

***CICA Conference on
Financial Reporting & Governance for
Small and Mid-Cap Companies***

**Opening Address by
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CICA Conference
March 3, 2008
Sheraton Suites Calgary Eau Claire
Calgary, Alberta

I propose to touch on a variety of subjects that are relevant for the Canadian capital markets generally, the regulatory regime here in Alberta, professionals advising in respect of public company financial reporting and reporting issuers in the small to medium capitalization range.

Canadian Capital Markets

On the Canadian capital markets front, a dominant issue has been the Passport vs. Single National Regulator debate. For those of you who do not live and breathe securities regulation or habitually read the articles at page 6 of the business sections, this debate has the federal government and the Ontario provincial government lined up on one side and the rest of the country's provincial and territorial governments on the other. The feds and the Ontario government would prefer to replace the current securities regulatory system with one Canadian securities regulator operating under, and administering, one set of securities laws. The other provincial and territorial governments favour the preservation of jurisdiction for securities regulation with the individual provinces and territories, the harmonization of provincial and territorial laws so that they are substantially the same across the country and the implementation of what has been labelled the

“Passport” system. Under the Passport system a market participant would need deal only with its one principal regulator (basically, the regulator in its home jurisdiction) to obtain a prospectus receipt, registration or exemption order. All other jurisdictions would be deemed, as a matter of law, to have also granted that same receipt, registration or exemption order.

In case there is any doubt, the Alberta Securities Commission is a strong proponent of the Passport system. In addition, when compared to any yet-to-be defined single national regulator model, I would judge our current CSA model to be superior to that of a single national regulator, having regard to the realities of Canadian geography, political structure and capital markets.

Historically, the Canadian securities regulatory system has been criticized for two legitimate reasons: (1) a single participant in the Canadian capital markets had to deal with up to 13 different regulators; and (2) a single participant had to conform to up to 13 different sets of laws. From the standpoint of issuers, those criticisms have largely been addressed already through firstly, the introduction of the Mutual Reliance Review System in 2000, which essentially provided that each of the securities regulators would rely on the judgment of only one regulator to issue a prospectus

receipt or grant an exemption, and secondly, the gradual evolution of substantially harmonized securities laws across the country.

In the fall of 2004 a further major leap was made to address the acknowledged deficiencies. The Ministers across the country responsible for securities regulation, excluding the Minister in Ontario, entered into a Memorandum of Understanding which called for the creation of a "Passport" system, intended to provide a guaranteed single window of access to capital markets for all participants and for the further evolution of highly harmonized, streamlined and simplified securities laws.

The harmonization effort is one in which all jurisdictions, including Ontario, have participated and, with few exceptions that I would argue are a benefit for regional market participants and not a detriment, securities laws have been substantially harmonized across Canada.

The Passport system would, but for the ongoing refusal of Ontario to participate, permit a single window of access to the entirety of the Canadian securities regulatory regime through one principal regulator. But for the resistance of Ontario, the longstanding

criticisms of the Canadian securities regulatory regime have been addressed: a participant would need to deal with only one regulator and only one set of laws.

It is acknowledged that a single national regulator would also provide for a single window of access and for a single set of laws. But the creation of a single national regulator would require the destruction of the current system and the designing, building, testing and evolution of a whole new system. That kind of disruption might be justified were the current system broken; but it is not broken. In my view, it could do with improvements, but it is not broken.

Our current system serves well the interests of the various regions of Canada, such as Alberta, by providing ready access to regulatory authorities and their executive decision makers, and by permitting sufficient flexibility in rule and policy making to accommodate, where necessary, variations in business practices and environments. I believe that both regional access and regionally focused policy development would be threatened by a single national regulator. In addition, I believe that securities enforcement is best undertaken by a local agency that understands the local market, local players and localized risks

much more clearly than would an umbrella agency setting priorities and establishing strategies from afar.

Ingredients Needed for Perfection

If we were to take our present system and advance it to a point much closer to perfection, we would add significantly to the levels of knowledge, expertise and experience on the parts of both the regulators and the regulated.

On the regulator side, we need even more people who know the businesses of the issuers, have experienced the challenges of capital raising and structuring transactions for those issuers, appreciate the territory in which the registrant community functions and understand both the purpose and application of the rules administered.

On the side of those regulated, we need professional advisers who respect the integrity of the system, have a thorough understanding of the rules and can exercise the judgement to guide their clients in a responsible and measured manner.

