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FINANCIAL DISCLOSURE

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Before attempting to draft any of the provisions of the proposed new Act, there are a number of basic policy issues which must be considered. One major factor to be borne in mind is that extensive financial disclosure will in any event be required of all corporations incorporated under the new Act which issue securities to the public. It is assumed, for the purposes of these discussions, that the disclosure rules under a new Securities Act will closely follow those under the proposed Ontario Act.

1. PUBLIC DISCLOSURE.

The first question which must be considered is whether public disclosure, i.e. the filing with the Registrar of financial statements, is to be required of any corporation and, if so, of which corporations?

(a) Issuing corporations.

As stated above, these will have to make disclosure to the Commission under the SA. It may therefore be unnecessary to also require disclosure under the BCA. However:

(i) It may be desirable that financial information be also given to the Registrar and be accessible to the public in this way.

(ii) To do so imposes no extra burden on issuing corporations, provided the form and content of the information is the same.

(iii) There may be certain information which ought to be required under the BCA, being properly regarded as a matter of company law though not required by securities law.

If it is considered that financial disclosure is intended to benefit and protect persons other than investors, e.g. creditors, then it seems proper to require such disclosure under the BCA. Unnecessary duplication with the provisions of the SA should be avoided, so it is suggested that the disclosure requirements should be the same as under the SA, with the addition of any other information which it is considered proper to require under the BCA, if any.

(b) Non-issuing corporations.

The major question is whether any other corporation should be required to make public disclosure. This will depend, in part, upon whether the BCA should require additional information to that required by the SA, i.e., if it is felt that certain matters are a proper subject for disclosure under company law then it may be irrelevant whether or not the corporation is an issuing corporation.

Disclosure under the BCA might be required of:

(i) all public companies (whether issuing or not);

(ii) all companies with more than a specified number of shareholders, or with assets or turnover exceeding a specified amount;

(iii) all companies.

Two major objections can be made to the type of distinctions suggested in (i) and (ii). Firstly they tend to lead to avoidance devices, such as the reduction in the number of shareholders by means of trusts, etc., or the splitting up of an enterprise into smaller units, and these devices in turn lead to complex anti-avoidance provisions. Secondly, such distinctions are arbitrary in nature and normally have little regard to the purpose for which disclosure is required, e.g., if one requires disclosure of sales figures,

the number of shareholders is scarcely relevant.

The fundamental question seems to be whether or not some public disclosure should be required of all corporations This would not necessarily mean that the disclosure need be as detailed or extensive as that required under the SA of issuing corporations. Nor does it necessarily mean that the amount of type of disclosure might not vary from corporation to corporation according to certain criteria. Thus, certain basic information might be required of all corporations, with additional information from those which fall into certain categories, e.g., those with turnover in excess of a stated amount might be required to give details of sales, those with more than a specified number of shareholders might have to give details of directors' remuneration and those employing more than a certain number of workers might have to give information relating to employment conditions.

This would necessitate complex legislation and it therefore seems proper to first enquire whether public disclosure is necessary at all. In the United Kingdom, where public disclosure has been required of all companies since 1967 (though small private companies are exempted from some of the requirements), it now seems to be widely considered that the requirements are excessive, impose an unnecessary burden on small companies, may operate unfairly and possibly hinder economic growth. Partly as a result of EEC proposals it seems that the future trend will be to demand ever-increasing disclosure from large companies and to give more exemptions to private ones.

In favour of requiring public disclosure of all corporations it may be argued that this is a reasonable price to pay for the privileges of incorporation and of

limited liability. However, this can only be convincing if there is a valid purpose in requiring disclosure. If the "price" serves no valuable public function then it ought not to be demanded for its own sake. Nor, it is suggested, should it be demanded if the value to the public is out of all proportion to the cost or burden which it imposes upon corporations.

Against disclosure, it may be argued:

(i) it imposes an excessive administrative burden on small companies. This is almost certainly true if extensive disclosure, such as required by the SA, is demanded. However, if less detailed disclosure is required the burden is reduced considerably and it must be remembered that all corporations will, in any event, have to make proper disclosure to their own shareholders and to various tax authorities. Thus, every corporation will have to prepare financial accounts even if, in some cases, they may not be professionally audited.

(ii) Public disclosure can operate unfairly towards the small company. This is especially true where, for example, a private company is in direct completion in a particular locality with the branch of a major public company. However, exemption procedures will normally be available in such circumstances and the same is true where a local public company is in completion with a multi-national.

