Canadian Evidence of Adherence to “Comply or Explain” Corporate Governance Codes: An International Comparison*

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ABSTRACT
This study documents the rate of compliance by Canadian public firms with corporate governance recommendations imposed by the Canadian Securities Administrators. Canada uses a “comply or explain” governance structure in which harmonized provincial regulation establishes mandatory disclosure of governance practices. Firms can be compliant with these requirements either by voluntarily adopting the recommended best practices (i.e., adopt) or by explaining the alternative practices implemented to achieve the same governance principle (i.e., explain). Firms that fail to comply (i.e., neither adopt nor explain) are in violation of Canadian securities regulation with respect to governance. Using a hand-collected sample of 742 Canadian public companies and 16 governance recommendations, our results show that an average of 82 percent of firms complied by adopting the best practice and an additional 4 percent complied by explanation. Our study also shows that 39 percent of Canadian publicly traded firms were completely compliant with all 16 recommendations examined in this study, either by adoption or explanation. To provide a broader context for these results, we compare rates of compliance in Canada to rates in Australia, a country broadly similar to Canada with comparable governance recommendations. The Australian Securities Exchange supplied data sample of 1334 Australian companies reports a complete compliance rate of 74 percent compared to Canada’s 39 percent complete compliance rate. Our analysis shows that compliance by adoption of best practice is more common in Canada, whereas compliance by explanation is more common in Australia. In our analysis of compliance with individual recommendations, we find that half of the recommendations are more likely to be complied with in Australia, and the other half are more likely to be complied with in Canada.

Keywords Governance; Regulation; International; Comply or explain

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DONNÉES CANADIENNES RELATIVES AU RESPECT DES CODES DE GOUVERNANCE FONDÉS SUR LE PRINCIPE « CONFORMITÉ OU EXPLICATION » : COMPARAISON INTERNATIONALE

RÉSUMÉ
Les auteurs s’intéressent au taux de conformité des sociétés ouvertes canadiennes aux recommandations des Autorités canadiennes en valeurs mobilières, en matière de gouvernance d’entreprise. Le Canada a adopté la structure de gouvernance selon laquelle les sociétés doivent « se conformer ou s’expliquer », la réglementation provinciale uniformisée exigeant la communication d’information sur les pratiques de gouvernance. Les sociétés peuvent se conformer à ces exigences soit en adoptant volontairement les pratiques d’excellence recommandées (en choisissant l’adoption), soit en expliquant les pratiques différentes qu’elles ont adoptées pour atteindre les mêmes objectifs de gouvernance (en choisissant l’explication). Les sociétés qui ne se conforment pas (celles qui ne choisissent ni l’adoption ni l’explication) dérogent à la réglementation canadienne à laquelle sont assujetties les valeurs mobilières en ce qui a trait à la gouvernance. En analysant un échantillon constitué manuellement de 742 sociétés ouvertes canadiennes et de 16 recommandations en matière de gouvernance, ils constatent qu’en moyenne 82 pour cent des sociétés se sont conformées en adoptant les pratiques d’excellence et que 4 pour cent de plus se sont conformées en s’expliquant. L’étude révèle également que 39 pour cent des sociétés ouvertes canadiennes se conforment intégralement aux 16 recommandations examinées, en choisissant l’adoption ou l’explication. Afin d’élargir le contexte de ces résultats, les auteurs comparent les taux de conformité du Canada aux taux de conformité de l’Australie, un pays semblable au Canada et dont les recommandations en matière de gouvernance s’apparentent aux recommandations canadiennes. L’échantillon de données provenant de 1 334 sociétés australiennes fourni par l’ASX révèle un taux de conformité intégrale de 74 pour cent par rapport à 39 pour cent au Canada. Cette comparaison révèle que la conformité par adoption des pratiques d’excellence est plus courante au Canada, alors que la conformité par explication est plus courante en Australie. Dans leur analyse de la conformité aux différentes recommandations, les auteurs constatent que la moitié des recommandations sont davantage susceptibles d’être respectées en Australie, et l’autre moitié, plus susceptibles d’être respectées au Canada.

Mots clés : gouvernance, international, réglementation, se conformer ou s’expliquer

With the rapid increase in the number of regulatory bodies issuing codes of governance “best practices” for public companies (Aguilera and Cuervo-Cazurra, 2009), two dominant approaches have emerged: mandatory rule-based systems and principles-based “comply or explain” systems. While much is known about the United States’ mandatory rule-based approach to corporate governance (e.g., Coates, 2007; Hochberg, Sapienza, and Vissing-Jorgensen, 2009; Zhang, 2007; Wang, 2010; Bargeron, Lehn, and Zutter, 2010; Gao, Wu, and Zimmerman, 2009), there is much less known about the principles-based “comply or explain” approach. Despite this, the “comply or explain” approach has been adopted by all
Organization for Economic Co-operation and Development (OECD) member countries except the United States (OECD, 2004).

What is commonly referred to as a “comply or explain” approach is more accurately described as an “adopt or explain” approach. In general, these codes of corporate governance have an overarching set of principles or goals, accompanied by suggested “best practices” for achieving the desired result. Firms comply with these requirements either through voluntarily adopting the recommended best practices (i.e., adopt) or through an explanation of the alternative practice used to achieve the governance principle (i.e., explain). Firms are noncompliant if they fail to adopt and fail to provide an explanation. The governance codes address issues such as board independence, composition of committees, compensation, ethics, board mandate, director nomination, board member assessment, orientation and continuing education of board members, position descriptions, and audit committees (see Canadian Securities Administration (CSA), 2004a,b as examples).

Canada has been cited by the OECD for having the second strongest set of security regulations in the world, following New Zealand (OECD, 2006: 125–26), and ahead of the United States. Canada was among the original set of countries adopting the “comply or explain” approach. However, the extent of noncompliance and the specific governance areas in which noncompliance exists is currently unknown. Therefore, the aim of this paper is twofold: first, to document the extent to which Canadian publicly traded companies are in compliance with certain corporate governance recommendations, and second, to situate these Canadian levels of compliance by comparison to Australian levels. We contrast Canada and Australia as both are British Commonwealth countries that have comparable “comply or explain” corporate governance approaches and recommendations, among other similarities (e.g., governmental systems based on states/provinces in a federal form; Kilcullen, 2000). Beyond identifying specific governance areas where one country’s compliance rates may differ from the other, comparison of compliance rates across these two countries may offer insight into further research that may hypothesize why the differences and similarities exist.

