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and are an integral part of the internal policies and procedures of the larger firms and some smaller firms. Nearly all of the engagement deficiencies revealed by CPAB's inspections should have been detected

by a proper independent review by the audit firm prior to completing the engagement. The fact that the deficiencies existed, had not been identified and were not corrected demonstrates that there is substantial room for improvement in this area. CPAB has recommended to most firms that they either implement or enhance the quality of their engagement quality control reviews.

As a result of its inspections to date, CPAB has placed requirements on four firms. These include:

- Requiring three firms not to accept any new reporting issuer audit clients until all of CPAB's recommendations have been dealt with in a satisfactory manner.
- Requiring a fourth firm to permit only certain partners to carry out engagement quality control reviews and specifically prohibiting certain other partners from performing such reviews.

In summary, CPAB's quality inspections to date demonstrate that there is room for improvement

in the quality of the audit work being done on the financial statements of reporting issuers in Canada. In some firms, the necessary improvements could be characterized as further enhancement to an already fundamentally sound process. Other firms have an urgent need to implement substantial improvement in order to continue to audit reporting issuers. The early results from the second inspection of the four largest firms indicate that CPAB's work is having the desired effect on audit quality. CPAB continues to be encouraged by the understanding in audit firms that the public interest requires them to place greater emphasis on audit quality and "getting it right" every time, with no tolerance for substandard performance. Every firm inspected so far has committed in writing to implement all of CPAB's recommendations. Over the coming months, CPAB will be revisiting the firms to test whether they have fully implemented the recommendations to CPAB's satisfaction, and there will be consequences for those that fail to do so. Directors can be assured that CPAB takes its responsibilities for enhancing public confidence in the integrity of the financial statements of publicly-traded companies very seriously.

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Multiple Voting Shares and Governance

*By Robert Parizeau
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The relevance of corporate structures with multiple voting shares is regularly called into question. The Canadian Coalition for Good Governance has spoken out against this business model in the name of the "one-share, one-vote" principle. Last spring, *The Globe and Mail* reported that the Ontario Teachers' Pension Plan had asked the Federal Government to make its financial support for the new Bombardier aircraft conditional upon the Bombardier family giving up control of shares with 10 votes. The Caisse de dépôt de placement du Québec immediately distinguished itself from Teachers by recommending that government refrain from mixing industrial policies

with corporate governance, since this would set a dangerous precedent.

In 1972, I founded Sodarcan Inc., a holding company that operated through its subsidiaries in insurance brokering, reinsurance brokering and actuarial consulting. The company went public in 1986 and was sold to Aon in 1997. From the very beginning, when it was a private company, I ensured that I maintained control through multiple voting shares as the family held about 40% of the equity. During the course of my career, I have served on Boards of Directors with very different share ownership: the National Bank of

Canada with a broad shareholder base, Gaz Métro with a reference and controlling shareholder, Noverco — Groupe Canam, Power Corporation and Van Houtte, where individual shareholders and families exert their control through multiple voting shares. These are five companies where the trustee and strategic roles of the Board of Directors are carried out very differently. Governance is not carried out the same way in a holding company as it is in an operating company; it is different if the company has a broad shareholder base or if it is controlled by a group of companies, a family or a few individuals.

On the basis of my diverse experience, I wanted to share my thoughts on the relevance of companies with multiple voting shares¹, several of which are flagships of our Canadian economy.

In 1999, Professor Yves Bozec² from HEC Montréal, the Business School at the University of Montreal, identified Canada's top 500 non-financial companies listed on the Toronto Stock Exchange with market capitalization in excess of \$10 million. Here are some observations:

500 companies, non-financial sector, listed in 1999		
	Number ³	%
Family controlled	257	51%
Controlled, non-family	122	24%
Companies with broad shareholder base (< 10% of votes)	108	22%

Of the 257 companies that were controlled by individuals or families, 93 were through multiple voting shares or the equivalent; 39 were headquartered in Québec and 54 in the other provinces.

Of the 500 Canadian companies in the sample group, only 108 had a broad shareholder base, or 22% of the total, where broad shareholder base implies that no one shareholder holds more than 10% of voting shares.

Here is a short list of companies with a market value of more than \$2 billion as at March 31st, 2005, with, in each case, the percentage of shares held and the corresponding voting rights.