(iii) The affairs of a private company are of concern only to its shareholders and should not be a matter for public knowledge. A simple answer to this is that no one is compelled to incorporate - one can choose between the privilege of privacy and that of limited liability. However, as suggested above, such an answer can only be regarded as satisfactory provided there is a valid reason for requiring publicity. The

question can, perhaps, be phrased in the following manner: does the conferment of the benefit of corporate status and of limited liability give rise to any risk to the public, or any part of it, which should be protected against and can only, or can best, be prevented by means of public disclosure? To answer this question it is necessary to inquire as to the purpose and function of public disclosure.

(c) Purposes of public disclosure.

As Gower states (3rd edn, p. 472), "published accounts have become the linch-pin of the system of protection through disclosure." But whom is it sought to protect and against what?

(i) Shareholders. It seems ovbious that the principal intended beneficiaries are the shareholders. They "own" the company and are entitled to know the manner in which the management deals with "their" money. This, however, does not require public disclosure. Certainly, a shareholder should be entitled, unless he expressly waives his right, to receive properly prepared and audited financial statements from those who manage his company. If he has reason to suspect that all is not as it should be he can raise questions at the annual meeting, require the auditor to attend and answer, seek expert advice from his lawyer or accountant and pursue one or more of the various remedies available to him. None of this requires public disclosure. It is only in the rare case where, if the accounts were made public, some outsider, e.g. a financial analyst or researcher, might stumble upon some irregularity which had evaded the notice of the non-managing shareholders, that it can be said that public disclosure could assist the shareholders. This seems to be a very marginal benefit to weigh against the loss of privacy.

(ii) Potential investors. Protection is only necessary in the case of an issuing company and is provided by securities legislation. A person proposing to buy shares in a non-issuing company can obtain what would probably be the same information from his prospective vendor and will normally demand more up-to-date information from the company before investing. His main protection lies in the integrity and competence of the auditor: see Haig v. Bamford. A person who inherits, or is given, shares has no means of protection but it is difficult to see why he should be in any more favourable position than the shareholder from whom he receives them.

(iii) Creditors. Companies legislation has traditionally been as much concerned with the protection of creditors as with that of shareholders, and it is in this context that public disclosure can be seen as the corollary of limited liability. In theory, it seems entirely reasonable to demand that a person should be entitled to know the financial standing of the company to which he lends money or advances credit. What must be questioned, however, is the extent to which public disclosure of financial statements does provide any protection to creditors. No person is obliged to give creditor to a company. A lender may protect himself by first demanding financial information, by taking security for his loan or by taking a personal quarantee from the directors. All this is normal business practice and it is suggested that it is rarely if ever that a creditor examines the public record (or would do so if accounts were made public) before giving credit, or at any rate, does so without also taking more effective steps for his own protection. Apart from the fact that the requirement to file financial statements (and other information) may, of itself, act as a general deterrent to impropriety - a point which will

be considered later - it is suggested that public disclosure is of very little value in protecting creditors.

(iv) Other public interests. Public disclosure may be of value to the public generally, or to sections of the public other than shareholders, investors and creditors. A few examples of this may be considered:

(a) Government. Financial and other types of disclosure may be required by government for a variety of reasons. This information may be confidential, as between the government and the corporation (e.g. tax returns, information relevant to the awarding of a government contract or subsidy, etc.) or may be public, in the sense that it may be passed on to the public in published form (e.g. in government reports, statistics, etc.). In the former case it is obvious that the information ought not to be gathered by way of public disclosure by the corporation. In the latter case no such objection can be taken, but it may still be questioned whether this is a proper matter for companies legislation. For example, a government may require the disclosure of financial information for a variety of reasons - in connection with the control of monopolization or restrictive practices, in pursuance of a wages and prices control policy, in connection with a policy to encourage exports, investment, research, etc. It will frequently be desirable for the public to have access to this information and it may be that the most convenient way of publishing this information is in the annual financial statements of corporations. Generally this will probably not be the case. Financial statements are already too long and comple to be readily understandable and if information is

required for a particular purpose, e.g. in the fight against inflation, it will almost always be preferable for it to be published separately in a government report. The same is true in the case of non-financial disclosure. The trend, especially in Britain, has been to demand more and more informa tion from corporations on a great diversity of matters - environmental matters, pollution control, energy conservation, employment policy, health and safety at work, equal pay and discrimination, pensions and retirement arrangements, etc. It is certainly not suggested that such information ought not to be provided to the government, nor that they are not matters of public interest. However, it is suggested that these are not properly matters for companies legislation. For one thing, matters such as pollution control or employment poli concern all manufacturers or employers, whether or not incorporated. Secondly, the corporation's published documents at the Registry may not be the appropriate place for such information - to require ever increasing amounts of diverse information to be collected together in the annual return may be self-defeating, simply making it more difficult for a member of the public to find a particular piece of information which he requires. Finally, it is felt that a distinction must be drawn between what is properly companies legislation and what is simply legislation which affects companies. The majority of the matters mentioned above fall into the second category.

