

MULTILATERAL INSTRUMENT 52-110

AUDIT COMMITTEES

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**MULTILATERAL INSTRUMENT 52-110
AUDIT COMMITTEES**

**PART 1
DEFINITIONS AND APPLICATION**

1.1 Definitions – In this Instrument,

“accounting principles” mean a body of accounting principles that are generally accepted in a jurisdiction of Canada or a foreign jurisdiction and include, without limitation, Canadian GAAP, U.S. GAAP and International Financial Reporting Standards;¹

“AIF” has the meaning set out in National Instrument 51-102 *Continuous Disclosure Obligations*;

“asset-backed security” means a security that is primarily serviced by the cash flows of a discrete pool of mortgages, receivables or other financial assets, fixed or revolving, that by their terms convert into cash within a finite period and any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders;²

“audit committee” means a committee (or an equivalent body) established by and among the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer, and, if no such committee exists, the entire board of directors of the issuer;

“audit committee financial expert” means, with respect to an issuer, a person who has:

- (a) an understanding of financial statements and the accounting principles used by the issuer to prepare its financial statements;
- (b) the ability to assess the general application of such accounting principles in connection with the accounting for estimates, accruals and reserves;
- (c) experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of

¹ This definition has been adopted from proposed National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currencies*.

² This definition has been adopted from National Instrument 44-101 *Short Form Prospectus Distributions* and proposed National Instrument 51-102 *Continuous Disclosure Obligations*.

accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the issuer's financial statements, or experience actively supervising one or more persons engaged in such activities;

- (d) an understanding of internal controls and procedures for financial reporting; and
- (e) an understanding of audit committee functions;

“designated foreign issuer” has the meaning set out in National Instrument 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*;

“executive officer” of an entity means a person who is:

- (a) a chair of the entity, if that person performs the functions of the office on a full-time basis;
- (b) a vice-chair of the entity, if that person performs the functions of the office on a full-time basis;
- (c) the president of the entity;
- (d) a vice-president of the entity in charge of a principal business unit, division or function including sales, finance or production;
- (e) an officer of the entity or any of its subsidiary entities who performs a policy-making function in respect of the entity; or
- (f) any other person who performs a policy-making function in respect of the entity;³

“financially literate” means the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements;

“immediate family member” means an individual's spouse, parent, child, sibling, mother or father-in-law, son or daughter-in-law, brother or sister-in-law, and anyone (other than an employee of the individual or immediate family member) who shares the individual's home;

“investment fund” has the meaning set out in National Instrument 51-102 *Continuous Disclosure Obligations*;

³ This definition is derived from proposed National Instrument 51-102 and Ontario Securities Commission Rule 14-501 *Definitions*.

“marketplace” has the meaning set out in National Instrument 21-101 *Marketplace Operation*;

“MD&A” has the meaning set out in National Instrument 51-102 *Continuous Disclosure Obligations*;

“non-audit services” means any services provided to an issuer by its external auditor, other than those provided to the issuer in connection with an audit or review of the financial statements of the issuer;

“venture issuer” means an issuer that does not have any of its securities listed or quoted on any of the Toronto Stock Exchange, the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market, the Nasdaq SmallCap Market, the Pacific Exchange or a marketplace outside of Canada or the United States.⁴

1.2 Application – This Instrument applies to all reporting issuers other than:

- (a) investment funds;
- (b) issuers of asset-backed securities;
- (c) designated foreign issuers; and
- (d) reporting issuers that are subsidiary entities if
 - (i) the subsidiary entity does not have equity securities displayed for trading on a marketplace, and
 - (ii) the parent of the subsidiary entity is subject to the requirements of this Instrument.

1.3 Meaning of Affiliated Entity, Subsidiary Entity and Control –

- (1) For the purposes of this Instrument, a person or company is considered to be an affiliated entity of another person or company if
 - (a) one of them controls or is controlled by the other or if both persons or companies are controlled by the same person or company, or
 - (b) the person or company is
 - (i) both a director and an employee of an affiliated entity, or

⁴ This definition is derived from proposed National Instrument 51-102.

- (ii) an executive officer, general partner or managing member of an affiliated entity.
- (2) For the purposes of this Instrument, a person or company is considered to be a subsidiary entity of another person or company if
 - (a) it is controlled by,
 - (i) that other, or
 - (ii) that other and one or more persons or companies each of which is controlled by that other, or
 - (iii) two or more persons or companies, each of which is controlled by that other; or
 - (b) it is a subsidiary entity of a person or company that is the other's subsidiary entity.
- (3) For the purpose of this Instrument, "control" means the direct or indirect power to direct or cause the direction of the management and policies of a person or company, whether through ownership of voting securities or otherwise.
- (4) Despite subsection (1), a person will not be considered to be an affiliated entity of an issuer for the purposes of this Instrument if the person:
 - (a) owns, directly or indirectly, ten per cent or less of any class of voting equity securities of the issuer; and
 - (b) is not an executive officer of the issuer.

