

Notice of Multilateral Instrument 52-110
Audit Committees

Multilateral Instrument 52-110 *Audit Committees*, Form 52-110F1, Form 52-110F2 (collectively, the Instrument) and Companion Policy 52-110CP *Audit Committees* (the Companion Policy) are initiatives of certain members of the Canadian Securities Administrators (the CSA or we).

The Instrument has been made, or is expected to be made, as:

- a rule in each of Québec, Alberta, Manitoba, Ontario, Nova Scotia and Newfoundland and Labrador,
- a Commission regulation in Saskatchewan and Nunavut,
- a policy in each of New Brunswick, Prince Edward Island and in the Yukon Territory, and
- a code in the Northwest Territories.

It is expected that the Companion Policy will be implemented as a policy in Québec, Alberta, Saskatchewan, Manitoba, Ontario, Nova Scotia, Newfoundland and Labrador, New Brunswick, Prince Edward Island, Nunavut, the Yukon Territory and the Northwest Territories.

We expect to implement the Instrument and Companion Policy on March 30, 2004.

In Ontario, the Instrument and other required materials were delivered to the Minister of Finance on January 14, 2004. The Minister may approve or reject the Instrument or return it for further consideration. If the Minister approves the Instrument or does not take any further action by March 15, 2004, the Instrument will come into force on March 30, 2004. The Companion Policy will come into force on the date that the Instrument comes into force.

In Québec, the Instrument is a regulation made under section 331.1 of *The Securities Act* (Québec) and must be approved, with or without amendment, by the Minister of Finance. The Instrument will come into force on the date of its publication in the *Gazette officielle du Québec* or on any later date specified in the regulation. It must also be published in the Bulletin.

In Alberta, the Instrument and other materials were delivered to the Minister of Revenue. The Minister may approve or reject the Instrument. Subject to Ministerial approval, the Instrument and Companion Policy will come into force on March 30, 2004. The Alberta Securities Commission will issue a separate notice advising of whether the Minister has approved or rejected the Instrument.

Background

In July of 2002, the *Sarbanes-Oxley Act of 2002 (SOX)* was enacted in the United States. SOX prescribes a broad range of measures designed to restore the public's faith in the U.S. capital markets in the wake of several U.S. financial reporting scandals. These measures include requirements regarding the responsibilities and composition of audit committees. Since our markets are largely integrated with and affected by the U.S. markets, they are not immune from

real or perceived erosion of investor confidence in the United States. Therefore, we have initiated measures, including the audit committee requirements set out in the Instrument, to address the issue of investor confidence and to maintain the reputation of our markets internationally. The Instrument is based on the audit committee requirements currently being implemented in the United States. In particular, it is derived from the audit committee requirements in SOX, certain requirements of the U.S. Securities and Exchange Commission (the **SEC**) and listing requirements of the New York Stock Exchange and Nasdaq.

Recent U.S. financial scandals have demonstrated that a conflict of interest may arise when management assumes the role of overseeing the relationship between an issuer and its external auditor. In particular, a conflict arises when the external auditor begins to consider management, and not the issuer and its shareholders, as its client. As a result, U.S. listed issuers will now be required to have an independent audit committee which is directly responsible for the appointment, compensation, retention and oversight of the work of the external auditor and to whom the external auditor must report directly. By barring management from any oversight role with respect to the external auditor, the U.S. audit committee requirements facilitate the independent review and oversight of a company's financial reporting processes and the work of the external auditors. The Instrument requires certain reporting issuers to comply with provisions similar to those in the United States. The Instrument differs from the U.S. audit committee requirements to the extent required by Canadian corporate law and certain realities of the Canadian markets (*i.e.*, the high number of public junior issuers and controlled companies).

Substance and Purpose

The purpose of the Instrument is 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 investor confidence in Canada's capital markets.

The Instrument requires that every reporting issuer have an audit committee to which the issuer's external auditor must directly report. In addition, every audit committee must be responsible for:

- overseeing the work of the external auditor engaged for the purpose of preparing or issuing an audit report or related work;
- pre-approving all non-audit services to be provided to the issuer or its subsidiary entities by the issuer's external auditor; and
- reviewing the issuer's financial statements, MD&A, and annual and interim earnings press releases before they are publicly disclosed by the issuer.

Every audit committee must recommend to the board of directors the external auditor to be nominated for the purpose of preparing or issuing an auditor's report (or any related work), as well as the compensation to be paid to the external auditor.

The Instrument also establishes composition requirements for audit committees. Every audit committee must have a minimum of three members, and each member must be financially literate and independent. A member is independent if the member has no direct or indirect material relationship with the issuer. A material relationship is defined as a relationship that

could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgement. In addition, certain categories of persons are considered to have a material relationship with the issuer.

The Instrument requires that every audit committee be provided with the authority to engage and compensate independent counsel and other advisers which the committee determines are necessary to carry out its duties. Every audit committee must also have the authority to communicate directly with the internal and external auditors. In our view, these powers are essential to enable an independent audit committee to perform its role without reliance on management.

The Instrument exempts venture issuers from the requirements of Parts 3 (*Composition of the Audit Committee*) and 5 (*Reporting Obligations*) of the Instrument. As a result, the members of a venture issuer's audit committee are not required to be either independent or financially literate; however, venture issuers must provide, on an annual basis, the alternative disclosure required by Form 52-110F2.

The Instrument also contains an exemption for issuers who are U.S. listed issuers.

The Companion Policy provides interpretive guidance and other background information regarding the Instrument.

Summary of Written Comments Received by the CSA

The Instrument and the Companion Policy were published for comment on June 27, 2003. We have subsequently received submissions from 50 commenters. We have considered the comments received and thank all the commenters. The names of all the commenters are contained in Appendix A of this Notice.

Generally, the commenters were supportive of the Instrument and the Companion Policy, although many had comments on specific portions of the Instrument and Companion Policy. A summary of these comments is contained in Appendix B of this Notice, together with our responses to those comments.

Upon considering the comments, we made several revisions to the Instrument and the Companion Policy. Blacklined versions of these documents, which highlight all of the revisions that were made, are published as Appendix C of this Notice. We have not republished the Instrument and Companion Policy for comment, as we believe that the revisions do not constitute material changes to the Instrument or Companion Policy. In reaching this conclusion, we note that the fundamental purpose and approach of the Instrument remain unchanged, and that for the most part the revisions reflect either clarifications to the Instrument or certain additional exemptions to the Instrument that we do not believe materially alter the Instrument.

Summary of Changes

Set out below are noteworthy changes made to the Instrument and Companion Policy since those materials were published for comment on June 27, 2003.

1. Application of the Instrument

Section 1.2 has been revised so that the following classes of issuers will not be subject to the Instrument:

(a) SEC foreign issuers

An “SEC foreign issuer” has the meaning set out in National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*.

(b) Exchangeable security issuers

Issuers that are “exchangeable security issuers” are not subject to the Instrument, provided that they qualify for the relief contemplated by, and are in compliance with the requirements and conditions set out in, section 13.3 of National Instrument 51-102 *Continuous Disclosure Obligations*.

(c) Credit support issuers

Issuers that are “credit support issuers” are not subject to the Instrument, provided that they qualify for the relief contemplated by, and are in compliance with the requirements and conditions set out in, section 13.4 of National Instrument 51-102 *Continuous Disclosure Obligations*.

In addition, the Companion Policy now incorporates additional guidance regarding the application of the Instrument to income trusts and other non-corporate entities.

2. Meaning of Independence

The meaning of independence has been revised to more closely parallel similar provisions in the U.S. We have also added guidance to the Companion Policy that discusses the origins of our definition of independence.

3. Audit Committee Responsibilities

Section 2.3 has been revised to clarify the audit committee’s responsibilities regarding the pre-approval of non-audit services.

(a) Pre-approval of non-audit services

Subsection 2.3(4) of the Instrument has been revised to clarify that it is the provision of non-audit services by the issuer’s external auditors that must be pre-approved by the issuer’s audit committee, regardless of whether the non-audit services are provided to the issuer or a subsidiary entity of the issuer.

(b) Pre-approval policies and procedures

Section 2.6 now provides that an audit committee satisfies the pre-approval requirements in subsection 2.3(4) through the adoption of specific policies and procedures for the engagement of non-audit services. In addition, the Companion Policy now includes additional guidance regarding the development and application of such policies and procedures.

4. New Exemptions from the Composition Requirements

Part 3 of the Instrument has been amended by the addition of certain exemptions.

(a) New exemption for controlled companies

To accommodate controlling shareholders, we have added an additional exemption to section 3.3 of the Instrument. The new exemption exempts an audit committee member from the independence requirements where:

- (i) the member would be independent, but for his or her status as an “affiliated entity”;
- (ii) the member is not an executive officer, general partner or managing member of a publicly traded affiliated entity, or an immediate family member of such a person;
- (iii) the member does not act as the chair of the audit committee; and
- (iv) the board determines in its reasonable judgement that
 - A. the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an audit committee member, and
 - B. the appointment of the member is required by the best interests of the issuer and its shareholders.

The exemption is not available to a member unless a majority of the audit committee members will be independent. When an audit committee member relies on this exemption, the issuer must make certain disclosure. See Item 5 of Form 52-110F1.

(b) Temporary exemption for limited and exceptional circumstances

A new exemption has been added to the Instrument as section 3.6. It provides an exemption from the independence requirements for a period of up to two years, provided that

- (i) the member is not an individual described in paragraphs 1.4(3)(f)(i) or 1.4(3)(g) of the Instrument.
- (ii) the member is not an employee or officer of the issuer, or an immediate family member of such a person;
- (iii) the board, under exceptional and limited circumstances, determines in its reasonable judgement that
 - A. the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an audit committee member, and

B. the appointment of the member is required by the best interests of the issuer and its shareholders; and

(iv) the member does not act as the chair of the audit committee.

The exemption is not available to a member unless a majority of the audit committee members will be independent. When an audit committee member relies on this exemption, the issuer must make certain disclosure. See Item 5 of Form 52-110F1.

(c) Financial literacy

Section 3.8 has been added to the Instrument to clarify that an audit committee member who is not financially literate at the time of his or her appointment to the audit committee will be permitted a reasonable amount of time in which to become financially literate. However, where this provision is relied upon, Form 52-110F1 now requires an issuer to disclose the name of the member in question and the date by which the member expects to become financially literate.

5. Restriction on Use of Certain Exemptions

As previously published, Form 52-110F1 required issuers that relied upon certain exemptions contained in the Instrument to disclose an assessment of whether, and if so, how, such reliance could materially adversely affect the ability of the audit committee to satisfy the other requirements of the Instrument. Upon reflection, we recognized that this disclosure requirement would act as a *de facto* condition to the use of the exemption, and that such a provision should more appropriately be included in the Instrument. This provision has therefore been added as section 3.9 of the Instrument.

6. Disclosure Regarding Audit Committee Financial Experts

The Instrument no longer requires an issuer to disclose whether or not an audit committee financial expert is serving on its audit committee. Instead, issuers are required to describe, for each member of the audit committee, that member's education and experience that relate to his or her responsibilities as an audit committee member (see Item 3 of Form 52-110F1). Guidance regarding the application of this disclosure requirement has been included in the Companion Policy.

7. Exemption for U.S. Listed Issuers

The conditions applicable to the exemption for U.S. listed issuers in section 7.1 has been revised to clarify that

- an issuer using the exemption must be in compliance with the requirements of the U.S. marketplace applicable to issuers other than foreign private issuers, and
- only issuers incorporated, continued or otherwise organized in Canada must comply with the AIF disclosure requirement in clause 7.1(b).

8. Effective Date and Transition

The effective date of the Instrument is March 30, 2004. However, it will not apply to issuers until the earlier of

- (a) the first annual meeting of the issuer after July 1, 2004, and
- (b) July 1, 2005.

9. Audit committee procedures

The Companion Policy has been revised to clarify that nothing in the Instrument is intended to restrict the ability of the board of directors or the audit committee to establish the audit committee's quorum or procedures, nor to restrict the committee's ability to invite additional parties to attend audit committee meetings.

Authority for the Instrument – Ontario

In those jurisdictions in which the Instrument is to be adopted or made as a rule or regulation, securities legislation provides the securities regulatory authority with rule-making or regulation-making authority regarding the subject matter of the Instrument.