I believe that just as those who participate in the public markets must be prepared to accept a specially designed regulatory

framework, professional advisers must be prepared to apply specialized skill for their fees. Those who dabble infrequently in the area offer inconsistent value and detract from the efforts of others to add speed, efficiency and reliability to the process. They bring the potential to do damage in specific circumstances and to the reputation of the system as a whole.

ASC as a Resource

In exchange for a commitment on the part of issuers and their advisers to get better at understanding and fulfilling their regulatory obligations, the ASC dedicates substantial time to coaxing, helping and teaching. We share the view that the paramount goal is that there be an efficient capital market in Alberta to which organizations, big and small, have access . We are prepared to assist issuers and their advisers to get bigger in their businesses and better at responding to regulatory requirements. Clearly, a disproportionate amount of time is spent with small issuers in Alberta, but it is our experience that many small issuers do grow into large organizations and some eventually take a place among the largest of Canada's publicly capitalized enterprises.

While we at the ASC are prepared to devote time and resources to helping participants through the process and try to be tolerant of the challenges to efficiency faced by small staffs and inexperienced executives, we are not prepared to overlook lack of effort, recklessness, thoughtlessness or plain dishonesty. Small players are encouraged to join our market and we are prepared to help them along while they grow and learn, but we do expect a good faith reciprocal effort.

In addition to the assistance provided in respect of specific files, we engage in a variety of educational programs such as:

- an annual Day with the ASC - which is designed to provide a high-level overview of various securities regulatory developments over the prior year;
- more particular areas of focus are highlighted during the numerous speaking engagements our staff is encouraged to accept and in specific breakfast seminars the ASC conducts for new or controversial proposals;

- we conduct targeted stakeholder consultations for certain potentially controversial topics such as internal controls and registration of exempt market dealers;
- the office of the Chief Accountant publishes annually a Report on Continuous Disclosure and our observations of its quality; and
- we participate throughout the year in many professionally structured seminars, conferences and presentations dealing with securities regulation.

The ASC will as a matter of course answer inquiries concerning the proper interpretation and application of our rules and will endeavour to educate an issuer or adviser through a complicated or novel situation. There is a difference, however, between offering guidance to a newcomer or solutions to a new problem and serving as an alternative to a competent professional adviser or as the first line of inquiry for questions that the issuer or its adviser is too lazy to pursue on their own. It is appreciated if the inquirer has reviewed the applicable rules, can focus on a particular issue and has a good enough appreciation for the problem that an answer or suggestion will be understood. The

ASC is here to help but not to do the jobs of others or to relieve them of their responsibilities.

Expectations of the Smaller Issuer

The common complaint of the smaller issuers is that the regulatory requirements are so complicated and voluminous that they become an overwhelming burden that either the small issuers cannot manage at all or they cannot manage without sacrificing time and resources that should be spent instead in the building of their businesses.

Regulators have tried to respond by explaining that simple businesses require simple descriptions and good disclosure can come from a knowledgeable executive officer who takes the time to tell a straightforward story. Too often the stories we read are not straightforward at all, contain totally unhelpful boilerplate and fail to convey basic information about the nature, prospects and risks of the business.

Professional advisers can assist greatly in elevating the integrity of small issuer disclosure, by proposing internal systems that will support the confidence of the executive officer that he or she

really does know what is going on and by arguing for clear explanations in disclosure documents that convey a fair picture for the investor.

It is a valid argument that first hand knowledge by one or more executive officers of internal functions and operations in a small issuer is as good as or superior to elaborate internal reporting and control systems necessary in a large and diverse organization. But if that is to be accepted, the executive officers of the small issuer must indeed take the responsibility for knowing first hand what is going on and be prepared to take sufficient time to describe what is going on to shareholders and investors.

MI 52-109

The evolution of MI 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* provides a text book case for an analysis of the Canadian securities regulatory regime. An historical review of the rule highlights the public pressure on regulators to react to dramatic losses in the capital markets, the influence that regulation in the United States has on Canadian securities regulation, the reliance of investors on auditors to not only ensure the fair presentation of financial information relevant

to an issuer but also to police the integrity of the internal operations of the issuer, the efforts of regulators to balance cost against benefit in their imposition of new regulatory requirements, the reaction of participants in practice to principles-based regulation, and the challenges in creating rules that are both effective and practical for both very large and very small issuers.

The collapse of Enron came on in the fall of 2001. This dramatic failure, apparently brought about by the fraudulent behaviour of senior executives was followed by similar debacles at Tyco, Global Crossing and WorldCom in 2002 and at HealthSouth in 2003. In 2002 the *Sarbanes-Oxley Act* was passed in the United States and the Public Companies Accounting Oversight Board (PCAOB) was created.

