed to be an expert for any other purpose, including, without limitation, for the purpose of filing a consent pursuant to section 10.4 of National Instrument 44-101 *Short Form Distributions*.

Part Five Non-Audit Services

- 5.1 Pre-Approval of Non-Audit Services.** Subsection 2.3(4) of the Instrument requires an audit committee to pre-approve certain non-audit services. In our view, it may be sufficient for an audit committee to adopt specific policies and procedures for the engagement of non-audit services where
- the pre-approval policies and procedures are detailed,
 - the audit committee is informed of each non-audit service, and
 - the procedures do not include delegation of the audit committee's responsibilities to management.
- 5.2 Pre-Approval By Parent Company's Audit Committee.** Subsection 2.3(4) of the Instrument requires an audit committee to pre-approve certain non-audit services that are provided to the issuer or its subsidiary entities. Where a subsidiary entity is also subject to the Instrument, the audit committee of the parent company may pre-approve the services on behalf of the subsidiary entity's audit committee. However, the parent company and subsidiary entity should first examine all relevant facts and circumstances surrounding the engagement or relationship to determine which audit committee, that of the parent or subsidiary entity, is in the best position to review the impact of the service on the external auditor's independence.