Some companies with multiple-voting shares			
Market valuation of \$2 billion or more ⁴			
	Market Capitalization (\$B)	Controlling Shareholders	
		% of equity	% of votes
March 31, 2005			
Headquartered in Quebec			
Power Corporation	14.0	30	65
Bombardier	5.2	17	59
Alimentation Couche-Tard	3.7	17	46
CGI Group	3.2	7	38
Jean Coutu Group	2.7	55	90
Quebecor Inc.	2.0	27	65
Headquartered outside Quebec			
Rogers Communications	9.2	22	91
Magna International	8.7	1	56
Shaw Communications	5.5	9	78
Canadian Tire	4.7	3	61
Celestica	3.0	16	79
Onex	2.7	20	60

The ownership of equity by the controlling shareholder varies considerably from company to company, ranging from 1% at Magna and 3% at Canadian Tire to 30% at Power and 55% at Jean Coutu.

Most of these companies were not much 30 years ago. How many of them could have developed in this way if their controlling shareholders were not protected from a hostile takeover? Of course, when share ownership is less than 10%, it becomes much more difficult to justify voting control of 50% or more. In my view, the structure of capital with multiple voting

¹ For the purposes of this article, the term "multiple voting shares" applies to all companies where there are participating but non-voting shares, preferred stock with special voting rights, as well as share capital structures which place certain limitations on the exercise of voting rights.

² *Concentration of ownership rights, separation between capital participation and voting control, and operating performance of companies: a Canadian study.* By Yves Bozec and Claude Laurin.

³ 13 companies were eliminated from the sample for lack of adequate information.

⁴ Compilations based on management proxy circulars on the SEDAR website and data from the TSX; SEDAR is The System for Electronic Document Analysis and Retrieval developed by the Canadian Securities Administrators.

shares can only be justified when the controlling shareholder owns a significant part of the company and, therefore, when that shareholder is much more at risk than any other shareholder.

In the debate on multiple voting shares, some go so far as to advocate that existing, outstanding multiple-vote shares should have their multiple votes removed, or reduced to one vote per share, without compensation to the controlling shareholder; this is really advocating a form of confiscation. These advocates appear to ignore the fact that there is value in those multiple votes. That value is known as a “control premium” and it will benefit all shareholders in the event of a takeover. To support confiscation in a free enterprise, industrialized economy is contrary to long-established rights and principles, and would take us down a very slippery road indeed.

Whoever invests in a company controlled by one or a few individuals must be able to acquire good knowledge of the characteristics of the company; even more is needed when the percentage of equity held by the controlling shareholder is low. To do this, information concerning the control must be available and transparent. Over the last few years, there has been a noteworthy improvement in the quality of information given to investors, notably in the management circular and the annual information form, thanks to the intervention of regulators and courts. Companies must report on elements like protection clauses or coat-tail provisions in the case of takeover bids, the existence of sunset clauses, specific agreements between controlling shareholders and any other specific aspect of their statutes. In fact, statutes, by-laws and certain material contracts must now be filed on SEDAR. Many provide exemplary disclosure; others are still too timid. With adequate information, investors can assess whether there exists additional risk; they then have the choice to invest or not in these companies.

Governance is exerted in a much different way in a company with a controlling shareholder than in a company with a broad shareholder base where management plays the role of motor and spark plug. When there is a controlling shareholder, particular attention must be paid to transactions between related parties and more specifically those involving the controlling shareholder, including acquisitions that the controlling shareholder has decided to conduct outside the company’s framework. Independent directors must do their homework with all appropriate rigour and ensure that there are no conflicts of interest to the detriment of minority shareholders.

Canadian laws protect minority shareholders much more completely than in many other jurisdictions, notably in continental Europe or Asia. The governance principles in force in Canada for listed companies and the resulting responsibility of directors are such that the risks of slip-ups are certainly not excluded but much more contained than in the past.

What is the situation outside Canada? The figures below date back to December 1996 and come from three studies⁵ published between 1999 and 2002. There have certainly been some changes and evolution, but the overall picture has not really been modified.

Number of companies – December 1996	Canada ⁶	US	Europe ⁷	Asia ⁸
% with broad shareholder base (<10% of votes)	22%	80%	14%	20%
% that are controlled (≥10% of votes)	75%	20%	86%	80%
% of companies controlled by families	51%	20%	56%	45%

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⁵ Compilation from the studies:

- La Porta, Lopez-de-Silanes and Shleifer, 1999, Corporate Ownership Around the World, *Journal of Finance*, Vol. 54, No. 2, p. 471-518.
- Faccio and Lang, 2002. The Ultimate Ownership of Western European Corporations. *Journal of Financial Economics*, 65 p.365-395.
- Claessens, Djankov and Lang, 2000. The Separation of Ownership and Control in East Asia Corporations. *Journal of Financial Economics*, 58 p.81-112.

