

Recent regulatory developments

The CSA has been developing its enhancements to the current executive compensation regime (contained in Form 51-102F6) for several years. As it happened, the final rules almost coincided with the credit crisis, which has renewed the focus on whether compensation paid to executives reflects any meaningful concept of pay for performance. The new rules are effective for December 31, 2008 year-ends and (similar to those in place in the US for SEC registrants) require disclosing a single dollar value for total compensation for each named executive officer. They also require a Compensation Discussion and Analysis providing much more detail about the rationale for the entity's compensation decisions. They also require more detail about such matters as pension entitlements and termination and change of control provisions.

Particularly given recent market developments, Deloitte believes that these new rules will provide a basis for greater scrutiny of compensation arrangements by investors and the media, perhaps providing in turn a base for greater investor activism in matters such as advisory "say on pay" votes. This can already be seen developing in the US since the SEC adopted its enhanced disclosure rules two years ago. We also believe the new rules will provide a basis for more active questioning and review by securities regulators and perhaps for a greater number of enforcement or civil liability actions relating to compensation disclosure.

Note also that when IFRS becomes mandatory for Canadian public companies starting in 2011, it will require that certain key compensation disclosures be included in the notes to the financial statements, and therefore included for the first time within the scope of the auditors' report.

All of this provides a compelling case why companies should take steps now to ensure that they have the most rigorous and reliable compensation structure possible – for how they set their compensation arrangements, for how they identify and manage the associated risks, and for how they evolve the disclosure that provides a window into all this.

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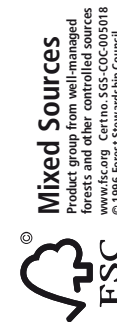


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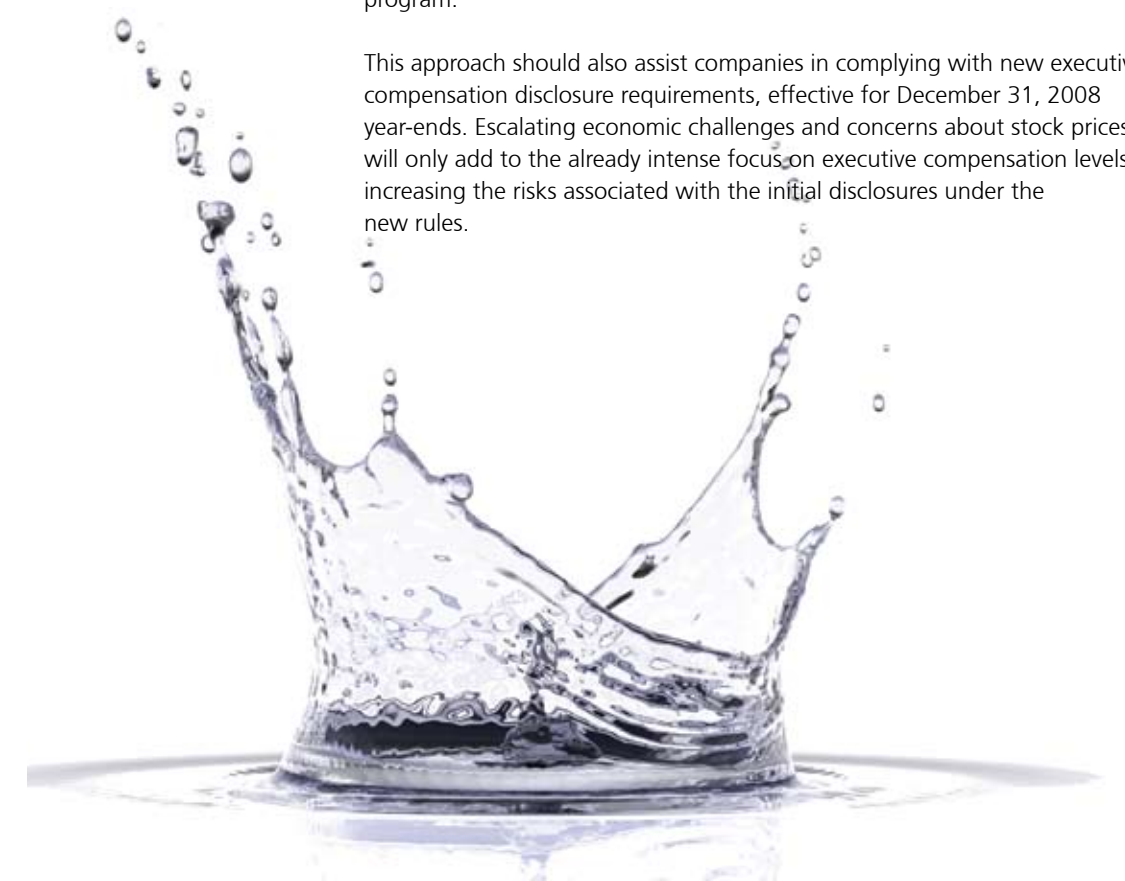
Integrated approach to assessing compensation-related risks

An enterprise's executive compensation strategy is often the most visible aspect of its corporate governance. It's an area highly susceptible to being second-guessed by stakeholders, capable of generating significant distraction or embarrassment. Concerns may focus on the compensation amounts themselves, on lack of transparency about the process that generated them, or both. Despite the area's sensitivity, it frequently isn't overseen or controlled with the same rigour as other, perhaps ultimately less mission-critical aspects of an enterprise's activities.

