

Deciding to Go Public

What CFOs Need to Know

Beth Deazeley, LL.B.

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What CFOs Need to Know

This publication provides an overview of the role of the CFO in the decision to take a company public. It sets out the areas in which the CFO provides critical input to the other members of the management team and to the board of directors. CFOs, boards, and others can use it as a guide to assist them in making the decision as to whether or not to take a company public.

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Preface

The Risk Management and Governance Board (RMGB) of the Canadian Institute of Chartered Accountants has commissioned this briefing to provide practical guidance to CFOs on working with CEOs and boards of directors in making the decision to take a company public.

The decision to go public is a critical one in the life of the company, and one that must be considered carefully. The promised rewards come with high risks, and it is essential that the factors underlying the decision, the preparation required prior to going public, and the realities of life as a public company are understood before the first step is taken.

CFOs, as functional heads of finance, have a unique perspective on the organization and its relationship to the capital markets and business environment. They have established credibility by being competent and reliable in their financial role. They are also respected for their values of objectivity, independence and integrity.

It has been said that the CFO “quarterbacks” the going public initiative, but that job must be done in collaboration with the CEO, other members of the senior management team, and the owners or board of directors. This document is directed to CFOs, but will also be of value to others in order to stimulate discussion, facilitate the process of going public, and set the stage for life as a successful public company.

The material in this document is informed by interviews with a number of CFOs and professional advisors. It was also reviewed by staff at both the Toronto Stock Exchange and the TSX Venture Exchange.

The RMGB acknowledges and thanks the research participants and reviewers, as well as the members of the Directors Advisory Group and the CFO Task Force for their invaluable advice, Beth Deazeley who wrote this document under their guidance, and the CICA staff who provided support to the project.

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Introduction

The decision to take a company public is one of the most important that a CFO is involved in. Some companies are founded on the assumption that they will go public as soon as possible. Others come to the decision later, due to changes in their environment or business plan. Whether the organization is in its inception or is an established private company, it is important to ensure that the decision to go public is made after full consideration of the challenges involved. The more consideration that goes into the decision, the better prepared the company will be to deal with the rigors of the going public process itself and the responsibilities of life as a public company.

Although the process of taking a company public may be a long one, it moves quickly once started and demands an enormous amount of attention and energy. There will likely be few opportunities to reconsider the decision and little chance to address issues for which the organization is unprepared. It is therefore vital that the CFO, in consultation with the CEO, the board, and other major stakeholders such as owners and investors, has addressed the following questions when making the decision to go public:

1. What factors must be considered in making the decision to go public?
2. What must the company have in place prior to going public?
3. What will life be like as a public company?

This document provides guidance in addressing these three areas. It does not address the technical aspects of prospectus writing, listing on the exchange, etc., as these topics are well-covered by a number of other sources, some of which are listed in the section entitled “Where to Find More Information”.

The discussion of going public in this document is intended to be generally applicable regardless of the method chosen: Initial Public Offering (IPO), reverse take-over, or the Capital Pool Company Program of the TSX Venture Exchange¹. Likewise, while there is some discussion of selection of the exchange to list on, this document will not deal with technical listing requirements and as such is intended to be generally applicable irrespective of the listing exchange.

¹ A summary of the different methods of going public on the Toronto Stock Exchange and the TSX Venture Exchange is included as Appendix A.

What factors must be considered in making the decision to go public?

- Analyzing the reasons for going public
- Weighing the advantages and the disadvantages of going public
- Assessing the alternatives to going public
- Signs that a company is ready to go public
- Choosing the exchange

What must the company have in place before going public?

- Selecting advisors and managing relationships
- Getting the corporate house in order: organization and operations
- Preparation and review of financial statements
- Developing reporting systems and controls: disclosure controls and procedures and internal control over financial reporting
- Evaluating the skill sets of management and the board
- Securing a strong, independent board of directors
- Ensuring that corporate governance complies with best practices
- Developing a communications strategy

What will life be like as a public company?

- Coping with increased disclosure obligations
- Complying with regulatory requirements regarding financial disclosure
- Fulfilling obligations to shareholders
- Adapting to the new role of the CFO
- Managing ongoing communications and delivering on the promise

What factors must be considered in making the decision to go public?

One of the most costly mistakes that a CFO can make is participating in taking a company public without adequate consideration of both the benefits and the challenges of the decision. The decision to go public will be made by the owners of the company, who will likely include founders and investors, and the CFO's recommendation can be a valuable part of the decision-making process. Such a momentous decision should not be made on the spur of the moment, but neither should it proceed unquestioned simply because it has always been part of the company's plan. Careful consideration of the reasons for going public as well as assessment of the advantages, disadvantages and alternatives is critical to a successful endeavor. Management, the board and the owners of the company must "own" the decision and take control of the process.

Analyzing the reasons for going public

In making the decision to take a company public, the first step must be a careful consideration of the reasons for wanting to do so, and an analysis of what is hoped to be achieved.

Generally accepted reasons for taking a company public include:

- To raise capital beyond that which is available privately, in order to
 - allow for upgrading or expansion of existing capital assets
 - fund acquisitions
 - pay down debt
- To finance exploration or research and development
- To provide an exit strategy for original investors, including venture capitalists and angel investors, as well as owners².

Once the reasons are identified, assessment of the advantages and disadvantages of going public as a means to achieve those goals can occur.

² This is a longer-term goal as principal shareholders may be subject to escrow requirements imposed by the listing exchange or relevant securities commission, as well as agreements with underwriters and statutory restrictions on resale.

Not-so-good Reasons for Going Public

Some reasons for taking a company public may not be as valid, and should signal to the CFO that careful scrutiny is necessary:

- To provide a windfall for owners.
- Bowing to pressure from investors.
- To take advantage of a “bubble” in the market.
- Blindly following a business plan which has not been revised regularly.
- In lieu of a succession plan, or to resolve a dispute amongst owners.

Weighing the advantages and the disadvantages of going public

Once the reasons for wanting to take a company public have been ascertained, the advantages and disadvantages must be assessed, with the focus on the company, its particular stage of development, the industry sector and the market.

Advantages of going public may include:

- access to capital
- improved financial status: immediate benefits for balance sheet and debt-to-equity ratio
- enhanced capacity for growth: stock can be used as currency for acquisitions
- facilitation of mergers and acquisitions
- easier access to debt financing due to disclosure requirements, improved debt/equity ratios
- access to secondary equity financing through the ability to issue further shares
- public company multiple: potential for higher valuation due to liquidity of shares
- publicity
- credibility/prestige which may attract investors, strategic partners, and/or customers
- improved recruitment and retention through the ability to grant equity participation to employees

Disadvantages of going public may include:

Disadvantages relating to the process of going public

- expenses: legal fees, audit/accounting fees, underwriting, printing costs, roadshow, filing fees etc.
- disclosure/due diligence burden
- relationship challenges when dealing with existing shareholders and/or management
- time commitment and distraction from the day-to-day running of the business

Disadvantages relating to life as a public company

- ongoing time and resource costs of compliance and reporting
- reduced flexibility: requirement to consult board, and sometimes shareholders, on decisions
- reduced control: dilution of shareholdings
- vulnerability to takeover
- increased scrutiny by regulators and public
- restrictions on investor communications and selective disclosure of information
- increased disclosure of competitive information (eg. financial performance, terms of contracts, executive compensation, environmental issues) compared to private companies
- short-termism and pressure to keep stock price up, which may be incompatible with the company's existing strategy

- investor relations obligations and other pressures of being in the public eye
- exposure to shareholder activism
- exposure to the effects of volatility in the market price of shares
- smaller pool of director/officer candidates due to complexity of skill sets required in public companies
- increased liability for directors and officers under laws relating to secondary market liability, etc. leading to increased costs of compensation and directors' and officers' insurance

Some advantages may not apply in particular circumstances. For example, going public may not always lead to improved access to capital and better valuations for companies entering a market in which their stock is undervalued or in which there is little liquidity.