⁶ 1999 figures.

⁷ Countries included: Austria, Belgium, Finland, France, Germany, Ireland, Norway, Portugal, Spain, Sweden, Switzerland and the UK.

⁸ Countries included: Hong Kong, Indonesia, Japan, Malaysia, Philippines, South Korea, Taiwan and Thailand.



The vast majority of companies in the US market have a broad shareholder base: 80% of listed companies. Our 22% in Canada is much more in line with Europe and Asia. The US market structure was largely influenced by a series of laws passed following the 1929 crisis, which discouraged the concentration of financial power and protected minority shareholders. In addition, tax measures made pyramid control more difficult as dividends between corporations became taxable. Structures like Power, Weston, Brascan or Québecor were more complicated to set up in the US. The existence of a succession tax might have also played a role in the way the US market evolved to favour a broad shareholder base.

As for companies controlled by families, the Canadian market, with some 51%, is comparable to Europe (56%) and Asia (45%). Of course, these figures must be taken as a guide only, but they provide an interesting illustration of the overall situation.

The structure of the European market is not uniform, as can be seen below:

Number of companies – December 1996	UK	France	Germany	Sweden
% with broad shareholder base (<10% of votes)	63%	14%	10%	39%
% that are controlled (≥10% of votes)	37%	86%	90%	61%
% of companies controlled by families	24%	65%	65%	47%

The British market resembles the US market in terms of broad shareholder base. However, 37% of British listed companies are controlled by one major shareholder compared to 20% in the US. In this respect, our financial market resembles continental Europe. Note that multiple voting shares are frequently used in Germany and even more so in Sweden.

In an article last March 23rd, *The Economist* summarized a study prepared by Deminor Rating, a Belgian firm, for the Association of British Insurers. The study concerned companies on the FTSE Eurofirst 300 Index, which includes the 300 largest European market capitalizations, representing 70%

of the total European market capitalization; this is a totally different sample than what was presented in the previous tables. This study concludes that the “one-share, one-vote” structure is growing in Europe, but presently only two-thirds of the companies in the index have such a capital structure. Overall, one-third of the very large European companies have one or a few controlling shareholders that exert control through multiple votes or by limiting the voting rights of a shareholder regardless of the number of shares held. Companies with a “one-share, one-vote” structure represent 14% of Dutch firms in the index, 25% of Swedish firms and 31% of French companies. However, for German and British companies in the index, the percentage reaches 97% and 88% respectively; but let us remember that there is in Germany an important number of large public companies that are not part of this index where control is exerted by non-voting equity or by preferred stock with special voting rights.

Very imaginative techniques are in place in continental Europe to separate shares from voting rights. *The Economist*, in an August 27, 2000 article, mentioned that in Sweden there are shares with 1000 voting rights, which could have influenced Magna in Canada! The Swedish industrial conglomerate Investor can have a 22% say at the votes of Ericsson with only 2.7% of the capital. In Denmark, many companies limit to 2% the voting rights of shareholders, regardless of the number of shares held.

These are situations that fit with the historical context of Europe, and many of these structures were designed to prevent takeovers by foreigners. With the Euro and the restructuring of Europe, we will witness gradually the establishment of greater uniformity in corporate structures, better legal protection for minorities, accompanied by more uniform corporate governance with higher standards, but company control will stay for the foreseeable future very concentrated. This concentration is similar in Asia where we will not see major structural changes overnight.

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internationally. With their head offices in Canada, these companies contribute greatly to the well-being of our society. It is incomprehensible for me that certain major institutional investors in Canada dog these companies, like in the recent case of Bombardier, while in Europe and Asia, these same investors often do not have any other choice but to invest our money in companies with capital structures involving voting right restrictions and, most of the time, without legal guarantees that we have in Canada for minority shareholders, nor the quality of governance in place in Canada. Let us be careful of dogmatism in governance — it is as dangerous in business as it can be in other domains.

