

Corporate Securities

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Corporate Governance: What Should Your Company Be Doing?

Over the past year, there have been significant changes and proposed changes to the framework within which governance practices for public companies are being assessed. These changes result significantly from proposals made by the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") with respect to their listing standards and statutory requirements arising from the *Sarbanes-Oxley Act of 2002* (the "Act") and rules implementing the Act made by the U.S. Securities and Exchange Commission ("SEC").

This recent flurry of corporate governance initiatives has significantly altered the corporate governance landscape. Proxy season is here and these changes may appear mystifying. What should your company be doing?

Notwithstanding the volumes of rules that have been published, the vast majority of the proposed reforms have not yet been formally implemented. Although precedent is sparse, it appears that public companies are exercising some restraint in formally responding to the proposed initiatives and in voluntarily adopting and publicly disclosing reforms that may require further amendment as rule-making progresses.

You should review your corporate governance policies on an ongoing basis and re-assess your practices as new rules are finalized. Canadian companies that are not subject to the SEC rules and NYSE proposals may nonetheless wish, or feel the need from a market perspective, to consider their governance practices in the context of these reforms and disclose, on a general basis, how their governance practices compare to the TSX and NYSE proposed guidelines.

Summary of Corporate Governance Reforms

In the spring of 2002, the TSX proposed amendments to its corporate governance guidelines in response to the recommendations in the final report of the Joint Committee on Corporate Governance. In addition, in the fall of 2002, by way of a letter to the Chair of the Ontario Securities Commission, the TSX suggested that further changes might be made to its guidelines and other listing standards. These guidelines are not yet in effect.

The NYSE amendments generally will not be applicable to "foreign private issuers". Foreign private issuers listed on the NYSE will, however, be required to disclose any significant differences in their corporate governance practices as compared to U.S. companies under the NYSE listing requirements. On August 15, 2002, the NYSE amendments were submitted to the SEC for review and approval, including a public comment period. The proposals are pending.

The *Sarbanes-Oxley Act* prescribes a variety of governance and audit-related requirements that, with limited exceptions, apply (or upon the SEC promulgating the necessary rules will apply) to all issuers that have registered securities under §12 of the *Securities Exchange Act of 1934* or that are required to file periodic reports with the SEC pursuant to §15(d) of the *Exchange Act*. Under the *Sarbanes-Oxley Act*, violations of certain of these requirements can result in criminal sanctions.

The following checklist provides an overview of the main reforms currently in force or soon to be effective and applicable to companies that are required to file reports with the SEC. Although the TSX proposals are not yet finalized, the italicized text below summarizes the main reforms proposed by the TSX.

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Audit Committees

- Among other responsibilities, the audit committee must be directly responsible for the appointment, compensation and oversight of the independent auditor, which must report directly to the audit committee. The audit committee must pre-approve all audit services and all non-audit services that the independent auditor is permitted to provide, and disclose these services to investors in periodic reports.
- All members of the audit committee must be independent. A director of a company will not be considered “independent” if the director accepts, directly or indirectly, any consulting, advisory or other compensatory fee from the company or is an “affiliated person” of the company or its subsidiaries.
- *The TSX is proposing that audit committees be composed of “unrelated directors”, all of whom should be “financially literate” and one of whom should have accounting or related financial expertise.*
- *The TSX is proposing a new definition of “unrelated director” which would exclude directors that are members of management or have any interest or any business, family or other relationships that could reasonably be perceived to materially interfere with a director’s ability to act with a view to the best interests of the company (other than interests and relationships arising solely from holdings in the company). Additionally, individuals who currently are, or in the last three years have been, an officer, employee of or a material service provider to the company or any of its subsidiaries or affiliates or who are officers, employees or controlling shareholders of an entity that has a material business relationship with the company, would not be “unrelated directors”.*
- Companies must disclose whether (and if not, why not) the audit committee includes at least one member that is a “financial expert”. Generally, a person will be deemed a “financial expert” if, among other things, the person has an understanding of Generally Accepted Accounting

Compliance Timeframe

The “pre-approval” requirement will apply to all audit and non-audit services entered into after **May 6, 2003**.

The rules relating to appointment of the independent auditor are still pending.

These rules are still pending.

The requirement for disclosing the audit committee “financial expert” applies to companies with fiscal years ending on or after **July 15, 2003**.

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Principles (“GAAP”) and financial statements; the ability to apply GAAP in connection with accounting for estimates, accrual and reserves; experience in the preparation, auditing or evaluation of financial statements; an understanding of internal controls and procedures for financial reporting; and an understanding of audit committee functions.