Paragraph 143(1)57 of the *Securities Act* (Ontario) authorizes the Ontario Securities Commission to make rules requiring reporting issuers to appoint audit committees and prescribing requirements relating to the functioning and responsibilities of audit committees, including requirements in respect of the composition of audit committees and the qualifications of audit committee members, including independence requirements.

Related Instruments

The Instrument is related to National Instrument 51-102 *Continuous Disclosure Obligations* and National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*.

Anticipated Costs and Benefits

The anticipated costs and benefits of implementing the Instrument and the Companion Policy are discussed in the paper entitled, *Investor Confidence Initiatives: A Cost-Benefit Analysis* (the Cost-Benefit Analysis), which was published on June 27, 2003. A response to comments received on the Cost-Benefit Analysis has been published together with this Notice, and is incorporated by reference into this Notice.

Alternatives Considered

As noted above, the Instrument is largely derived from the audit committee requirements currently being implemented in the United States. The U.S. requirements are being adopted to restore the public's faith in the U.S. capital markets. Because our markets are largely integrated with and affected by the U.S. markets, we determined it appropriate to propose similar

requirements. We did consider proposing an instrument or policy which would contain less onerous requirements than those found in the Instrument; however, because an aim of the Instrument is to foster investor confidence in Canada's capital markets, we determined that it was necessary to propose requirements that are as robust as those proposed in the United States.

Reliance on Unpublished Studies, Etc.

In developing the Instrument, we did not rely upon any significant unpublished study, report or other written materials.

Questions

Questions regarding the Instrument and Companion Policy may be referred to the following people:

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Instrument and Companion Policy

The text of the Instrument and Companion Policy follows.

DATED: January 16, 2004.

APPENDIX A**LIST OF COMMENTERS**

The Advisory Group on Corporate Responsibility Review
Agrim Inc.
Association for Investment Management and Research
Association of Chartered Certified Accountants
Automodular Corporation
BDO Dunwoody LLP
Jean Bédard
Bennett Jones LLP
Blake, Cassels & Graydon LLP
British Columbia Securities Commission
Canadian Bankers Association
Canadian Council of Chief Executives
The Canadian Institute of Chartered Accountants
Canadian Oil Sands Trust
Canadian Pacific Railway Limited
Certified General Accountants Association of Canada
Davies Ward Phillips & Vineberg LLP
Deloitte & Touche LLP
EnCana Corporation
Ernst & Young LLP
Fasken Martineau
Joel Fried
Grant Thornton LLP
Imperial Oil Limited
Institute of Corporate Directors
Institute of Internal Auditors
KPMG LLP
Leon's Furniture Limited
MacPherson Leslie & Tyerman LLP
Mendelsohn
Robert W. A. Nicholls and Robert F.K. Mason
Ontario Teachers' Pension Plan Board
Ogilvy Renault
Osler, Hoskin & Harcourt LLP
Power Corporation of Canada
PricewaterhouseCoopers LLP
Raymond Chabot Grant Thornton
Thomas P. Reilly
Simon Romano
Stephen D. Rotz
Harry G. Schaefer

Sears Canada Inc.
Shoppers Drug Mart Corporation
Talisman Energy Inc.
TELUS Corporation
TransCanada Corporation
TransCanada Power,L.P.
Torys LLP
TSX Group
Winpak Ltd.

APPENDIX B**SUMMARY OF COMMENTS AND RESPONSES**

No.	Section/Topic	Comment	Response
	Part 1 Definitions and Application		
1.	Section 1.1 (Definitions ? Definition of Audit Committee Financial Expert)	<p>One commenter suggested that the definition of “audit committee financial expert” should be harmonized with the definition utilized by the SEC, and that the Instrument should specify how a person can acquire the requisite attributes.</p> <p>One commenter suggested that paragraph (b) of the definition of “audit committee financial expert” be broadened to read “the ability to assess the general application of such accounting principles to the activities and the affairs of the issuer”. Another commenter suggested that paragraph (b) be deleted as it is unclear and is captured by paragraph (c). One commenter also questioned whether paragraph (e) of the definition was necessary, as all directors and senior officers would be expected to have such knowledge.</p>	The definition of “audit committee financial expert” has been deleted. See comments regarding Topic 36, below.
2.	Section 1.1(Definitions ? Definition of Immediate Family Member)	Several commenters raised concerns about the definition of “immediate family member”.	See the comments regarding Topic 13, below.
3.	Section 1.1 (Definitions – Financially Literate)	A number of commenters considered the definition of “financially literate” to provide sufficient guidance to allow an issuer to adequately assess a member’s compliance with the Instrument. One commenter did not.	We have clarified in the Companion Policy that, in our view, it is not necessary for an audit committee member to have a comprehensive knowledge of generally accepted accounting principles and generally accepted auditing standards to be considered “financially literate”.

No.	Section/Topic	Comment	Response
		One commenter suggested that the definition of “financially literate” be revised to expressly give the board the power to determine the requisite level of financial literacy for its audit committee members.	We disagree. In our view, an audit committee member must at least have the ability required by the definition.
4.	Section 1.1 (Definitions – Definition of Non-Audit Services)	One commenter believed that the definition of “non-audit services” was unhelpful, as it merely referred to services other than audit services. The commenter recommended that services provided to an issuer in connection with the issuer’s statutory and regulatory filings be excluded from the definition of “non-audit services”.	We have revised the definition of “audit services” to mean the professional services rendered by the issuer’s external auditors for the audit and review of the issuer’s financial statements or services that are normally provided by the external auditor in connection with statutory and regulatory filings or engagements. We believe this will address the commenters concerns about “non-audit services”.
5.	Section 1.1 (Definitions – Definition of Venture Issuer)	<p>One commenter noted that an issuer that only has securities quoted on an “alternative trading system” in Canada or the U.S. is a “venture issuer”. The commenter suggested that it was anomalous that an issuer that has its securities listed or quoted on any marketplace outside of Canada or the U.S. would not be a “venture issuer”.</p> <p>Three commenters recommended that the definition of “venture issuer” be based upon the size or market capitalization of the issuer.</p>	The definition of “venture issuer” is based upon the definition used in National Instrument 52-102 <i>Continuous Disclosure Obligations</i> . To ensure harmony between these two instruments, we have not revised the definition to address these comments.
6.	Section 1.2 (Application ? Subsidiary Entities)	<p>One commenter recommended that the Instrument contain a clear definition of “equity securities”. The commenter suggested that the definition include only voting securities and exclude preferred securities where the security holders do not ordinarily have a right to vote.</p> <p>One commenter noted that a subsidiary entity that has no equity securities displayed for trading on a marketplace is exempt from the Instrument if its parent entity is subject to the requirements of the Instrument. The commenter suggested that the exemption should be expanded to include those situations where the parent is subject to the equivalent provisions under SEC rules.</p>	<p>A definition of “equity securities” has not been incorporated into the Instrument, as this term is defined in the securities legislation of various jurisdictions. However, we have revised section 1.2 so that subsidiary entities that only have non-convertible, non-participating preferred securities displayed for trading on a marketplace are not subject to the Instrument, provided that the parent issuer is subject to the Instrument or to comparable US requirements.</p> <p>We agree, subject to the issuer having its securities listed on a U.S. marketplace and the issuer being in compliance with the requirements of that marketplace. We have revised section 1.2 accordingly.</p>

No.	Section/Topic	Comment	Response
7.	Section 1.2 (Application - Exchangeable Securities and other Issuers Exempt from Continuous Disclosure Requirements)	<p>Several commenters recommended that the Instrument provide an exemption for issuers of exchangeable securities, as the financial statements of such issuers are not relevant to security holders.</p> <p>Another commenter noted that many issuers of medium term notes (MTNs) are exempt from both the continuous disclosure requirements in securities legislation and the audit committee requirements in corporate statutes. Consequently, the commenter recommended that MTN issuers be exempt from the requirement to have an audit committee that complies with the Instrument.</p> <p>One commenter suggested that any issuer eligible to rely on an exemption, waiver or approval granted to it by a regulator or securities regulatory authority relating to continuous disclosure be entitled to rely upon a similar exemption from the Instrument.</p>	<p>We agree. We have revised section 1.2 so that the Instrument will not apply to these issuers.</p> <p>We agree. We have revised section 1.2 so that the Instrument will not apply to these issuers who are credit support issuers.</p> <p>We believe that such an exemption would be too broad. However, when applying for relief from the continuous disclosure requirements in securities legislation, issuers may also seek exemptive relief from the Instrument. Applications for such relief will be considered on a case-by-case basis.</p>
8.	Section 1.2 (Application-Limited Partnerships, Income Trusts and Holding Company Structures, etc)	<p>Several commenters questioned how the Instrument would apply, generally, to issuers such as limited partnerships, income trusts and holding company structures.</p>	<p>Paragraph 1.2 of the Companion Policy describes our views regarding how the Instrument should apply to entities such as limited partnerships and income trusts. In our view, 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. In other words, in the case of an income trust, we expect that the trustees will appoint a minimum of three independent trustees to act as an audit committee and fulfil the responsibilities of the audit committee imposed by the Instrument. Similarly, in the case of a limited partnership, we expect the directors of the general partner to appoint an audit committee which fulfils these responsibilities. However, where the structure of an issuer would not permit it to comply with the Instrument, the issuer may seek exemptive relief.</p>

No.	Section/Topic	Comment	Response
		<p>Another commenter recommended that an exemption from the independence requirements be made for arm's length qualifying transactions for capital pool companies (CPCs) and reverse take-over bids of public company shells. The commenter noted that in both cases, the directors and officers of the CPC or public shell company will often continue with the post-transaction entity, but may not meet the definition of independence on account of their association with the former CPC or public shell company. The commenter suggested that, because the director's or officer's association with the former CPC or public shell company would not have been in a managerial role, it would be inappropriate to preclude those officers and directors from being independent of the resulting entity.</p>	<p>In addition, we have also added guidance to the Companion Policy regarding the application of the term "executive officer" to individuals who are employed through management companies.</p> <p>Notwithstanding that the transaction in question may be arm's length, we do not believe that the directors and officers of a former CPC or public shell company will necessarily be independent of the resulting issuer. Consequently we are not prepared to incorporate such an exemption.</p>
9.	<p>Section 1.3 (Meaning of Affiliated Entity, Subsidiary Entity and Control)</p>	<p>Two commenters noted that the definitions of affiliated entity, control and subsidiary entity were very fuzzy or difficult to follow. Two other commenters noted that the definitions were borrowed from U.S. securities law, but that neither the Instrument nor Companion Policy provided guidance as to how these terms were to be interpreted. The commenters strongly urged the CSA to adopt bright line definitions that reflect how these terms are commonly understood in Canada.</p> <p>One commenter suggested that it was unclear what was meant by "managing member" in subsection 1.3(1)(b)(ii).</p> <p>One commenter noted that subsection 1.3(1)(b) was an example of an incomplete definition, as it did not follow an "if this, then that" formula.</p>	<p>We considered the comments related to the definitions used in this section, but determined to retain them as they are the same as those contained in Rule 10A-3 under the 1934 Act (or Rule 10A-3). We believe that this is necessary for the Instrument to be as consistent as possible with the equivalent U.S. regulation.</p> <p>The term "managing member" is meant to capture individuals who occupy positions of authority with entities other than corporations or limited partnerships (<i>i.e.</i>, limited liability companies, etc.).</p> <p>We believe that the definition in subsection 1.3(1)(b) is complete and, accordingly, have not modified it.</p>

No.	Section/Topic	Comment	Response
10.	Section 1.4 (<i>Meaning of Independence ? General</i>)	<p>A number of commenters endorsed the definition of independence contained in subsections 1.4(1) and (2).</p> <p>Seven commenters suggested that any examination of a member’s independence should focus on the member’s independence from management, rather than on his or her independence from the issuer.</p> <p>One commenter was concerned that issuers operating in regulated industries, especially those issuers designated as “common carriers”, would find it difficult to locate directors who did not have a material relationship with the issuer.</p> <p>Two commenters suggested that a director should be considered to be not independent only if the director had a material relationship with the issuer that might interfere with the exercise of the director’s judgement with respect to matters that might come before the audit committee.</p> <p>One commenter suggested that where a director had a material relationship with the issuer, the board should be permitted to override this determination if the independent directors unanimously approve the decision and disclosure of the decision is made in the issuer’s annual disclosure.</p>	<p>-</p> <p>We concur that an audit committee member’s independence from management is a critical component of the member’s independence. However, in addition, a member should not be affiliated with the issuer, as affiliated entities can exert control over management. Furthermore, a member must also be independent of the issuer’s internal and external auditors, to facilitate auditor independence.</p> <p>As noted in subsection 1.4(2), a material relationship means a relationship that could, in the view of the issuer’s board of directors, reasonably interfere with the exercise of a member’s independent judgement. We believe that there is likely a pool of directors who are not related to the common carrier in a manner that, in the view of its board, would reasonably interfere with the exercise of their independent judgement.</p> <p>We do not agree that the scope of the independence definition should be restricted to those matters that might come before the audit committee. Independence requires objectivity on the part of the director with respect to all matters related to the issuer. Further, this suggestion would be inconsistently applied given the subjectivity that would be involved in determining whether a matter might come before the audit committee. We also do not agree that the board should be able to override the independence provisions where a director has a material relationship with the issuer. Both of these suggestions would detract from consistency in the application of the independence provisions included in the Instrument.</p>