In conclusion, one might add that government scarcely needs to be "protected" by means of public financial disclosure by corporations.

(b) Employees. A more serious issue is whether public disclosure of financial accounts is desirable or necessary for the protection of employees and for the promotion of good industrial relations and responsible collective bargaining. It cannot be denied that employees and labour unions do make use of published financial statements of corporations and, indeed, if they are to be expected to behave in a responsible manner it is difficult to see how they can do so without being given some information as to the financial position of employers. This said, there are a variety of approaches to the problem:

(1) Given that issuing corporations must make public disclosure, and these are frequently the largest employers and will therefore tend to set wage levels in a particular area, it may be that one can simply rely upon normal market forces to operate upon private companies. If they genuinely cannot afford to pay the going wage rate then they will either have to convince their employees of the fact, by disclosure, or go out of business. Conversely, if they can afford to pay higher wages they are more likely to do so out of self-interest, to secure a loyal and contented work-force, than because they are made to disclose their financial position to the public. However, "normal" market forces do not always apply, e.g. in an area where the major employer is itself a private company.

(2) A more radical approach to the question of disclosure lies in the greater involvement of employees in the management and affairs of corporations, by means of worker-directors and statutory works councils, as in Europe. Alternative encouragement can be given to employee stock-option plans, so that employees will have access to

financial information in their capacity as shareholders rather than by means of public disclosure. Apart from the question whether such developments are appropriate in the context of Canadian corporate and industrial affairs, it should be pointed out that these developments, in Europe, are essentially restricted to corporations of public type. Thus, whatever their general merits and demerits, they do not appear to be relevant to the issue under consideration, namely whether private (or non-issuing) corporations should make public financial disclosure.

(3) It may be that all corporations which employ more than, say, 500 persons, should be required to make public disclosure. Provisions of this type exist in Europe. It can, however, be objected that this singles out the employment factor as a determining criterion, when others, such as turnover, number of shareholders, etc., might be equally relevant. Such a criterion is arbitrary and may lead to avoidance devices. Moreover, if the objective is to secure disclosure by employers, then it ought to apply equally whether or not the employer is incorporated. Admittedly there will be very few unincorporated businesses which employ 500 people, but it does seem that a provision of this sort is not properly a matter for companies legislation.

It is appreciated that the relationship of corporations and their employees is a very sensitive area. Whilst it is felt that labour relations can only benefit from the full and frank disclosure of all relevant information, it is suggested that any more in this direction should be made in the context of labour legislation rather than of companies legislation.

(c) The public generally. Public disclosure by corporations may be of benefit to various sections of the public, e.g. consumer associations, environmentalists, scholars and researchers, etc. Normally it will be the accounts of public corporations, which must publish in any event, which will be of most interest, but this will not always be so. However, it may again be questioned whether this is a proper concern of company law.

(v) Conclusions. The above analysis is based upon the admittedly narrow, and probably unfashionable, view that the function of companies legislation is to protect those persons who deal with corporations. The state, insofar as it authorizes a business to be carried on by an entity which is incorporated and has limited liability, owes a duty, to the public generally and to persons who deal with this artificial creature in particular, to ensure that the privilege which it has bestowed is not abused or misused. But if this proposition is accepted, then it would seem to follow that the public disclosure to be required by company law should be restricted to the purpose of ensuring that members of the public are not injured by virtue of the fact that an enterprise is incorporated and has limited liability.

From the above analysis, it is suggested that disclosure under company law is concerned with three classes of persons:

(a) shareholders. These must be protected by disclosure of financial information, but the disclosure must be made to shareholders and need not be public.

(b) potential investors. It is only in the case of issuing corporations that this is relevant, and protection is provided by securities legislation.

(c) creditors. It would seem that public disclosure is of very little, if any, value in this regard and is unnecessary.