Some disadvantages may also be inapplicable in some cases. For example, the increased costs of compliance may be minimal for companies which are already run like public companies or subject to heavy regulatory requirements. Investor relations obligations may not be as onerous for companies with only a few large institutional investors.

Some advantages and disadvantages may balance each other out. For example, it may be harder to find directors and officers with the skill sets necessary for a public company, but the ability to offer share-based compensation may assist in attracting and retaining talent.

Assessing the alternatives to going public

CFOs should ensure that the alternatives to going public are assessed, especially in situations in which numerous disadvantages to going public have been identified. It may be that the goals which the company hoped to achieve by going public can be attained via an alternate route.

Alternate forms of financing which may address some of the company's capital requirements include:

- bank loans
- subordinate debt
- venture capital
- private placements
- asset-based borrowing

Alternate forms of organization other than that of a publicly listed company which may be appropriate:

- joint ventures
- partnerships
- employee participation in ownership
- limited partnerships with flow-through shares (resource industry)

Certain indicators may suggest an alternative to an IPO. These include:

- Significant accounts receivable, inventory or property, plant and equipment that may not be pledged as collateral. These indicators could suggest asset-based borrowing as a workable alternative.
- A promising proprietary product or business that isn't sufficiently developed to go public. It might make more sense to look at a venture capital or private placement alternative.
- An existing but undeveloped technology. May want to look at trading off a portion of future earnings for a financial infusion through a research and development joint venture, partnership or other arrangement.³

Alternate means of accessing operating capital may include:

- divestiture of non-core operations/assets
- leasing

Alternative exit strategies for investors may include buyouts or mergers. It is increasingly common in Canada for private companies to proceed on a “dual track”: simultaneously pursuing both M&A opportunities as well as an IPO.

A decision to pursue an alternative to going public does not represent a determination that the company will never go public, just that there is another more appropriate option at this time. It is a decision which can always be revisited in the future, particularly if the circumstances of the company change.

Signs that a company is ready to go public

Once the owners of the company, in consultation with management and the board, have concluded that going public is the best route for the company to achieve its goals, it is important to assess timing. Careful consideration is necessary to determine whether the company is at a point in its life cycle in which it is prepared to face the challenges of going public and of life as a public company.

One expensive mistake is focusing too much on the state of the capital markets. The readiness of the company should almost always be the paramount consideration. Companies that rush into a public offering ill-prepared in order to take advantage of a market “bubble” will often be unable to meet ongoing compliance and disclosure requirements and may be inadequately managed and capitalized to withstand subsequent downturns. Many of the companies which went public during the “dot-com bubble” and subsequently failed made this mistake.

The focus should be on the company's state of readiness. Once the company is fully prepared, it will be possible to take advantage of “windows” in the market as they open up. Signs that a company is ready to go public include:

- the company can demonstrate a good earnings history and asset backing, solid industry position and growth potential
- the company is able to cover the costs associated with the process of going public
- the board and management are familiar with and are able to meet the listing requirements of the exchange and the relevant securities commissions
- the company has reached “critical mass”: it is sufficiently developed both in terms of capitalization and management and board resources to be able to meet the ongoing costs and pressures of being public, maintaining a public image and competing against competitor public companies
- a reasonable timeline has been developed for the going public process
- both the drawbacks and advantages of being a public company are understood and accepted
- going public is in line with business objectives and is part of a considered business plan

³ PricewaterhouseCoopers LLP: *The Guide to Going Public* at p. 28.

Once a company is prepared to go public, it may sometimes be necessary to delay due to a sudden downturn in the market. Such delays may incur significant costs both in terms of the going public process as well as securing other financing to continue operations while waiting for conditions to improve.

Market conditions will affect different companies in different ways. For example, numerous IPOs were canceled in the United States during the early months of 2008. However other companies, such as RiskMetrics Group and Visa Inc., found that market conditions were in fact favorable to their company, and were able to conduct successful IPOs.

Red Flags	Indicators of a Strong IPO ⁴
<p>Signs that a company is not yet ready to become public and should put its plans on hold may include:</p> <ul style="list-style-type: none"> • Lack of experienced, capable senior management and board members • An owner who isn't ready to let go of control of the company • Insufficient resources to meet ongoing reporting requirements • Lack of interest from investment community • Company is not consistently meeting listing requirements of the exchange 	<ul style="list-style-type: none"> • track record of success (consistent revenue growth and proven earnings) • high growth prospects • innovative product/service • competitive in industry • proven management team • significant upside potential (high net profit margins, market niche, proprietary technologies, distinctive products or services)

Choosing the exchange

Going public involves listing company stock on an exchange and becoming a reporting issuer with the relevant securities commission(s). Companies planning on going public have several options when it comes to the exchange on which their stock will be listed. They may list on a Canadian exchange, a foreign exchange, or a combination of the two. Each exchange may provide advantages and disadvantages in terms of rules and listing requirements as well as the markets accessed. Before beginning the process of going public, CFOs must carefully consider which exchange will be most advantageous for their company.

Canadian stock exchanges include:

- Toronto Stock Exchange (TSX)—Canada's senior exchange, a division of the TMX Group
- TSX Venture Exchange (TSX-V)—also part of the TMX Group, with similar listing requirements but geared towards emerging and/or junior companies
- CNQ—an alternative stock exchange with simplified listing and reporting requirements

Some companies choose to list on an exchange outside of Canada, such as:

- The London Stock Exchange's Alternative Investment Market (AIM), which has less onerous listing and compliance requirements
- A U.S. exchange such as the New York Stock Exchange (NYSE) or NASDAQ⁵

⁴ Jim Defer, *Questions That Should Be Asked At the Outset Before You Start the Process* <http://www.bctechnology.com/connector/scripts/experts/public4.cfm>

⁵ For a detailed comparison of global stock exchanges, see *IPO Insights: Comparing Global Stock Exchanges*, Ernst & Young, 2007.

The following are key considerations when deciding which stock exchange to list on:

- **Listing requirements**—may include specifications as to assets, earnings, market capitalization, number of shares outstanding, etc. Some exchanges may impose more stringent requirements than others, which may be a barrier to some emerging companies. Listing requirements will also affect the cost of listing.
- **Ongoing requirements**—different exchanges and securities commissions may have different requirements with respect to ongoing disclosure, annual filings, etc., which may significantly increase or decrease the compliance burden on the company.
- **Market activity and valuations**—certain exchanges may have more market activity and/or more favorable valuations in respect of certain types of stocks. It is important to consider liquidity when assessing the appropriateness of the exchange for the particular company in question.
- **Capital market accessed**—different exchanges may tap into the resources of very different investors. Whether retail or institutional, foreign or domestic, it is important to identify the kind of investors the company is seeking and then consider which exchange will provide the best access to them.
- **Regulatory environment**—different geographic jurisdictions will be subject to different regulatory requirements due to securities and other regulations. For example, listing in the United States provides access to large capital markets, but will require costly Sarbanes-Oxley (SOX) compliance.
- **Litigation environment**—listing on a foreign exchange will also affect the company's exposure to litigation risk. The litigiousness of the jurisdiction, including factors such as the prevalence of shareholder lawsuits, class actions, regulatory prosecutions and the existence of secondary market liability, should be carefully reviewed.
- **GAAP reconciliation**—choosing to list on the exchange of a foreign jurisdiction has traditionally required reconciliation between Canadian Generally Accepted Accounting Principles (GAAP) and those of the listing jurisdiction, a process which is often costly and time-consuming. The transition from Canadian GAAP to International Financial Reporting Standards (IFRS) in 2011 should largely resolve this barrier.

The CFO may also decide, in consultation with the other members of the executive team, the owners and the board, that they wish to access both domestic and foreign capital markets. This may be done by listing the company on more than one stock exchange. Such interlisted companies will benefit from accessing multiple capital markets, but will also be subject to multiple sets of legal, regulatory and disclosure requirements.