No.	Section/Topic	Comment	Response
11.	Section 1.4 (Meaning of Independence? Prescribed Relationships, General)	<p>One commenter commended the CSA for providing such a comprehensive test for independence. However, 14 commenters suggested that the prescribed relationships set out in subsection 1.4(3) were either too stringent or unnecessary.</p> <p>Eight commenters recommended that a board be permitted to designate a director as being independent notwithstanding that the director would be deemed to be not independent under subsection 1.4(3) of the Instrument. Five commenters suggested, however, that any such determination by the board be publicly disclosed by the issuer, together with the board's reasons for making the determination.</p> <p>Two commenters suggested that the specific relationships identified in subsection 1.4(3) should be moved to the Companion Policy, where they would provide guidance to the board in applying the test set out in subsection 1.4(1). Another commenter believed that it was unnecessary to specifically deem directors with the identified relationships to be not independent.</p> <p>With respect to the specific relationships prescribed by subsection 1.4(3), one commenter considered them to be generally appropriate. Two other commenters, however, noted that the prescribed relationships did not capture some relationships (such as close friendships) and other factors that could influence board independence.</p>	<p>We appreciate the concerns that have been expressed and have made the following accommodations. Subsection 1.4(3) has been revised such that an immediate family member must be an executive officer, rather than merely an employee, in order to preclude a finding of independence. The Instrument has also been revised to provide a temporary exemption for a director who is not independent to be a member of the audit committee in limited and exceptional circumstances. While we have made these accommodations to address the concerns expressed, we consider the prescribed relationships set out in subsection 1.4(3) to be of a sufficiently fundamental nature as to preclude a finding of independence. Further, in the revised Instrument, they generally mirror the relationships that have been prescribed by the SEC in Rule 10A-3 and the NYSE listing requirements.</p> <p>We do not agree that the board should be able to designate a member as being independent notwithstanding that the member would be deemed to be not independent under subsection 1.4(3) of the Instrument. We also do not agree that the specific relationships identified in subsection 1.4(3) should be moved to the Companion Policy. The underlying premise of subsection 1.4(3) is that individuals in these relationships lack the independence to be audit committee members.</p> <p>We recognize that subsection 1.4(3) does not capture all possible relationships that could influence a member's independence. However, it is the responsibility of the board to consider all relationships in exercising its discretion under subsection 1.4(2) of the Instrument.</p>

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that only the independence restrictions imposed by SOX (i.e., those found in subsections 1.4(3)(e) and (f)) should apply to audit committees. Another commenter suggested that, if the prescribed relationships were to be included in the Instrument, they should go no further than those proposed by the SEC and NYSE.</p>	<p>We do not agree that only the independence provisions imposed by SOX should apply to audit committees. This would be inconsistent with broader regulation that is imposed by U.S. exchanges. The SEC has recognized the importance of U.S. exchange regulation in approving the listing requirements of such exchanges.</p> <p>We have revised the Instrument to ensure that the prescribed relationships included in the Instrument are no broader than those prescribed by the SEC and the NYSE.</p>
12.	<p>Section 1.4 (<i>Meaning of Independence ? Non-Executive Chairs</i>)</p>	<p>Five commenters noted that many non-executive chairs and vice-chairs would be deemed to be not independent under the proposed Instrument.</p> <p>One commenter noted that the term “full time” was not very helpful.</p>	<p>We acknowledge that a full-time chair and vice-chair would be deemed to have a material relationship with the issuer under the proposed Instrument. The presumption is that, if a person is performing the function on a full time basis, they are acting in the capacity of an executive officer regardless of their designation.</p> <p>The Instrument has been revised to clarify that fees paid to a non-executive chair or vice-chair will not, alone, cause that person’s independence to be impeded.</p>
13.	<p>Section 1.4 (<i>Meaning of Independence ? Restrictions regarding Immediate Family Member</i>)</p>	<p>Various commenters raised concerns regarding the definition of “immediate family member” and its role in determining a member’s independence under section 1.4 of the Instrument. Many of the commenters noted that the relationships identified in subsections 1.4(3)(a) through (d) were derived from the listing requirements of the NYSE and use the NYSE definition of “immediate family member” which is broader than the definition of “immediate family member” used by the SEC. They suggested that the test in subsection 1.4(3)(e), which was derived from Rule 10A-3, use the narrower SEC definition of immediate family member.</p>	<p>The Instrument has been revised accordingly.</p>

No.	Section/Topic	Comment	Response
		<p>Five commenters suggested that it was inappropriate to deem a director to be not independent merely because their immediate family member was employed by the issuer. Instead, they suggested that the determination of independence in such circumstances be left to the board of directors.</p> <p>Other commenters suggested that a director’s independence should be impaired by an immediate family member’s employment with the issuer only if the immediate family member worked full time for the issuer and occupied a senior position that involved a policy-making function. They suggested that the board be given discretion to override these prohibitions.</p> <p>Six commenters suggested that a monetary threshold be used to measure the seniority of an employment relationship. One commenter suggested a \$75,000 threshold, while others suggested a threshold of \$100,000 or \$150,000. A seventh commenter noted that any monetary threshold would be arbitrary.</p>	<p>The Instrument has been revised so that the immediate family member must be an executive officer of the issuer to preclude independence. However, we do not agree that the determination of independence in that circumstance should be left to the board of directors.</p> <p>See our response above.</p> <p>Subsections 1.4(3)(a) and (b) of the revised Instrument focus on employment while subsection 1.4(3)(f) focuses on compensation. As noted above, an immediate family member must now be an executive officer of the issuer to preclude independence. We continue to believe that if a member is an employee of the issuer, that person should be precluded from being considered independent.</p>
14.	<p>Section 1.4 (<i>Meaning of Independence? The Prescribed Period</i>)</p>	<p>Several commenters noted that, unlike the Instrument, the SEC requirements did not impose a “look-back” position. These commenters recommended that the Instrument be more closely harmonized with the U.S. requirements.</p> <p>Two commenters recommended that a two year cooling off period would be more appropriate. Another commenter suggested a one year period. A fourth commenter recommended either a one or two year period, while a fifth commenter recommended a one year cooling off period, to be used as a guideline only. Generally, the commenters recognized that a balance must be achieved between directors who are independent and those that have knowledge and expertise in the business and industry.</p>	<p>We agree that the provisions that have been derived from Rule 10A-3 should not impose a “look-back” period. The Instrument has been revised accordingly.</p> <p>We do not agree with these comments and continue to believe that three years is an appropriate cooling off period. The NYSE has also adopted a three year cooling off period in its director independence requirements. We do not agree that the three year cooling off period should be rebuttable by the board.</p>

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that a three year cooling off period for former partners, members or executive officers of entities that provide consulting, legal, investment banking or financial advisory services is too restrictive. Instead, this presumption should be rebuttable by the board.</p> <p>One commenter suggested that the policy include an example of how the prescribed period should be applied.</p>	
15.	Section 1.4 (Meaning of Independence? Persons Employed by Auditor)	<p>Two commenters suggested limiting the prescribed relationship in subsection 1.4(3)(b) to those employed in a “professional capacity”, in the same manner that they are used in subsection 1.4(3)(c).</p> <p>Another commenter recommended that the restrictions in subsections 1.4(3)(b) and (c) relating to former partners and employees of the current or former external auditors only apply to those persons who provided services to the issuer.</p>	We do not agree. These prescribed relationships are consistent with those included in the NYSE listing requirements.
16.	Section 1.4 (Meaning of Independence? Prohibition Against Certain Compensatory Fees)	<p>Five commenters recommended that the prohibition against compensatory fees be subject to a <i>de minimis</i> threshold.</p> <p>Two commenters suggested that a monetary threshold for various independence requirements would not be successful, as the number would be either arbitrary or otherwise insufficient.</p> <p>One commenter questioned whether being in a lawyer-client relationship necessarily created a situation of non-independence. In the experience of the commenter, the reverse was often true, as the commenter believed that lawyers were often very conservative and risk-averse by training.</p>	<p>We are of the view that the prohibition against compensatory fees should not be subject to a <i>de minimis</i> threshold. The application of a <i>de minimis</i> threshold may not be appropriate for all types of fees and services and may not be consistently applied by issuers. Further, the absence of a <i>de minimis</i> threshold is consistent with the parallel restriction included in Rule 10A-3. As noted above, it is desirable that the Instrument be as consistent with equivalent U.S. regulation as possible.</p> <p>We disagree.</p>
17.	Section 1.4 (Meaning of Independence? Limited Partners)	One commenter questioned the use of the term “limited partner” in subsection 1.4(5) because, to the knowledge of the commenter, no accounting firm was organized as a limited partnership. Instead, the commenter recommended the use of the term “fixed income partner”.	We agree and have amended subsection 1.4(5) accordingly.

No.	Section/Topic	Comment	Response
18.	Section 1.4 – (Meaning of Independence ? Indirect Acceptance of Compensatory Fees)	<p>Three commenters noted that the indirect acceptance provisions in subsection 1.4(7) are phrased differently than the corresponding provisions in the U.S. The commenters thought that this may result in confusion. The commenters also believed that the language in subsection 1.4(7) captured a broader group of persons and companies than the comparable U.S. provisions.</p> <p>Another commenter suggested that subsection 1.4(7)(b) be amended to clarify that the exception included therein extends to associates (<i>i.e.</i>, non-partner employees of professional firms) whose compensation does not depend directly on the fees received from the issuer.</p> <p>Three commenters were unclear regarding the meaning of “member” or “non-managing member”.</p>	<p>The provisions of subsection 1.4(7) have been revised to more closely parallel the equivalent U.S. provisions.</p> <p>The term “member” is meant to capture individuals who occupy positions of authority with entities other than corporations or limited partnerships (<i>i.e.</i>, limited liability companies, etc.). The term “non-managing member” has the reciprocal meaning.</p>
Part 2 Audit Committee Responsibilities			
19.	Section 2.2 – (Relationship with External Auditor)	<p>One commenter suggested that the Instrument include some direction regarding the scope of the work that may be performed by the external auditor for the benefit of the audit committee. At the very least, the commenter suggested revising subsection 2.3(4) to prohibit the audit committee from pre-approving any non-audit work which, in the opinion of the audit committee, would result in the external auditors auditing their own work.</p>	<p>We believe that the restrictions on the scope of work that can be performed by an external auditor are appropriately dealt with by the Canadian Institute of Chartered Accountants (CICA) standards on independence. We have therefore not added the suggested guidance to the Instrument.</p>

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that the Instrument go further to strengthen the interaction between the auditor and the audit committee. The commenter suggested that the audit committee be required to meet with the external auditor at least once per year, and to discuss with the external auditor his or her professional judgements with respect to all critical accounting policies and practices used by the issuer and all alternative accounting treatments. The commenter also recommended that material written communication between the auditor and the issuer's management be discussed. Further, the commenter suggested that the audit committee be required to disclose the number of times per year that such meetings were held and whether such discussions took place.</p> <p>One commenter suggested that the relationship of the audit committee and the internal audit function be formalized in the Instrument. The commenter suggested that where an internal auditing function does not exist in an issuer, the audit committee be required to annually assess whether its absence creates unacceptable risk for the organization.</p>	<p>We believe that it would not be appropriate to include such responsibilities in the Instrument. If the external auditors are unable to fulfil their professional obligations, they will be unable to complete the issuer's audit.</p> <p>At this time, we have decided not to require issuers to maintain internal audit functions.</p>
20.	Subsection 2.3(2) (<i>Audit Committee Responsibilities – Recommendations to the Board</i>)	<p>One commenter suggested that, rather than requiring the audit committee to recommend to the issuer's board of directors the compensation of the external auditors as provided in subsection 2.3(2)(b), an issuer's board of directors should be permitted to delegate to the audit committee its authority to approve the compensation of the external auditors. The commenter noted that, under the <i>Canada Business Corporations Act</i> and the <i>Alberta Business Corporations Act</i>, the delegation of the director's authority to fix the remuneration of the auditors is not restricted as it is for other director actions.</p>	<p>We agree that the board of directors may delegate such matters to the audit committee. However, the directors may only fix the remuneration of the external auditors if the shareholders fail to do so (s.162 (4), CBCA; s.162(4), ABCA) Although in practice, the directors may fix the remuneration, the right to fix the remuneration is, nevertheless, a right of the shareholders. We therefore believe that it is inappropriate to include in the Instrument a presumption that the right will not be exercised.</p>

