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The Whistle

Gaps revealed in mandatory disclosure

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Many Canadian companies are violating a new securities regulation that requires disclosure of their corporate governance standards, a recent review by regulators has concluded.

Securities regulators in seven provinces adopted new guidelines in 2005 requiring companies to disclose how they adhere to nine fundamental governance guidelines. The guidelines are voluntary, but it is mandatory for companies to disclose annually whether or not they have chosen to follow the guidelines and explain their practices.

Regulators recently reviewed disclosures by 100 public companies, including 65 that trade on the Toronto Stock Exchange and 35 that trade on the TSX Venture Exchange.

The review found 23 per cent of companies listed on the TSX Venture Exchange did not provide any governance disclosure – a complete violation of the requirement.

And while all TSX-listed companies had some disclosure, the review found many of them did not address all nine of the required topics. For example, 30 per cent did not disclose whether they have position descriptions for the CEO and chairman of the board and 23 per cent did not disclose whether the board has a written mandate. Twenty per cent did not comply with the requirement to disclose the process for determining executive compensation and 18 per cent did not describe the process the board uses to identify new director candidates for nomination. Fifteen per cent did not disclose whether there are board and director performance assessments. Rick Whiler, senior accountant at the Ontario Securities Commission, said he could not explain why so many companies are failing to provide mandatory disclosure. “I don't know exactly what went through their minds. They might have thought, ‘If we don't do anything, notwithstanding what the language says, we're not going to disclose anything.' ”

Regulators asked 27 TSX-listed companies to improve their disclosures in their next shareholder proxy circulars. Two TSX Venture Exchange companies with no disclosure were asked to refile their circulars, while six others were asked to include the disclosure in their imminent new proxy filings.

Beyond strict compliance with the disclosure rule, the review also assessed the quality of the information and found many examples of vague or boilerplate language. “When reviewing the disclosure, it ranged from excellent to absolutely abysmal,” Mr. Whiler said. “It was just a complete continuum.”

Mr. Whiler said companies often disclosed the amount of compensation paid, but not how they arrived at those numbers. He said companies were similarly vague about describing the processes they use to assess the performance of the board and individual directors. “It's absolutely critical for investors to know how are boards, committees and individual directors assessed, because that lets an investor know their performance is being measured. … And that, in turn, relates to compensation.”

Regulators also studied compliance with a mandatory rule adopted in 2004 requiring companies to have independent audit committees of the board. The review looked at 25 companies on the TSX and TSX Venture Exchange. While all TSX-listed companies had independent audit committees, the review found six companies did not report that their audit committees oversee the work of external auditors – a key feature of ensuring auditors work independently of management.

“If you distill it down to the objectives ... the [rules] where there was in aggregate the most non-compliance related to ensuring auditor independence,” Mr. Whiler said. “The instances where these weren't followed was disconcerting.”

Regulators required all companies to correct the deficiencies they found with the audit rules because they are mandatory standards.

ICBC's zero tolerance for fraud saves motorists $75 million — April 16

In 2006, 104 fraud-related convictions were laid against 69 defendants

B.C. motorists saved more than $75 million in 2006 thanks to ICBC anti-fraud programs. Savings are based on the estimated value of fraudulent claims which were denied, money recovered and savings generated through fraud prevention.
"The rising cost of claims is a concern for ICBC. Cracking down on fraud is one of ICBC's strategies to keep rates low and stable," said Steve Tripp, manager Fraud Prevention and Investigation. "We will not sit back and simply pass the cost of fraud onto our customers."

ICBC's anti-fraud efforts led to 104 convictions against 69 defendants, last year. More than $207,000 was paid back to ICBC in restitution and fines in 2006, up from $73,000 in 2005. And there was a significant increase in jail time. ICBC fraudsters were sentenced to a total 2,087 days behind bars in 2006.

Annually, ICBC invests approximately $8 million in fraud prevention and investigation programs, more than most property and casualty insurance companies in Canada. Last year, ICBC's team of close to 90 investigators and staff conducted approximately 3,000 investigations covering all types of suspected fraud including: staged collisions, exaggerated claims, premium fraud, licensing and identity fraud.

The general public is also a helpful resource in cracking down on potential fraudsters. ICBC's anonymous tip line recorded over 10,000 calls last year. Anyone with information on a suspicious, exaggerated or fraudulent claim is encouraged to phone 604-661-6844 or 1-800-661-6844. Information provided to the fraud tips line is confidential and callers can remain anonymous.

Real life stories from ICBC's fraud files

The Moose Mistake

It doesn't pay to lie to ICBC. A Prince George resident was driving down a logging road north-west of Mackenzie, when he lost control of the vehicle and crashed into a tree. At the time of the crash, the driver did not have a valid driver's licence and the vehicle he was driving belonged to his wife.

When interviewed by ICBC, the driver and his wife lied about who was driving at the time of the crash and claimed they collided with a moose. A joint investigation by ICBC, and RCMP from Prince George, Terrace and Prince Rupert uncovered the truth. The driver was sentenced to four months in jail, while his wife received a three month conditional sentence, one year probation, and was ordered to repay ICBC $26,360, the cost to repair the vehicle and to investigate the fraudulent claim.