The conclusion, therefore, is that public disclosure of financial information should not be required, as a matter of company law, from corporations which do not issue securities to the public. The position of a non-issuing corporation which is a subsidiary of, or associated with, an issuing corporation will be considered later.

(d) Compliance effects of public disclosure.

Before leaving this topic, however, one other proposition should be considered. Given that all corporations should be required to make proper financial disclosure to their shareholders, it may be argued that requiring the filing of annual financial statements with the Registrar increases the protection given to shareholders, by helping to ensure (i) that the directors do actually produce accounts and (ii) that they are reasonably accurate and comprehensive. Similarly, it may help to ensure that auditors perform their duties properly. A number of points can be made:

(i) Sanctions. The CBCA, s. 243, specifically makes it an offence to make an untrue statement, or omit a material fact, in any report, return, etc. required to be filed under the Act. Failure to file copies is also an offence under s. 154. However, it is also an offence not to send copies to shareholders (under s. 153) and it would seem that s. 243 also applies to

false statements in documents required to be sent to shareholders. In addition, various general compliance provisions apply, e.g. ss. 244, 245, the oppression remedy under s. 234 is available, and non-compliance with s. 153 is a ground for dissolution under s. 206. Thus it would seem that adequate sanctions exist without having to rely upon those imposed for failure to file.

(ii) The Publicity factor. It seems a basic tenet, at any rate of English company law, that a director who might otherwise be tempted to act improperly will be deterred from doing so if his impropriety must be revealed for all the world to see. No doubt there is some truth in this, though a dishonest director is more likely to add another offence to the list by concealing his activities and failing to disclose. Nevertheless, the fact that financial statements will be open to public inspection may help to ensure their accuracy. Similarly, an auditor may take extra care if he knows that his report will be public, rather than merely restricted to the shareholders, especially if this could result in his being held liable for damages in negligence How important is this publicity factor must be a matter of opinion. Certainly, in public (issuing) corporations it may be extremely important, since the reports will be scrutinized by financial analysts and journalists, stock exchange officials, institutional investors, etc. In private companies, even if required to publish, this will rarely be so, though it certainly does happen occasionally, e.g. where it is thought that a private company might be intending to go public or is an attractive target for a take-over. An auditor's liability for negligently audited accounts is unclear: recent case law suggests that he could well be liable to a person who buys shares in a publicly-traded corpora-

tion on the strength of a negligent audit. In a private company, however, a prospective purchaser would normally require the company to furnish accounts (see Haig v. Bamford) or would rely upon the accounts provided to the vendor-shareholder. The publicity factor, one may conclude, may add a little to the protection of shareholders by encouraging the directors and auditor to be diligent in the performance of their duties.

(iii) The Registrar. By requiring the filing of financial statements it might be argued that the Registrar is given a "watchdog" status. It is most unlikely that the Registrar would attempt to verify any of the information filed, but it may at least ensure that the appropriate documents do get filed, and filed on time. English experience, however, suggests - if one has regard to the high proportion of private companies which fail to file the required financial statements - that the requirement is not very effective and it does add considerably to the administrative burden imposed upon the Registrar.

In conclusion it is suggested that to require private corporations in addition to presenting accounts to their shareholders to file annual financial statements with the Registrar may give some added protection to shareholders, in ensuring that financial statements are in fact prepared and are reasonably accurate. This would be achieved only at the cost of greatly increased administration. In view of the extensive remedies already given, or proposed to be given, to shareholders it may be doubted whether it is necessary for their protection.

2. THE CONTENT OF PUBLIC DISCLOSURE.

If the position outlined above is adopted, namely that only corporations which issue securities to the public should be

required to file financial statements, the result will be that those companies which must file under the proposed BCA will also be required to file under the Securities Act. Since the purpose of public disclosure will be to protect investors and potential investors, it should follow that substantially the same information will be required under both Acts. Consequently, there seems little point in further comment until it is known what information will be required under the Securities Act. A few observations may be made, however:

(i) As a corporation will, in any event, have to prepare annual financial returns under the Securities Act there seems to be no point in considering whether disclosure under the BCA might be less extensive. Even if it is felt that certain disclosure under the SA is not also necessary under the BCA and could be omitted, such omission would serve no useful purpose.