No.	Section/Topic	Comment	Response
21.	Subsection 2.3(3) (Audit Committee Responsibilities-Oversight of Work of External Auditor)	<p>One commenter was concerned that the responsibility to “oversee” the work of the external auditors would preclude the external auditors from providing their views directly to the shareholders if the external auditors disagreed with the approach being taken by the audit committee. The commenter viewed the responsibility to oversee the “resolution of disagreements between management and the external auditors regarding financial reporting” as reinforcing this interpretation. The commenter believed that the matter of whether the external auditors are performing their function appropriately should be left to the standards established and maintained by the accounting profession and its various oversight bodies.</p> <p>One commenter questioned whether the phrase “directly responsible” implied an additional responsibility for the audit committee. If so, this commenter recommended clarification in the Instrument.</p>	<p>We have included a paragraph in the Companion Policy to clarify that the external auditors have the authority to also give their views directly to the shareholders if they disagree with the approach being taken by the audit committee.</p> <p>We agree that the external auditors are subject to professional standards and oversight by professional oversight bodies. We believe that specific decisions regarding the execution of the audit committee’s oversight responsibilities, as well as decisions regarding the extent of desired involvement by the audit committee, are best left to the discretion of the audit committee of the issuer in addressing the issuer’s individual circumstances.</p> <p>The phrase “directly responsible” is used to clarify that the oversight responsibility rests with the audit committee. Accordingly, no additional clarification has been added.</p>
22.	Subsection 2.3(4) (Audit Committee Responsibilities-Pre-approval of nonaudit services)	<p>Five commenters believed that the Instrument should address the use of specific policies and procedures for the pre-approval of non-audit services.</p> <p>Three commenters suggested that we incorporate in the Companion Policy guidance regarding pre-approval requirements similar to that provided in the SEC’s FAQ on Auditor Independence.</p> <p>Two commenters suggested that the pre-approval requirements in subsection 2.3(4) should also extend to audit services.</p>	<p>The discussion of pre-approval policies and procedures previously found in paragraph 5.1 of the Companion Policy has been incorporated into the Instrument.</p> <p>Guidance related to monetary thresholds and the appropriate level of detail necessary for such pre-approval has been included in the Companion Policy.</p> <p>We disagree with this suggestion. Under Canadian corporate law, the shareholders have the right to appoint the external auditor. By requiring the audit committee to pre-approve the provision of audit services, we believe that we would interfere with this right of the shareholders.</p>

No.	Section/Topic	Comment	Response
		<p>Two commenters suggested that the pre-approval requirement in subsection 2.3(4) should not be extended to the external auditors of an issuer's subsidiary if they are not the auditors of the issuer. One of the commenters limited this suggestion to the situation where the subsidiary, itself, is subject to the Instrument. Another commenter suggested that the pre-approval requirement should relate to all audit services provided to the issuer whether by its external auditors or the external auditors of subsidiary entities, that non-audit services provided to subsidiary entities by their external auditors (where they are not also the issuer's external auditors) should not be subject to pre-approval by the audit committee of the issuer, and that fee disclosure requirements should relate to all services provided by the external auditors of the issuer but not to any services provided to subsidiary entities by their external auditors (where they are not also the issuer's external auditors.)</p> <p>One commenter suggested that that it is the responsibility of the audit committee and the board of directors to establish pre-approval policies and procedures that are appropriate to assess auditor independence. Consequently, detailed rules and interpretations should not be prescribed in this respect.</p>	<p>Subsection 2.3(4) has been revised so that non-audit services that are provided by the issuer's external auditors to either the issuer or its subsidiary entities must be pre-approved by the issuer's audit committee.</p> <p>Paragraph 9 of Form 52-110F1 and paragraph 6 of Form 52-110F2 have been revised to clarify that the fee disclosure requirements contained therein relate to all services provided to the issuer or its subsidiary entities by the issuer's external auditors. They do not relate to any services provided by the external auditors of a subsidiary entity if they are different than the external auditors of the issuer.</p> <p>We agree. We do not believe that the provisions of the Instrument regarding pre-approval policies and procedures constitute "detailed rules and interpretations".</p>
23.	<p>Subsection 2.3(5) (Audit Committee Responsibilities ? Review of Financial Statements, etc)</p>	<p>One commenter noted that the requirement for the audit committee to review an issuer's earnings press releases prior to public disclosure was unnecessary as such releases were derived from an issuer's primary financial documents which must also be reviewed by the audit committee. The commenter suggested that it was logically inconsistent to single out earnings press releases from the other statements an issuer might make about itself and its prospects, many of which would be unscripted. The commenter argued that this logical inconsistency was recognized in the recent and pending amendments to the <i>Securities Act</i> (Ontario). By requiring the audit committee to review earnings press releases, the commenter suggested that such releases would effectively become "board statements", and dangerously cross the line between management and the board.</p>	<p>We believe that earnings press releases, unlike many of the other statements that an issuer may make about itself or its prospects, are high profile documents which can often trigger media attention and affect an issuer's share price. Consequently, we believe such documents are sufficiently important to be reviewed by the audit committee prior to public release.</p>

No.	Section/Topic	Comment	Response
		Another commenter requested clarification as to whether the phrase “earnings press releases” included profit warnings and similar guidance. If so, the commenter recommended that a temporary exemption be provided where an earnings press release was used in the context of a “material change”, as the issuer has an obligation to make prompt disclosure of information to the marketplace.	We do not consider the phrase “earnings press releases” to include profit warnings or similar guidance. To clarify this point, subsection 2.3(5) has been revised by replacing the phrase “earnings press releases” with “annual and interim earnings press releases”.
24.	Subsection 2.3(6) (Audit Committee Responsibilities ? Procedures for review of Other Financial Disclosure)	One commenter suggested that subsection 2.3(6) be clarified as to whether the review of financial information must occur before or after its public disclosure.	In our view, to be meaningful, the review must occur prior to the public disclosure of such financial information.
25.	Subsection 2.3(7) (Audit Committee Responsibilities- Establishing Complaint Procedures, etc.)	<p>One commenter recommended that issuers also be required to establish procedures for the treatment of reports of alleged fraud and illegal acts.</p> <p>One commenter recommended that there be a six month transition period to allow meaningful procedures to be established.</p> <p>One commenter suggested that anonymity not be required to be maintained in subsection 2.3(7)(b) if, in the reasonable opinion of the audit committee, the maintenance of anonymity would significantly impair the audit committee’s ability to investigate and deal with concerns initially submitted by an employee. Another commenter suggested that anonymous submissions by employees should not be allowed, but that each submission should be required to be signed by the employee.</p>	<p>Subsection 2.3(7) presently encompasses fraud and possibly illegal acts to the extent they relate to accounting, internal accounting controls, or auditing matters. As such, we do not believe it necessary for subsection 2.3(7) to be revised.</p> <p>We disagree. We believe issuers will have sufficient time to establish such procedures given the proposed effective date of July 1, 2004. See Topic 41, below.</p> <p>We disagree. We believe that anonymity is essential for employees to communicate their concerns.</p>
26.	Section 2.4 (De Minimis Non-Audit Services)	Two commenters suggested that subsection 2.4(a) should refer to services that are “reasonably expected to constitute” a maximum percentage of the total amount of revenues, since one may not know the total revenues until year end.	We agree. Section 2.4 has been revised accordingly.

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that the <i>de minimis</i> exemption for pre-approval of non-audit services should be increased from 5% to 10% of total audit fees paid by both the issuer and its subsidiary entities to the issuer’s external auditors in subsection 2.4(a).</p> <p>This commenter also suggested that the issuer and the auditor should not have to not recognize the services as non-audit services for the <i>de minimis</i> exemption to be available and, accordingly, that subsection 2.4 (b) should be deleted.</p> <p>One commenter suggested that subsection 2.4(c) should require that non-audit services be brought to the attention of , and approved by, the audit committee of the issuer prior to the public release of the audited financial statements rather than prior to completion of the audit. Another commenter suggested that the appropriate deadline be the next scheduled meeting of the audit committee. Both commenters suggested that the word “promptly” be deleted from subsection 2.4(c).</p>	<p>Subsection 2.4 has been revised to clarify that the <i>de minimis</i> exemption relates to 5% of the fees paid by the issuer and the issuer’s subsidiary entities to the issuer’s external auditors. It does not relate to the fees paid for any services provided by the external auditors of a subsidiary entity if those auditors are different than the external auditors of the issuer.</p> <p>We do not agree that subsection 2.4(b) should be deleted. The purpose of section 2.4 is to provide relief only in the circumstances where there has been an oversight.</p> <p>We consider it to be important that the provision of non-audit services be reported promptly, and that they be approved by the audit committee prior to completion of the audit, so that the audit committee can assure itself that the non-audit services did not detract from auditor independence.</p>
27.	Section 2.5 (Delegation of Pre-Approval Function)	<p>One commenter suggested that by expressly allowing pre-approval of <i>de minimis</i> non-audit services to be delegated to one or more audit committee members, it could be inferred that no other audit committee functions may be delegated. The commenter suggested that boards and audit committees should be free to determine their own functions and procedures and that audit committees should be free to delegate any powers within their responsibility and mandate to one or more audit committee members as they see fit in the context of the issuer, the membership of the audit committee and other unique factors. In the commenter’s view, this would be particularly critical where timeliness is required such as in connection with the review of the issuer’s financial statements, MD&A and earnings press releases as per subsection 2.3(5). According to the commenter, any matter so delegated should be presented to the full audit committee at its next annual meeting.</p>	<p>See our response to Topic 28, below.</p>

No.	Section/Topic	Comment	Response
	Part 3 Composition of the Audit Committee		
28.	Section 3.1 (<i>Composition</i>)	<p>One commenter suggested that the Instrument be clarified such that an audit committee can set its own quorum requirements and procedures, including those related to its ability to act without all members being present.</p> <p>Two commenters suggested that the Instrument permit venture issuers or other small issuers to have an audit committee composed of less than three members. Another commenter suggested that an exemption from the minimum size requirement be provided in certain transitory circumstances, such as in the case of the death, disability or resignation of an audit committee member.</p> <p>One commenter was concerned that the composition requirements put too much emphasis on technical independence issues, and not enough emphasis on the broader business and industry knowledge that is critical for audit committee effectiveness.</p>	<p>We have revised the Companion Policy to provide clarification.</p> <p>We note that most Canadian corporate statutes require that an audit committee be composed of a minimum of three directors. Because any exemption from the minimum size requirement in section 3.1 would have little practical effect, we have not included such an exemption in the Instrument.</p> <p>While the Instrument focuses on the independence and financial skills and experience of audit committee members, we recognize the value of broader business and industry knowledge. In our view, however, it is the responsibility of the directors to ensure that audit committee members have this broader knowledge.</p>
29.	Section 3.2 (<i>Initial Public Offerings</i>)	<p>Four commenters were of the view that the exemptions were appropriate.</p> <p>One commenter suggested that section 3.2 should also clearly apply to a “secondary IPO”.</p>	<p>-</p> <p>We believe that the exemption in section 3.2, as written, clearly applies to all initial public offerings, including those that involve the distribution of securities by selling security holders. No change to the Instrument has therefore been made.</p>

