FINANCIAL AND CONSUMER SERVICES COMMISSION OF NEW BRUNSWICK

COMMISSION DES SERVICES FINANCIERS ET DES SERVICES AUX CONSOMMATEURS DU NOUVEAU-BRUNSWICK

CONSOLIDATED UP TO 17 MARCH 2008

COMPANION POLICY 52-110CP
TO NATIONAL INSTRUMENT 52-110
AUDIT COMMITTEES

Part One General

1.1 **Purpose –** National Instrument 52-110 *Audit Committees* (the Instrument) is a rule in each of Québec, Alberta, Manitoba, Ontario, Nova Scotia, Newfoundland and Labrador, New Brunswick and British Colombia, a Commission regulation in Saskatchewan and Nunavut, a policy in Prince Edward Island and the Yukon Territory, and a code in the Northwest Territories. We, the securities regulatory authorities in each of the foregoing jurisdictions (the Jurisdictions), have implemented the Instrument to encourage reporting issuers to establish and maintain strong, effective and independent audit committees. We believe that such audit committees enhance the quality of financial disclosure made by reporting issuers, and ultimately foster increased investor confidence in Canada's capital markets.

This companion policy (the Policy) provides information regarding the interpretation and application of the Instrument.

1.2 **Application to Non-Corporate Entities.** The Instrument applies to both corporate and non-corporate entities. Where the Instrument or this Policy refers to a particular corporate characteristic, such as a board of directors, the reference should be read to also include any equivalent characteristic of a non-corporate entity. For example, in the case of a limited partnership, the directors of the general partner who are independent of the limited partnership (including the general partner) should form an audit committee which fulfils these responsibilities.

Income trust issuers should apply the Instrument in a manner which recognizes that certain functions of a corporate issuer, its board and its management may be performed by any or all of the trustees, the board or management of a subsidiary of the trust, or the board, management or employees of a management company. For this purpose, references to "the issuer" refer to both the trust and any underlying entities, including the operating entity.

If the structure of an issuer will not permit it to comply with the Instrument, the issuer should seek exemptive relief.

1.3 Management Companies. The definition of "executive officer" includes any individual who performs a policy-making function in respect of the entity in question. We consider this aspect of the definition to include an individual who, although not employed by the entity in question, nevertheless performs a policy-making function in respect of that entity, whether through another person or company or otherwise.

1.4 Audit Committee Procedures. The Instrument establishes requirements for the responsibilities, composition and authority of audit committees. Nothing in the Instrument is intended to restrict the ability of the board of directors or the audit committee to establish the committee's quorum or procedures, or to restrict the committee's ability to invite additional parties to attend audit committee meetings.

Part Two
The Role of the Audit Committee

2.1 The Role of the Audit Committee. An audit committee is a committee of a board of directors to which the board delegates its responsibility for oversight of the financial reporting process. Traditionally, the audit committee has performed a number of roles, including

- helping directors meet their responsibilities,
- providing better communication between directors and the external auditors,
- enhancing the independence of the external auditor,
- increasing the credibility and objectivity of financial reports, and
- strengthening the role of the directors by facilitating in-depth discussions among directors, management and the external auditor.

The Instrument requires that the audit committee also be responsible for managing, on behalf of the shareholders, the relationship between the issuer and the external auditors. In particular, it provides that an audit committee must have responsibility for:

(a) overseeing the work of the external auditors engaged for the purpose of preparing or issuing an auditor's report or related work; and

(b) recommending to the board of directors the nomination and compensation of the external auditors.

Although under corporate law an issuer's external auditors are responsible to the shareholders, in practice, shareholders have often been too dispersed to effectively exercise meaningful oversight of the external auditors. As a result, management has typically assumed this oversight role. However, the auditing process may be compromised if the external auditors view their main responsibility as serving management rather than the shareholders. By assigning these responsibilities to an independent audit committee, the Instrument ensures that the external audit will be conducted independently of the issuer's management.

2.2 Relationship between External Auditors and Shareholders. Subsection 2.3(3) of the Instrument provides that an audit committee must be directly responsible for overseeing the work of the external auditors engaged for the purpose of preparing or issuing an auditor's 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. Notwithstanding this responsibility, the external auditors are retained by, and are ultimately accountable to, the shareholders. As a result, subsection 2.3(3) does not detract from the external auditors' right and responsibility to also provide their views directly to the shareholders if they disagree with an approach being taken by the audit committee.

2.3 Public Disclosure of Financial Information. Issuers are reminded that, in our view, the extraction of information from financial statements that have not previously been reviewed by the audit committee and the release of that information into the marketplace is inconsistent with the issuer's obligation to have its audit committee review the financial statements. See also National Policy 51-201 *Disclosure Standards*.

Part Three
Independence

3.1 Meaning of Independence. The Instrument generally requires every member of an audit committee to be independent. Subsection 1.4(1) of the Instrument defines independence to mean the absence of any direct or indirect material relationship between the director and the issuer. In our view, this may include a commercial, charitable, industrial, banking, consulting, legal, accounting or familial relationship, or any other relationship that the board considers to be material. Although shareholding alone may not interfere with the exercise of a director's independent judgement, we believe that other relationships between an issuer and a shareholder may constitute material relationships with the issuer, and should be considered by the board when determining a director's independence. However, only those relationships which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of a member's independent judgement should be considered material relationships within the meaning of section 1.4.