What must the company have in place before going public?

Before taking a company public, there is a substantial amount of preparation required. It is critical that CFOs take this into account when assessing the readiness of a company to go public. Advisors such as investment bankers, lawyers, auditors and other professionals must be selected. The company structure and function must be reviewed and brought into compliance with the regulatory requirements to which public companies are subject. A strong, independent board and good corporate governance practices should be put in place well in advance of the target date for going public. While recommendations of how long this preparation period should last vary, it is undisputed that the more preparation done and the more practice the company has meeting regulatory requirements, the more successful it is likely to be in the critical period immediately after going public.

Selecting advisors and managing relationships

One of the most important factors in determining the success of a company in going public may be the relationship between the board and senior management of the company and its external advisors. Experienced and dedicated advisors can help to guide a company smoothly through the process of going public, provided their relationship with the senior management of the company is clear and effective.

The advisory team for taking a company public will generally include the following members:

- **Underwriter / investment banker**— Will advise on the structure and timing of the offering, help determine the number and price of shares, conduct due diligence, sign the prospectus, coordinate the road show, and sell the shares of the company. This may be done by a single representative of one financial institution, or through a syndicate of institutions.
- **Accounting advisors**— May help assess whether going public is appropriate for the company, help establish the going public timetable and plan, and advise on internal controls and financial systems. Due to requirements relating to auditor independence, many companies engage accounting advisors other than their auditors to advise on the going public process.

- **Lawyer**—Usually prepares the prospectus, issues legal opinions to the underwriters, verifies disclosures for accuracy, completeness and consistency, and identifies and resolves outstanding legal issues.
- **Other experts**—Depending on the industry, the exchange, and the particular situation of the company, other expert advisors may be involved, such as engineers, oil and gas reserve analysts, management consultants, road show consultants, and others.

Advisors should be chosen carefully and after discussion between the CFO, the senior management team, the owners and the board of directors. Both the availability and the selection of advisors will depend on the type of business the company is involved in and the amount of money to be raised by going public. Some companies choose to use large, “Tier One” advisors in order to take advantage of their experience and reputation. Others prefer smaller organizations that specialize in a particular industry. Regardless of size or specialty, advisors must have the trust of the CFO, the owners and the board.

Relationships with professional advisors must be well-managed throughout the process of going public. The CFO will play a key role in coordinating the efforts of the advisors. Roles and responsibilities of each party must be clearly set out and understood, and someone must be in charge of seeing that the timeline is followed and deadlines are met. Good communication between advisors and the CFO is key. In order to get the most benefit from the relationship with advisors, and to avoid losing control of the process, CFOs are encouraged to educate themselves as much as they can about the process. This will allow them to better understand the advice they receive and know which questions to ask.

The Importance of Unofficial Advisors

Many CFOs receive invaluable practical advice on the going public process from other, “unofficial” sources. These may include investors such as venture capitalists with experience in taking companies public, or other CFOs who have been through the process.

Getting the corporate house in order: organization and operations

In preparation for the increased scrutiny to which the company will be subject once it is public, it is advisable that the CFO devote some time to reviewing the corporate organization and operations. In consultation with the CEO and the board of directors, changes may be necessary in order to simplify structure, formalize processes and procedures, and generally prepare the company to become public.

Having a well-developed business plan is essential to all companies, public and private, but it is especially important when a company is about to go public, and this is an ideal time to review an existing plan to ensure that the business model is accurate and sustainable. Such a plan may be used by investment bankers and analysts, and assists the company not only in formalizing its game plan, but in telling its story. Essential items which must be included in the business plan are: the business definition, market analysis, market strategy, product performance and potential, operations, and management structure.

A review of the company’s organization may suggest that it is appropriate to streamline operations or organizational structure to make the company more efficient and attractive to investors. This may involve the elimination of non-core products and processes, simplification of the corporate structure, or the separation of activities to take only certain operating units public. All related-party transactions should be identified and reviewed for compliance with applicable regulations. Relationships should be formalized, for example by the use of contracts.

An enterprise-wide risk assessment should be conducted to identify, and where possible, resolve outstanding risk issues such as pending litigation, intellectual property disputes, etc.

The existing share capital structure should also be reviewed. It is often advisable to eliminate complexities, for example, by creating a single class of common equity shares. It may also be expedient to authorize additional classes of shares even if they will not be issued immediately.

Maintaining Focus on the Business While Preparing to Go Public

Preparation for going public and the process itself generate an enormous amount of work, much of which will fall by default to the CFO. However, CFOs must avoid losing sight of the business itself during this critical time, especially since any changes in the business will have to be reflected in the prospectus. This issue should be explicitly addressed while still in the planning stages.

One solution employed by some companies is to set up IPO project teams, allowing some members to focus primarily on the going public process, while others focus on the business. Of course, this will be more difficult in smaller companies.

Preparation and review of financial statements

Although specific requirements of different exchanges may vary, audited financial statements for several previous years will be required as part of the listing process. Financial statements must be prepared in accordance with generally accepted accounting principles and have an unqualified audit opinion.

It is recommended that CFOs get in the practice of having a full annual audit conducted either from the inception of the company, or at minimum for several years prior to the time that the company is anticipated to go public. Otherwise, multiple years' worth of audited financial statements will have to be produced immediately prior to going public, which will involve a significant amount of time and energy.

The preparation and review of the historical financial statements can serve both as a chance to review the company's operations and pinpoint areas in which changes may be necessary, as well as valuable practice for the routine of regular financial reporting with which the company will be required to comply once it is public. Care should be taken to include predecessor companies and acquired companies where applicable.

Developing reporting systems and controls: disclosure controls and procedures and internal control over financial reporting

Some of the more onerous obligations to which public companies are subject are in the area of disclosure controls and procedures (DC&P) and internal controls over financial reporting (ICFR). The Canadian Securities Administrators' (CSA) Multilateral Instrument 52-109, *CEO and CFO Certification*, requires that CEOs and CFOs of non-venture issuers file certifications concurrently with the interim and annual filings. These certifications not only place a significant burden on CFOs in terms of workload, but can also expose them to substantial liability.

For more information, please see the CICA publication *Internal Control 2006: The Next Wave of Certification — Guidance for Management*.

In order to comply with the certification requirements, companies must ensure that they have in place a strong system of disclosure controls and procedures and internal controls over financial reporting, along with a procedure for reviewing their design and effectiveness. CFOs and CEOs may find that there is a substantial amount of education required in order for them to be comfortable with the certification process.

The certifications address two control areas: disclosure controls and procedures and internal control over financial reporting. CEOs and CFOs are currently required to certify as to the accuracy and completeness of the material included in the annual and/or interim filing as well as the design and effectiveness of disclosure controls and procedures and the design of internal controls over financial reporting. Any significant changes in ICFR must be disclosed in the Management's Discussion and Analysis (MD&A). In the future, some issuers will likely be required to certify as to the effectiveness of ICFR in the annual filing.⁶

Companies listed in the United States are subject to similar certification and reporting requirements under SOX sections 302 and 404.

It is crucial that a company is run "like a public company" for some time prior to actually going public. This will facilitate the transition from private company to public company, as it is only through the experience of complying with public company requirements that CFOs will learn what processes need to be in place and what areas need additional attention. Investment bankers, lawyers, and other professional advisors look for companies with some history showing their ability to comply with the regulatory requirements to which public companies are subject. The CFO and CEO should also be comfortable with the certification procedure prior to taking the company public.

Evaluating the skill sets of management and the board

Another key step in the process of preparing the company to go public is conducting a candid evaluation of the skill sets of senior management and the board of directors. The skill sets sufficient for a director or officer of a private company are often different from those of a director or officer of a public company, and it is critical to have the right team in place.