(ii) It might be possible to omit entirely from the BCA all requirements for public disclosure on the basis that the SA will already adequately secure this. Such would, of course, only be the case if it was decided that no additional information was required under the BCA. In any event, it is felt that issuing corporations should be required to file accounts with the Registrar as well as with the Commission. If a corporation incorporated under the BCA issues securities to the public then this is a matter which should concern the Registrar, and of which he should be aware, and it is suggested that the Registrar should have power to ensure that corporations which are within his jurisdiction comply with the disclosure provisions. In addition, this information ought to be available for public inspection in the companies' register, together with all other information required to be filed.

(iii) Until regulations are published under the SA it will not be possible to determine whether any additional information should be required under the BCA. If we assume that the SA will require disclosure of all matters necessary for the protection of potential investors, then any additional disclosure under the

BCA will be required for the protection of <u>shareholders</u>. In which case, it might apply equally to issuing and non-issuing corporations and, it would seem to follow, disclosure to the shareholders will be required, but not necessarily disclosure to the public. However, since in an issuing corporation disclosure to shareholders is virtually the same as disclosure to the public, an issuing corporation will rarely be prejudiced by having to file all the information which it is required to give to its own shareholders: the exemption order procedure is appropriate in cases where this may be the case.

(iv) As stated above, the content of financial disclosure cannot properly be considered until it is known what matters will be required to be disclosed under the SA. Nevertheless, a number of issues merit consideration as being matters which may properly be regarded as the concern of company law:

(a) <u>Group accounts</u>.

It seems clear that disclosure should be made, to shareholders and potential investors, of the financial position of the particular company in which they invest. In addition, if the company is a member of a group - association either vertically or horizontally with other companies - the shareholder should be given information relating to the group as a whole in the form of consolidated accounts. In principle, it is suggested that disclosure requirements should go even further so that a shareholder in one member of the group should be given accounts, not only of his own corporation and of the group as a whole, but of every other corporation which is a member of that group, whether or not it is an issuing corporation and wherever it is resident. However, it is recognized that this could create considerable difficulties and might be impossible to implement. It also gives rise to numerous demarcation and definition problems, which will be considered in a separate (short) paper.

(b) Information relating to directors and officers.

In view of the wide powers of management given to the directors, including the fixing of their own remuneration and negotiating their own service contracts, it seems proper that shareholders should be given comprehensive information concerning the shareholdings and dealings of directors, their remunerations, etc. In particular, if shareholders are to have the right to dismiss directors they ought to be able to ascertain in advance how much this will cost them. In the case of a private company, this information belongs only to the shareholders and should not be divulged to the public, but in the case of an issuing corporation it should be a matter of public disclosure.

(1) Directors' shareholdings and dealings.

In the case of an issuing corporation this information will be provided by way of insider reporting. It is suggested that the BCA should require the filing with the Registrar of information similar to that which will be required under the SA. There would seem to be no good reason for requiring public disclosure of such information by non-issuing corporations, but it should be considered whether such information should be made available to shareholders. In general, this would seem to be unnecessary, since an up-to-date list of shareholders must be maintained and is open to inspection by shareholders. In a private company, with a restricted number of shareholders, it will be relatively easy to identify the actual shareholdings, and dealings, of the directors except where shares are held in the name of a nominee or of a corporation controlled by a director and even this fact is likely

to be known to the directors. It is felt that the misuse of confidential information by a director or insider should give rise to liability, to the corporation or to a person injured thereby, in a private company just as in an issuing corporation. The problem, then, is to ensure that insider dealing of this sort can be effectively controlled. One possibility is to require all corporations to maintain, in addition to a shareholders list, a separate list of directors' holdings and dealings, including any shares owned beneficially by a director or member of his family. This is required in England. Alternatively, it may be that the general remedies available to minority shareholders, notably the "oppression" section and the provisions for investigation, are sufficient to remedy, if not prevent, such abuse.

(2) Remuneration.

A common abuse, especially in private companies, arises where directors cream off an excessive part of the profits in the form of fees and salaries. It is felt that shareholders should be entitled to know how much of the profits of the business are diverted in this manner. This does not necessarily mean that the precise remuneration of each director should be made known (even to the shareholders, let alone to the public) but at least the total amount of such remuneration should be identified specifically, rather than being concealed in some global figure for "management expenses". Contrast the provisions in the U.K. Companies Acts (C.A. 1948, s. 196; C.A. 1967, ss. 608), which perhaps go further than is necessary. It is suggested that it is sufficient for the shareholders, and the public in the case of an issuing

corporation, to know the aggregate amount of such emoluments, but that "emoluments" be defined widely to include expense allowances and other benefits.

(3) Service contracts.