Identifying areas of Canadian corporate governance noncompliance and differences relative to another country should be of interest to a broad range of stakeholders, such as boards of directors, public accounting firms, and the provincial securities commissions. In the realm of corporate governance and control, boards of directors are viewed as the ultimate internal control authority in firms. The board of directors will directly affect the approach that a firm takes in relation to its accountability and monitoring requirements overall, as well as its responsibility for financial reporting specifically (e.g., Beasley and Salterio, 2001; Lu, Richardson, and Salterio, 2011; CSA, 2004c). In addition, public accounting firms often provide information about best board and audit committee practices (e.g., Deloitte, 2011). Finally, the Office of the Chief Accountant of the various securities commissions carry out much of the scrutiny of compliance with governance codes (e.g., CSA, 2007). Hence, answers to the questions posed in our study are relevant.
to a wide range of parties interested in governance issues with a unique Canadian flavor.

To answer our research questions, we examine sixteen corporate governance best practices that are common to the Canadian and Australian codes of governance. We examine compliance in a hand-collected sample of 742 Canadian corporations and trusts, where compliance is defined as “adopting” best practice or “explaining” the alternative means used. Adoption was the alternative chosen for 82 percent of individual items, explanation in 4 percent, and 14 percent were non-compliant. However, on a cumulative basis over the sixteen items, only 39 percent of companies were compliant for all sixteen items of governance disclosure. In the Canadian sample, noncompliance was a particular issue for five recommendations, including: disclosing board duties, independent chair of the board, disclosure of ethics code waivers, code of conduct, and remuneration committee.

The Canadian data is then compared to Australian Securities Exchange (ASX) supplied compliance data for the average of 1334 Australian corporations and trusts. For the sixteen nearly identical best practice recommendations, we find that the level of cumulative total compliance occurs in Australia at nearly twice the rate as in Canada (74 percent versus 39 percent of all firms). However, when looking at individual items, Canadian firms overall score higher in the adoption of best practice category (82 percent versus 70 percent). Further, when individual recommendations are examined, best practice adoption rates for specific items indicate that there are no differences between the Canadian and Australian adoption rates. When overall compliance (i.e., adoption plus explanation) is tested for individual items, there is again no clear winner: Australian firms on average comply to a higher degree for eight of the sixteen recommendations, and Canadian firms on average comply to a higher degree for seven of the other of the sixteen recommendations. These findings underscore the need for future research to further examine why certain firms comply or explain with certain governance disclosure requirements and others do not.

This study makes three important contributions to the corporate governance literature. First, this study documents the extent to which Canadian public firms adopt best practice corporate governance recommendations. Second, this study identifies areas in which Canadian public company disclosures are noncompliant with corporate governance securities regulation (i.e., did not adopt best practice or provide explanation). Finally, by contrasting the Canadian and Australia data, this study provides a rich context in which to situate the Canadian rates of compliance. We also identify differences across the two countries in firms’ choices of “adoption” versus “explanation”.

1. Compliance through adoption or mandatory disclosure is specified in Section 2.1 (“Required Disclosure”) of National Instrument 58-101 Disclosure of Corporate Governance Practices, as adopted by the Canadian Securities Administrators (CSA, 2004a). Noncompliance with the mandatory disclosure requirements indicates a violation of Canadian securities regulation with respect to governance.
In the following section, the Canadian institutional context is outlined, documenting the current state of corporate governance in Canada followed by a comparison of the Canadian institutional context to that of Australia. We then outline our method, data, and assessment of the extent of compliance with Canadian governance requirements. The next section explains the results of our statistical tests to contrast the Canadian data to the Australian data. Finally, conclusions and implications for Canadian corporate governance are discussed.

BACKGROUND AND RESEARCH QUESTIONS

Corporate Governance: The Canadian Institutional Context

The Canadian system is a variant of the “comply or explain” approach to corporate governance regulation, whereby a set of principles are enunciated and guidelines identify “best practices” as to how corporations achieve the goal of each principle. As noted by the CSA, the guidelines are not necessarily intended to be prescriptive and alternatives to identified best practices are acceptable (CSA, 2004b). Specifically, the Canadian regime is one of voluntary adoption of best practices but with mandatory disclosure of either the adoption of these best practices (i.e., “adopt”) or disclosure of how the alternative practice employed achieves the goal (i.e., “explain”) (CSA, 2004a, Section 2.1). In some cases, this explanation might lay out alternate measures taken to meet the governance goal, and in other cases, explanation simply justifies the departure. As such, a company is considered compliant either through substantively adopting the guideline’s best practice or through including appropriate disclosure of non-adoption.

The required corporate governance requirements, which came into effect on June 30, 2005, are contained in National Instrument 58-101 Disclosure of Corporate Governance Practices (CSA, 2004a) and best practices are enumerated in the companion National Policy 58-201 Corporate Governance Guidelines (CSA, 2004b). These requirements apply to all TSX companies, with less extensive disclosure provisions required for TSX Venture companies.

Canada’s corporate governance reform began in the mid-1990s as an exercise in self-regulation by the Toronto Stock Exchange (TSE) to improve the quality of listings (Dey, 1994, 1999). Minimal governance standards were considered a first step (see Daniels and Waitzer, 1993 for a discussion of the previous period). The initial identification of Canadian best practices stemmed from the TSE-sponsored

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2. In addition and in regard to audit committees, Multilateral Instrument 52-110 Audit Committees (CSA, 2004c) was effective as of March 30, 2004 with subsequent amendments effective June 30, 2005.

3. The TSX is the Canadian senior market which had 104.6 billion shares traded during 2010 for a traded value of $1,390.7 billion. In contrast, the TSX Venture is the Canadian junior market which had 67.3 billion shares traded during 2010 for a traded value of $34.3 billion (TMX Group, 2011a).
Dey Report of 1994 (Dey, 1994), whose original fourteen guidelines reflected the “best practices” of the day. In 2002, regulators became more focused on corporate governance practices, consistent with the corporate governance reformation in other countries and fueled by the U.S. financial reporting scandals (Di Pietra, McLeay, and Ronen, 2010; Hill, 2008). The CSA announced in 2002 that each province would take over the enforcement of the TSE “comply or explain” code and that the CSA would update best practices on an urgent basis. These updates were significantly influenced by the United States Sarbanes-Oxley Act of 2002 (U.S. Congress, 2002), by new U.S. stock exchange listing requirements (NYSE, 2003) and by the United Kingdom “comply or explain” regime advocated in the Higgs Report (Financial Reporting Council [FRC], 2003). It took three years for the CSA to complete new regulations, a lengthy period resulting from the negotiated approach required by having a cooperative national body attempting to arrive at a common standard with no means to compel acceptance by any provincial regulator.4

The 2005 policies were placed under review by the CSA virtually when they were first adopted. The first review report, CSA Staff Notice 58-303 Corporate Governance Disclosure Compliance Review, was issued in June 2007 (CSA, 2007). The data contained in the report were from a sample of 100 companies from seven provinces and comprised 65 TSX and 35 TSX Venture issuers. The report considered compliance with corporate governance disclosure requirements. Compliance rates (adopt or explain) in eight significant areas ranged from a low of 70 percent to a high of 94 percent. CSA staff expressed concern both with the noncompliance level and also with the lack of meaningful information contained in “boilerplate” disclosures. A total of 27 TSX and 11 TSX Venture issuers were required to address deficiencies, though the nature of redress was unspecified.5

