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Canada needs flexible accounting regulations, expert says

Steven Lamb

(September 14, 2004) America's strict, check-box corporate governance rules are not entirely appropriate for Canada's capital markets, according to one of the country's top accountants.

Instead of simply photocopying the Sarbanes-Oxley Act, Canadian regulators should take a more flexible, principles-based approach to corporate governance, allowing our many micro-cap companies to avoid crushing audit costs, says Brian Hunt, head of the Institute of Chartered Accountants of Ontario.

In a speech to the Economic Club of Toronto on Tuesday morning, Hunt compared corporate governance to generally accepted accounting principles (GAAP), which differ in Canada from U.S. GAAP.

"Under our principles-based system of GAAP, there are choices allowable for certain accounting policies," he said. "Depending on the facts of the situation, one alternative can be more suitable than another. No two companies are the same and that professional judgment must play a role in the evaluation of a company's financial position."

Aside from the principles-based approach to compliance, the chartered accountants are recommending a mandatory role for financial experts on corporate boards and audit committees, as well as an evaluation of 'tone from the top' and prohibitions on management override controls.

Hunt also called for compliance exemptions for smaller public companies as appropriate.

While the Sarbanes-Oxley Act applies only to U.S. listed firms, Canadian regulators have adopted some of its key aspects, such as the requirement of the CEO and CFO to certify financial reports. Also adopted north of the border; the requirement to include auditor oversight.

"Our capital markets are different, with 10,000 reporting issuers here, compared with 5,000 to 6,000 in the United States," says Hunt.

He suggests Canadian regulators take the same approach as the accounting profession in recognizing that some rules should be relaxed for smaller companies, due to the expense of implementing them.

While more oversight sounds like a positive development, it has been pointed out that Canada's capital markets have not been rocked by an accounting scandal, even with the increased post-Enron/Worldcom scrutiny.

Still, there have been financial scandals in Canada, such as the outright fraud of Bre-X and the alleged misappropriation of funds at Hollinger International. But it should be pointed out that as a NYSE-listed company, Hollinger was under U.S. rule-based regulations.

“Many experts believe the rules-based approach to U.S. GAAP may even have been a contributing factor to the recent U.S. corporate scandals ó that you can ‘tick all the boxes’ you like, but that the end result can still be less than the sum of its parts.”

This is not the first time that regulators have been called on to recognize the differences between the Canadian and U.S. markets. In 1994, the Dey Committee issued a similar recommendation.

“Recognizing that there is no ‘one size fits all’ solution, the TSE does not require compliance with the guidelines 3 but every year companies must disclose and explain any differences between their corporate governance practices and the guidelines,” read the introduction to Five Years to the Dey, a report on implementation of the committee’s recommendations.

This report found that in the five years following the original recommendations, corporate Canada had a mixed track record on adoption of the new requirements.

“The highest levels of compliance appear to be in controlling board size, participation in strategic planning for the corporation, and in the achievement of a majority of unrelated directors,” the report read. “The lowest levels of compliance appear to be in formalizing the roles and measuring the performance of the board.”

With the stated objective of improving investor confidence, the new proposed regulations may never be enough. The Chartered Accountants of Ontario surveyed its membership and found 43% of respondents believed investors were now too cynical for the currently proposed regulations to increase their confidence.

Filed by Steven Lamb, Advisor.ca, steven.lamb@advisor.rogers.com