As suggested above, if shareholders have the power to dismiss a director they should be able to ascertain how costly this may be in terms of damages for breach of contract, etc. They should also know the pension arrangements, etc., which have been made. It is therefore suggested that the service contracts of directors should be available for inspection, by shareholders, at the company's registered office on the lines of the U.K. Companies Act 1967, s. 26. This information should not, however, be available to the public.

(v) Other information. The recent tendency, especially in the U.K., has been to require disclosure of an increasing number of matters, relating to such things as exporting, health and safety, employment, etc. This type of disclosure is likely to increase further: see the Consultative Document, "The Future of Company Reports", 1977 Cmnd. 6888. For reasons suggested earlier, it is considered that, though disclosure of this type of information may be desirable, it is not properly a matter for companies legislation.

3. DISCLOSURE TO SHAREHOLDERS

It has been proposed above that public disclosure should be restricted to issuing corporations. However, the shareholders of all corporations should be entitled to full financial disclosure.

(a) The obligation to disclose.

Under CBCA, s. 149, the directors must place before

the shareholders, at every annual meeting, financial statements relating to the preceeding financial year and the auditor's report. In addition, copies of these statements and report must be sent to every shareholder at least 21 days before the annual meeting: s. 153. This is an absolute requirement which, essentially, can only be waived unanimously: see CBCA, ss. 136(1), 153(1) and 157(3). It is recommended that these rules be adopted. They do not differ substantially from the present rules under the Alberta Companies Act.

(b) Information which must be disclosed.

The imposition of standard requirements, under the SA and BCA, as to form and content of published accounts for issuing corporations seems to be justified and desirable, both for the sake of uniformity and convenience and because all issuing corporations share at least one characteristic, namely size. In the case of private or non-issuing, corporations it seems less desirable to set out extensive, detailed, requirements as to what must be disclosed. Essentially the information is for shareholders only, and it is not intended that comparisons should be made with the accounts of other corporations. Thus there is no need for uniformity. Moreover, there is greater diversity among private corporations, as to their size, extent of their operations, etc. Much of the information, or categorization, which is desirable in the accounts of issuing corporations, is irrelevant for most private companies. Consequently, it is felt that a far greater degree of flexibility should be permitted. The shareholder's basic protection lies in the fact that the accounts must be audited, that an independent auditor must certify that they present a true and fair view of the financial position and that a shareholder is entitled to question the directors and auditor with regard

to the accounts at the annual meeting. In addition, accounting standards and practices are constantly being revised, reformed and (hopefully) improved, and it is considered more important that the accounts of a corporation should accord with what is currently recognized as good accounting practice than that they adhere to a rigid formula set out in a companies act which may become out of date. It is therefore suggested that the requirements of the BCA should be brief and should be on the following lines:

(i) A corporation which issues securities to the public should be required to file with the Registrar financial statements which comply with the requirements of the SA. This point has already been discussed.

(ii) All corporations should be required to place before the shareholders at the annual meeting, and to send copies not less than 21 days before the meeting, financial statements relating to the preceding financial year, together with the auditor's report.

(iii) The financial statements and auditor's report referred to in (ii) shall be prepared in accordance with the recommendations of the Canadian Institute of Chartered Accountants as set out, from time to time, in the C.I.C.A. Handbook.

This follows CBCA, Reg. 44. Alternatively, Manitoba Reg. 10(1) may be more appropriate. It would seem that the rules governing financial disclosure are more suitable for inclusion in separate Regulations rather than in the body of the Act.

(iv) The financial statements shall include:

(a) a balance sheet;

(b) a statement of retained earnings;

(c) an income statement;

(d) a statement of changes in financial position, and

(e) such other statements as are necessary to present a true and fair view of the corporation's

financial position.

This is based upon CBCA, Reg. 46(1). It should also be added that the financial statements need not be designated by the names set out above: see Reg. 46(2).

(v) Given the requirements of (iii) and (iv), it ought not to be necessary to specify further that the statements shall summarize separately each major class of business, cf. CBCA Reg. 47. If this is unnecessary in order to present a true picture it should not be a statutory requirement. In any event, shareholders may always raise questions at the meeting regarding such matters.

(vi) It does not seem necessary to require comparative financial statements, as in CBCA s. 149(1). Shareholders in a private company will normally have in their possession earlier statements and, it is suggested, they should be able to examine earlier statements at the registered office if they so wish. See also s. 120 (1) of the present Alberta Act.