1.4 Meaning of Independence –

- (1) A member of an audit committee is independent if the member has no direct or indirect material relationship with the issuer.
- (2) For the purposes of subsection (1), a material relationship means a relationship which could, in the view of the issuer's board of directors, reasonably interfere with the exercise of a member's independent judgement.
- (3) Despite subsection (2), the following persons are considered to have a material relationship with an issuer:

- (a) a person who is, or whose immediate family member is, or at any time during the prescribed period has been, an officer or employee of the issuer, its parent, or of any of its subsidiary entities or affiliated entities;
 - (b) a person who is, or has been, an affiliated entity of, a partner of, or employed by, a current or former internal or external auditor of the issuer, unless the prescribed period has elapsed since the person's relationship with the internal or external auditor, or the auditing relationship, has ended;
 - (c) a person whose immediate family member is, or has been, an affiliated entity of, a partner of, or employed in a professional capacity by, a current or former internal or external auditor of the issuer, unless the prescribed period has elapsed since the person's relationship with the internal or external auditor, or the auditing relationship, has ended;
 - (d) a person who is, or has been, or whose immediate family member is or has been, employed as an executive officer of an entity if any of the issuer's current executives serve on the entity's compensation committee, unless the prescribed period has elapsed since the end of the service or employment;
 - (e) a person who accepts, or has accepted at any time during the prescribed period, directly or indirectly, any consulting, advisory or other compensatory fee from the issuer or any subsidiary entity of the issuer, other than as remuneration for acting in his or her capacity as a member of the audit committee, the board of directors, or any other board committee; and
 - (f) a person who is an affiliated entity of the issuer or any of its subsidiary entities.
- (4) For the purposes of subsection (3), the prescribed period is the shorter of
- (a) the period commencing on **[January 1, 2004]** and ending immediately prior to the determination required by subsection (3); and
 - (b) the three year period ending immediately prior to the determination required by subsection (3).
- (5) For the purposes of clauses (3)(b) and (3)(c), a partner does not include a limited partner whose interest in the internal or external auditor is limited to the receipt of fixed amounts of compensation (including deferred

compensation) for prior service with an internal or external auditor if the compensation is not contingent in any way on continued service.

- (6) For the purposes of clause (3)(e), compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the issuer if the compensation is not contingent in any way on continued service.
- (7) For the purposes of clause 3(e), the indirect acceptance by a person of any consulting, advisory or other compensatory fee includes acceptance of a fee by
 - (a) an immediate family member, or
 - (b) a partner, member or executive officer of, or a person who occupies a similar position with, an entity that provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary entity of the issuer, other than limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity.

PART 2

AUDIT COMMITTEE RESPONSIBILITIES

- 2.1 Audit Committee** – Every issuer must have an audit committee that complies with the requirements of the Instrument.
- 2.2 Relationship with External Auditor** – An external auditor must report directly to the audit committee.
- 2.3 Audit Committee Responsibilities** –
 - (1) An audit committee must have a written charter that sets out its mandate and responsibilities.
 - (2) An audit committee must recommend to the board of directors:
 - (a) the external auditors to be nominated for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer; and
 - (b) the compensation of the external auditors.

- (3) An audit committee must be directly responsible for overseeing the work of the external auditors engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer, including the resolution of disagreements between management and the external auditors regarding financial reporting.
- (4) An audit committee must pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by its external auditors or the external auditors of the issuer's subsidiary entities.
- (5) An audit committee must review the issuer's financial statements, MD&A and earnings press releases before the issuer publicly discloses this information.
- (6) An audit committee must be satisfied that adequate procedures are in place for the review of the issuer's disclosure of financial information extracted or derived from the issuer's financial statements, other than the disclosure referred to in subsection (5), and must periodically assess the adequacy of those procedures.
- (7) An audit committee must establish procedures for:
 - (a) the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and
 - (b) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.
- (8) An audit committee must review and approve the issuer's hiring policies regarding employees and former employees of the present and former external auditors of the issuer.

2.4 *De Minimis Non-Audit Services* – An audit committee may satisfy the pre-approval requirement in subsection 2.3(4) if:

- (a) the aggregate amount of all the non-audit services that were not pre-approved constitutes no more than five per cent of the total amount of revenues paid by the issuer to its external auditors during the fiscal year in which the services are provided;
- (b) the services were not recognized by the issuer at the time of the engagement to be non-audit services; and

- (c) the services are promptly brought to the attention of the audit committee of the issuer and approved, prior to the completion of the audit, by the audit committee or by one or more members of the audit committee to whom authority to grant such approvals has been delegated by the audit committee.