The second review, CSA Staff Notice 58-306 2010 Corporate Governance Disclosure Compliance Review, was issued in December 2010 (CSA, 2010). The data for the second review was based on a sample of 72 companies from four provinces and comprised 46 TSX and 26 TSX Venture issuers. The rate of necessary “prospective enhancements” to firms’ corporate governance disclosures increased from the earlier 2007 report for both TSX and TSX Venture samples. Specifically, the 2010 review found 63 percent (42 percent) of the TSX (TSX Venture) sample

4. All major securities regulations in Canada are harmonized through the CSA with policies cited as “National Instruments” having unanimous adoption and those labelled as “Multilateral Instruments” being accepted by all except one provincial securities commission from among the largest four (Alberta, British Columbia, Ontario and Quebec). The largest disserter from national policies is British Columbia (Salterio and Conrod, 2009).

5. We were only able to trace a handful of deficiencies to refilling of documents. Refiling of information was normally included along with other disclosure changes to continuous disclosure documents, which masked the focus on the incomplete governance disclosures. From an enforcement perspective, this is the closest we could find to any regulatory action.
required “prospective enhancements” as compared to 42 percent (26 percent) from the 2007 review.  

The CSA concluded that, “We view the level of noncompliance with the disclosure requirements of the Corporate Governance Instrument to be unacceptable … issuers need to further improve their disclosure. We will continue to review corporate governance disclosure as part of our overall [compliance disclosure] review program” (CSA, 2010: 3). Although the CSA’s review identified many companies that failed to satisfy mandated securities regulation disclosure requirements, the CSA chose not to disclose information on repeat offenders, including the company names or penalties imposed, if any. From a transparency perspective, including review of corporate governance disclosures with the overall review program may serve to reduce attention given to noncompliance in this one specific area.

Given the small sample sizes and unclear sampling methods used by the CSA, this study is designed to provide clear insights into the extent of Canadian corporate governance compliance, and best practice adoption, by examining a large hand-collected sample of publicly traded Canadian companies.

**Canada versus Australia**

Compared to Canada, Australia has a similar “comply or explain” corporate governance regime, the development of which has been well documented (e.g., Zadkovich, 2007; Dignam and Galanis, 2004; Robins, 2006). There are strong similarities between Canada and Australia in “regard to its federal and provincial division of powers, its federal constitution and legal history” (Mitchell, 2003: 382). Canada and Australia are both common law countries, with a federal system of government, and a history of ebbs and flows between centralization in the federal government versus devolution of powers to states/provinces (e.g., Kilcullen, 2000). The Gross Domestic Product (GDP) per person is roughly equivalent in Canada and Australia (about $37,000 US for Australia and $39,000 US for Canada in 2008) and GDP across various economic sectors are also relatively equal (Stevens, 2009). Canada has relatively more manufacturing activity, and Australia has relatively more mining activity, but the overall combined level of agriculture, manufacturing, and services has a similar contribution to GDP (Stevens, 2009).

6. The term “prospective enhancements” used by the CSA underscores the absence of refiling the applicable disclosure documents, and only requiring future modification to company disclosures.

7. Ten provinces and three territories in Canada versus six states and one territory in Australia. One unique Canadian feature is the code law–based province of Quebec versus common law in the rest of Canada and in all of Australia. However, as discussed above, National Policy instruments agreed upon by the CSA member bodies apply the same way across Canada, and Quebec was one of the four jurisdictions that took part in each CSA study of compliance with the Corporate Governance Code (CSA, 2007, 2010).
Similarities also exist in the respective capital markets and the nature of the resource-based economies. The TSX is the 8th largest stock exchange in the world, with the ASX being 12th (World Federation of Exchanges [WFE], 2008). While the market capitalization of Canadian firms is about 1.8 times that of Australian firms ($1.8 trillion (US) on TSX versus $1.0 trillion (US) on ASX; WFE, 2008), the number of listed entities is roughly the same on the senior Canadian Exchange as compared to the Australian Exchange (TSX had 1663 listings [TSX Group, 2008] versus the ASX with 1913 listings; WFE, 2008). Both exchanges have large and stable financial sectors (Stevens, 2009), and have large natural resource and energy sectors, with the ASX being the second most active resource market and energy market in the world after the TSX (TMX Group, 2011b; ASX, 2011).

There are two main differences between the ASX and the TSX, other than size. First, the ASX is the only market in Australia, whereas the TMX Group includes both the TSX and the TSX Venture Exchange (TMX, 2011a). The latter includes thousands of small cap firms but represents a relatively small share of total market capitalization (about 3 percent) (TMX, 2011b). Second, firms on the TSX are influenced to a greater extent than firms on the ASX by U.S. laws and regulations. There are approximately 180 Canadian firms cross-listed on U.S. exchanges, making them subject to U.S. mandatory governance laws, whereas, according to Audit Analytics, fewer than 20 Australian firms are cross-listed on U.S. exchanges in the same time period.

Overall, there are remarkable similarities between Canada and Australia in legal and constitutional history and basic economic elements, as well as similarities in stock exchanges and the nature of firms present on those exchanges. There are some major differences, as well. Canada is in closer proximity to the United States, with its significant financial markets and onerous legislative and legal environment. Also, Australia has a national securities regulator, whereas the Canadian model involves a decentralized cooperative of provincial regulators (e.g., Mitchell, 2003; French, 2003).8

Despite these differences, contrasting corporate governance compliance experience between Canada and Australia provides an opportunity to explore Canada’s rates of compliance with an international counterpart. Given the similarities between countries, it is reasonable to expect that firms in both countries will comply similarly, and that differences, and similarities, in compliance would be of interest to securities regulators and others.