(vii) In addition, the financial statements should state the aggregate amount of all emoluments paid to directors, in whatever capacity this has been paid. This point has been discussed above. The present Alberta Act, s. 125(3), (10), requires this only in the case of a <u>public</u> company. However, it is felt that it is in the private company where there is greater scope for abuse and it is also the shareholders of a private company who more closely correspond to the traditional notion of the "owners" of the business.

(viii) As suggested above, directors' service contracts should be available for inspection by shareholders at the company's registered office. This is not properly a question of financial disclosure and would be more appropriately included in the "Directors" chapter.

(ix) The content of the auditor's report will be considered separately.

(c) Availability of information.

The above information should be presented to shareholders at the annual meeting and copies sent in advance. In addition, the annual financial statements should be kept, and be available for inspection by shareholders, at the company's registered office. This would obviate the need for comparative statements and would allow shareholders to go back more than one year. Under CBCA, s. 20(1)(b), minutes of all shareholders meetings must be maintained, and one would suppose that minutes of annual meetings would include the financial statements presented there. This should be made clear in s. 20(1)(b). It may also be questioned whether minutes of directors meetings and resolutions, and adequate accounting records, as referred to in CBCA s. 20(2), should not also be available for inspection by shareholders. It can be argued that the shareholders, especially of a private company, are the owners of the business and are the persons who elect the directors and that they therefore should have access to all information concerning the business and affairs of the company. However, this might present problems of confidentiality and undermine the discretion of the directors to manage the business. Clearly, the auditor has access to all accounts and this ought to be sufficient for the protection of shareholders. Where there is serious suspicion of irregularity an investigation may be ordered.

(d) Waiver of disclosure.

It is felt that properly audited financial statements constitute an essential part of shareholder protection and that no shareholder should be deprived of this against his wishes. The CBCA provides that:

(a) The shareholders may unanimously in writing adopt a resolution which satisfies the requirements of holding an annual meeting: s. 136(1). Normally the shareholders would still have received by post copies of the financial statements.

(b) It is not necessary to send copies of the financial statements to a shareholder who has informed the corporation in writing that he does not want copies: s. 153(1).

(c) The shareholders, including those not entitled to vote, may unanimously resolve not to appoint an auditor: s. 157(1), (3).

These provisions seem desirable, in that they allow small companies to avoid unnecessary expense, and adequate in that no shareholder is deprived of protection against his wishes. It is suggested, however, that if shareholders can unanimously agree to dispense with an auditor entirely they ought also to be able to consent to the appointment of an auditor who does not meet the statutory requirements as to independence or professional qualifications. This, however, should be made clear to all shareholders each year such a person is appointed.

4. EXEMPTION FROM DISCLOSURE.

This needs to be considered in relation to public disclosure and disclosure to shareholders separately.

(a) Public Disclosure.

As the requirements under the SA, and hence also under the BCA, will be extensive and detailed, it is necessary to have some exemption procedure, both as to form and content.

(i) Form.

The object of the legislation is to ensure that adequate information is provided in a reasonably comprehensible manner. There may be certain features peculiar to a particular corporation which make it desirable, or reasonable, to present accounts in some format other than that prescribed. The only difficulty seems to be whether the permission to adopt a different format should be given by the Commission, the Registrar, or both. In all matters where there is overlap between the SA and BCA it should be possible for a corporation to file identical statements. This is essentially an administrative matter between the two departments.

(ii) Content.

A major problem which confronts the smaller issuing corporations is that public disclosure of such matters as turnover, profit margin, etc., can give vital information to a larger competitor, whose own accounts, if it operates on a wider scale, provide no such information. Again, an exemption procedure is necessary such as that provided by CBCA, s. 150, or the Ontario BCA, s. 173(3). The difficulty again is who should grant the exemption - the Registrar, the Commission, both, or the Court? The problem will be considered further in connection with disclosure to shareholders.

(b) Disclosure to shareholders.

With regard to format it has been rpoposed above that the Act, or Regulations, should not contain detailed requirements, and therefore no exemption would seem to be necessary: see CBCA, Regs. 44, 46. An issuing corporation could,

presumably, prepare a less detailed and less formal set of statements to present to its shareholders in addition to that required to be filed under the SA and BCA. It is difficult to see why it should wish to do so and there appears to be no harm in permitting this since the shareholders could also examine the publicly filed accounts.