2.5 Delegation of Pre-Approval Function –

- (1) An audit committee may delegate to one or more independent members the authority to pre-approve non-audit services in satisfaction of the requirement in subsection 2.3(4).
- (2) The pre-approval of non-audit services by any member to whom authority has been delegated pursuant to subsection (1) must be presented to the full audit committee at its first scheduled meeting following such pre-approval.

PART 3 COMPOSITION OF THE AUDIT COMMITTEE

3.1 Composition –

- (1) An audit committee must be composed of a minimum of three members.
- (2) Every audit committee member must be a director of the issuer.
- (3) Subject to sections 3.2, 3.3, 3.4 and 3.5, every audit committee member must be independent.
- (4) Subject to section 3.5, every audit committee member must be financially literate.

3.2 Initial Public Offerings ?

- (1) If an issuer has filed a prospectus to qualify the distribution of securities that constitutes its initial public offering, subsection 3.1(3) does not apply for a period of up to 90 days commencing on the date of the receipt for the prospectus, provided that one member of the audit committee is independent.
- (2) If an issuer has filed a prospectus to qualify the distribution of securities that constitutes its initial public offering, subsection 3.1(3) does not apply for a period of up to one year commencing on the date of the receipt for the prospectus, provided that a majority of the audit committee members are independent.

- 3.3 Controlled Companies** – An audit committee member that sits on the board of directors of an affiliated entity is exempt from the requirement in subsection 3.1(3) if that member, except for being a director (or member of the audit committee or any other board committee) of the issuer and the affiliated entity, is otherwise independent of the issuer and the affiliated entity.
- 3.4 Events Outside Control of Member** – If an audit committee member ceases to be independent for reasons outside that member’s reasonable control, that member is exempt from the requirement in subsection 3.1(3) for a period ending on the later of:
- (a) the next annual meeting of the issuer, and
 - (b) the date that is six months from the occurrence of the event which caused the member to not be independent.
- 3.5 Death, Disability or Resignation of Member** – Where the death, disability or resignation of an audit committee member has resulted in a vacancy on the audit committee that the board of directors is required to fill, an audit committee member appointed to fill such vacancy is exempt from the requirements in subsections 3.1(3) and (4) for a period ending on the later of:
- (a) the next annual meeting of the issuer, and
 - (b) the date that is six months from the day the vacancy was created.

PART 4 AUTHORITY OF THE AUDIT COMMITTEE

- 4.1 Authority** – An audit committee must have the authority
- (a) to engage independent counsel and other advisors as it determines necessary to carry out its duties,
 - (b) to set and pay the compensation for any advisors employed by the audit committee, and
 - (c) to communicate directly with the internal and external auditors.

PART 5
REPORTING OBLIGATIONS

- 5.1 Required Disclosure** – Every issuer must include in its AIF the disclosure required by Form 52-110F1.
- 5.2 Management Information Circular** – If management of an issuer solicits proxies from the security holders of the issuer for the purpose of electing directors to the issuer’s board of directors, the issuer must include in its management information circular a cross-reference to the sections in the issuer’s AIF that contain the information required by section 5.1.

PART 6
VENTURE ISSUERS

- 6.1 Venture Issuers** – Venture issuers are exempt from the requirements of Parts 3 (*Composition of the Audit Committee*) and 5 (*Reporting Obligations*).
- 6.2 Required Disclosure** –
- (1) Subject to subsection (2), every venture issuer that relies on the exemption in section 6.1 must annually disclose in its management information circular the disclosure required by Form 52-110F2.
 - (2) If a venture issuer does not have a management information circular, the annual disclosure required by subsection (1) must be provided in the venture issuer’s AIF or MD&A.

PART 7
U.S. LISTED ISSUERS

- 7.1 U.S. Listed Issuers** –An issuer that has securities listed on a national securities exchange registered pursuant to section 6 of the 1934 Act or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the 1934 Act is exempt from the requirements of Parts 2 (*Audit Committee Responsibilities*), 3 (*Composition of the Audit Committee*), 4 (*Authority of the Audit Committee*), and 5 (*Reporting Obligations*), provided that:
- (a) the issuer is in compliance with the requirements of that exchange or quotation system regarding the role and composition of audit committees; and
 - (b) the issuer includes in its AIF the disclosure, if any, required by paragraph 5 of Form 52-110F1.

**PART 8
EXEMPTIONS**

8.1 Exemptions –

- (1) The securities regulatory authority or regulator may grant an exemption from this rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.
- (2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.

**PART 9
EFFECTIVE DATE**

9.1 Effective Date –

- (1) This Instrument comes into force on **[January 1, 2004]**.
- (2) Despite subsection (1), this Instrument applies to an issuer commencing on the earlier of:
 - (a) the first annual meeting of the issuer after **[January 1, 2004]**, and
 - (b) **[June 30, 2004]**.