Concerns about executive compensation have risen yet again during the recent credit crisis. Boards and compensation committees may believe they are in some sense "paying for performance." But how can this measure of "performance" be the right one, when it doesn't address an organization's real – possibly even fatal – risks?

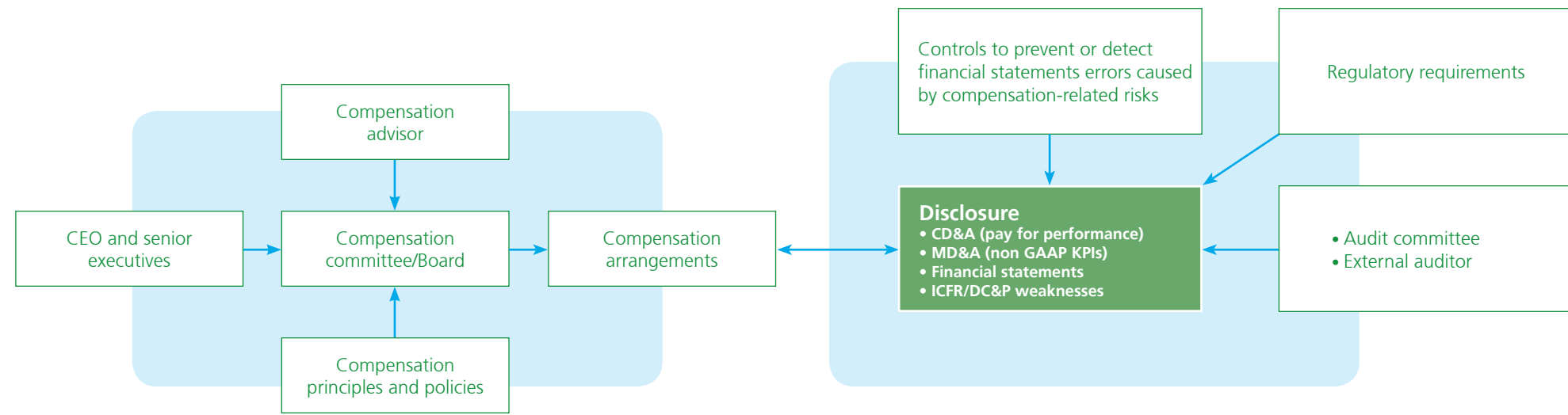
We suggest, at a high level, an integrated approach for assessing the risks associated with executive compensation and therefore for starting to build a better control framework. This approach is intended to help the Compensation Committee and the Audit Committee better understand their shared responsibilities and work more effectively together, in a way that better identifies and responds to the exposures related to the compensation program.

This approach should also assist companies in complying with new executive compensation disclosure requirements, effective for December 31, 2008 year-ends. Escalating economic challenges and concerns about stock prices will only add to the already intense focus on executive compensation levels, increasing the risks associated with the initial disclosures under the new rules.



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Overview of Deloitte's integrated approach



Benefits of an integrated approach

Many entities can benefit from carrying out an overall assessment of compensation-related risks and exposures. This could be facilitated internally, carried out by an external advisor, or through a combination of both. The assessment should be tailored to the entity's specific circumstances – including prevailing market conditions and temperament – but would typically include:

- comprehensively reviewing all compensation arrangements to identify key performance measures, embedded risks, and resulting control requirements
- independently reviewing key corporate strategies and key performance indicators, to assess any “gap” between these and the measures embodied in the compensation arrangements
- reviewing committee mandates and practices, again to identify gaps in oversight focus
- reviewing related control systems (for example, for their ability to track measurement inconsistencies, or the impact of changes such as the pending transition to International Financial Reporting Standards (IFRS))
- reviewing external disclosure both from a regulatory compliance and communication effectiveness perspective.

Background

The **left half of the diagram** represents the key participants and processes that impact executive compensation in an organization. Working within an entity's defined compensation principles and policies, the compensation committee/board, with some input from management and most likely from an external advisor, develops and approves the compensation arrangements for the organization's key people.