The composition of management and the board will affect the process of going public itself, as investment bankers and analysts will often rely on the reputation and experience of the people involved with the company. It will also affect the company's performance once it is public, as there will be a major change in the roles and responsibilities of directors and officers, as well as a high degree of scrutiny of their background and performance.

Key considerations should include:

- **Public company experience**—will increase the confidence of analysts and investors as well as providing expertise and a 'steady hand' to guide the organization through the going public process and into life as a public company.
- **Industry experience**—not only valuable in terms of insights into running and growing the business, industry experience will be noted favorably by investment bankers, analysts and investors.

⁶ At the time of writing, MI 52-109 is undergoing review and revision by the Canadian Securities Administrators. Venture issuers will likely be subject to less stringent requirements regarding DC&P and ICFR.

- **Impeccable background**—while an officer or director of a private company may hide a few skeletons in the closet, the increased scrutiny that comes with public company status will likely expose them to the light of day, to the detriment of the company’s reputation.
- **Highest standards of integrity**—from the day the company goes public, the actions of the board and management will be constantly in the public eye and all actions must be able to withstand a high level of scrutiny from regulators, investors and other stakeholders.
- **Communications skills**—one of the main differences between the functioning of a private company and a public one is the increased communication which comes with being public. Communication with investors, analysts, regulators and other stakeholders is ongoing and crucial and directors and officers must be prepared to excel in this area.
- **Ability to cope with compliance requirements**—the onerous disclosure and filing requirements to which public companies are subject, along with rigid three month deadlines, require a diligence and an attention to detail which may not be compatible with the creative genius of some of the founding members of an emerging company.
- **Understanding and respect for obligations to shareholders**—it is crucial that founding members and original investors understand that with the access to capital provided by going public comes the dilution of control. Many decisions will now be subject to shareholder approval, and a founder who can’t “let go” will likely cause problems.

Members of the board or management team with experience in a public company will be a great asset. Those with experience in taking a company public will be even more valuable. Those without experience would be wise to take advantage of excellent education programs such as the bootcamp run by the Toronto Stock Exchange and the TSX Venture Exchange.

The result of the evaluation of the skill sets of management and the board of directors against those required for directors and officers of a public company may lead to the conclusion that additional people are needed, or emphasize how valuable some team members are. This may provide a good starting point to address issues of human capital; namely attracting, retaining, motivating, and compensating talent. The evaluation may also suggest that some team members are not equipped to continue their roles in a public company, or should consider transitioning to a different role within the company.

The need for honest self-evaluation by the CFO

While evaluating the skill sets of other members of senior management, it is critical that CFOs make an objective assessment of their own abilities in order to determine their capacity to be the CFO of a public company. In some cases, a responsible CFO will undertake education or training in order to make up for lack of experience in a certain area. Some CFOs also decide to step down or to assume an alternate role in the company.

When a founder just can’t let go

One of the most difficult situations is when a company is nearly ready to go public but has a founder who isn’t willing to relinquish control. While approving in principle the idea of a public offering, this founder has not yet grasped the idea that the company will no longer be theirs. It is crucial for the success of the company that this issue is dealt with prior to the public offering. Some experts recommend transitioning the founder onto the board so as to continue to benefit from their years of experience and knowledge of the company.

Securing a strong, independent board of directors

A strong board of directors will have a dramatic impact, both on the success of the company in going public as well as its performance afterwards. Committed, experienced board members will bring not only expertise but their reputations to the table. The newer the company, and the less history of success that it can point to, the greater the reliance that investors and analysts will place on the reputations of board members. The members of the board should be identified in advance of the anticipated date for going public.

SKILL SETS REQUIRED

One of the primary concerns in selecting directors must always be the skill sets that they bring to the table. Whether it be public company experience, industry connections, or technical expertise, it is important that owners and management clearly identify the skill sets currently in place and those that are lacking, and make a determined effort to recruit directors to meet the needs identified.

When recruiting board members, attention should also be paid to the specific skill sets required for certain board committees. In addition to the financial literacy requirement for audit committee members, recommended committees such as the compensation committee and the nominating committee also require board members with special skills and experience.

For more information, please see the CICA publication *20 Questions Directors Should Ask about Building a Board*.

Just as existing members of management and the board must meet the highest standards of integrity and have impeccable backgrounds, due diligence must be done to ensure that potential new board members meet these standards as well.

INDEPENDENCE

One of the challenges that many emerging companies face in building a board is the fact that the board that has been in place since the inception of the company is frequently made up of founders and investors, and although it has served the private company well, it may not meet the requirements or best practices for board composition of a public company, particularly in terms of independence.

Director independence is defined in the CSA's Multilateral Instrument 52-110 as having "no direct or indirect material relationship with the issuer". A "material relationship" is one that "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."⁷ Individuals that are not independent include current and former employees as well as professional advisors.

The CSA's *Corporate Governance Guidelines* in National Policy 58-201 recommend that the majority of directors be independent, and that the nomination and compensating committees be composed entirely of independent directors. More importantly, Multilateral Instrument 52-110 *requires* that every company have an audit committee composed of a minimum of three members who must be independent. Venture issuers are exempt from this requirement, although they must disclose in their annual filings whether or not the audit committee members are independent.

⁷ MI 52-110, s. 1.4(1). The entire provision is included as Appendix B.

FINANCIAL LITERACY

In addition to the independence requirement, Multilateral Instrument 52-110 requires that all audit committee members be financially literate, or become so within a reasonable period of time following appointment. Under 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”.⁸ Again, venture issuers are exempt from this requirement, although they must disclose the financial literacy (or lack thereof) of audit committee members in their annual filings.

RECRUITMENT AND RETENTION

Recruiting independent board members can be a major challenge for new and emerging companies. While many directors are recruited via word of mouth and personal connections, consideration should be given to broadening the search by looking to graduates of director accreditation programs and matching services.

Another challenge for emerging companies is providing sufficient compensation to attract directors. A good compensation system provides fair compensation for the services directors perform and aligns their individual interests with those of the company. Emerging companies unable to afford high levels of cash compensation to directors may have to rely more heavily on stock-based compensation.

A comprehensive Directors’ and Officers’ liability insurance package will also be critical in order to recruit directors.

Although it may not be possible to build the ideal board at the outset, it will always be possible to strengthen it as the company grows.

For more information, please see the CICA publication *20 Questions Directors Should Ask about Director Compensation*.

For more information, please see the CICA publication *20 Questions Directors Should Ask about Directors’ and Officers’ Liability Indemnification and Insurance*.

Ensuring that corporate governance complies with best practices

Good corporate governance is essential for any company, whether public or private, but is especially important for companies preparing to go public due to the additional responsibilities of the company’s officers and board of directors, and the additional scrutiny to which the company and its practices will be subject.

There are several sources of information on best practices in corporate governance. The CSA’s *Corporate Governance Guidelines* are contained in National Policy 58-201.⁹ The guidelines are not mandatory, but compliance (or lack of) must be disclosed. The areas addressed are:

- **Composition of the board**—the board should have a majority of independent directors and be led by an independent chair or lead director.
- **Meetings of independent directors**—the independent directors should meet regularly in the absence of management.

⁸ MI 52-110 s. 1.6

⁹ National Policy 58-201 is included as Appendix C.

- **Board mandate**—the board should adopt a written mandate expressly acknowledging responsibility for stewardship of the company, including:
 - the integrity of officers and the organization
 - strategic planning
 - risk identification and management
 - succession planning
 - communication policy
 - internal control and management information systems
 - corporate governance
- **Position descriptions**—should be developed for the CEO, chair of the board, and chairs of board committees.
- **Orientation and continuing education**—the board should ensure that new directors receive a comprehensive orientation and that all board members have opportunities for ongoing education.
- **Code of business conduct and ethics**—the board should adopt and monitor compliance with a written code of business conduct and ethics, addressing:
 - conflicts of interest
 - protection and use of corporate assets and opportunities
 - confidentiality of corporate information
 - fair dealing with stakeholders
 - compliance with laws, rules and regulations
 - reporting of illegal or unethical behavior (whistleblower policies).
- **Nomination of directors**—the board should have a nominating committee composed of independent directors with a written charter, and should follow specific steps in nominating or appointing directors.
- **Compensation committee**—the board should have a compensation committee composed of independent directors with a written charter.
- **Regular board assessments**—the board, its committees and each individual director should be regularly assessed as to effectiveness and contribution.