- *The TSX is proposing that the audit committee have a formal charter setting out its role and responsibilities. The charter should be published either once every three years in the company’s annual report or information circular or following material amendments to the charter, on the company’s website.*

Compliance Timeframe

External Auditor

- The independent auditor of a company is prohibited from providing certain non-audit related services to the company. These prohibited services include:
 - bookkeeping or other services related to the accounting records or financial statements of the company,
 - financial system design and implementation,
 - appraisal or valuation services and fairness opinions or contribution-in-kind reports,
 - actuarial services,
 - internal audit outsourcing services,
 - management functions,
 - human resources services,
 - broker-dealer, investment advisor or investment banking services,
 - legal services, or
 - expert services unrelated to the audit.

This requirement will apply as of **May 6, 2004**, provided that during the period from **May 6, 2003** to **May 5, 2004**, such services are being performed pursuant to a contact in existence on **May 6, 2003**.

The first five categories of services may, however, be provided if they would not reasonably be expected to be subject to audit.

All other non-audit services, including tax services that do not fall into an otherwise prohibited category, must be pre-approved by the audit committee (*see Audit Committees*).

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- A five year “cooling off” period is required for lead or concurring partners in the audit engagement for the company after five consecutive financial years in that position. A two year “cooling off” period is required for other partners in the audit engagement for the company after seven consecutive financial years in that position.

Compliance Timeframe

This requirement will apply for fiscal years beginning after **May 6, 2003**.

For audit partners in non-U.S. firms, the period of service does not include time served on the audit engagement team prior to fiscal years beginning after **May 6, 2003**.

Disclosure Committee

- The SEC recommends that companies create a disclosure committee that is responsible for considering the materiality of information and determining disclosure obligations.
- This disclosure committee would report to senior management, including the officers who are responsible for establishing and maintaining the company’s disclosure controls and procedures.

Currently in effect.

CEO and CFO Certification

- Every periodic report filed with the SEC that contains financial statements must be accompanied by a certificate of the CEO and CFO that certifies that the information contained fairly presents, in all material respects, the financial condition and results of operations of the company, and complies with the *Exchange Act*.
- Every annual and quarterly report filed with the SEC must be accompanied by a certificate of the CEO and CFO that certifies the truthfulness and accuracy of the contents of the reports and the effectiveness and composition of internal and disclosure controls.
- *The TSX is proposing that the CEO and CFO certify, on an annual basis, the company’s compliance with its listing agreement.*

Currently in effect.

Currently in effect.

Foreign private issuers are only required to certify annual reports.

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Compliance Timeframe

Off-Balance Sheet Transactions

- Annual and quarterly financial reports filed with the SEC must disclose material “off-balance sheet” transactions, obligations and other relationships that may have a material impact on the company’s financial conditions or results.
- Annual and quarterly financial reports filed with the SEC must disclose, in tabular form, any long-term obligations.

This requirement applies to companies with fiscal years ending on or after **June 15, 2003**.

This requirement applies to companies with fiscal years ending on or after **December 15, 2003**.

Foreign private issuers do not need to include this disclosure with quarterly reports filed on Form 6-K.

Non-GAAP Financial Measures

- A company will not be able to include non-GAAP financial measures in SEC reports or press releases unless they are reconciled with the financial results of the company under GAAP and are otherwise not misleading.

This requirement will apply to all releases issued, and SEC filings for periods ending, after **March 28, 2003**.

Generally, this rule does not apply to foreign private issuers, unless the financial measure is derived from or based on a measure calculated in accordance with U.S. GAAP.

Code of Ethics

- A company must disclose in its periodic reports whether it has adopted a Code of Ethics for the CEO and senior financial officers (and if not, why not).
- The Code of Ethics must be filed with the company’s annual materials and posted on the company’s website. Changes to or waivers of the Code of Ethics would need to be disclosed on a periodic basis.
- *The TSX is proposing that companies be required to adopt a formal code of business ethics and disclose that code and any waivers of it.*

This requirement applies to companies with fiscal years ending on or after **July 15, 2003**.

Trading During “Blackout Periods”

- Directors and officers cannot trade during pension “blackout periods” if those directors or officers acquired the securities in connection with their service or employment in those capacities.

Currently in effect.

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- A “blackout period” refers to a period of more than three business days during which trading in the security by 50% or more of the beneficiaries or participants in the company’s retirement plans is suspended.
- Foreign private issuers are not subject to this requirement unless plan participants represent more than 15% of all plan participants worldwide or more than 500,000 individuals.

Compliance Timeframe

Loans to Executive Officers

- A company cannot extend or arrange, directly or through a subsidiary, personal loans to directors or executive officers. **Currently in effect.**
- Existing loans are “grandfathered” but cannot be renewed or materially modified.

Please do not hesitate to contact any member of the Goodmans securities team to discuss your corporate governance.

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