No.	Section/Topic	Comment	Response
30.	Section 3.3 (Controlled Companies)	<p>Two commenters believed that the exemption in section 3.3 appropriately addressed the concerns of controlling shareholders. Many commenters, however, expressed concern about the inability of a controlling shareholder to fully participate in an issuer's audit committee. In particular:</p> <ul style="list-style-type: none"> • One commenter recommended that shareholdings alone should not taint independence. • Three commenters noted that where equity and voting rights were controlled by the same person or entity, such person or entity should not (on that basis alone) be precluded from being an independent member of the audit committee. • One commenter suggested 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 on the audit committee. • Two commenters suggested that a controlling shareholder should be permitted to sit on an audit committee. The first commenter recommended that a majority of the audit committee members be unrelated to the major shareholder. The second commenter recommended that the remaining members be independent. • Several commenters recommended that senior employees of controlling shareholders be permitted to sit on audit committees. • Two commenters noted that the very nature of a family business almost requires that a family member sit on the audit committee. • One commenter suggested extending the exemption in section 3.3 to any insider or associate as well as any affiliate. 	<p>We acknowledge the comments received and have revised the Instrument to provide exemptions for the following persons to sit on an issuer's audit committee:</p> <ul style="list-style-type: none"> • a controlling shareholder that is not a publicly traded company; and • a controlling shareholder who is a natural person.
31.	Section 3.4 (Events Outside Control of Member)	<p>One commenter recommended that the Instrument contain an exemption from the financial literacy requirements for a period following the introduction of new accounting standards, to provide members an opportunity to get up to speed on the new standards.</p>	<p>We do not believe that a person's financial literacy, as defined in the Instrument, will necessarily be affected by the introduction of new accounting standards. As a result, this comment has not been reflected in the Instrument.</p>
32.	Section 3.5 (Death, Disability or Resignation of Member)	<p>One commenter suggested that section 3.5 provide an exemption from the minimum size requirement of subsection 3.1(1).</p>	<p>We disagree. See the response to comments on Topic 28, above.</p>

No.	Section/Topic	Comment	Response
33.	Part 3 (Other)	<p>One commenter was of the view that the Instrument required audit committee members to have industry specific financial literacy. The commenter suggested that a two year exemption from the industry specific provisions of the financial literacy requirement be provided for all new audit committee members.</p> <p>Another commenter recommended that a temporary exemption from the financial literacy requirements be provided for all existing audit committee members.</p>	The Instrument has been revised whereby a director who is not financially literate may be appointed to the audit committee provided the member becomes literate within a reasonable period of time following his or her appointment.
Part 5 Reporting Obligations			
34.	Section 5.1 (Required Disclosure - Location of Required Disclosure)	<p>Three commenters supported including the disclosure required by Form 52-110F1 in an issuer's AIF. Another commenter suggested that an issuer should have the option of including this information in either its management information circular or its AIF. Another commenter suggested that an issuer should have the flexibility to include this information in its annual report or proxy circular provided that the location of the disclosure is referenced in its AIF. Another commenter suggested that the disclosure be included in an issuer's financial statements.</p> <p>One commenter suggested that an issuer should be permitted to post the text of its audit committee's charter on its web site, provided that the AIF contain an appropriate cross-reference.</p>	We are of the view that the disclosure required by Form 52-110F1 should always be included in the AIF so that an investor knows where to look for it. However, we will not object to an issuer incorporating information into the AIF by reference to another document, other than a previous AIF. See paragraph 6.1 of the Companion Policy.
35.	Section 5.1 (Required Disclosure - Content of Required Disclosure- Text of Audit Committee Charter)	Three commenters suggested that only a summary of the audit committee's charter should be required to be disclosed rather than the full charter. One of the commenters was also of the view that the disclosure about the audit committee's charter should be restricted to the audit committee's responsibilities and the extent to which those responsibilities were fulfilled. In the view of the commenters, summary information about the charter would be more succinct and useful to readers.	We disagree. We believe that access to the complete text of an audit committee's charter is valuable to investors and other market participants. We note that the Instrument does not prohibit an issuer from providing succinct, summary information about the charter if the issuer believes such a summary would be useful to readers, provided that the full text of the charter is also disclosed in accordance with the Instrument.

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that annually disclosing the text of the audit committee’s charter was too onerous, and recommended that such disclosure only be required every three years. The commenter noted that such a change would harmonize the Instrument with the equivalent U.S. requirements.</p> <p>One commenter suggested that the publication of the audit committee’s charter may lead to enhanced personal civil liability for audit committee members, which would discourage participation on audit committees. The commenter therefore queried whether publication should be mandatory.</p>	<p>See our response to Topic 34, above.</p> <p>We disagree.</p>
36.	<p>Section 5.1 (Required Disclosure – Content of Required Disclosure- Identification of an Audit Committee Financial Expert)</p>	<p>One commenter supported the approach to the audit committee financial expert because it would provide flexibility for issuers, being only a disclosure requirement; the definition is relative to the complexity of an issuer and its affairs and therefore sensitive to the circumstances of small issuers; and it is consistent with the approach that has been taken in the United States.</p> <p>Four commenters were of the view that the disclosure requirement was inadequate and suggested that every issuer be required to have an audit committee financial expert on its audit committee. Another commenter made the same recommendation for all issuers other than venture issuers.</p> <p>14 commenters expressed concern that the requirement for an issuer to disclose the identity of any audit committee financial expert serving on its audit committee may result in increased legal liability for that person. The commenters generally noted that the CSA’s clarifying views expressed in paragraph 4.2 of the Companion Policy are not binding on the courts (or even on the Commission), and many expressed the view that legislative reform will be necessary to achieve the protective goal that the Companion Policy aspires to achieve.</p> <p>The solutions put forward by these commenters include:</p> <ul style="list-style-type: none"> • eliminating the disclosure requirement entirely; • replacing the disclosure requirement with a positive statement as to why a person with financial experience or expertise is desirable; 	<p>We continue to believe that the attributes of an audit committee financial expert will be a valuable resource for an audit committee. However, we acknowledge the concerns that have been expressed about this provision including: actual or perceived incremental liability for an individual who is identified as an audit committee financial expert; the limited number of individuals who are qualified to be audit committee financial experts; and the negative impact that actual or perceived incremental liability would have on the willingness of individuals to serve as an audit committee financial expert.</p> <p>Accordingly, the Instrument will no longer require an issuer to disclose the identity of an audit committee financial expert. However, in order to encourage issuers to have available to their audit committees the attributes that were previously included in the definition of an audit committee financial expert, we have amended paragraph 3 of Form 52-110F1 to require disclosure of each member’s education and experience that is relevant to the performance of his or her responsibilities as an audit committee member and, in particular, any education and experience that would provide the member with certain specified attributes. These attributes are nearly identical to the attributes of an audit committee financial expert as defined by the SEC, after giving effect to the SEC instruction regarding the term</p>

No.	Section/Topic	Comment	Response
		<ul style="list-style-type: none"> • disclosing that the audit committee has an audit committee financial expert but not specifically identifying the individual; • permitting (but not requiring) an explanation if there is no audit committee financial expert; • requiring detailed “non-boilerplate” disclosure about the qualifications of each member of the audit committee; and • including in the Instrument itself (as opposed to in the Companion Policy) a statement that the mere designation and public identification of an audit committee financial expert does not affect that person’s duties, obligations or liabilities as an audit committee member or board member. <p>A number of commenters expressed concern about the number of audit committee financial experts that would be available to serve on boards. One of these commenters also noted that it would be of questionable value to have the same audit committee financial expert serving on the boards of numerous issuers.</p> <p>One commenter believed that the operation of the audit committee, being a committee of financially literate members, should be sufficient to meet the goals of good governance.</p> <p>One commenter was of the view that the identification of an audit committee financial expert by the issuer may be misleading to investors. The commenter believed that such identification would likely be relied on by investors, and may cause investors to not examine the qualifications of each audit committee member to assess whether the committee as a whole is adequately imbued with the requisite level of expertise and experience.</p> <p>One commenter suggested that the Companion Policy should make it clear that the conclusions with respect to minimizing financial expert liability exposure apply as well to financial experts on the audit committees of inter-listed issuers that avail themselves of the Part 7 exemption.</p> <p>One commenter suggested that the requirements related to the audit committee financial expert be deferred until July 31, 2005, the date by which foreign private issuers in the U.S. are required to comply with the</p>	<p>“generally accepted accounting principles” in connection with the application of that definition for foreign private issuers. The guidance regarding how an individual may acquire the requisite attributes has been deleted from Form 52-110F1.</p>

No.	Section/Topic	Comment	Response
		U.S. audit committee rules.	
37.	Section 5.1 (Required Disclosure - Content of Required Disclosure- Disclosure Where Reliance on Certain Exemptions)	<p>One commenter expressed broad support for disclosure obligations for those relying upon the exemptions in sections 3.2, 3.3, 3.4 and 3.5 of the Instrument.</p> <p>Two commenters suggested that there should be no requirement to disclose whether an issuer is relying on the controlled company exemption in section 3.3. The commenters noted that Rule 10A-3 does not contain a similar disclosure requirement.</p>	<p>-</p> <p>We agree. Form 52-110F1 has been revised accordingly.</p>
38.	Section 5.1 (Required Disclosure- Content of Required Disclosure- Fees and Other Disclosure)	<p>One commenter suggested that paragraphs (a) “Audit Fees” and (b) “Audit-Related Fees” of paragraph 7 of Form 52-110F1 and paragraph 5 of Form 52-110F2 should be collapsed into one disclosure item requiring disclosure of “any services other than non-audit services.”</p> <p>One commenter suggested that disclosure of “Tax Fees” is not relevant and should be removed. The commenter was of the view that this disclosure could impair the capability of an issuer to plan its affairs to minimize its tax expenses.</p> <p>One commenter suggested that only one year of the external auditor’s service fees should be required to be disclosed by paragraph 7 of Form 52-110F1 and paragraph 5 of Form 52-110F2.</p> <p>One of the commenters noted that the requirement for venture issuers to disclose their practices, fees and reliance on the exemption would provide an incentive for them to upgrade their audit committees as soon as possible.</p>	<p>We disagree. We note that those disclosure categories parallel those adopted in the U.S.</p> <p>We disagree. In our view, all fees that are paid to the external auditors should be reported to shareholders. Further, we do not believe that disclosing fees, as opposed to strategies, would impair the capability of an issuer to plan its affairs to minimize its tax expenses.</p> <p>We disagree. Disclosure of the external auditor’s fees should be required for each of the issuer’s two most recent fiscal years to allow an investor to consider them in the context of the issuer’s comparative financial statements and other financial disclosure.</p> <p>-</p>

No.	Section/Topic	Comment	Response
		<p>One commenter suggested that the audit committee should be required to report on its activities.</p> <p>One commenter was concerned that the disclosure required by paragraph 5 of Form 52-110F1 would be prejudicial to the external auditors and that such disclosure could repress the dialogue amongst board members.</p>	<p>We disagree. The Instrument requires an audit committee to perform a number of activities. We believe that, in the circumstances, there is no need for a disclosure requirement.</p> <p>We disagree. We believe that such disclosure is necessary to ensure that the board seriously considers the recommendations of the audit committee.</p>
	Part 6 Venture Issuers		
39.	Section 6.1 (Venture Issuers)	<p>Five commenters supported the exemption for small issuers. One commenter, however, was not supportive of the exemption because, in their view, it would create a two-tier market in Canada in connection with the core principles of financial reporting, auditing and governance.</p> <p>Two commenters supported the exemption based on the definition of “venture issuer” in section 1.1. Two commenters suggested that small TSX-listed issuers should also be entitled to this exemption. One commenter noted that some fairly large issuers will meet the definition of a venture issuer and that they should not be afforded the exemption. One commenter suggested that a more appropriate exemption might be based on the size or market capitalization of the issuer.</p> <p>One of the commenters supported the exemption but suggested that at least one audit committee member should be required to meet the independence and financial literacy requirements outlined in subsection 3.1.</p>	<p>We thank the commenters for their support. We believe that the exemption constitutes a practical trade-off between the furtherance of the goals of the Instrument and the practical realities of small issuers.</p> <p>We have left the exemption unchanged. We do not agree with the suggested changes. Basing the exemption on exchange listing status provides for a readily discernible bright line test. Furthermore, the TSX is Canada’s senior stock exchange and, as such, investors (particularly, international investors) expect to be accorded regulatory protection that is equivalent to that provided by the major U.S. stock exchanges. Confidence in Canada’s capital markets is predicated on such equivalent regulatory protection. An investor can readily determine whether or not an issuer is complying with all of the provisions of the Instrument by the stock exchange on which its securities are listed.</p> <p>We thank the commenter for their support. However, we do not agree that the exemption should be more limited. We believe that the exemption constitutes a practical trade-off between the furtherance of the goals of the Instrument and the practical realities of small issuers.</p>