Groups such as the Canadian Coalition for Good Governance also offer corporate governance guidelines for public companies.¹⁰

The CFO, CEO and board of directors should review the existing corporate governance practices of the company against recognized best practices and determine where changes need to be made. In some areas, it may simply be a case of formalizing existing processes and structures, while in others, the bar may need to be raised. There may be some areas in which emerging companies are not able to fully comply initially, and so a plan should be developed to bring the company into compliance as soon as possible.

Developing a communications strategy

A well thought-out communications strategy is very important during the preparation for taking the company public. On one hand, the CEO and CFO must be able to effectively communicate the company's "story" to investment bankers, analysts and investors to generate interest in the company's shares. On the other hand, communications must be carefully man-

¹⁰ See *Corporate Governance Guidelines for Building High Performance Boards*. Canadian Coalition for Good Governance, 2005.

aged in order not to run afoul of strict rules which govern corporate communication during the going public process.

Forthright communication is important with all key stakeholders:

- **Existing shareholders and investors**—communication is essential to maintain their trust and involvement.
- **Major customers and suppliers**—should not be neglected, as CFOs will want to ensure their continued support.
- **Analysts and potential investors**—building and maintaining relationships with analysts is key to building investor interest.
- **Regulators**—early and honest communication is important to develop trust and rapport, which will aid in the smooth execution of the going public transaction.

It is essential that the company be able to communicate its value proposition, or tell its story. Some companies choose to hire consultants to assist in the process, in order to maximize efficiency and help to develop the skills of the CFO and CEO. Others are comfortable designing and managing their communications strategy in house. While the CFO will be involved in telling the company's story, his or her part of the story is usually less of a "sales pitch" and more of a sober analysis. It is up to the CFO to demonstrate to potential investors that the company can live up to the promises made by the CEO. The CEO and CFO should work together to ensure that the scale of the strategy is based on the needs of the corporation: over-hyping and failing to live up to promises can be every bit as damaging as failing to generate market interest in the first place.

The CFO should also be aware that many jurisdictions have regulations governing communications in the period immediately prior to going public. For example, it is frequently impermissible to disclose any information not contained in the prospectus during the period after a prospectus is filed and prior to the initial public offering. It is recommended that companies develop a disclosure policy, authorizing only certain members of the company to speak on its behalf, and ensure that this policy is made public.

As the company becomes public, the role of the CFO will involve more communication than ever before, and the communications strategy should be reviewed and updated as necessary. Ongoing communications and investor relations will be discussed further in Part III.



What will life be like as a public company?

It is critical that CFOs clearly understand what life will be like as a public company when recommending whether or not to take the company public. The transition from private to public company involves a total cultural change, affecting everything from company strategy to executive compensation arrangements, regulatory obligations and liability. Once public, it is extremely difficult to go private again, and many companies are taken by surprise by the rigors of life in the public sphere.

The public company realm has been likened to “life in a goldfish bowl”. Suddenly, nearly everything the company, its executives, or its board does is public knowledge, subject to scrutiny by shareholders, regulators, analysts, and others. This impacts virtually every facet of the company and the way it does business.

Part of the increased disclosure burden is due to the regulatory requirement of quarterly reporting. The company’s future is now broken down into a series of three month intervals, each with its looming deadlines. This additional disclosure creates a substantial burden in terms of work for the CFO and finance staff, but also brings with it the risk of short-termism and the loss of focus on the company’s long-term strategy.

The CFO’s job will become more challenging than ever. After the intensive work involved in taking the company public, there will be little chance to rest. New responsibilities will include complying with regulatory requirements as well as managing investor relations. The CEO and board of directors will have corresponding obligations, and it often falls to the CFO to educate the other members of the management team, and sometimes even the board, as to the details of their new roles and responsibilities.

Coping with increased disclosure obligations

The extent of the scrutiny to which a public company is subject shocks many unprepared CFOs and changes the way the business is run. It is not just the company’s financial statements that must be disclosed, but also information such as executive compensation, environmental policies, risk factors, intercorporate relations, legal proceedings, and material contracts.

Continuous disclosure obligations are governed by National Instrument 51-102, which sets out the obligations of reporting issuers relating to financial statements, management's discussion and analysis, annual information forms, material change reports, business acquisition reports, proxy solicitation and information circulars, and other disclosure requirements.¹¹

ANNUAL INFORMATION FORMS

A reporting issuer that is not a venture issuer must file an Annual Information Form. Annual information forms are intended to provide material information about a company, describing the company, its operations, prospects, risks and other external factors. They must comply with 51-102F2 and include disclosure of items such as:

- intercorporate relationships
- significant acquisitions
- the business of the company, including competitive conditions and economic dependence
- social and environmental policies
- risk factors
- security holdings of directors and officers
- conflicts of interest
- legal proceedings and regulatory actions
- interests of management and others in material transactions

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis is intended to be a narrative explanation, through the eyes of management, of how the company performed during the period covered by the financial statements, and of the company's financial condition and future prospects. It must comply with 51-102F1, which requires extensive disclosure, including discussion of:

- overall performance, including financial condition, results of operations and cash flows
- liquidity and capital resources
- transactions including off-balance sheet arrangements and related-party transactions
- critical accounting estimates and changes to accounting policy

For more information, please see the
[CICA publication *20 Questions Directors Should Ask about Management's Discussion and Analysis*](#)

¹¹ Note that there are exceptions or exemptions to some disclosure requirements for venture issuers under NI 51-102, however these exceptions or exemptions should be carefully reviewed with the TSX Venture Corporate Finance Manual as venture Policy may still require certain disclosures notwithstanding any exceptions or exemptions available to venture issuers under NI 51-102.

MATERIAL CHANGE REPORTING

Material change reports, along with press releases, must be issued and filed with the relevant securities commission(s) whenever a “material change” occurs. A “material change” is defined in NI 51-102 as follows:

- (a) a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer; or
- (b) a decision to implement a change referred to in paragraph (a) made by the board of directors or other persons acting in a similar capacity or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors or any other persons acting in a similar capacity is probable.

The *Timely Disclosure Guideline* of the TSX, contained in Part IV of the *TSX Company Manual*, supplements NI 51-102, and is the primary timely disclosure standard for all TSX listed issuers. It deals with material information, which is defined as “any information relating to the business and affairs of a company that results in or would reasonably be expected to result in a significant change in the market price or value of any of the company’s listed securities”¹². Material information consists of both material facts and material changes relating to the business and affairs of a listed company. The policy requires immediate disclosure of material information.

TSX Venture Policy 3.3 *Timely Disclosure Policy* in the TSX Venture Corporate Finance Manual also supplements NI 51-102 and is the primary disclosure standard for all TSX Venture listed issuers. It deals with material information and specific events that are deemed material without limiting the concept of material information. In addition, the policy addresses pre-filing requirements with Market Regulations Services, trading halts, contents of news releases, and confidential filings. To further assist in the creation and understanding of disclosure there is also Appendix 3E *News Release Guidelines* in the TSX Venture Exchange Corporate Finance Manual.

Companies should also reference National Policy 51-201 *Disclosure Standards*, which deals with selective disclosure of material information.

CORPORATE GOVERNANCE REPORTING

Disclosure of corporate governance practices is mandated by National Instrument 58-101, and requires disclosure of compliance (or lack thereof) with the *Corporate Governance Guidelines* contained in National Policy 58-201. This includes:

- independence of board members
- mandate
- position descriptions
- orientation and education
- code of ethics
- compensation
- board committees
- board assessments
- nomination procedures

¹² TSX Company Manual, s. 407.