8. Securities regulation is under state jurisdiction in Australia, similar to the Canadian case. A series of attempts to create a national regulator in the 1980s and 1990s all met with failure on constitutional grounds; in 2001 a national securities regulator was made possible through a “assignment of powers clause” in the Australian constitution that is similar to a constitutional amendment, albeit requiring regular renewal by the state governments (Mitchell, 2003; French, 2003).
Canadian Data

The data for the Canadian firms in this study is based on a sample that started with the population of Canadian companies covered by COMPUSTAT 2007, Canadian edition. Canadian companies listed on the TSX Venture were not eligible for the sample because of their lower governance disclosure requirements. After deleting the TSX Venture firms and firms that did not have the required data we arrived at a sample of 874 Canadian companies traded on the TSX. This represents 68 percent of the firms covered in COMPUSTAT Canada 2007. In selecting the final sample, we excluded 132 firms cross-listed on U.S. stock exchanges, because these companies must comply with the mandatory corporate governance requirements of the Sarbanes-Oxley Act (U.S. Congress, 2002) and the various U.S. exchange listing requirements (e.g., NYSE, 2003). This left a sample of 742 companies.9

The data for our sample of Canadian companies were hand-collected from annual reports and proxy statements (also referred to as management information circulars) for the first fiscal year-end after June 30, 2006, and have been cross-referenced to corporate directories, corporate websites, “Who’s Who”–style publications, and other secondary data sources to enhance data reliability. The 742 TSX companies included in the sample reported average (median) total assets of $4.67 billion ($190 million) and a market capitalization of an average (median) of $1.47 billion ($205 million).10

We have organized Canadian data by the Australian [governance] Code disclosure numbering system, to facilitate later comparisons. There are sixteen nearly identical corporate governance disclosures that we found for the two regimes and for which Australian data was made available to us. Major areas covered include recommendations to lay solid ground for management and oversight, appropriately structure the board of directors, promote ethical and responsible decision making, safeguard integrity in financial reporting, respect the rights of shareholders, recognize and manage risk, encourage enhanced performance, remunerate fairly and responsibly, and recognize the legitimate interests of stakeholders. The appendix describes the Australian [governance] Code classification numbering system for disclosures, versus the appropriate companion in the Canadian [governance] Code. Our analysis suggests that there is at least a 75 percent overlap in items that could be coded. Other governance disclosure items were inconsistent and eliminated from the study.

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9. We employ the same sample as Lu et al. (2011) augmented by 142 firms that did not meet their data restriction of being a publicly traded company for five years.

10. Local currency units reported.
In each of the sixteen items that we are able to assess and compare, each company’s disclosure was assigned to one of the following three categories: 11

1. the company has adopted the best practice in the guideline (i.e., adopt);

2. the company has not adopted the best practice from the guideline but provides an explanation (i.e., explain) as to how it achieves the principle via a disclosure as permitted by regulation, or

3. the company has not made any disclosure about the particular guideline (i.e., not disclosed).

If we could find the governance information in any location in the annual report or proxy statement, hard copy or online information, we assigned the item to Category 1 or 2, as appropriate. Note that firms that are compliant with regulation are those in Category 1 plus Category 2 above. Companies are noncompliant if they fail to adopt or disclose regarding the item (i.e., Category 3 above).

**Australian Data**

Comparative Australian data was generously provided by the ASX, for 1371 firms in 2006 and 1295 firms in 2007 (hereafter referred to as the 1334 firm sample). The ASX states that this represents approximately 69 percent of the firms that are public companies in Australia (ASX, 2008: 20) and represents the complete population of Australian firms that have a June 30 year end. 12 The descriptive statistics and comparisons in this paper are based on the average of the 2006 and 2007 data (i.e., 1334 firms) because the dominant fiscal year-end is June 30 in Australia whereas the Canadian norm is December 31. 13 As discussed above, the ASX sample may include some companies that are cross-listed on U.S. stock exchanges. 14

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11. This coding system is consistent with the previous regulatory reviews (e.g., ASX, 2007) and goes beyond the extent of the disclosures reviewed by Canadian regulators (CSA, 2007) by including company website disclosures about governance that might have disclosures beyond those in regulatory documents.

12. The ASX studied the population of companies with December 31 year-ends in 2009 and 2010, to assess any potential effect of choice of year-end. This took the total percentage of Australian firms covered from 69 percent to 79 percent. No material differences were reported between the two year-ends, suggesting that governance practices are similar across year-ends in Australia.

13. Results are no different if individual years are used for the Australian data rather than averages. We present average data across the two years for ease of exposition. Eighty-nine percent of the firms in our Canadian sample had December 31 year-ends.

14. As a practical matter, because we only have Australian aggregate data by recommendation, we cannot remove any cross-listed companies from the data set. As a sensitivity analysis, we assume that all the Australian cross-listed firms are fully compliant by adoption of best practices and remove 17 firms from the Australian sample by reducing by 17 the number in each adoption category making it an analysis of 1278 firms. There are no differences in our results based on making this reasonable assumption.
While the ASX reports do not include firm size data, Damodaran (2007) provides data for a sample of 617 ASX firms covered by Bloomberg that allows us to compute an average (median) total assets of $1.76 billion ($87 million) and a market capitalization average (median) of $1.90 billion ($252 million).15

For the Australian data, the governance disclosure is again classified as Category 1, “adopt”, Category 2, “explain”, the two compliant categories, or Category 3, “not disclosed”, which is noncompliant. To assess compliance and categorize the results of assessment, the ASX reports that it follows similar procedures to our Canadian data. In particular, the Australian Securities Exchange (ASX) (2007) reports the following approach:

70. In the first instance, the review considered compliance with the Listing Rules, in particular Listing Rule 4.10.3 (i.e., the Australian governance code). An entity was found to have complied with this Listing Rule in relation to a Recommendation where the company reported on its approach to the Recommendation in some form and whether it followed the Recommendation or not and, if not, provided some explanation for why not. The explanation could be in the form of reasons for non-adoptions of the Recommendation; for example, the company was too small to justify appointment of independent directors, or in the form of a description of an alternate practice; for example, that the whole board performs the duty of a particular committee. (ASX, 2007: 17, italics added for explanatory purposes)

Thus, the ASX reports the same definition of “adopt” or “explain” as we employed in coding the Canadian data.16 In addition, the ASX did not confine itself to the corporate governance disclosures in isolation but, as we did in Canada, examined the entire information set, whether hard copy or online (ASX, 2007: 17 paragraph 69).17

RESULTS

Canadian Descriptive Statistics

To provide insights into corporate governance, two approaches are used. First, we examine the extent that best practices were adopted; Category 1, above. Table 1 (left-hand columns) provides a breakdown of the data for Canadian firms using the three compliance categories. Compliance is reported by number of firms and percentages. Secondly, given that best practice recommendations are not

15. Local currency units reported. 2007 data for 649 Australian firms from the same source reveals average (median) total assets of $2.00 billion ($88 million) with market capitalization of $2.10 billion ($221 million) (Damodaran, 2008).
16. This approach to coding was confirmed by one of the authors in an interview with the ASX Director of Information on November 30, 2009 via phone call and confirmed via email.
17. We expand our review in Canada beyond the material in the annual report and other regulatory disclosures to be consistent with the Australian approach. Further, this allows us to be comprehensive in our search of disclosures for the Canadian firms.
TABLE 1
Canadian versus Australian corporate governance disclosures: Distribution of responses across adopt, explain, and not disclosed/not comply

Panel A: Raw numbers and percentages of adopt, explain and not disclosed/not comply by country and recommendation