In Canada, the original instrument 52-109 was developed from late 2002 through 2003, coming into force March 30, 2004. At the same time, audit committee and auditor oversight rules were enacted. Instrument 52-109 called for the certification by officers of an issuer's design and evaluation of disclosure controls and procedures and the design, but not the evaluation, of internal controls over financial reporting.

On February 4, 2005 proposed instrument 52-111 was published for comment. Proposed instrument 52-111 contemplated the evaluation of the effectiveness of an issuer's internal controls over financial reporting by both management and the auditor of the issuer and the delivery of an opinion by the auditor. The instrument contemplated a four year phase-in based on the capitalization of the issuer.

The proposed instrument drew considerable negative comment and, during the same time period, some pullback by the SEC from the demands of SOX 404 was observed. On March 20, 2006 the CSA published Staff Notice 52-313 advising that proposed instrument 52-111 would not be implemented, but existing instrument 52-109 would be expanded to require the CEO and CFO evaluation and certification of the effectiveness of an issuer's internal controls over financial reporting. In addition, there would be a requirement to include in the issuer's MD&A a description of the process followed for the evaluation and the conclusions reached as to effectiveness. The expanded requirements of 52-109 were to become effective December 31, 2007.

On February 9, 2007 the CSA published CSA Staff Notice 52-317 advising that the proposed publication date for the expanded 52-109 was the end of March 2007 and that the effective date would be June 30, 2008. The proposed revisions to 52-109 were published for comment on March 30, 2007.

Revised 52-109, as published for comment, would have required management's evaluation of ICFR, as well as MD&A disclosure of the conclusions reached as to its effectiveness. It also included the concept of a "reportable deficiency" for determining effectiveness. No control framework was mandated by the revised instrument. A description of the issuer's process was to be described in the MD&A and, to the extent reportable deficiencies were identified, a plan for remediation set forth.

In recognition of the challenges faced by venture issuers in complying with the proposed requirements, a design accommodation was proposed for venture issuers. If the venture issuer could not reasonably remediate a reportable deficiency in the design of its ICFR, it need only disclose such a circumstance in its MD&A.

During the following comment period the commentary from venture issuers was strongly negative. Venture issuers did not know what they were to do or say and felt that the required acknowledgement of reportable deficiencies reflected unfairly on them.

On November 23, 2007 the CSA published CSA Staff Notice 52-319 advising that proposed revised 52-109 would not be effective June 30, 2008, but new proposals would be published for comment instead. The Staff Notice advised further that the amended proposals would not require the CEO and CFO of a venture issuer to certify as to the design or evaluation of either of the issuer's disclosure controls and procedures or the issuer's internal controls over financial reporting. The ASC and other jurisdictions have issued a Blanket Order allowing use of a specified new form of certificate reflecting on or after December 31, 2007.

Quite a journey, and we are not there yet. But while the process has been long and the requirements uncertain, one might appreciate the pressure on regulators in Canada not to be seen as weaker in our regulation than the U.S. and the recognition by regulators of the excessive expense caused by the auditor

attestation requirement imposed in the U.S., of the challenges faced by the many small issuers in Canada, of the difficulties on the part of small issuers in responding to principles-based regulatory requirements, and of the extreme gap between the cost and benefit for venture issuers of the requirements imposed in the U.S. and previously proposed in Canada.

Two-Tier Regulation

ASC staff has for well over a year been considering the practicalities and implications of introducing a clearly defined two-tiered regulatory system drafted for companies listed on the venture exchange.

In the development of national rules and policies, regulators struggle to find the compromise position that is suitable for both the very biggest and the very smallest of public issuers. It is thought that we might save much time and frustrating negotiating if it were to be recognized that one size cannot fit all and that a discrete set of requirements should be developed for small issuers.

While the argument is made that principles-based regulation in itself will leave room for proportionately less detail and formality on the part of smaller public issuers, it has been our experience that smaller issuers are both unaware of the principles to be applied and at sea as to how to go about responding to regulatory requirements in a proportionate way.

The right answer for smaller issuers might be a prescriptive set of rules that details the requirements for inexperienced participants but gives proper recognition to the truly relevant matters of disclosure for investors in, and shareholders of, smaller companies. We would contemplate a clear set of rules, but fewer of them.

One concern expressed is that a shorter rule book will suggest lax standards, shoddy presentation and unreliable disclosure. We will not have done much for the ability of small companies to raise capital if we project an environment in which investors should not have confidence. The intent would be to relax regulatory demands only where they are not relevant to small enterprises, are not useful to investors in small companies or require time and resources out of all proportion to the benefit demonstrated in compliance.