INSIDER TRADING REPORTS

Insider trading is addressed in the TSX *Timely Disclosure Guidelines*, TSX Venture Policy 3.1 *Directors, Officers and Corporate Governance*, provincial *Securities Acts*, and the *Canada Business Corporations Act*. The Ontario *Securities Act* requires insiders who own securities of a listed company to file an initial report with the Ontario Securities Commission upon becoming insiders and to report all trades made in the securities of the company of which they are insiders within ten days after a trade is made.

The TSX and TSX Venture guidelines recommend that listed companies should establish a clear written policy to help them comply with the disclosure rules. Every company's policy should:

- describe the procedures to be followed and spell out the consequences of violations,
- be updated regularly, and
- be brought to the attention of employees regularly.

The policy should also give specific guidance in the following areas:

- disclosing material information,
- maintaining the confidentiality of information, and
- restricting employee trading.¹³

Companies should also reference National Policy 51-201 *Disclosure Standards* when establishing a disclosure policy.

OTHER MANDATORY DISCLOSURE

In addition to the above, special disclosure obligations apply to certain industries, such as mineral projects (NI 43-101) and oil and gas activities (NI 51-101).

Complying with regulatory requirements regarding financial disclosure

The CFO of a public company must work to an ongoing series of three month deadlines to comply with regulatory requirements regarding the disclosure of financial information, which includes:

- annual and interim financial statements
- quarterly news releases
- management's discussion and analysis
- CEO and CFO certifications
- annual information form

There may be additional disclosure required, depending on the stock exchange and securities commission. Going forward, companies must ensure that they continue to comply with the listing requirements of the exchange.

¹³ TSX Company Manual s.423.5, TSX Venture Corporate Finance Manual Appendix 3B

Scrupulous attention to fair presentation in all financial reporting is essential, as restatements can be catastrophic to a newly public company's reputation. In addition, it must not be forgotten that many of the required filings may also expose CFOs and CEOs to the risk of litigation under secondary market liability legislation.

These regulatory compliance requirements impose an enormous burden, both in terms of the workload involved for management as well as the financial cost. Another, more hidden, cost is the risk of "short-termism": the exclusive focus on quarterly results and keeping the stock price up, to the detriment of the company's long term strategy. It can be very difficult to take the time to step back and look at the bigger picture, as well as to defend a more long term approach when analysts and investors are focusing on the quarterly results.

Financial reporting obligations can be especially burdensome for smaller companies which may have fewer resources. The best advice that can be given for all companies is to ensure that adequate systems and staff are in place to deal with accounting and disclosure, and to develop a routine of compliance, preferably before going public.

Fulfilling obligations to shareholders

Obligations to shareholders trigger another set of disclosure responsibilities. Public companies are required under applicable corporate legislation to hold annual meetings. Advance notice of these meetings must be given, and shareholders must be provided with a prescribed form of proxy, and an information circular.

The information circular is governed by form 51-102F5 and must include:

- particulars of matters to be acted on at meeting
- details of directors standing for election
- material interest of certain parties in matters to be acted upon
- statement of executive compensation
- security ownership of directors, principal shareholders, and management

In addition, National Instrument 54-101 *Communications with Beneficial Owners of Securities of a Reporting Issuer* contains further regulations regarding communication between reporting issuers, beneficial owners of shares, and third parties.

CFOs, CEOs and boards of directors must remember the reason for the increased disclosure obligations: once public, the company will no longer belong to the founders but to the shareholders, and obligations to them must be met. These are all issues which should be considered and discussed prior to deciding to take the company public.

Adapting to the new role of the CFO

The role of the CFO will change dramatically once the company becomes public. There will be new priorities, new skill sets required, and new dynamics in existing relationships, including the relationship between the CEO and CFO. The CFO of a public company will also have new responsibilities such as compliance and reporting and investor relations.

COMPLIANCE

Compliance and reporting, as discussed above, involves a huge expenditure of time and effort. It is important for the CFO to be able to prioritize and delegate. Many companies hire more staff in their finance department around the time that they go public, and the CFO may find that a controller, director of financial reporting, or controller of external reporting is an invaluable support. In addition, the CFO will generally become the primary educator of senior management with respect to the new compliance and reporting obligations.

The increased disclosure obligations highlight the importance of reliable information systems. The CFO will have overall responsibility for the systems generating the quarterly financial information as well as ongoing operating information. It is crucial that information systems generate timely and effective operating information which then rolls seamlessly into quarterly statements.

Many find that while the CFO of a public company remains in charge of the “big picture”, and brings the finance perspective to company strategy, he or she is less involved in the day to day accounting of the company. The CFO must be able to look forward and plan for growth, guarding against the risks of short-termism and working with the CEO to maintain a strategic focus on the company’s long-term plans. At the same time, however, the CFO cannot lose track of his or her responsibility for the financial statements, and the certification requirements mandate an extremely detailed level of attention.

INVESTOR RELATIONS

Investor relations will likely take on a greater importance once the company is public. Instead of dealing only with two or three knowledgeable investors, the CFO is now responsible for communications with what may be a very diverse group of shareholders. This will vary somewhat depending on whether shareholders are primarily retail or institutional.

For more information, please see the CICA publication *How CFOs are Adapting to Today’s Realities*

The CFO is the voice of the company when addressing investors, and communication is critical. Many CFOs seek the assistance of an investor relations expert. This may be done by hiring an investor relations specialist as an employee of the company or contracting with an investor relations firm.

Managing ongoing communications and delivering on the promise

Once the company is public, the CFO, working with the CEO and the board of directors, must ensure that they deliver on the promise made to investors in the prospectus and during the road show. Communication and good stakeholder relations will be critical to maximizing the company’s performance in the aftermarket.

The scrutiny will be constant. With every quarterly filing, the company must demonstrate key elements including:

- **Effective use of proceeds of IPO** — one of the first indicators of a company's management is the use that is made of the IPO proceeds.
- **Operational success** — concrete measures of operational success will demonstrate the company's commitment and boost investor confidence.
- **Increasing shareholder value** — demonstrating increasing value to shareholders or managing expectations where necessary.
- **Ability to meet or beat forecasts** — failure to meet forecasts once public can be extremely damaging to stock prices.

Frequent and forthright communication with investors, regulators and other stakeholders will be necessary in order to keep interest up and maintain liquidity. This will be an ongoing process, as the market's response must be gauged and the message refined to become more effective. The CFO will be front and center with the CEO in communicating the company's strategy to the market.

Finally, CFOs should not rest on their laurels once a company has successfully gone public. The next set of strategic goals will need to be developed in consultation with management and the board and the first steps taken to achieve them.

Conclusion

In making the decision as to whether or not to take a company public, it is essential that CFOs, in consultation with management, owners and the board of directors, address the three key areas discussed:

- analyzing the factors to be considered in taking the company public
- knowing what the company should have in place prior to going public, and
- understanding what life will be like as a public company.

Consideration of these elements will allow for an informed decision as to whether or not going public is the right choice for the company, and maximize the chances of success if the decision is made to go ahead.