Some Dreams Really Do Come True

Mr. R owned two vehicles. He carried full insurance coverage on his first vehicle, however only basic coverage on his second. Early one September morning, Mr. R awoke suddenly and began to vividly recall his dream. He had dreamt that his sister was going to be involved in a crash with this second vehicle. Mr. R jumped out of bed and drove off, in his first vehicle, to the local Autoplan agent where he promptly added full insurance coverage to his second vehicle.

While driving home Mr. R's sister called to report she had just been in a crash. Mr. R. was stunned, his dream had come true. ICBC investigated the claim and uncovered Mr. R couldn't read the future. A number of witnesses, some with cellphone cameras, had seen his sister crash the vehicle hours prior to Mr. R rushing out to buy additional insurance coverage. The claim was denied.

Source: ICBC

Study: Financial-Statement Fraud not a Solo Job

Creating fraudulent financial statements takes teamwork, according to a new study of financial restatements filed prior to the enactment of Sarbanes-Oxley.

The study, conducted by the Institute of Fraud Prevention, looked at 834 companies that filed financial restatements between 1997 and 2002. Of those, 374, or 45 percent, were accused of securities fraud and subject to shareholder suits, Securities and Exchange Commission enforcement action or both, the IFP reported. In those cases, an average of seven people were involved, and could include the CEO, CFO, Chief Operating Officer, general counsel, members of the Board of Directors, and internal and external auditors.

In cases of fraud, the Board of Directors often was driven by senior management, and the CEO also served as chairman.

“Far from being a solitary act, securities fraud necessarily requires complicity,” said IFP Executive Director William Black in a statement. “In situations where the CEO is chair of the Board of Directors, a body that is supposed to oversee management, independence can be compromised. When independence falls by the wayside, fraud is the consequence.”

Black noted that 39 percent of the companies accused of fraud were so-called New Economy industries, including dot-coms, energy traders and telecommunications.

“When the dot-com fever hit its peak, there was a loss of perspective as people saw the possibility of making a lot of money very quickly,” he said. “We saw what former Federal Reserve Chairman Alan Greenspan called 'irrational exuberance.' Good business practices were ignored under the pressure to meet earnings forecasts.”

The study, “Control Overrides in Financial Statement Fraud,” http://www.theifp.org/research%20grants/tillman%20final%20report_revised_mac-orginal-EDITED.pdf calls for maintaining the reforms of Sarbanes-Oxley while resisting efforts to make it more difficult for shareholders to file suit. The report also concludes that liability of audit firms and corporate board members should not be lessened.

“The events captured by our data largely ended prior to the passage of the Act and comparisons with more recent data suggest that the reform measures have had a positive impact,” the report states.

The Institute for Fraud Prevention is a coalition of domestic and international universities dedicated to research, education and prevention of fraud and corruption. The study was written by Robert Tillman and Michael Indergaard of St. John's University.

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Measures passed by SEC to ease burden of SOX

By Jeremy Grant in Washington
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US regulators yesterday approved measures to ease compliance with Sarbanes-Oxley five years after the law was passed in the wake of big corporate scandals. The move is a sign a more "principles-based" approach to financial regulation is gaining ground in the US.

Critics of the way Sarbox has been implemented said reliance on rules and a "box-ticking" mentality to internal controls checks have been cumbersome and added needlessly to costs.

The Securities and Exchange Commission's five commissioners agreed unanimously to the establishment of a set of guidelines for company management on how they should carry out internal control checks mandated under Section 404 of the law. Section 404 requires management to check controls over financial statements and have those signed off by an external auditor.

Critics of the way Sarbox was written had argued that the lack of such guidance had led to over-reliance by executives on the checks carried out by their external auditors, leading to often unnecessary audits. Specifically, the SEC's new "interpretive guidance for management" would allow executives to "scale and tailor their procedures to fit the facts and circumstances" of a company's situation, according to SEC chairman Christopher Cox.

Michael Ryan, executive director of the Centre for Capital Markets Competitiveness at the US Chamber of Commerce, said: "This major rewrite is a clear step forward and recognises how seriously off-track Section 404 implementation has become." The guidance is not only "scalable" according to size of company but also takes account of the complexity of a company's business.

Annette Nazareth, one of two Democrats on the commission, said: "I strongly support this principles-based interpretive guidance. "It encourages innovation instead of a one-size-fits-all approach. I hope that it will help liberate companies by allowing them to apply the guidance to their own situations. It will provide overarching principles without forcing companies to fit into a prescribed mould."

The SEC also sharpened its definition of "material weakness" in accounts - a key uncertainty in previous audit cycles - as "a deficiency, or combination of deficiencies, in internal control over financial reporting" such that there is "a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis".

The new guidance is likely to have the biggest effect on smaller companies, which will have to comply with the SEC's management controls provisions of Section 404 by year-end.

Today the Public Company Accounting Oversight Board, the US accounting watchdog, is expected to produce new rules for auditors checking a company's internal controls.

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