No.	Section/Topic	Comment	Response
	Part 7 U.S. Listed Issuers		
40.	Section 7.1 (U.S. Listed Issuers)	<p>One commenter suggested that the exemption in Part 7 be expanded to include unlisted issuers that are in compliance with U.S. federal securities laws implementing the audit committee requirements of the Sarbanes-Oxley Act</p> <p>One commenter suggested that section 7.1 should refer to “quoted” as well as “listed” securities.</p> <p>One commenter questioned why 10-Ks (which, by definition, are AIFs) that are filed by foreign issuers must include the disclosure required by paragraph 5 of Form 52-110F1.</p>	<p>The exemption in Part 7 was intended to provide relief for issuers who are subject to U.S. audit committee requirements which are comparable with those in the Instrument. The U.S. audit committee requirements include requirements imposed by U.S. exchanges and Nasdaq. Expanding the exemption to include unlisted issuers would not ensure that the issuers in question are subject to U.S. audit committee requirements comparable to those in the Instrument. Consequently, we have not adopted this suggestion.</p> <p>This change has been made.</p> <p>We have revised the exemption in Part 7 to clarify that the requirement to include the paragraph 5 disclosure will only apply to Canadian issuers that use the exemption.</p>
	Part 9 Effective Date		
41.	Section 9.1 (Effective Date)	<p>Several commenters expressed concern about the transitional provisions included in this Part. Only one commenter was fully supportive of its provisions.</p> <p>Five commenters were of the view that the provisions were too restrictive. Two of these commenters suggested that the implementation dates for issuers that are interlisted on U.S. exchanges should not be earlier than July 31, 2005, the date by which foreign private issuers in the U.S. are required to comply with the U.S. audit committee rules. One of the commenters also supported a later date given that the rules are not yet in force and could impose significant new requirements on issuers. A third commenter was of the view that a six month transitional period would be appropriate. Two other commenters suggested that there should be at least a 12 month transitional period.</p>	<p>Subsection 9.2(2) has been revised so that the Instrument applies to an issuer commencing on the first annual meeting of the issuer after July 1, 2004. We believe this effective date will provide issuers with sufficient time to arrange their affairs in compliance with the Instrument.</p>

No.	Section/Topic	Comment	Response
		<p>One commenter requested clarification as to whether issuers with fiscal year ends prior to the implementation date included in Part 9 will be required to take the Instrument into account in preparing their annual proxy materials during the 2004 proxy season.</p> <p>Three commenters suggested revisions to the mechanics of the transitional provisions. One commenter suggested that the effective date relate to year-ends of filings of annual financial statements but not annual meeting dates. Each commenter was concerned that the existing transition period could result in a lack of consistent disclosure.</p>	

APPENDIX C

Comparison to the materials published June 27, 2003

**MULTILATERAL INSTRUMENT 52-110
AUDIT COMMITTEES**

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**MULTILATERAL INSTRUMENT 52-110
AUDIT COMMITTEES**

**PART 1
DEFINITIONS AND APPLICATION**

1.1 Definitions – In this Instrument,

“accounting principles” ~~mean a body of accounting principles that are generally accepted in a jurisdiction of Canada or a foreign jurisdiction and include, without limitation, Canadian GAAP, U.S. GAAP and International Financial Reporting Standards;~~¹ “AIF” has the meaning ~~set out~~ascribed to it in National Instrument ~~51-102 *Continuous Disclosure Obligations*~~52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*;

“AIF” has the meaning ascribed to it in National Instrument 51-102;

~~“asset-backed security” means a security that is primarily serviced by the cash flows of a discrete pool of mortgages, receivables or other financial assets, fixed or revolving, that by their terms convert into cash within a finite period and any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders;~~²

“asset-backed security” has the meaning ascribed to it in National Instrument 51-102;

“audit committee” means a committee (or an equivalent body) established by and among the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer, and, if no such committee exists, the entire board of directors of the issuer;

~~“audit committee financial expert” means, with respect to an issuer, a person who has: (a) an understanding of financial statements and the accounting principles used by the issuer to prepare its financial statements;~~services” means the professional services rendered by the issuer’s external auditor for the audit and review of the issuer’s financial statements or services that are normally provided by the external auditor in connection with statutory and regulatory filings or engagements;

~~(b) — the ability to assess the general application of such accounting principles in connection with the accounting for estimates, accruals and reserves;~~

¹ — This definition has been adopted from proposed National Instrument *52-107 Acceptable Accounting Principles, Auditing Standards and Reporting Currencies*.

² — This definition has been adopted from National Instrument *44-101 Short Form Prospectus Distributions* and proposed National Instrument *51-102 Continuous Disclosure Obligations*.

~~(c) — experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the issuer’s financial statements, or experience actively supervising one or more persons engaged in such activities;~~

~~(d) — an understanding of internal controls and procedures for financial reporting; and~~

~~(e) — an understanding of audit committee functions;~~

“credit support issuer” has the meaning ascribed to it in section 13.4 of National Instrument 51-102;

“designated foreign issuer” has the meaning ~~set out~~ascribed to it in National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*;

“exchangeable security issuer” has the meaning ascribed to it in section 13.3 of National Instrument 51-102;

“executive officer” of an entity means a person~~an individual~~ who is:

(a) a chair of the entity, ~~if that person performs the functions of the office on a full-time basis;~~

(b) a vice-chair of the entity, ~~if that person performs the functions of the office on a full-time basis;~~

(c) the president of the entity;

(d) a vice-president of the entity in charge of a principal business unit, division or function including sales, finance or production;

(e) an officer of the entity or any of its subsidiary entities who performs a policy-making function in respect of the entity; or

(f) any other ~~person~~individual who performs a policy-making function in respect of the entity;³

~~“financially literate” means the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that~~

³ — This definition is derived from proposed National Instrument 51-102 and Ontario Securities Commission Rule 14-501 *Definitions*.

~~are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements;~~
"foreign private issuer" means an issuer that is a foreign private issuer within the meaning of Rule 405 under the 1934 Act;

"immediate family member" means an individual's spouse, parent, child, sibling, mother or father-in-law, son or daughter-in-law, brother or sister-in-law, and anyone (other than an employee of either the individual or the individual's immediate family member) who shares the individual's home;

"investment fund" has the meaning ~~set out~~ascribed to it in National Instrument 51-102-~~Continuous Disclosure Obligations~~;

"marketplace" has the meaning ~~set out~~ascribed to it in National Instrument 21-101 *Marketplace Operation*;

"MD&A" has the meaning ~~set out in~~ascribed to it in National Instrument 51-102;

"National Instrument 51-102" means National Instrument 51-102 *Continuous Disclosure Obligations*;

"non-audit services" means ~~any services provided to an issuer by its external auditor, other than those provided to the issuer in connection with an audit or review of the financial statements of the issuer;~~services other than audit services;

"SEC foreign issuer" has the meaning ascribed to it in National Instrument 71-102 Continuous Disclosure and Other Exemptions Relating to Foreign Issuers;

"U.S. marketplace" means an exchange registered as a 'national securities exchange' under section 6 of the 1934 Act, or the Nasdaq Stock Market;

"venture issuer" means an issuer that does not have any of its securities listed or quoted on any of the Toronto Stock Exchange, ~~the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market, the Nasdaq SmallCap Market, the Pacific Exchange~~ a U.S. marketplace, or a marketplace outside of Canada ~~or~~and the United States-⁴ of America.

1.2 Application – This Instrument applies to all reporting issuers other than:

- (a) investment funds;
- (b) issuers of asset-backed securities;
- (c) designated foreign issuers; ~~and~~

⁴ ~~_____ This definition is derived from proposed National Instrument 51-102.~~

- (d) ~~reporting~~ SEC foreign issuers;
- (e) issuers that are subsidiary entities, if
 - (i) the subsidiary entity does not have equity securities ~~displayed for~~ (other than non-convertible, non-participating preferred securities) trading on a marketplace, and
 - (ii) the parent of the subsidiary entity is
 - (A) subject to the requirements of this Instrument, or
 - (B) an issuer that (1) has securities listed or quoted on a U.S. marketplace, and (2) is in compliance with the requirements of that U.S. marketplace applicable to issuers, other than foreign private issuers, regarding the role and composition of audit committees;
- (f) exchangeable security issuers, if the exchangeable security issuer qualifies for the relief contemplated by, and is in compliance with the requirements and conditions set out in, section 13.3 of National Instrument 51-102; and
- (g) credit support issuers, if the credit support issuer qualifies for the relief contemplated by, and is in compliance with the requirements and conditions set out in, section 13.4 of National Instrument 51-102.

1.3 Meaning of Affiliated Entity, Subsidiary Entity and Control –

- (1) For the purposes of this Instrument, a person or company is considered to be an affiliated entity of another person or company if
 - (a) one of them controls or is controlled by the other or if both persons or companies are controlled by the same person or company, or
 - (b) the person or company is
 - (i) both a director and an employee of an affiliated entity, or
 - (ii) an executive officer, general partner or managing member of an affiliated entity.
- (2) For the purposes of this Instrument, a person or company is considered to be a subsidiary entity of another person or company if

- (a) it is controlled by,
 - (i) that other, or
 - (ii) that other and one or more persons or companies each of which is controlled by that other, or
 - (iii) two or more persons or companies, each of which is controlled by that other; or
 - (b) it is a subsidiary entity of a person or company that is the other's subsidiary entity.
- (3) For the purpose of this Instrument, "control" means the direct or indirect power to direct or cause the direction of the management and policies of a person or company, whether through ownership of voting securities or otherwise.
- (4) Despite subsection (1), a person will not be considered to be an affiliated entity of an issuer for the purposes of this Instrument 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.

1.4 Meaning of Independence –

- (1) A member of an audit committee is independent if the member has no direct or indirect material relationship with the issuer.
- (2) For the purposes of subsection (1), a material relationship means a relationship which could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgement.
- (3) Despite subsection (2), the following ~~persons~~ individuals are considered to have a material relationship with an issuer:
- (a) ~~a person~~ an individual who is, or ~~whose immediate family member is, or at any time during the prescribed period~~ has been, an ~~officer or~~ employee or executive officer of the issuer, ~~its parent, or of any of its subsidiary entities or affiliated entities~~ unless the prescribed period has elapsed since the end of the service or employment;

- (b) ~~a person who~~ an individual whose immediate family member is, or has been, an executive officer of the issuer, unless the prescribed period has elapsed since the end of the service or employment;
- (c) an individual who is, or has been, an affiliated entity of, a partner of, or employed by, a current or former internal or external auditor of the issuer, unless the prescribed period has elapsed since the person's relationship with the internal or external auditor, or the auditing relationship, has ended;
- (e) ~~a person~~ an individual whose immediate family member is, or has been, an affiliated entity of, a partner of, or employed in a professional capacity by, a current or former internal or external auditor of the issuer, unless the prescribed period has elapsed since the person's relationship with the internal or external auditor, or the auditing relationship, has ended;
- (d) ~~a person~~ an individual who is, or has been, or whose immediate family member is or has been, ~~employed as~~ an executive officer of an entity if any of the issuer's current ~~executives~~ executive officers serve on the entity's compensation committee, unless the prescribed period has elapsed since the end of the service or employment;
- (e) ~~a person who accepts, or has accepted at any time during the prescribed period~~ f) an individual who
- (i) has a relationship with the issuer pursuant to which the individual may accept, directly or indirectly, any consulting, advisory or other compensatory fee from the issuer or any subsidiary entity of the issuer, other than as remuneration for acting in his or her capacity as a member of the audit board of directors or any board committee, or as a part-time chair or vice-chair of the board ~~of directors, or any other~~ or any board committee; ~~and~~ or
- (ii) receives, or whose immediate family member receives, more than \$75,000 per year in direct compensation from the issuer, other than as remuneration for acting in his or her capacity as a member of the board of directors or any board committee, or as a part-time chair or vice-chair of the board or any board committee, unless the prescribed period has elapsed since he or she ceased to receive more than \$75,000 per year in such compensation.
- (f) ~~a person~~ an individual who is an affiliated entity of the issuer or any of its subsidiary entities.