Where to Find More Information

Canadian Institute of Chartered Accountants publications¹:

20 QUESTIONS SERIES

- 20 Questions Directors and Audit Committees Should Ask about IFRS Conversions
- 20 Questions Directors Should Ask about Building a Board
- 20 Questions Directors Should Ask about Codes of Conduct
- 20 Questions Directors Should Ask about Crisis Management
- 20 Questions Directors Should Ask about Crown Corporation Governance
- 20 Questions Directors Should Ask about Director Compensation
- 20 Questions Directors Should Ask about Directors' and Officers' Liability Indemnification and Insurance
- 20 Questions Directors Should Ask about Executive Compensation
- 20 Questions Directors Should Ask about Governance Assessments
- 20 Questions Directors Should Ask about Internal Audit
- 20 Questions Directors Should Ask about IT
- 20 Questions Directors Should Ask about Management's Discussion and Analysis
- 20 Questions Directors Should Ask about their Role in Pension Governance
- 20 Questions Directors Should Ask about Risk
- 20 Questions Directors Should Ask about Special Committees
- 20 Questions Directors Should Ask about Strategy

¹ More information available at www.rmgbc.ca

NOT-FOR-PROFIT SERIES

20 Questions Directors of Not-for-profit Organizations Should Ask about Governance

20 Questions Directors of Not-for-profit Organizations Should Ask about Strategy and Planning

CFO SERIES

Financial Aspects of Governance: What Boards Should Expect from CFOs

How CFOs are Adapting to Today's Realities

Risk Management: What Boards Should Expect from CFOs

Strategic Planning: What Boards Should Expect from CFOs

CONTROL ENVIRONMENT SERIES

CEO and CFO Certification: Improving Transparency and Accountability

Internal Control: The Next Wave of Certification—Helping Smaller Public Companies with Certification and Disclosure about Design of Internal Control over Financial Reporting

Internal Control 2006: The Next Wave of Certification—Guidance for Directors

Internal Control 2006: The Next Wave of Certification—Guidance for Management

Understanding Disclosure Controls and Procedures: Helping CEOs and CFOs Respond to the Need for Better Disclosure

Additional References:

Corporate Governance Guidelines for Building High Performance Boards. Canadian Coalition for Good Governance, 2005

Going Public in Canada: Issues and Considerations Associated with an Initial Public Offering. Stikeman Elliott LLP, 2006

Going Public in Canada and the United States. Davies Ward Phillips & Vineberg LLP, 2006

IPO Insights: Comparing Global Stock Exchanges. Ernst & Young, 2007

Lessons from Leaders: How to Prepare for a Successful IPO. Ernst & Young, 2008

Questions That Should Be Asked At the Outset Before You Start the Process. Jim Defer. <http://www.bctechnology.com/connector/scripts/experts/public4.cfm>

Strategies for going public and accessing capital in Canada. Deloitte & Touche LLP and TSX Inc. 2007

The Guide to Going Public. PriceWaterhouseCoopers LLP, 1999

TSX Company Manual



Appendix A

METHODS OF GOING PUBLIC IN CANADA¹

Most issuers that become public companies in Canada will list their securities on one of the two principal stock exchanges in Canada: the Toronto Stock Exchange, also known as the “TSX”, and the TSX Venture Exchange, also known as the “TSX-V”.

A company can go public on the TSX or the TSX-V via an IPO, a reverse take-over or through the TSX-V capital pool program, each of which is described below.

INITIAL PUBLIC OFFERING

An IPO is the traditional method of obtaining a listing on a stock exchange. This method involves the issuance of securities in a public offering by means of a detailed prospectus filed publicly with the relevant securities commissions and the subsequent completion of an application for a public listing on an exchange. The prospectus provides potential investors with all material information related to the issuer and the securities being issued.

REVERSE TAKE-OVER

A reverse take-over (or “RTO”), also known as a back door listing or reverse merger, can be done in a number of ways, including an amalgamation or issuance of shares in exchange for other shares or assets of the issuer. Such a transaction involves an already listed “shell” company that no longer has an operating business but continues to have public shareholders. The company resulting from the RTO must meet the original listing requirements of the TSX or TSX-V and must submit to an approval procedure similar to that of an original listing application.

¹ The material in this question is taken from *Going Public in Canada and the United States*, Davies Ward Phillips and Vineberg LLP, 2006 at p. 3.

TSX-V CAPITAL POOL COMPANY PROGRAM

The TSX-V allows an issuer to list as a capital pool company (or “CPC”). The CPC program was designed as a corporate finance vehicle aimed at providing businesses with the opportunity to obtain financing and public company management expertise, when a traditional IPO is not the preferred route. The CPC program permits an IPO to be conducted and a TSX-V listing to be obtained by a newly created company that has no assets, other than cash, and has not commenced commercial operations. The CPC is then expected to use this “pool” of funds to identify and evaluate potential assets or businesses which, when acquired, would qualify the CPC for listing on the TSX-V.



Appendix B

MULTILATERAL INSTRUMENT 52-110

AUDIT COMMITTEES

1.4 Meaning of Independence —

- (1) An audit committee member is independent if he or she has no direct or indirect material relationship with the issuer.
- (2) For the purposes of subsection (1), a “material relationship” is a relationship 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.
- (3) Despite subsection (2), the following individuals are considered to have a material relationship with an issuer:
 - (a) an individual who is, or has been within the last three years, an employee or executive officer of the issuer;
 - (b) an individual whose immediate family member is, or has been within the last three years, an executive officer of the issuer;
 - (c) an individual who:
 - (i) is a partner of a firm that is the issuer’s internal or external auditor,
 - (ii) is an employee of that firm, or
 - (iii) was within the last three years a partner or employee of that firm and personally worked on the issuer’s audit within that time;
 - (d) an individual whose spouse, minor child or stepchild, or child or stepchild who shares a home with the individual:
 - (i) is a partner of a firm that is the issuer’s internal or external auditor,
 - (ii) is an employee of that firm and participates in its audit, assurance or tax compliance (but not tax planning) practice, or
 - (iii) was within the last three years a partner or employee of that firm and personally worked on the issuer’s audit within that time;
 - (e) an individual who, or whose immediate family member, is or has been within the last three years, an executive officer of an entity if any of the issuer’s current executive officers serves or served at that same time on the entity’s compensation committee; and
 - (f) an individual who received, or whose immediate family member who is employed as an executive officer of the issuer received, more than \$75,000 in direct compensation from the issuer during any 12 month period within the last three years.

- (4) Despite subsection (3), an individual will not be considered to have a material relationship with the issuer solely because
 - (a) he or she had a relationship identified in subsection (3) if that relationship ended before March 30, 2004; or
 - (b) he or she had a relationship identified in subsection (3) by virtue of subsection (8) if that relationship ended before June 30, 2005.
- (5) For the purposes of clauses (3)(c) and (3)(d), a partner does not include a fixed income partner whose interest in the firm that is the internal or external auditor is limited to the receipt of fixed amounts of compensation (including deferred compensation) for prior service with that firm if the compensation is not contingent in any way on continued service.
- (6) For the purposes of clause (3)(f), direct compensation does not include:
 - (a) remuneration for acting as a member of the board of directors or of any board committee of the issuer, and
 - (b) 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) Despite subsection (3), an individual will not be considered to have a material relationship with the issuer solely because the individual or his or her immediate family member
 - (a) has previously acted as an interim chief executive officer of the issuer, or
 - (b) acts, or has previously acted, as a chair or vice-chair of the board of directors or of any board committee of the issuer on a part-time basis.
- (8) For the purpose of section 1.4, an issuer includes a subsidiary entity of the issuer and a parent of the issuer.

1.5 Additional Independence Requirements –

- (1) Despite any determination made under section 1.4, an individual who
 - (a) accepts, 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 board of directors or any board committee, or as a part-time chair or vice-chair of the board or any board committee; or
 - (b) is an affiliated entity of the issuer or any of its subsidiary entities,
 is considered to have a material relationship with the issuer.
- (2) For the purposes of subsection (1), the indirect acceptance by an individual of any consulting, advisory or other compensatory fee includes acceptance of a fee by
 - (a) an individual's spouse, minor child or stepchild, or a child or stepchild who shares the individual's home; or
 - (b) an entity in which such individual is a partner, member, an officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary entity of the issuer.
- (3) For the purposes of subsection (1), 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.