<table>
<thead>
<tr>
<th>Code*</th>
<th>Canada firms</th>
<th>Not disclosed/not comply</th>
<th>Australia Firms</th>
<th>Not disclosed/not comply</th>
</tr>
</thead>
<tbody>
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<td></td>
<td>Adopt† %</td>
<td>Explain %</td>
<td>Adopt† %</td>
<td>Explain %</td>
</tr>
<tr>
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<td>486 65%</td>
<td>101 14%</td>
<td>155 21%</td>
<td>1251 94%</td>
</tr>
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<td>636 86%</td>
<td>39 5%</td>
<td>67 9%</td>
<td>538 40%</td>
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</tr>
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<td>27 4%</td>
<td>29 4%</td>
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<td>21 3%</td>
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</tr>
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<td>0 0%</td>
<td>33 4%</td>
<td>1006 76%</td>
</tr>
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<td>10 1%</td>
<td>35 5%</td>
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<tr>
<td>9.2</td>
<td>521 70%</td>
<td>56 8%</td>
<td>165 22%</td>
<td>779 59%</td>
</tr>
<tr>
<td>10.1</td>
<td>688 93%</td>
<td>9 1%</td>
<td>45 6%</td>
<td>1045 78%</td>
</tr>
</tbody>
</table>

Panel B: Significance of difference in distribution of firms across adopt, explain or not disclose/not comply and identification of country with higher adoption rate

<table>
<thead>
<tr>
<th>Code reference</th>
<th>$\chi^2(2)$</th>
<th>p-value#</th>
<th>Country with greater adoption</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>279.4</td>
<td>&lt;.0001</td>
<td>Australia</td>
</tr>
<tr>
<td>2.1</td>
<td>425.44</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>2.2</td>
<td>76.41</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>2.4</td>
<td>647.79</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>3.1</td>
<td>78.74</td>
<td>&lt;.0001</td>
<td>Australia</td>
</tr>
<tr>
<td>3.2</td>
<td>486.51</td>
<td>&lt;.0001</td>
<td>Australia</td>
</tr>
<tr>
<td>4.1</td>
<td>12.62</td>
<td>0.0018</td>
<td>Australia</td>
</tr>
</tbody>
</table>

(The table is continued on the next page.)
prescriptive and that alternative governance practices are possible if adequately explained (CSA, 2004b), we examine the extent of corporate governance “compliance,” though adoption or explanation. Table 2 (left-hand columns) repeats the data, with the first two categories (i.e., adoption and explanation) combined as being “compliant,” and the third category designated as “noncompliant” (not disclosed/not compliant).

For our sample of Canadian firms, we see in Table 1 panel A (left-hand columns) adoption rates in Category 1 ranged from 48 percent for Recommendation 3.2 (disclosure of ethics code waivers) to 97 percent for Recommendation 4.1 (CEO and CFO certification of the financial statements). Category 1 adoption

\[ \chi^2(2) \text{ } p\text{-value} \text{#} \text{ Country with greater adoption} \]

<table>
<thead>
<tr>
<th>Code reference</th>
<th>( \chi^2(2) )</th>
<th>( p\text{-value} \text{#} )</th>
<th>Country with greater adoption</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.2</td>
<td>210.96</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>4.3</td>
<td>526.61</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>4.4</td>
<td>237.22</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>6.1</td>
<td>52.2</td>
<td>&lt;.0001</td>
<td>Australia</td>
</tr>
<tr>
<td>7.1</td>
<td>63.29</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>7.2</td>
<td>138.14</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>8.1</td>
<td>68.71</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
<tr>
<td>9.2</td>
<td>80.47</td>
<td>&lt;.0001</td>
<td>Canada</td>
</tr>
</tbody>
</table>
| 10.1           | 279.4          | <.0001          | Australia                   

\textbf{Panel C: Overall comparison of compliance rates for sixteen coded items for adopt, explain and not disclosed/not comply}

\begin{align*}
\text{Total: Australian firms} & \text{ adopt significantly more than Canadian firms} \\
\text{Total: Canadian firms} & \text{ adopt significantly more than Australian firms} \\
\text{Different from 50%-50% split for 16 recommendations} & \\
\end{align*}

\begin{align*}
\text{Number of code items (percentage)} & \text{ 6 (37.5%) 10 (62.5%)} \\
\chi^2 & = 0.51, \\
p & > 0.20 \\
\end{align*}

\textbf{Notes:}

* Refer to the appendix for the detailed corporate governance recommendation for each reference number in the table.
† \textit{Adopt} includes companies whose disclosure indicates compliance with the corporate governance principle. \textit{Explain} includes companies that explain why their policies are not in compliance. \textit{Not disclosed/not comply} includes companies who either do not disclose compliance with the corporate governance principle or disclose noncompliance but provide no explanation.
# Given 16 tests on the same set of data, a conservative interpretation of \( p\)-value would be 5 percent significance achieved at \( p < 0.003 \) and 1 percent significance achieved at \( p < 0.0006 \).
TABLE 2
Canadian versus Australian corporate governance disclosures: Test of compliant vs. noncompliant

Panel A: Raw numbers and percentages of firms compliant and noncompliant by country and recommendation with test for significant differences and identification of country whose firms are more compliant