- (4) For the purposes of subsection (3), the prescribed period is the shorter of
- (a) the period commencing on ~~[January 1, March 30, 2004]~~ and ending immediately prior to the determination required by subsection (3); and
 - (b) the three year period ending immediately prior to the determination required by subsection (3).
- (5) For the purposes of clauses (3)(~~b~~)c) and (3)(~~e~~)d), a partner does not include a ~~limited~~fixed income partner whose interest in the internal or external auditor is limited to the receipt of fixed amounts of compensation (including deferred compensation) for prior service with an internal or external auditor if the compensation is not contingent in any way on continued service.
- (6) For the purposes of clause (3)(~~e~~)f), compensatory fees and direct compensation do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the issuer if the compensation is not contingent in any way on continued service.
- (7) For the purposes of ~~clause~~subsection 3(~~e~~)f)(~~i~~), the indirect acceptance by a person of any consulting, advisory or other compensatory fee includes acceptance of a fee by
- ~~(a) — an immediate family member, or~~
 - (a) a person's spouse, minor child or stepchild, or a child or stepchild who shares the person's home; or
 - (b) an entity in which such person is a partner, member, an officer such as a managing director occupying a comparable position or executive officer ~~of~~, or ~~a person who~~ occupies a similar position ~~with, an entity that~~(except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary entity of the issuer, ~~other than limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity.~~
- (8) Despite subsection (3), a person will not be considered to have a material relationship with the issuer solely because he or she

(a) _____ has previously acted as an interim chief executive officer of the issuer, or

(b) _____ acts, or has previously acted, as a chair or vice-chair of the board of directors or any board committee, other than on a full-time basis.

1.5 Meaning of Financial Literacy – For the purposes of this Instrument, an individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer’s financial statements.

PART 2

AUDIT COMMITTEE RESPONSIBILITIES

- 2.1 Audit Committee** – Every issuer must have an audit committee that complies with the requirements of the Instrument.
- 2.2 Relationship with External Auditor** – ~~An~~**Auditors** – Every issuer must require its external auditor ~~must~~to report directly to the audit committee.
- 2.3 Audit Committee Responsibilities** –
- (1) An audit committee must have a written charter that sets out its mandate and responsibilities.
 - (2) An audit committee must recommend to the board of directors:
 - (a) the external ~~auditors~~auditor to be nominated for the purpose of preparing or issuing an ~~audit~~auditor’s report or performing other audit, review or attest services for the issuer; and
 - (b) the compensation of the external ~~auditors-~~auditor.
 - (3) An audit committee must be directly responsible for overseeing the work of the external ~~auditors~~auditor engaged for the purpose of preparing or issuing an ~~audit~~auditor’s report or performing other audit, review or attest services for the issuer, including the resolution of disagreements between management and the external ~~auditors~~auditor regarding financial reporting.
 - (4) An audit committee must pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by ~~its external auditors or the external auditors of~~ the issuer’s ~~subsidiary entities~~external auditor.

- (5) An audit committee must review the issuer's financial statements, MD&A and annual and interim earnings press releases before the issuer publicly discloses this information.
- (6) An audit committee must be satisfied that adequate procedures are in place for the review of the issuer's public disclosure of financial information extracted or derived from the issuer's financial statements, other than the public disclosure referred to in subsection (5), and must periodically assess the adequacy of those procedures.
- (7) An audit committee must establish procedures for:
 - (a) the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and
 - (b) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.
- (8) An audit committee must review and approve the issuer's hiring policies regarding partners, employees and former partners and employees of the present and former external ~~auditors~~auditor of the issuer.

2.4 De Minimis Non-Audit Services – An audit committee ~~may satisfy~~satisfies the pre-approval requirement in subsection 2.3(4) if:

- (a) the aggregate amount of all the non-audit services that were not pre-approved ~~constitutes~~is reasonably expected to constitute no more than five per cent of the total amount of ~~revenue s fees~~ paid by the issuer ~~to its and its subsidiary entities to the issuer's~~ external ~~auditors~~auditor during the fiscal year in which the services are provided;
- (b) the ~~services were not recognized by the issuer~~issuer or the subsidiary entity of the issuer, as the case may be, did not recognize the services as non-audit services at the time of the engagement ~~to be non-audit services~~; and
- (c) the services are promptly brought to the attention of the audit committee of the issuer and approved, prior to the completion of the audit, by the audit committee or by one or more of its ~~members of the audit committee~~ to whom authority to grant such approvals has been delegated by the audit committee.

2.5 Delegation of Pre-Approval Function –

- (1) An audit committee may delegate to one or more independent members the authority to pre-approve non-audit services in satisfaction of the requirement in subsection 2.3(4).
- (2) The pre-approval of non-audit services by any member to whom authority has been delegated pursuant to subsection (1) must be presented to the ~~full~~ audit committee at its first scheduled meeting following such pre-approval.

2.6 Pre-Approval Policies and Procedures – An audit committee satisfies the pre-approval requirement in subsection 2.3(4) if it adopts specific policies and procedures for the engagement of the non-audit services, if:

- (a) the pre-approval policies and procedures are detailed as to the particular service;
- (b) the audit committee is informed of each non-audit service; and
- (c) the procedures do not include delegation of the audit committee’s responsibilities to management.

PART 3

COMPOSITION OF THE AUDIT COMMITTEE

3.1 Composition –

- (1) An audit committee must be composed of a minimum of three members.
- (2) Every audit committee member must be a director of the issuer.
- (3) Subject to sections 3.2, 3.3, ~~3.4~~3.4, 3.5 and ~~3.5~~3.6, every audit committee member must be independent.
- (4) Subject to ~~section 3.5~~sections 3.5 and 3.8, every audit committee member must be financially literate.

3.2 Initial Public Offerings -

- (1) **~~If~~Subject to section 3.9, if an issuer has filed a prospectus to qualify the distribution of securities that constitutes its initial public offering, subsection 3.1(3) does not apply for a period of up to 90 days**

commencing on the date of the receipt for the prospectus, provided that one member of the audit committee is independent.

- (2) ~~H~~Subject to section 3.9, if an issuer has filed a prospectus to qualify the distribution of securities that constitutes its initial public offering, subsection 3.1(3) does not apply for a period of up to one year commencing on the date of the receipt for the prospectus, provided that a majority of the audit committee members are independent.

3.3 **Controlled Companies** ~~--~~

- (1) An audit committee member that sits on the board of directors of an affiliated entity is exempt from the requirement in subsection 3.1(3) if ~~that~~the member, except for being a director (or member of ~~the audit committee or any other~~a board committee) of the issuer and the affiliated entity, is otherwise independent of the issuer and the affiliated entity.
- (2) Subject to section 3.7, an audit committee member is exempt from the requirement in subsection 3.1(3) if:
- (a) the member would be independent of the issuer but for the relationship described in paragraph 1.4(3)(g);
- (b) the member is not an executive officer, general partner or managing member of a person or company that
- (i) is an affiliated entity of the issuer, and
- (ii) has its securities trading on a marketplace;
- (c) the member is not an immediate family member of an executive officer, general partner or managing member referred to in paragraph (b), above;
- (d) the member does not act as the chair of the audit committee; and
- (e) the board determines in its reasonable judgement that
- (i) the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an audit committee member, and
- (ii) the appointment of the member is required by the best interests of the issuer and its shareholders.

3.4 Events Outside Control of Member – ~~If~~ Subject to section 3.9, if an audit committee member ceases to be independent for reasons outside ~~that~~the member's reasonable control, ~~that~~the member is exempt from the requirement in subsection 3.1(3) for a period ending on the later of:

- (a) the next annual meeting of the issuer, and
- (b) the date that is six months from the occurrence of the event which caused the member to not be independent.

3.5 Death, Disability or Resignation of Member – ~~Where~~Subject to section 3.9, if the death, disability or resignation of an audit committee member has resulted in a vacancy on the audit committee that the board of directors is required to fill, an audit committee member appointed to fill such vacancy is exempt from the requirements in subsections 3.1(3) and (4) for a period ending on the later of:

- (a) the next annual meeting of the issuer, and
- (b) the date that is six months from the day the vacancy was created.

3.6 Temporary Exemption for Limited and Exceptional Circumstances – Subject to section 3.7, an audit committee member is exempt from the requirement in subsection 3.1(3) if:

- (a) the member is not an individual described in paragraphs 1.4(3)(f)(i) or 1.4(3)(g);
- (b) the member is not an employee or officer of the issuer, or an immediate family member of an employee or officer of the issuer;
- (c) the board, under exceptional and limited circumstances, determines in its reasonable judgement that
 - (i) the member is able to exercise the impartial judgement necessary for the member to fulfill his or her responsibilities as an audit committee member, and
 - (ii) the appointment of the member is required by the best interests of the issuer and its shareholders;
- (d) the member does not act as chair of the audit committee; and
- (e) the member does not rely upon this exemption for a period of more than two years.

3.7 Majority Independent – The exemptions in subsection 3.3(2) and section 3.6 are not available to a member unless a majority of the audit committee members would be independent.

3.8 Acquisition of Financial Literacy – Subject to section 3.9, an audit committee member who is not financially literate may be appointed to the audit committee provided that the member becomes financially literate within a reasonable period of time following his or her appointment.

3.9 Restriction on Use of Certain Exemptions – The exemptions in sections 3.2, 3.4, 3.5 and 3.8 are not available to a member unless the issuer's board of directors has determined that the reliance on the exemption will not materially adversely affect the ability of the audit committee to act independently and to satisfy the other requirements of this Instrument.

PART 4

AUTHORITY OF THE AUDIT COMMITTEE

- 4.1 Authority** – An audit committee must have the authority
- (a) to engage independent counsel and other advisors as it determines necessary to carry out its duties,
 - (b) to set and pay the compensation for any advisors employed by the audit committee, and
 - (c) to communicate directly with the internal and external auditors.

PART 5

REPORTING OBLIGATIONS

- 5.1 Required Disclosure** – Every issuer must include in its AIF the disclosure required by Form 52-110F1.
- 5.2 Management Information Circular** – If management of an issuer solicits proxies from the security holders of the issuer for the purpose of electing directors to the issuer's board of directors, the issuer must include in its management information circular a cross-reference to the sections in the issuer's AIF that contain the information required by section 5.1.

PART 6

VENTURE ISSUERS

- 6.1 Venture Issuers** – Venture issuers are exempt from the requirements of Parts 3 (*Composition of the Audit Committee*) and 5 (*Reporting Obligations*).
- 6.2 Required Disclosure** –
- (1) Subject to subsection (2), ~~every venture issuer that relies on the exemption in section 6.1 must annually disclose~~ if management of a venture issuer solicits proxies from the security holders of the venture issuer for the purpose of electing directors to its board of directors, the venture issuer must include in its management information circular the disclosure required by Form 52-110F2.
 - (2) ~~If a~~ A venture issuer ~~does that is~~ not have required to send a management information circular, ~~the annual~~ to its security holders must provide the disclosure required by ~~subsection (1) must be provided in the venture issuer's~~ Form 52-110F2 in its AIF or annual MD&A.

PART 7

U.S. LISTED ISSUERS

- 7.1 U.S. Listed Issuers** –An issuer that has securities listed ~~on a national securities exchange registered pursuant to section 6 of the 1934 Act or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the 1934 Act~~ or quoted on a U.S. marketplace is exempt from the requirements of Parts 2 (*Audit Committee Responsibilities*), 3 (*Composition of the Audit Committee*), 4 (*Authority of the Audit Committee*), and 5 (*Reporting Obligations*), ~~provided that~~ if:
- (a) the issuer is in compliance with the requirements of that ~~exchange or quotation system~~ U.S. marketplace applicable to a issuers, other than foreign private issuers, regarding the role and composition of audit committees; and
 - (b) if the issuer is incorporated, continued or otherwise organized in a jurisdiction in Canada, the issuer includes in its AIF the disclosure, ~~(if any,~~) required by paragraph 5 of Form 52-110F1.

PART 8

EXEMPTIONS

8.1 Exemptions –

- (1) The securities regulatory authority or regulator may grant an exemption from this rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.
- (2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.

PART 9

EFFECTIVE DATE

9.1 Effective Date –

- (1) This Instrument comes into force on ~~January 1, 2004~~. March 30, 2004.
- (2) Despite subsection (1), this Instrument applies to an issuer commencing on the earlier of:
 - (a) the first annual meeting of the issuer after ~~January~~ July 1, ~~2004~~, 2004, and
 - ~~(b) June 30, 2004~~.
 - (b) July 1, 2005.