The **right half of the diagram** expands the zone of interested parties and related responsibilities. The compensation arrangements are reflected in various disclosures (most prominently in the annual management information circular but also elsewhere); this in turn makes them of interest to the audit committee and external auditor. The audit committee also has overall responsibility for the disclosure controls and procedures that generate the compensation information.

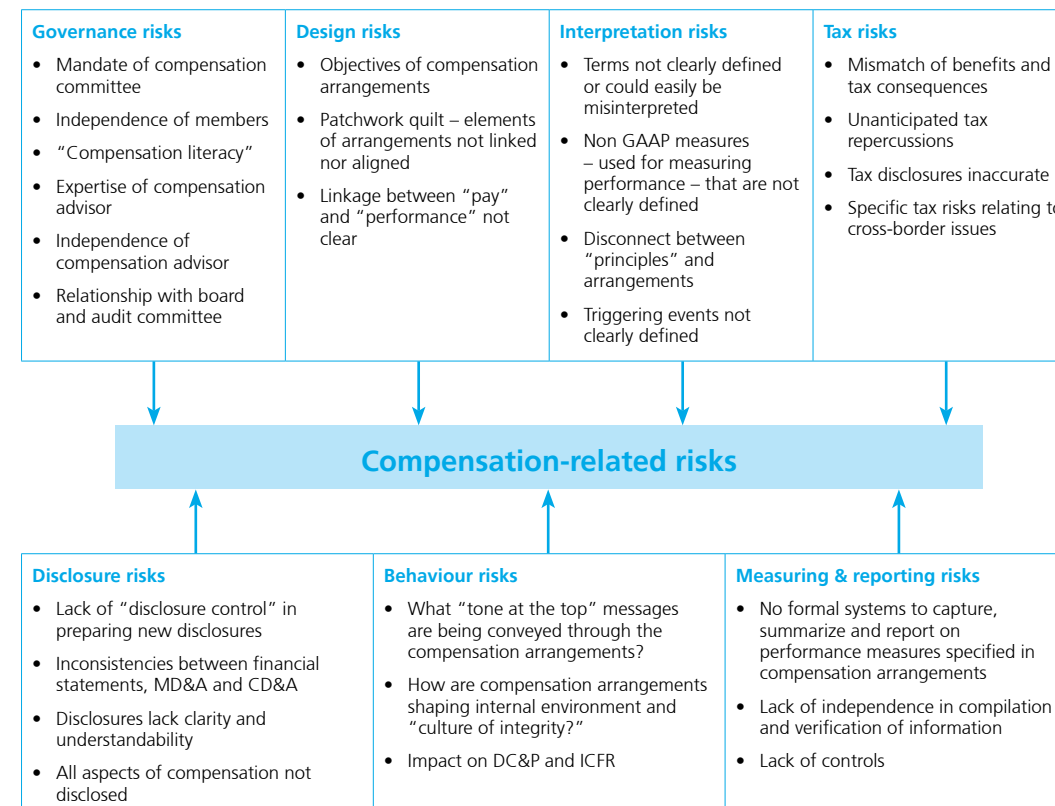
Deloitte perspective

Deloitte has observed that the connections in the second half of the diagram are usually incompletely drawn within organizations:

- Although boards and compensation committees are generally aware that the subject of executive compensation is of interest to shareholders, and often carries some possibility for embarrassment or even scandal, they nevertheless do not usually spend sufficient time thinking through the risks attached to their own compensation programs;
- The design and oversight of executive compensation often does not lie fully within an enterprise's normal financial controls, causing a heightened possibility of error;
- Although virtually all commercial entities now subscribe to some concept of pay for performance, it is not always clear that the “performance” impacting on pay is well-aligned with the entities' strategic objectives.

Although boards generally take the view that compensation-based matters fall wholly within the province of the compensation committee, this overlooks the diverse nature of the risks that can attach to these programs. The following diagram sets out some of these. We doubt that all of these are or even could be standard elements of a compensation committee meeting agenda.

Key compensation-related risks



Responsibility for controlling these risks cuts across different parts of the organization and different board committees. For example, both the audit and compensation committees should have an interest in what is disclosed about compensation: the compensation committee has the primary responsibility, but what is disclosed is heavily intertwined with the information in the financial statements and MD&A, reviewed by the audit committee.

We can help

Deloitte can assist you in carrying out a comprehensive assessment of compensation-related risks and exposures, and in the following specific areas:

- **assessing controls** related to the compensation program
- **developing an action plan** to improve your compensation or audit committee's practices and procedures
- **constructing the disclosure** necessary to comply with the revised CSA requirements
- **developing learning materials** tailored to your company's situation to assist you in meeting your director education plan objectives
- **performing specified audit procedures**, such as verifying the compilation of the amounts included in the compensation disclosures

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