<table>
<thead>
<tr>
<th>Code*</th>
<th>Canada Firms</th>
<th></th>
<th></th>
<th></th>
<th>Australia firms</th>
<th></th>
<th></th>
<th>χ²(1)</th>
<th>p-value#</th>
<th>Country more compliant</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Compliant†</td>
<td>%</td>
<td>Noncompliant</td>
<td>%</td>
<td>Compliant†</td>
<td>%</td>
<td>Noncompliant</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1</td>
<td>587</td>
<td>79.11%</td>
<td>155</td>
<td>20.89%</td>
<td>1287</td>
<td>96.48%</td>
<td>47</td>
<td>3.52%</td>
<td>161.74</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>2.1</td>
<td>675</td>
<td>90.97%</td>
<td>67</td>
<td>9.03%</td>
<td>1124</td>
<td>84.45%</td>
<td>207</td>
<td>15.55%</td>
<td>17.11</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>2.2</td>
<td>560</td>
<td>75.47%</td>
<td>182</td>
<td>24.53%</td>
<td>1171</td>
<td>87.91%</td>
<td>161</td>
<td>12.09%</td>
<td>52.54</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>2.4</td>
<td>713</td>
<td>96.09%</td>
<td>29</td>
<td>3.91%</td>
<td>1199</td>
<td>90.02%</td>
<td>133</td>
<td>9.98%</td>
<td>23.6</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>3.1</td>
<td>574</td>
<td>77.36%</td>
<td>168</td>
<td>22.64%</td>
<td>1199</td>
<td>89.95%</td>
<td>134</td>
<td>10.05%</td>
<td>59.74</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>3.2</td>
<td>366</td>
<td>49.33%</td>
<td>376</td>
<td>50.67%</td>
<td>1221</td>
<td>92.01%</td>
<td>106</td>
<td>7.99%</td>
<td>482.88</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>4.1</td>
<td>721</td>
<td>97.17%</td>
<td>21</td>
<td>2.83%</td>
<td>1313</td>
<td>98.50%</td>
<td>20</td>
<td>1.50%</td>
<td>3.69</td>
<td>0.0547 Equal</td>
</tr>
<tr>
<td>4.2</td>
<td>709</td>
<td>95.55%</td>
<td>33</td>
<td>4.45%</td>
<td>1314</td>
<td>98.50%</td>
<td>20</td>
<td>1.50%</td>
<td>15.49</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>4.3</td>
<td>707</td>
<td>95.28%</td>
<td>35</td>
<td>4.72%</td>
<td>1184</td>
<td>89.02%</td>
<td>146</td>
<td>10.98%</td>
<td>22.64</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>4.4</td>
<td>709</td>
<td>95.55%</td>
<td>33</td>
<td>4.45%</td>
<td>1175</td>
<td>88.48%</td>
<td>153</td>
<td>11.52%</td>
<td>28.27</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>6.1</td>
<td>602</td>
<td>81.13%</td>
<td>140</td>
<td>18.87%</td>
<td>1204</td>
<td>90.46%</td>
<td>127</td>
<td>9.54%</td>
<td>36.1</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>7.1</td>
<td>660</td>
<td>88.95%</td>
<td>82</td>
<td>11.05%</td>
<td>1249</td>
<td>93.98%</td>
<td>80</td>
<td>6.02%</td>
<td>16.03</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>7.2</td>
<td>694</td>
<td>93.53%</td>
<td>48</td>
<td>6.47%</td>
<td>1027</td>
<td>77.45%</td>
<td>299</td>
<td>22.55%</td>
<td>86.95</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>8.1</td>
<td>688</td>
<td>92.72%</td>
<td>54</td>
<td>7.28%</td>
<td>1123</td>
<td>84.44%</td>
<td>207</td>
<td>15.56%</td>
<td>28.96</td>
<td>&lt;.0001 Canada</td>
</tr>
<tr>
<td>9.2</td>
<td>577</td>
<td>77.76%</td>
<td>165</td>
<td>22.24%</td>
<td>1270</td>
<td>95.49%</td>
<td>60</td>
<td>4.51%</td>
<td>152.78</td>
<td>&lt;.0001 Australia</td>
</tr>
<tr>
<td>10.1</td>
<td>697</td>
<td>93.94%</td>
<td>45</td>
<td>6.06%</td>
<td>1170</td>
<td>87.51%</td>
<td>167</td>
<td>12.49%</td>
<td>20.82</td>
<td>&lt;.0001 Canada</td>
</tr>
</tbody>
</table>

(The table is continued on the next page.)
TABLE 2 (Continued)

Panel B: Overall comparison of compliance rates for sixteen coded items for compliant versus noncompliant

<table>
<thead>
<tr>
<th>Number of code items (percentage)</th>
<th>Total: Australian firms significantly more compliant than Canadian firms</th>
<th>Total: Canadian firms significantly more compliant than Australian firms</th>
<th>Equal rate of compliance statistically</th>
<th>Different from 50%-50% split for 16 recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8 (50.0%)</td>
<td>7 (43.75%)</td>
<td>1 (6.25%)</td>
<td>n.s.</td>
</tr>
</tbody>
</table>

Notes:

* Refer to the appendix for the detailed corporate governance recommendation for each reference number in the table.
† Compliant includes companies whose disclosure indicates compliance with the corporate governance principle plus companies that explain why their policies are not in compliance. Not compliant includes companies who neither disclose compliance with the corporate governance principle, nor provide explanation.
# Given 16 tests on the same set of data, a conservative interpretation of $p$-value would be 5 percent significance achieved at $p < 0.003$ and 1 percent significance achieved at $p < 0.0006$. 
rates were lowest for Recommendation 1.1, disclosing board duties (65 percent), Recommendation 2.2, independent chair of the board (53 percent), and Recommendation 3.2, disclosure of ethics code waivers (48 percent). Category 1 adoption rates exceeded 90 percent for seven recommendations.

In Category 2, the explain category, the highest was Recommendation 2.2 at 22 percent, (independent chair of the board) followed by Recommendation 1.1 at 14 percent (disclosing board duties). Noncompliance was highest at 51 percent for Recommendation 3.2 (disclosure of ethics code waivers) followed by 25 percent for Recommendation 2.2 (independent chair of board).

We find that across the sixteen items, the average compliance rate in Category 1 is 82 percent and the average compliance rate in Category 2 is 4 percent; this average is used to determine the overall average compliance rate for individual items of 86 percent. The rate of noncompliance is 14 percent (see Salterio and Conrod, 2009 for comparable results).

However, on a cumulative basis, analysis of individual firms in this study shows that only 116 Canadian firms (15.6 percent) complied through Category 1 adoption of all sixteen best practices, with a further 119 (16 percent) adopting fifteen out of the sixteen recommendations. All of these 235 (31.5 percent) firms provided an explanation as to how they employed alternative means to achieve the best practice principle, hence were 100 percent compliant. A further 38 (5 percent) firms adopted fourteen of the sixteen recommendations, and also provided an explanation for the two not adopted, and hence were also 100 percent compliant. Finally, 15 (2 percent) firms were compliant by providing explanations for alternative approaches to achieving the governance principles, while adopting fewer than fourteen of the sixteen recommendations. Overall, only 39 percent (or 288 / 742) of Canadian firms were completely compliant with all sixteen best practices (either by adoption or explanation).

Table 2 panel A (left hand-columns) more directly examines the Canadian data for compliance with individual items by examining overall compliance rates. Not surprisingly, the three recommendations with low Category 1 adoption are among the items with the lowest overall compliance: disclosure has not been used consistently to achieve compliance (Recommendation 1.1 (79 percent), Recommendation 2.2 (75 percent) and Recommendation 3.2 (49 percent)). In addition, Recommendation 3.1, code of conduct, at 77 percent, and Recommendation 9.2, remuneration committee, at 78 percent, appear problematic. The combination of lack of adoption and lack of explanation bring these two areas to lower levels of compliance.

A low level of compliance with required disclosures, previously observed and documented by the CSA (CSA, 2007, 2010), is substantiated by our study. We find that although individual recommendations have reasonably high compliance levels, Canadian firms seem to be completely avoiding either adopting or explaining a small number of governance items, and thus do not meet the test for overall compliance for the whole package of governance structures.
**Australian Descriptive Statistics**

We see in Table 1 panel A (right-hand columns) that Australian firms adopt the governance best practices (Category 1, “adopt”) at rates that range from 35 percent for Recommendation 2.4 (composition of the nominating committee) to 98 percent for Recommendation 4.1 (CEO and CFO certification of the financial statements). Australian firms fell in Category 2, “explain” as their alternative approach to compliance, most often for Recommendation 2.4 (composition of the nominating committee) at 55 percent, and Recommendation 4.3 (composition of the audit committee) at 45 percent, closely followed by Recommendation 2.1 (board composition) at 44 percent. The noncompliant category was Category 3; no disclosure. Incidence in this category in Australian firms was highest for Recommendation 7.2 (risk management practices and monitoring) at 22 percent, followed by Recommendation 2.1 (board composition) and Recommendation 8.1 (disclosing how board performance is evaluated); both at 16 percent.