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Format changed	0
Total changes	290

FORM 52-110F1

AUDIT COMMITTEE INFORMATION REQUIRED IN AN AIF**1. The ~~audit committee's charter~~ Audit Committee's Charter**

Disclose the text of the audit committee's charter.

2. Composition of ~~audit committee~~ the Audit Committee

Disclose the name of each audit committee member. ~~If a~~ and state whether or not the member is ~~not~~ (i) independent, ~~state that fact and explain why~~ and (ii) financially literate.

~~3. Audit Committee Financial Expert~~

~~(a) Disclose the identity of any audit committee financial expert(s) serving on the audit committee.~~

~~If the audit committee does not have an audit committee financial expert serving on the audit committee, state that fact and explain why.~~

~~(b) If an audit committee financial expert's qualifications were acquired other than as a result of:~~

~~(i) education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;~~

3. Relevant Education and Experience

~~(ii) experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions; or~~

Describe the education and experience of each audit committee member that is relevant to the performance of his or her responsibilities as an audit committee member and, in particular, disclose any education or experience that would provide the member with:

~~(iii) experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements;~~

(a) an understanding of the accounting principles used by the issuer to prepare its financial statements;

- (b) the ability to assess the general application of such accounting principles in connection with the accounting for estimates, accruals and reserves;
- (c) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the issuer's financial statements, or experience actively supervising one or more persons engaged in such activities; and
~~provide a brief listing of the audit committee financial expert's relevant experience.~~
- (d) an understanding of internal controls and procedures for financial reporting.

4. Reliance on Certain Exemptions ~~from the Instrument~~

If, at any time since the commencement of the issuer's most recently completed financial year, the issuer has relied on ~~sections~~

- (a) the exemption in section 2.4 (De Minimis Non-audit Services),
- (b) the exemption in section 3.2 (Initial Public Offerings), ~~3.3 (Controlled Companies),~~
- (c) the exemption in section 3.4 (Events Outside Control of Member),
- (d) the exemption in section 3.5 (Death, Disability or Resignation of Audit Committee Member) or
- (e) an exemption from this Instrument, in whole or in part, granted under Part ~~7 (Exemptions), disclose that fact and provide an assessment of whether, and if so, how, such reliance could materially adversely affect the ability of the audit committee to act independently and to satisfy the other requirements of the Instrument.~~ 8 (Exemptions),

state that fact.

5. Reliance on the Exemption in Subsection 3.3(2) or Section 3.6

If, at any time since the commencement of the issuer's most recently completed financial year, the issuer has relied upon the exemption in subsection 3.3(2) (Controlled Companies) or section 3.6 (Temporary Exemption for Limited and Exceptional Circumstances), state that fact and disclose

- (a) the name of the member, and

(b) the rationale for appointing the member to the audit committee.

6. Reliance on Section 3.8

If, at any time since the commencement of the issuer's most recently completed financial year, the issuer has relied upon section 3.8 (*Acquisition of Financial Literacy*), state that fact and disclose

(a) the name of the member.

(b) that the member is not financially literate, and

(c) the date by which the member expects to become financially literate.

5.7. Audit Committee Oversight

If, at any time since the commencement of the issuer's most recently completed financial year, a recommendation of the audit committee to nominate or compensate an external auditor was not adopted by the board of directors, ~~disclose~~state that fact and explain why.

6.8. Pre-Approval Policies and Procedures

If the audit committee has adopted specific policies and procedures for the engagement of non-audit services, describe those policies and procedures.

7.9. External Auditor Service Fees (By Category)

(a) Disclose, under the caption "Audit Fees", the aggregate fees billed ~~for~~by the issuer's external auditor in each of the last two fiscal years for ~~professional services rendered by an external auditor for the audit and review of the issuer's financial statements or services that are normally provided by the external auditor in connection with statutory and regulatory filings or engagements~~audit services.

(b) Disclose, under the caption "Audit-Related Fees", the aggregate fees billed in each of the last two fiscal years for assurance and related services by ~~an~~the issuer's external auditor that are reasonably related to the performance of the audit or review of the issuer's financial statements and are not reported under clause (a) above. Include a description of the nature of the services comprising the fees disclosed under this category.

(c) Disclose, under the caption "Tax Fees", the aggregate fees billed in each of the last two fiscal years for professional services rendered by ~~an~~the issuer's external auditor for tax compliance, tax advice, and tax planning. Include a description of the nature of the services comprising the fees disclosed under this category.

- (d) Disclose, under the caption “All Other Fees”, the aggregate fees billed in each of the last two fiscal years for products and services provided by ~~an~~ the issuer’s external auditor, other than the services reported under clauses (a), (b) and (c), above. Include a description of the nature of the services comprising the fees disclosed under this category.

INSTRUCTION

The fees required to be disclosed by this paragraph 9 relate only to services provided to the issuer or its subsidiary entities by the issuer’s external auditor.

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Document 1	file://L:/Projects/Corp_Fin/Sarbanes_Oxley/Audit Committee/Materials published for comment June 27/Form 52-110F1 Information in an AIF (v.2.0).doc
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Format changed	0
Total changes	70

FORM 52-110F2

DISCLOSURE BY VENTURE ISSUERS

1. The Audit Committee's Charter

Disclose the text of the audit committee's charter.

2. Composition of the Audit Committee

Disclose the name of each audit committee member and state whether or not the member is (i) independent and (ii) financially literate.

3. Audit Committee Oversight

If, at any time since the commencement of the ~~venture~~ issuer's most recently completed financial year, a recommendation of the audit committee to nominate or compensate an external auditor was not adopted by the board of directors, state that fact and explain why.

4. Reliance on Certain Exemptions

If, at any time since the commencement of the issuer's most recently completed financial year, the issuer has relied on

- (a) the exemption in section 2.4 (*De Minimis Non-audit Services*), or
- (b) an exemption from this Instrument, in whole or in part, granted under Part 8 (*Exemptions*),

state that fact.

5. Pre-Approval Policies and Procedures

If the audit committee has adopted specific policies and procedures for the engagement of non-audit services, describe those policies and procedures.

6. External Auditor Service Fees (By Category)

- (a) Disclose, under the caption "Audit Fees", the aggregate fees billed by the issuer's external auditor in each of the last two fiscal years for audit fees.
- (b) Disclose, under the caption "Audit-Related Fees", the aggregate fees billed in each of the last two fiscal years for assurance and related services by the issuer's external auditor that are reasonably related to the performance of the audit or review of the ~~venture~~ issuer's financial

statements and are not reported under clause (a) above. Include a description of the nature of the services comprising the fees disclosed under this category.

- (c) Disclose, under the caption “Tax Fees”, the aggregate fees billed in each of the last two fiscal years for professional services rendered by the issuer’s external auditor for tax compliance, tax advice, and tax planning. Include a description of the nature of the services comprising the fees disclosed under this category.
- (d) Disclose, under the caption “All Other Fees”, the aggregate fees billed in each of the last two fiscal years for products and services provided by the issuer’s external auditor, other than the services reported under clauses (a), (b) and (c), above. Include a description of the nature of the services comprising the fees disclosed under this category.

INSTRUCTION

The fees required to be disclosed by this paragraph 5 relate only to services provided to the issuer or its subsidiary entities by the issuer’s external auditor.

7. Exemption

Disclose that the ~~venture~~-issuer is relying upon the exemption in section 6.1 of the Instrument.

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Format changed	0
Total changes	7

**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 and Nunavut, 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.

E.g., for an income trust to comply with the Instrument, the trustees should appoint a minimum of three trustees who are independent of the trust and the underlying business to act as an audit committee and fulfil the responsibilities of the audit committee imposed by the Instrument. Similarly, in the case of a limited partnership, the directors of the general partner who are independent of the limited partnership (including the general partner) should form an audit committee which fulfils these responsibilities.

If the structure of an issuer will not permit it to comply with the Instrument, the issuer should seek exemptive relief.

- 1.3 Management Companies.** The definition of “executive officer” includes any individual who performs a policy-making function in respect of the entity in question. We consider this aspect of the definition to include an individual who, although not employed by the entity in question, nevertheless performs a policy-

making function in respect of that entity, whether through another person or company or otherwise.

1.4 Audit Committee Procedures. The Instrument establishes requirements for the responsibilities, composition and authority of audit committees. Nothing in the Instrument is intended to restrict the ability of the board of directors or the audit committee to establish the committee’s quorum or procedures, or to restrict the committee’s ability to invite additional parties to attend audit committee meetings.

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,~~ auditor.
- increasing the credibility and objectivity of financial reports, and
- strengthening the role of the directors by facilitating in -depth discussions among directors, management and the external ~~auditors~~auditor.

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:

- (ia) overseeing the work of the external auditors engaged for the purpose of preparing or issuing an ~~audit~~auditor’s report or related work; and
- (ib) 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.~~

2.2 **Relationship between External Auditors and Shareholders.** Subsection 2.3(3) of the Instrument provides that an audit committee must be directly responsible for overseeing the work of the external auditors engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the issuer, including the resolution of disagreements between management and the external auditors regarding financial reporting. Notwithstanding this responsibility, the external auditors are retained by, and are ultimately accountable to, the shareholders. As a result, subsection 2.3(3) does not detract from the external auditors' right and responsibility to also provide their views directly to the shareholders if they disagree with an approach being taken by the audit committee.

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*.

10. 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 **Derivation of Definition.** The definition of independence and associated provisions included in the Instrument have been derived from both the rules promulgated by the SEC in response to the Sarbanes-Oxley Act and the corporate governance rules issued by the NYSE. The SEC rules set out requirements for a member of the audit committee to be considered independent. The NYSE corporate governance rules define independence and outline conditions for a director to be considered independent and also require that audit committee members be independent directors as defined by both the SEC provisions and the NYSE rules. We have mirrored this composite approach to the definition of independence for audit committee members in the Instrument.

3.3 **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.~~ **Literacy, Financial Education and Experience**

4.1 **Financial Literacy.** For the purposes of the Instrument, an individual is financially literate if he or she has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements.

In our view, it is not necessary for a member to have a comprehensive knowledge of GAAP and GAAS to be considered financially literate.

- (1) ~~Subsection (a) of the definition of~~ **4.2 Financial Education and Experience.** (1) Item 3 of Form 52-110F1 requires an issuer to disclose any education or experience of an audit committee member that would provide the member with, among other things, 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 In our view, for a member to have such an understanding, the member needs a detailed understanding of only those accounting principles ~~of Canadian GAAP which~~ that 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~~ accounting principles relating to the 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~~ Item 3 of Form 52-110F1 also requires an issuer to disclose any experience that the member has, among other things, actively supervising persons engaged in preparing, auditing, analyzing or evaluating certain types of financial statements. 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) Section 2.6~~ 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~~ allows an audit committee to satisfy, in certain circumstances, the pre-approval requirements in subsection 2.3(4) by adopting specific policies and procedures for the engagement of non-audit services ~~where~~. The following guidance should be noted in the development and application of such policies and procedures:

- Monetary limits should not be the only basis for the pre-approval policies and procedures ~~are detailed~~. The establishment of monetary limits will not, alone, constitute policies that are detailed as to the particular services to be provided and will not, alone, ensure that the audit committee will be informed about each service.
- ~~the audit committee is informed of each non-audit service, and~~ The use of broad, categorical approvals (e.g. tax compliance services) will not meet the requirement that the policies must be detailed as to the particular services to be provided.
- ~~the procedures do not include delegation of the audit committee's responsibilities to management.~~ The appropriate level of detail for the pre-approval policies will differ depending upon the facts and circumstances of the issuer. The pre-approval policies must be designed to ensure that the audit committee knows precisely what services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on the auditor's independence. Furthermore, because the Instrument requires that the policies cannot result in a delegation of the audit committee's responsibility to management, the pre-approval policies must be sufficiently detailed as to particular services so that a member of management will not be called upon to determine whether a proposed service fits within the policy.

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.~~

11. Part Six

Disclosure Obligations

6.1 Incorporation by Reference. National Instrument 51-102 permits disclosure required to be included in an issuer's AIF or information circular to be incorporated by reference, provided that the referenced document has already been filed with the applicable securities regulatory authorities.¹ Any disclosure required by the Instrument to be included in an issuer's AIF or management information circular may also incorporated by reference, provided that the procedures set out in National Instrument 51-102 are followed.

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¹ See Part 1, paragraph (f) of Form 51-102F2 (*Annual Information Form*) and Part 1, paragraph (c) of Form 51-102F5 (*Information Circular*).

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