If there are to be different rules, it is believed that there should be no doubt on the part of the investor as to which rules are applicable to which issuers, and no research should be required in order to make that determination. The obvious place for the drawing of the line is between venture and non-venture companies. The exchange upon which an issuer is listed is readily apparent to investors. That different sets of rules are applied to issuers on the different exchanges would not come as a surprise. The choice of which set of rules the issuer wished to work with would be left to the issuer. If the small issuer believed there to be a reputational disadvantage associated with the venture exchange, that issuer could move up to the bigger exchange. If the larger issuer believed that the costs of compliance with the rules applicable to non-venture companies were not worth the reputational up-tick, that issuer could select the venture exchange for its listing.

There are already differences in the requirements for venture and non-venture issuers. However, we would observe that these have evolved in a haphazard way and that many more differences might be appropriate if a fresh analysis were made of all of the outstanding rules. It is not necessarily the case that each of the differences would present a lesser standard or even a shorter list

of requirements for the venture companies. There might well be instances where processes or disclosure that would not be relevant to a larger and longer established entity would be of benefit for shareholders and investors in smaller and newly created enterprises.

It is important to understand, and if we are to have any success in selling the idea it would be essential for us to make clear, that we would not be removing from the regulatory regime for venture issuers any of the requirements for processes or disclosure that are truly relevant to them or their investors. The goal would be to identify the matters that are material to investment decisions and give proper recognition to the assumptions made and the risk profile presented by investors in venture companies. Having then written the applicable rules, it would be essential that those rules would be rigorously enforced. Neither compliance expectations nor enforcement activities would be relaxed in any way.

I do not know whether we will have any success in gaining support for the two-tier approach. There remains an overhanging concern that any relaxation of demands will bring to mind the negative reputation of the Vancouver Stock Exchange and, at the moment, there is a somewhat inflexible acceptance by some that

principles-based regulation is the answer to all identifiable problems with the current regulatory regime. As I stated earlier, I am not comfortable that principles-based regulation works very well for participants who do not have enough experience to have learned the principles and do not have the time or resources to figure out how to apply them.

Compliance and Continuous Disclosure

One of the principal responsibilities of the ASC is to ensure that market participants in Alberta are complying with the rules. One of the most important areas of securities rules relates to continuous disclosure. To a greater and greater degree the focus of disclosure is moving away from the single point in time disclosure set forth in an issuer's securities offering document to the ever evolving aggregation of periodic and real time disclosure made for the benefit of traders of securities both issued by an issuer and purchased or sold in the secondary market. The ASC has a formalized program for reviewing, evaluating, commenting on, correcting and improving continuous disclosure.

The key objectives of the CD review program are to monitor the adequacy of filings and to assess their quality. However, we also

take the opportunity to raise awareness with reporting issuers and their advisers as to problem areas, with a view to improving the completeness, quality and timeliness of their disclosure.

The Chief Accountant's Office, Corporate Finance Team and Oil and Gas Branch, where appropriate, all participate in the ASC CD Review Program. The Corporate Finance Group conducts both full and issue-oriented reviews on selected Alberta prime issuers. The Chief Accountant's Office acts as an accounting resource and reviews all CD reviews carried out by Corporate Finance. The Oil and Gas Branch conducts their own reviews of oil and gas technical disclosure and acts as a resource to the Corporate Finance Group during the full CD review process of an oil and gas issuer.

Annually, the Chief Accountant's Office and Oil and Gas Branch report on the results of the reviews carried out in the prior calendar year. The 2007 CD Review Program report was published on February 20, 2008 and can be found on our website.

Currently, the following types of reviews are undertaken during the CD review process:

Firstly, by the ***Corporate Finance & Chief Accountant's Office***:

1. **Full, Detailed CD Review**

- This consists of a detailed review of all CD related information filed on SEDAR since the beginning of the most recently completed fiscal year, including annual and interim financial statements, MD&A, Annual Information Forms, Business Acquisition Reports, Material Change Reports, press releases and information circulars.
- This review focuses heavily on assessing compliance with GAAP disclosure requirements.
- It places equal emphasis on identifying and resolving material deficiencies and raising awareness with the issuer of the CD requirements.
- It is also used to review “new” issuers.

2. **Full, Risk Based Review**

- This review focuses on the most recently filed annual and interim financial statements and MD&A. Staff also review

Business Acquisition Reports, Material Change Reports and press releases filed since the beginning of the most recently completed fiscal period and conduct a high level overview of the AIF and information circular.