Regarding content, and the competition problem, there exists a fundamental problem. On the one hand it can be argued that the shareholders ought to have access to all relevant information even if the public does not. But in the case of an issuing corporation it makes no sense to grant an exemption from public disclosure if the information must still be given to shareholders. Thus, presumably, an order exempting a corporation from disclosing its sales revenue would have to apply equally to the publicly filed accounts and to the statements presented to the shareholders. The question must then be asked whether a private company should similarly be able to obtain an order exempting it from disclosing such information from its own shareholders. In certain companies it may be practically impossible to produce meaningful accounts without disclosing information which could be valuable to a competitor and could, if it fell into the wrong hands, ruin the company's business. It can be argued that this is one of the risks inherent in incorporation. To a large extent a private company chooses its own members, who are in effect business partners. If one cannot trust one's own "partners" then the law cannot provide protection. But this ignores the fact that shareholder unlike partners, owe no fiduciary duty to their company (except, of course, where they are also directors, officers or employees). It seems to be contrary to fundamental principles that a shareholder should be deprived of his right to proper information regarding the company's financial position but it has to be admitted that if this right is an absolut

one then serious problems of confidentiality may arise. Further, it scarcely seems consistent to allow an issuing corporation to withhold information from its shareholders but not to allow this in the case of a non-issuing company. For these reasons it is suggested that only a court should have power to grant exemptions from disclosure. This, incidentially, would solve the problem referred to above as to conflict between the SA and BCA. An exemption granted by the court would apply to public disclosure under both acts and to private disclosure to shareholders.

5. AUDIT REQUIREMENTS.

It has been stated above that financial disclosure is regarded as an indispensible part of any system of shareholder protection and, in the case of issuing corporations, of investor protection. It is equally essential that financial statements should be reliable and as accurate as possible and this can only be ensured if they are subject to the scrutiny of an independent and properly-qualified auditor. Given this basic philosophy, a number of issues call for discussion.

(a) Audit Committees.

A common criticism levelled against the modern public company is that the Board of Directors tends to be composed of, or dominated by, the full-time "managers" of the corporation who, by means of majority election and the proxy systems, are able to perpetuate their control over the corporation and are essentially answerable only to themselves. This absence of any real supervision of management by the elected representatives of the shareholders has led to the institution in Germany, and elsewhere in Europe, of a formalized two-tier system of Supervisory Board and Management Board. Elsewhere it has led to the

appreciation that "outside" directors, provided they genuinely represent the interests of the shareholders as a whole rather than some purely sectional interest, perform a valuable function. The German approach may be regarded as too inflexible and institutionalized to be appropriate in companies which have evolved in the Canadian or Anglo-American tradition and a simple board of directors, comprising both full-time "managers" and part-time "supervisors" is probably preferable. The two-tier system is also inextricably bound up with the question of worker representation, though logically there is no reason why it should be.

To a considerable extent the Canadian solution of an Audit Committee can be regarded as an attempt to secure a proper balance between managers and supervisors. At present, under the CBCA and the Ontario BCA, its role is restricted to reviewing the financial statements, though this is probably the most important function which might be exercised by any supervisory body. Whilst it is not suggested that the Committee be given, at this time, any other major functions it is perhaps worth considering whether its title might not be changed to "Supervisory Committee", to indicate that, if at a later stage it appears desirable to add to its functions (e.g. to require its consent to any management proposal to amend the articles, or the engage in any essentially new type of business), its role is not restricted to purely financial matters.

It is therefore recommended that every issuing corporation <u>must</u>, unless it obtains an exemption order, and any other corporation <u>may</u>, have an Audit (Supervisory) Committee.

(i) <u>Composition</u>.

The CBCA and other statutes which provide for an

audit committee require that it have not less than three members, a majority of whom are "outside" directors. It might be desirable, especially if the role of the committee were to be expanded, that all the members of the committee be outsiders. However, as it is a relatively new type of institution it would seem better, at least for the present, to follow the pattern adopted elsewhere in Canada.

(ii) Appointment.

The CBCA does not lay down any rules for the appointment of members, but the Ontario BCA, s. 182(1), provides that they shall be elected by the directors. There is some danger that the directors might appoint "tame" outsiders and, in view of the supervisory function of the committee, it might be preferable to have the outside members elected directly by the shareholders. Again, this is perhaps a reform which might be considered at a later stage. One possible step would be to develop the Audit Committee into a more effective Supervisory Committee, to be elected by a cumulative voting procedure unless, of course, cumulative voting were to apply to the election of the entire board of directors.