There is currently in governance a very troublesome approach through which some people try to put all companies in the same mould. I would even say a certain craze. If my understanding is correct, many criteria included in the new definition of independence for audit committees will also apply to boards, compensation committees and nomination committees that propose new directors. For instance, it would imply that an employee of a controlling company who sits on the board of directors of the public subsidiary of the controlling company could not be viewed as independent from the subsidiary. We are in many ways assimilating the notion of independence of the board vis-à-vis the controlling shareholder to what must exist between the board and management in a widely held company. It is a mistake: the controlling shareholder has the absolute right to be fully involved, notably in the election of the board of the company he controls. Both the NYSE and NASDAQ provide a carve-out for controlled companies from the requirement to have a majority of independent directors on the board, compensation and nomination committees composed entirely of independent directors. A carve-out of a different nature but with the same objectives does exist in the UK, France and Belgium.

The culture of a company with a controlling shareholder is much different from that which exists in a broadly held company dominated by management. Standards must be adapted accordingly and without compromising the objectives, that is, the existence of a corporate governance culture covering

notably conflicts of interest and the protection of minority shareholders.

Do you really believe that a controlling shareholder who has his entire fortune wrapped up in a company, to which he has devoted his life by often taking considerable financial risks, will accept that the essence of board responsibility be henceforth led by outsiders, however informed and devoted they might be, notably for the appointment of the CEO and the strategic direction of the company? It was the vision of the entrepreneur, his or her commitment and values that were the keys to success and that caused people to invest in the company. With these new guidelines, there are considerable risks that the real decisions will now be taken in parallel meetings with the controlling shareholder or his representatives; this will be totally unproductive and contrary to healthy governance. Never forget that many investors expect the controlling shareholder to exercise his or her leadership! That is often precisely why they accepted to invest in a company with a multiple voting capital structure.

The governance mechanisms of companies controlled by a shareholder are more complex and delicate to establish than in a widely held company. Sometimes the CEO is completely foreign to the controlling group, sometimes he or she is part of it. As much as it is important to have complicity, which does not mean complacency, between the CEO and the board, it is absolutely essential to have the same complicity with the controlling shareholder. Otherwise, we will have more and more situations such as at Van Houtte and Bombardier, where the controlling shareholder decided at a point to put his foot down, with all the insecurity and the collateral damage, human and financial, that entails.

If we multiply barriers to limit the control of the controlling shareholders, we risk, in the end, paying the price. The world is a big village and if talent is mobile, entrepreneurs are even more so. They will use their capital, their energy and their know-how in other markets that are more respectful of the notion of control. Our economy risks losing without fanfare



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some of its vital forces, just as France has lost over the last 20 years a considerable number of large fortunes with the creation in the 1980s of the wealth tax. Let us stop imagining that controlling shareholders only think of themselves to the detriment of minority shareholders and that directors of these companies are only puppets! The Dey Report marked a turning point in

corporate governance, as much for those companies controlled by a reference shareholder as for those broadly held. Yes, there have been slip-ups, and unfortunately there will be others in the future regardless of regulations, and we must then crack down without mercy.

As in many other fields, the Canadian financial market has been influenced by our southern neighbours and our European roots. We have developed our

own models, with a legal framework and governance standards that ensure the minority investor has quality financial information and guarantees that do not exist at the same level in most other countries. Our system functions with a minimum of slip-ups. We must continue to be vigilant, but let us not deprive ourselves of instruments like multiple voting shares that have helped to create some of the best corporate successes in our country, and some of the best corporate citizens. Let us also stop emasculating the notion of control; it is unproductive and, in real life, harmful to attaining the quality of good governance that we aim to achieve, that is governance which creates additional shareholder value.

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Where Economics Meets the Law: US Versus Non-US Financial Reporting Models Divided by Common Language

By *Tim Bush*
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Major differences exist between the United States and the rest of the world regarding both the preparation of financial statements and corporate governance matters.

The US regulatory reporting model, dictated by the 1933 Securities Act, was created because of inherent difficulties stemming from legal problems not present in most other jurisdictions. These difficulties still exist and reactions to recent events may be spawning new solutions that if copied in other jurisdictions may actually create problems where none existed before.

The US's difficulties are simple in origin, and not widely understood, but their impact is global. They are constitutionally rooted because the State of Delaware, the most common jurisdiction for the registration of publicly quoted companies in the US, has no framework for public/shareholder financial reporting or ongoing company accounting control frameworks. In addition, Delaware law offers comparatively weak shareholder rights. From these two causes stem difficulties with the US's financial reporting system, and mutually related problems with enforcing corporate governance matters.