Appendix C

NATIONAL POLICY 58-201 CORPORATE GOVERNANCE GUIDELINES

PART 1 PURPOSE AND APPLICATION

1.1 Purpose of this Policy—This Policy provides guidance on corporate governance practices which have been formulated to:

- achieve a balance between providing protection to investors and fostering fair and efficient capital markets and confidence in capital markets;
- be sensitive to the realities of the greater numbers of small companies and controlled companies in the Canadian corporate landscape;
- take into account the impact of corporate governance developments in the U.S. and around the world; and
- recognize that corporate governance is evolving.

The guidelines in this Policy are not intended to be prescriptive. We encourage issuers to consider the guidelines in developing their own corporate governance practices.

1.2 Application—This Policy applies to all reporting issuers, other than investment funds. Consequently, it applies to both corporate and non-corporate entities. Reference to a particular corporate characteristic, such as a board of directors (the board), includes any equivalent characteristic of a non-corporate entity. For example, in the case of a limited partnership, we recommend that a majority of the directors of the general partner should be independent of the limited partnership (including the general partner).

Income trust issuers should, in applying these guidelines, recognize 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.

PART 2 MEANING OF INDEPENDENCE

2.1 Meaning of Independence—For the purposes of this Policy, a director is independent if he or she would be independent for the purposes of National Instrument 58-101 *Disclosure of Corporate Governance Practices*.

PART 3 CORPORATE GOVERNANCE GUIDELINES

Composition of the Board

3.1 The board should have a majority of independent directors.

3.2 The chair of the board should be an independent director. Where this is not appropriate, an independent director should be appointed to act as “lead director”. However, either an independent chair or an independent lead director should act as the effective leader of the board and ensure that the board’s agenda will enable it to successfully carry out its duties.

Meetings of Independent Directors

3.3 The independent directors should hold regularly scheduled meetings at which non-independent directors and members of management are not in attendance.

Board Mandate

3.4 The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for:

- (a) to the extent feasible, satisfying itself as to the integrity of the chief executive officer (the CEO) and other executive officers and that the CEO and other executive officers create a culture of integrity throughout the organization;
- (b) adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business;
- (c) the identification of the principal risks of the issuer’s business, and ensuring the implementation of appropriate systems to manage these risks;
- (d) succession planning (including appointing, training and monitoring senior management);
- (e) adopting a communication policy for the issuer;
- (f) the issuer’s internal control and management information systems; and
- (g) developing the issuer’s approach to corporate governance, including developing a set of corporate governance principles and guidelines that are specifically applicable to the issuer.¹

The written mandate of the board should also set out:

- (i) measures for receiving feedback from stakeholders (e.g., the board may wish to establish a process to permit stakeholders to directly contact the independent directors), and
- (ii) expectations and responsibilities of directors, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

¹ Issuers may consider appointing a corporate governance committee to consider these issues. A corporate governance committee should have a majority of independent directors, with the remaining members being “non-management” directors.

In developing an effective communication policy for the issuer, issuers should refer to the guidance set out in National Policy 51-201 *Disclosure Standards*.

For purposes of this Policy, “executive officer” has the same meaning as in National Instrument 51-102 *Continuous Disclosure Obligations*.

Position Descriptions

3.5 The board should develop clear position descriptions for the chair of the board and the chair of each board committee. In addition, the board, together with the CEO, should develop a clear position description for the CEO, which includes delineating management’s responsibilities. The board should also develop or approve the corporate goals and objectives that the CEO is responsible for meeting.

Orientation and Continuing Education

3.6 The board should ensure that all new directors receive a comprehensive orientation. All new directors should fully understand the role of the board and its committees, as well as the contribution individual directors are expected to make (including, in particular, the commitment of time and resources that the issuer expects from its directors). All new directors should also understand the nature and operation of the issuer’s business.

3.7 The board should provide continuing education opportunities for all directors, so that individuals may maintain or enhance their skills and abilities as directors, as well as to ensure their knowledge and understanding of the issuer’s business remains current.

Code of Business Conduct and Ethics

3.8 The board should adopt a written code of business conduct and ethics (a code). The code should be applicable to directors, officers and employees of the issuer. The code should constitute written standards that are reasonably designed to promote integrity and to deter wrongdoing. In particular, it should address the following issues:

- (a) conflicts of interest, including transactions and agreements in respect of which a director or executive officer has a material interest;
- (b) protection and proper use of corporate assets and opportunities;
- (c) confidentiality of corporate information;
- (d) fair dealing with the issuer’s security holders, customers, suppliers, competitors and employees;
- (e) compliance with laws, rules and regulations; and
- (f) reporting of any illegal or unethical behaviour.

3.9 The board should be responsible for monitoring compliance with the code. Any waivers from the code that are granted for the benefit of the issuer’s directors or executive officers should be granted by the board (or a board committee) only.

Although issuers must exercise their own judgement in making materiality determinations, the Canadian securities regulatory authorities consider that conduct by a director or executive officer which constitutes a material departure from the code will likely constitute a “material change” within the meaning of National Instrument 51-102 *Continuous Disclosure Obligations*. National Instrument 51-102 requires every material change report to include a full description of the material change. Where a material departure from the code consti-

tutes a material change to the issuer, we expect that the material change report will disclose, among other things:

- the date of the departure(s),
- the party(ies) involved in the departure(s),
- the reason why the board has or has not sanctioned the departure(s), and
- any measures the board has taken to address or remedy the departure(s).

Nomination of Directors

3.10 The board should appoint a nominating committee composed entirely of independent directors.

3.11 The nominating committee should have a written charter that clearly establishes the committee's purpose, responsibilities, member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members and subcommittees), and manner of reporting to the board. In addition, the nominating committee should be given authority to engage and compensate any outside advisor that it determines to be necessary to permit it to carry out its duties. If an issuer is legally required by contract or otherwise to provide third parties with the right to nominate directors, the selection and nomination of those directors need not involve the approval of an independent nominating committee.

3.12 Prior to nominating or appointing individuals as directors, the board should adopt a process involving the following steps:

- (A) Consider what competencies and skills the board, as a whole, should possess. In doing so, the board should recognize that the particular competencies and skills required for one issuer may not be the same as those required for another.
- (B) Assess what competencies and skills each existing director possesses. It is unlikely that any one director will have all the competencies and skills required by the board. Instead, the board should be considered as a group, with each individual making his or her own contribution. Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic.

The board should also consider the appropriate size of the board, with a view to facilitating effective decision-making. In carrying out each of these functions, the board should consider the advice and input of the nominating committee.

3.13 The nominating committee should be responsible for identifying individuals qualified to become new board members and recommending to the board the new director nominees for the next annual meeting of shareholders.

3.14 In making its recommendations, the nominating committee should consider:

- (a) the competencies and skills that the board considers to be necessary for the board, as a whole, to possess;
- (b) the competencies and skills that the board considers each existing director to possess; and
- (c) the competencies and skills each new nominee will bring to the boardroom.

Compensation

3.15 The board should appoint a compensation committee composed entirely of independent directors.

3.16 The compensation committee should have a written charter that establishes the committee's purpose, responsibilities, member qualifications, member appointment and removal, structure and operations (including any authority to delegate to individual members or subcommittees), and the manner of reporting to the board. In addition, the compensation committee should be given authority to engage and compensate any outside advisor that it determines to be necessary to permit it to carry out its duties.

3.17 The compensation committee should be responsible for:

- (a) reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those corporate goals and objectives, and determining (or making recommendations to the board with respect to) the CEO's compensation level based on this evaluation;
- (b) making recommendations to the board with respect to non-CEO officer and director compensation, incentive compensation plans and equity-based plans; and
- (c) reviewing executive compensation disclosure before the issuer publicly discloses this information.

Regular Board Assessments

3.18 The board, its committees and each individual director should be regularly assessed regarding his, her or its effectiveness and contribution. An assessment should consider

- (a) in the case of the board or a board committee, its mandate or charter, and
- (b) in the case of an individual director, the applicable position description(s), as well as the competencies and skills each individual director is expected to bring to the board.

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