The average rate for Australian firms for all sixteen governance disclosure items is 70 percent for the “adopt” category, 20 percent for “explain” and 10 percent “noncompliant.” Categories 1 plus 2 therefore comprise 90 percent of the observations. Individual Australian company data is not available, but the ASX reports that 74 percent of all Australian listed companies had adopted all principles (ASX, 2007: 3); our sixteen comparable governance categories are a subset of this group.

**International Comparison: Canada versus Australia**

**Cumulative Results**

The rate of complete compliance by adoption or explanation of all sixteen recommendations seems to make it clear that Australian firms are more compliant on the whole than Canadian firms. Seventy-four percent of Australian firms are totally compliant as reported by the Australian Securities Exchange (ASX) (2008) sample whereas only 39 percent of Canadian firms are fully compliant per the Canadian sample. Using a chi-square test to examine whether there are differences in rates, the results document that this difference is highly significant ($\chi^2 = 255.8$, $p < 0.0001$).

In examining the individual governance code recommendations, it might seem that Recommendation 3.2 is an issue, because the noncompliance rate for Canadian firms (51 percent) might be the key to the low overall Canadian rate of compliance. However, re-analyzing the Canadian data without Recommendation 3.2 only raises the overall compliance rate for aggregate Canadian firms from 39 percent to 42 percent versus the Australian overall compliance rate of 74 percent and does not explain the overall trend in data.
Adoption of Best Practice Results

When turning to adoption of best practice for individual items (Category 1), the data supports a different conclusion from the one given by the overall cumulative results where Australian firms are more compliant overall. We find that Canadian firms have an average rate of adoption of best practice of over 82 percent (an additional 4 percent explaining and the remaining 14 percent noncompliant). The analogous Australian rates are 70 percent, 20 percent and 10 percent respectively. These two distributions are significantly different ($\chi^2$ (df = 2) = 100.42, $p < 0.0001$) indicating a higher rate of adoption of best practices for individual recommendations in Canada. The overall Australian compliance is higher by virtue of greater relative use of the “explain” category instead of the adoption of the best practices. That is, the average for Category 1, “adopt”, was higher in Canadian firms, with 82 percent, versus Australian firms at 70 percent. The average for “explain” was higher for the Australian firms, with 20 percent, versus Canadian firms at 4 percent.

Focusing on adoption of best practice, notable recommendations where Canada performed poorly compared to Australia are found in compliance rates of 48 percent versus 89 percent respectively for Recommendation 3.2 (disclosure of ethics code waivers), and 65 percent versus 94 percent respectively for Recommendation 1.1 (disclosing board duties). Alternatively, notable recommendations where Canada’s performed well compared to Australia are found in compliance rates of 92 percent versus 35 percent respectively for Recommendation 2.4 (composition of the nominating committee), and 94 percent versus 44 percent respectively for Recommendation 4.3 (composition of the audit committee). Evidently, both of these higher relative rates of best practice adoption in Canada relate to committee composition disclosures.

If we move to an examination of overall compliance rates (Category 1 plus 2; 86 percent compliant in Canada versus 90 percent compliant in Australia) the result favors Australian firms, a result that is significant ($\chi^2 = 7.06, p < 0.01$). This mixed pattern of results suggests that further examination of the detailed data is warranted. As such, Table 1 panel B examines the distributions across the three categories (adopt, explain, not disclosed/not comply) for each of the sixteen items on an item-by-item basis. We find that the distributions are statistically significantly different (at the $p < 0.01$ level or greater) across each of the sixteen items, even after using a conservative measure where only $p$-values less than 0.0006 are considered significant at the 0.01 level and $p$-values less than 0.003 are considered significant at the 0.05 level.18 In Table 1 panel B, analysis of the individual items shows that, in fact, only six items feature Australian firms with greater adoption rates (Category 1) than Canadian firms; however, Table 1 panel C documents that the difference is not statistically significant.

18. To be conservative with 16 comparisons, we divided the significance level (0.05, 0.01) by 16 in order to get a conservative test value. Unadjusted $p$-values are reported in the tables with a footnote of the conservatively adjusted $p$-values.
Compliance Results

Table 2 panel A more directly tests compliance for individual items by examining overall compliance rates. This test finds that, on an item-by-item basis, Australian firms have higher compliance rates in eight of the sixteen items ($p < 0.01$), with Canadian firms having higher compliance rates in seven of the sixteen items ($p < 0.01$) and one item is not statistically significant.$^{19}$ As Table 2 panel B shows, there is no statistically significant difference in compliance for individual items between the two countries.

Focusing on overall compliance, rather than adoption of best practice, Table 2 panel A shows that notable recommendations where Canada fared particularly poorly compared to Australia are found in compliance rates of 49 percent versus 92 percent respectively for Recommendation 3.2 (disclosure of ethics code waivers), and 79 percent versus 96 percent respectively for Recommendation 1.1 (disclosing board duties). Alternatively, notable recommendations where Canada outperformed Australia can be traced to compliance rates of 94 percent versus 77 percent for Recommendation 7.2 (risk management practices and monitoring), with the next largest difference being compliance rates of 93 percent versus 84 percent respectively for Recommendation 8.1 (disclosing how board performance is evaluated).

CONCLUSION AND DISCUSSION

The Canadian corporate governance regime is a principles-based “comply or explain” system whereby there is voluntary adoption of best practice recommendations with mandatory disclosure about governance practices adopted. This study contributes to the corporate governance literature by first documenting and describing the rates of corporate governance compliance in Canadian publicly traded companies, second, documenting and describing the rates of corporate governance best practice adoption in Canadian publicly traded companies, and third, comparing rates of corporate governance compliance between Canada and Australia. The comparison between Canada and Australia is relevant given the same “comply or explain” approach to corporate governance with comparable best practice recommendations. In addition, the two countries have similar capital markets, and organization of government into a constitutionally similar division of power between a federal and state/provincial governments system.

Compliance with corporate governance practices is of importance to securities commissions, public accounting firms, and indeed all shareholders and stakeholders, because it goes to the heart of the operation and control of economic activity. By distinguishing between compliance and best practice adoption on a wide variety of governance recommendations, our study provides insight into the current practices of Canadian publicly traded companies. Beyond that,

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19. Recall that a $p < 0.003$ is required to be considered significantly different at the 0.05 level given 16 comparisons.
noncompliance with mandated corporate governance disclosures not only undermines the success of governance reforms, but also raises questions of the effectiveness of monitoring and enforcement. Moreover, noncompliance with governance practices has implications for the auditor’s reliance on the company’s internal controls.

