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Canada Introduces Its Version of Sarbanes-Oxley

By David Clarke

OTTAWA - Amid controversy over the tactics used by the Royal Canadian Mounted Police in Canada's celebrated insider-trading case, one strategic success has been achieved.

On March 10, the Canadian Securities Administrators - the Montreal-based council of provincial and territorial securities regulators - announced proposals that would require all publicly traded companies to report on the effectiveness of their internal controls over financial reporting, though auditor attestation won't be required.

"We believe the proposed additional disclosure will increase management's focus on, and accountability for, the quality of internal controls over financial reporting," said Jean St-Gelais, chairman of the CSA and president and chief executive of Quebec's Autorité des marchés financiers, which is based in Montreal. "This will strengthen investor protection while appropriately balancing the costs and benefits associated with internal-control-reporting requirements for companies of all sizes."

The CSA said that after extensive consultation, and with the debate under way in the United States about the merits of the Sarbanes-Oxley Act of 2002, it "has decided not to proceed with an earlier proposal that would have required companies to obtain from their external auditors an audit opinion in respect of management's evaluation of the effectiveness of internal controls over financial reporting."

The CSA proposal was released on the same day that Nortel Networks Corp. of Brampton, Ontario, disclosed that it would be making another big accounting restatement, stating a fourth-quarter loss of $1.8 billion (U.S.) and marking down past announced years' revenue by an estimated $406 million.

In August 2004, the Mounties announced they were launching a criminal investigation into the financial accounting practices of Nortel, just days before the company was set to release some of its restated financial results. Nortel's accounting problems first came to light in 2003, when the company announced that it would restate financial results between 2000 and 2002.

In 2004, one analyst made a prophetic statement: "One thing that will probably happen with Nortel, and most of the other companies in the U.S. and Canada, is [that] the regulatory environment will be a lot more stringent, and a company will have to spend more money in terms of making sure their books are well accounted for," said Kevin Lo, equity analyst with Lightyear Capital Inc. in Calgary, Alberta.

"Nortel has been a mixed bag with respect to disclosure," said Bill Lawson, an associate professor and associate director of administration at the Eric Sprott School of Business at Carleton University in Ottawa. "However, the regulators and auditors are out of control on this issue today; Nortel is caught in a blender not entirely of their own design or responsibility."

Mr. Lawson approves of the CSA's move. "The move away from a regulator/auditor toward a market-driven solution to the issue of the effectiveness of internal controls over financial reporting is to be congratulated," he said.

“Standards which are understood by the market will provide the best enforcement. Firms will recognize what is in their own best interest from a disclosure point of view,” Mr. Lawson said. “Let ‘firm value maximization’ rule, not the regulator,” he added.

The new CSA requirements would apply to all reporting issuers - other than investment funds - listed on the Toronto Stock Exchange and the TSX Venture Exchange, in all Canadian jurisdictions.

Asked whether investment firms should have been included, a representative for Winnipeg, Manitoba-based Investors Group Inc. said, “We have no comment on the topic.”

Investors Group is a member of IGM Financial Inc., one of Canada’s premier financial services companies with more than $83 billion in assets under management.

Typical of the convoluted world of Canadian securities regulation, on the same day that Mr. St-Gelais announced the CSA proposals, he revealed that the Quebec authorities were filing charges against Vincent Lacroix, former president of the Montreal-based investment fund company Norbourg Financial Group Inc . “Mr. Lacroix misappropriated the funds of thousands of investors, and he continues to take steps to hamper procedures,” said Mr. St-Gelais, speaking in his capacity as head of AMF.

According to the regulator, it is being very careful in filing charges under the Quebec Securities Act in order to avoid hindering any criminal proceedings that may be launched by the Mounties’ Integrated Market Enforcement Teams, which are charged with combating securities crime.

There is a $112 million gap between the amount Norbourg had on its books and what investigators have been able to find.