- It focuses mainly on red flags and high-risk areas.
- It focuses on identifying and resolving material deficiencies, with a lesser emphasis on raising awareness with the issuer of the CD requirements.
- It is also used to review issuers that have not yet been reviewed.

3. **Issue-oriented Review**

- This review targets compliance with specific accounting or regulatory requirements that are considered higher risk or a priority based on complexity or recent introduction.
- These are generally conducted on a CSA-wide basis.

Secondly, by our ***Oil and Gas Branch***:

1. **Compliance Reviews**

- These assess compliance with Forms 51-101F1, F2 and F3.
- These include a review of press releases to ensure disclosure relating to reserves complies with NI 51-101 and the COGEH handbook.

2. **Technical Review**

- This involves a review of the reserves or resource evaluation report that underlies public disclosure to assess the quality of the disclosure and evaluations.

There are different approaches taken by ASC staff to deal with different deficiencies identified:

For Failure to File

- If certain key documents are not filed by the prescribed deadline, such as financial statements and/or MD&A, the

issuer will be noted in default on the list of reporting issuers and will be cease traded without further notice.

For Content Deficiencies

- When a deficiency is identified in an issuer's disclosure record an assessment is made to determine if it is material.
- If the deficiency is determined to be material, staff will generally note the issuer in default on the list of reporting issuers and require a restatement. In some instances, such as when financial information for multiple periods can no longer be relied upon, staff may consider issuing a cease trade order.
- In some instances where there is a significant breach in securities legislation that warrants further action and/or the issuer does not comply with staff's requests to correct the deficiency, staff may consider referring the file to enforcement.
- If the deficiency is determined to be immaterial, staff will generally bring the deficiency to the issuer's attention and

request that the deficiency be rectified on a prospective basis.

Enforcement

I would like to make a few brief remarks about enforcement. A great deal of commentary has been offered up by the media, by the public, by academics and by politicians who, for the most part, have chimed in on the national securities regulatory debate. Some of the adjectives used to describe the securities laws enforcement process in Canada are not very flattering. I think many of the evaluations made and expressed are based on: a lack of understanding of the differences between conduct that is not in compliance with securities rules and conduct that is criminally fraudulent; a lack of understanding of the differences between regulatory enforcement and criminal enforcement; a lack of understanding of the differences between U.S. and Canadian enforcement agencies, procedures and approaches; and a lack of understanding of the differences between the sentencing practices of U.S. courts and Canadian courts.

Regulations establish rules of conduct in the public markets arena. Criminal laws address deceit and theft. An offender of

regulations may be removed from participation in the public markets and fined through administrative proceedings. Deceit and theft warrant jail terms that can be ordered only in criminal or quasi-criminal proceedings.

In my view, there are some deficiencies in the overall securities laws enforcement regime. Principally, all proceedings take too long to be investigated and concluded and, secondly, there is far too little criminal law enforcement against criminal behaviour in the capital markets. Securities regulators must accept a significant degree of responsibility for the first problem - delay, but it should be understood that the lack of criminal law enforcement for criminal behaviour is not the responsibility of securities regulators.

In the view of most Canadian securities regulators a dramatic change is necessary in the approach to the investigation and prosecution of criminal fraud, but these subjects are not under the control of securities regulators and we do not have the authority to ourselves make that change.

MD&A

The last subject I would like to touch on is MD&A. As I am sure do all of you, I hear repeated complaints about the complexity and incomprehensibility of financial statements. They are intended to provide much of the most relevant information to investors, but in many cases the investor cannot understand them and, in some cases, is actually misled by them. Perhaps continuing efforts by professional bodies to change financial statement presentation, efforts to introduce more principles-based requirements and the advent of IFRS will assist in the creation of financial statements that are more understandable, but I would judge the odds to be long against short-term success.

In the meantime, the greatest potential for establishing a link between the formal presentation demanded by GAAP and actual reader comprehension is the MD&A. I would beseech the accounting profession to provide the greatest assistance and encouragement possible to educate issuers on the quality and utility of MD&A disclosure. I would urge both the standard setting organizations and individual accountants who advise public companies in their practices to: (1) help minimize the boilerplate provisions that provide no useful information to, but only tire, the

reader; (2) do not allow advisors to dictate the disclosure with warnings and qualifications to the point where any useful disclosure is buried; and (3) explain to the small or inexperienced issuers that their strongest contribution to the disclosure regime may be a clear and focused story in the MD&A that truly reflects their evaluation of, and expectations for, their enterprises.

Conclusion

I have covered a wide expanse of ground. I hope that there are a couple of messages or facts that you can take away with you. Thank you for allowing me the chance to convey some of the messages and facts that are relevant to the ASC.