

CORPORATE BULLETIN

September 2004

CORPORATE GOVERNANCE AND PRIVATE COMPANIES

As a response to a number of high profile corporate scandals in the United States, the Sarbanes-Oxley Act of 2002 (SOX) mandated a series of corporate governance rules for US public companies. The Canadian Securities Administrators (CSA) have followed suit through the introduction of a series of national instruments and policies (CSA Rules) that affect the governance of Canadian public companies. The CSA Rules are summarized below.

While private companies are largely outside the scope of both SOX and the CSA Rules, some progressive private companies are using these developments as a catalyst to examine their own accounting, internal control and governance processes.

OPPORTUNITY FOR PRIVATE COMPANIES

The current environment in relation to corporate governance provides an ideal opportunity for private companies to assess the extent to which adopting some or all of the rules applicable to public companies may make good business sense to them. Increased accountability and transparency of internal controls and accounting processes can be a significant benefit to many organizations.

Other private companies may be pressured to comply, to varying degrees, with SOX or the CSA Rules by third parties including shareholders, private equity investors, lenders, directors' and officers' liability insurers and government regulators. Concern over directors' liability and fiduciary obligations also may motivate board members to push for improved corporate governance.

Private companies planning to go public should have a thorough understanding of the requirements applicable to public companies and plan for the cost of compliance with such requirements so that they are in a position to comply with such requirements without delay. Indeed, a track record of compliance prior to going public may be a marketing benefit on any initial public offering. Private companies that consider themselves acquisition targets also may find it in their interests to comply with certain aspects of the new corporate governance regime in order to make themselves more attractive to potential public company acquirors.

PRIVATE COMPANY GOVERNANCE

Voluntary steps that can be taken by private companies to improve governance include electing independent board members, adopting a formal code of business conduct and ethics, establishing an internal audit function, requiring certification of financial information and limiting services provided by their accounting firm/auditors.

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CSA RULES

The CSA Rules are, in substance, very similar to the rules under SOX. The CSA Rules deal with:

- (1) *oversight of external auditors*, including pre-approval of audit and non-audit services, prohibited services, and audit partner and audit review partner rotation;
- (2) *chief executive officer and chief financial officer certification* with respect to the accuracy of public disclosure and filings (eg, annual and interim financial statements and related management discussion and analysis (MD&A)), disclosure controls and procedures and internal control over financial reporting;
- (3) *composition, authority and responsibilities of audit committees*, including the requirements that public companies have an audit committee composed of at least three directors, all of whom are independent and financially literate, and an audit committee charter giving the audit committee responsibility for, among other things:
 - appointing the external auditors and setting their compensation (subject to shareholder approval);
 - overseeing the work of the external auditors, including the resolution of disagreements between management and the external auditors;
 - pre-approving audit and non-audit services;
 - reviewing all public disclosure of financial information; and
 - establishing procedures for dealing with complaints with respect to accounting or auditing matters and for whistleblowing;
- (4) *continuous disclosure obligations*, including earlier filing of interim and annual financial statements and related MD&A and expanded interim and annual MD&A; and
- (5) *disclosure of corporate governance practices*, including disclosure of whether (and if not, why not) public companies have adopted the non-prescriptive corporate governance best practices recommended by the CSA, including:
 - having a majority of independent directors;
 - appointing a chair who is an independent director or, where this is not possible, a “lead” director who is an independent director;
 - adopting a charter setting out the responsibilities and operating procedures of the board of directors;
 - adopting a written code of business conduct and ethics; and
 - establishing nominating and compensation committees composed entirely of independent directors.

HOW CAN WE HELP?

McMillan Binch has assisted a number of its clients to assess and, where appropriate, revise their corporate governance processes. Our advice and assistance always is tailored to the client’s needs. We can conduct a comprehensive corporate governance “audit” and provide a report with recommendations and action plans. Or, we can conduct reviews of areas of specific concern to private companies.

After completion of the appropriate audit or review, we will work with the board, management, in-house counsel and other stakeholders to develop a customized corporate governance program.

MCMILLAN BINCH LLP

McMillan Binch is one of Canada’s leading business law firms, comprising over 160 lawyers, all based in Toronto.

For more information, please contact your McMillan Binch lawyer or one of the partners listed below:

Stephen Rigby	416.865.7793	stephen.rigby@mcmillanbinch.com
John Clifford	416.865.7134	john.clifford@mcmillanbinch.com