Subsection 1.4(3) and section 1.5 of the Instrument describe those individuals that

we believe have a relationship with an issuer that would reasonably be expected to interfere with the exercise of the individual's independent judgement. Consequently, these individuals are not considered independent for the purposes of the Instrument and are therefore precluded from serving on the issuer's audit committee. Directors and their counsel should therefore consider the nature of the relationships outlined in subsection 1.4(3) and section 1.5 as guidance in applying the general independence requirement set out in subsection 1.4(1).

3.2 Derivation of Definition. In the United States, listed issuers must comply with the audit committee requirements contained in SEC rules as well as the director independence and audit committee requirements of the applicable securities exchange or market. The definition of independence included in the Instrument has therefore been derived from both the applicable SEC rules and the corporate governance rules issued by the New York Stock Exchange. The portion of the definition of independence that parallels the NYSE rules is found in section 1.4 of the Instrument. Section 1.5 of the Instrument contains additional rules regarding audit committee member independence that were derived from the applicable SEC rules. To be independent for the purposes of the Instrument, a director must satisfy the requirements in both sections 1.4 and 1.5.

3.3 Safe Harbour. Subsection 1.3(1) of the Instrument provides, in part, that a person or company is an affiliated entity of another entity if the person or company controls the other entity. Subsection 1.3(4), however, provides that an individual will not be considered to control an issuer if the individual:

(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.

Subsection 1.3(4) is intended only to identify those individuals who are not considered to control an issuer. The provision is not intended to suggest that an individual who owns more than ten percent of an issuer's voting equity securities automatically controls an issuer. Instead, an individual who owns more than ten percent of an issuer's voting equity securities should examine all relevant facts and circumstances to determine if he or she controls the issuer and is therefore an affiliated entity within the meaning of subsection 1.3(1).

3.4 Remuneration of Chair of Board, Etc. Subsection 1.4(6) of the Instrument provides that, for the purpose of the prescribed relationship described in clause 1.4(3)(f), direct compensation does not include remuneration for acting as a member of the board of directors or of any board committee of the issuer. In our view, remuneration for acting as a member of the board also includes remuneration for acting as the chair of the board or of any committee of the board.

Part Four
Financial Literacy, Financial Education and Experience

4.1 Financial Literacy. For the purposes of the Instrument, an individual is financially literate if he or she has 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. In our view, it is not necessary for a member to have a comprehensive knowledge of GAAP and GAAS to be considered financially literate.

4.2 Disclosure of Relevant Education and Experience.

(1) Item 3 of Forms 52-110F1 and 52-110F2 require an issuer to disclose any education or experience of an audit committee member that would provide the member with, among other things, an understanding of the accounting principles used by the issuer to prepare its financial statements. The level of understanding that is requisite is influenced by the complexity of the business being carried on. For example, if the issuer is a complex financial institution, a greater degree of education and experience is necessary than would be the case for an audit committee member of an issuer with a more simple business.

(2) Item 3 of Forms 52-110F1 and 52-110F2 also require an issuer to disclose any experience that the member has, among other things, actively supervising persons engaged in preparing, auditing, analyzing or evaluating certain types of financial statements. The phrase active supervision means more than the mere existence of a traditional hierarchical reporting relationship between supervisor and those being supervised. An individual engaged in active supervision participates in, and contributes to, the process of addressing (albeit at a supervisory level) the same general types of issues regarding preparation, auditing, analysis or evaluation of financial statements as those addressed by the individual or individuals being supervised. The supervisor should also have experience that has contributed to the general expertise necessary to prepare, audit, analyze or evaluate financial statements that is at least comparable to the general expertise of those being supervised. An executive officer should not be presumed to qualify. An executive officer with considerable operations involvement, but little financial or accounting involvement, likely would not be exercising the necessary active supervision. Active participation in, and contribution to, the process, albeit at a supervisory level, of addressing financial and accounting issues that demonstrate a general expertise in the area would be necessary.

Part Five
Non-Audit Services

5.1 Pre-Approval of Non-Audit Services. Section 2.6 of the Instrument allows an audit committee to satisfy, in certain circumstances, the pre-approval requirements in

subsection 2.3(4) by adopting specific policies and procedures for the engagement of non-audit services. The following guidance should be noted in the development and application of such policies and procedures:

- Monetary limits should not be the only basis for the pre-approval policies and procedures. The establishment of monetary limits will not, alone, constitute policies that are detailed as to the particular services to be provided and will not, alone, ensure that the audit committee will be informed about each service.

- The use of broad, categorical approvals *(e.g.* tax compliance services) will not meet the requirement that the policies must be detailed as to the particular services to be provided.

- The appropriate level of detail for the pre-approval policies will differ depending upon the facts and circumstances of the issuer. The pre-approval policies must be designed to ensure that the audit committee knows precisely what services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on the auditor's independence. Furthermore, because the Instrument requires that the policies cannot result in a delegation of the audit committee's responsibility to management, the pre-approval policies must be sufficiently detailed as to particular services so that a member of management will not be called upon to determine whether a proposed service fits within the policy.

Part Six
Disclosure Obligations

6.1 Incorporation by Reference. National Instrument 51-102 permits disclosure required to be included in an issuer's AIF or information circular to be incorporated by reference, provided that the referenced document has already been filed with the applicable securities regulatory authorities.[1] Any disclosure required by the Instrument to be included in an issuer's AIF or management information circular may also incorporated by reference, provided that the procedures set out in National Instrument 51-102 are followed.

[1] See Part 1, paragraph (f) of Form 51-102F2 *(Annual Information Form)* and Part 1, paragraph (c) of Form 51-102F5 *(InformationCircular)*.