Our study documents that across the sixteen corporate governance items, there was an average 82 percent adoption of best practice by Canadian firms, with another 4 percent being compliant by explanation, and 14 percent noncompliant. However, only 39 percent of Canadian firms were completely compliant with all sixteen governance items (either by adoption of best practice or explanation). Australian data indicates 70 percent adoption of best practice, 20 percent compliant by explanation, and 10 percent noncompliant. According to the ASX, 74 percent of individual firms were completely compliant. It is noteworthy that Canadian companies demonstrate a greater rate of best practice adoption than the Australian companies, based on category averages. Australian firms are more likely to comply with governance items by using the “explain” alternative. This pattern of results, that Canadian firms have a greater extent of best practice adoption whereas Australian firms have a greater extent of explanation, may be a factor in the OECD’s high ranking of Canada’s security regulations (OECD, 2006).

Focusing on compliance (i.e., by means of adoption of best practice or explanation) for individual governance items, Australian firms have higher compliance rates in eight of the sixteen items, whereas Canadian firms have higher compliance rates in seven of the sixteen items. For both countries, it is troubling to see a large rate of noncompliance, with a range of 3 percent to 25 percent across Canadian firms, with one Canadian outlier of 51 percent, and a range of 1 percent to 22 percent across Australian firms. Noncompliance should be of particular concern to regulators as it suggests that firms are either unaware of required disclosure requirements or prepared to disregard these requirements. This highlights the need for effective securities regulation monitoring and enforcement.

Of course, this study has limitations. While we have a rich and detailed data set for Canadian firms, we rely on the ASX for data relating to adoption and compliance with recommendations in Australia. While we have a broad sample from both markets (over two thirds of all listed companies and trusts in Australia and a similar number for all Canadian firms included on COMPUSTAT) the lack of firm-specific Australian data does not allow us to control for potential differences in adoption or compliance rates due to firm-specific factors, if any. Nonetheless, we have provided evidence to suggest that the Australian and Canadian settings are about as similar on other dimensions (i.e., constitutionally, size of capital markets, nature of economy, and so forth) as

20. We are not aware of any published studies that examine adoption or compliance rates based on such firm-specific factors (or determinants) in a “comply or explain” regime.
one can get in an international comparison. Although this study is designed to examine rates of corporate governance compliance and best practice adoption, it is possible that some governance principles are more important to capital markets than other principles. Future research may extend this study to examine what particular disclosures are meaningful to the market, the ramifications of noncompliance, and the implications of uninformative or boilerplate disclosures (CSA, 2010) (e.g., restatements, fraudulent reporting, and so forth).

We conclude that the overall 74 percent rate of complete compliance (i.e., either by adoption of best practice or explanation) suggests that Australia has a higher degree of complete compliance compared to Canada’s 39 percent rate of complete compliance. However, focusing on each individual governance item, we find that the two countries are approximately equal in their level of compliance. The implication of this difference between overall compliance rates, where Australian firms dominate, and the individual rates, where no domination exists, is that there is a high degree of noncompliance by Canadian firms in a low number of governance areas. This noncompliance in Canada underscores the concern for securities monitoring and enforcement.
### APPENDIX

**Corporate Governance Best Practice Recommendations**

Reported in the ASX Annual Report on Compliance and Common with Canadian Code*

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Topic</th>
<th>Australian Recommendation**</th>
<th>Canadian Recommendation***</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Board duties</td>
<td>1.1 Formalize and disclose the functions reserved to the board and those delegated to management.</td>
<td>58-201-3.4(g)(ii) Board mandate should include expectations and responsibilities of directors.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>58-201-3.5 Board develops clear position descriptions for: (a) the chair of the board, (b) chair of each board committee, &amp; (c) CEO. The board should also develop the CEO goals &amp; objectives.</td>
</tr>
</tbody>
</table>

#### 2. Structure the board to add value

| 2.1   | Board                  | 2.1 A majority of the board should be independent directors. | 58-201-3.1 The board should have a majority of independent directors. |
| 2.2   | Board                  | 2.2 The chairperson should be an independent director.     | 58-201-3.2 The chair of the board should be an independent director. |

(The table is continued on the next page.)
### APPENDIX (Continued)

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Topic</th>
<th>Australian Recommendation**</th>
<th>Canadian Recommendation***</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.4</td>
<td>Composition of committees</td>
<td>2.4 The board should establish a nomination committee ... the majority being independent directors and be chaired by the chairperson of the board or an independent director.</td>
<td>58-201-3.10 Board should appoint a nominating committee composed entirely of independent directors.</td>
</tr>
</tbody>
</table>

#### 3. Promote ethical and responsible decision making

**3.1 Ethics**

Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to ensure:

- 3.1.1 the practices necessary to maintain confidence in the company’s integrity
- 3.1.2 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

58-201-3.4(a) Board responsible for the integrity of CEO and executive officers and the creation of a culture of integrity.

58-201-3.8 Board should adopt a written code of business conduct and ethics.

58-201-3.9 Board is responsible for monitoring compliance with the code.

**3.2 Ethics**

3.2 Disclose the policy concerning trading in company securities by directors, officers, and employees.

OSC16.c) The firm must disclose if it has granted a waiver from a provision of the code of ethics in favor of a director or officer. The nature of the waiver, the name of the person to whom the waiver was granted, the basis for granting the waiver, and the waiver date must also be included.

(The table is continued on the next page.)
### TABLE 3 (Continued)

<table>
<thead>
<tr>
<th>Ref #</th>
<th>Topic</th>
<th>Australian Recommendation**</th>
<th>Canadian Recommendation***</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4. Safeguard integrity in financial reporting</td>
<td></td>
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</tr>
<tr>
<td>4.1</td>
<td>Financial reporting</td>
<td>4.1 Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company’s financial reports present a true and fair view, in all material respects, of the company’s financial condition and operational results and are in accordance with relevant accounting standards.</td>
<td>52-109 F1.1-3 Require that the CEO/CFO have acknowledged in writing that the annual filings do not contain any untrue or misleading statement of material fact, and present fairly in all material respects the financial condition, operations and cash flows.</td>
</tr>
<tr>
<td>4.2</td>
<td>Financial reporting</td>
<td>4.2 The board should establish an audit committee.</td>
<td>52-110 Every issuer must have an audit committee that complies with the requirements of the Instrument.</td>
</tr>
<tr>
<td>4.3</td>
<td>Financial reporting</td>
<td>4.3 Structure the audit committee so that it consists of: only non-executive directors, a majority of independent directors, an independent chairperson, who is not chairperson of the board, at least three members.</td>
<td>52-110 F1.2(b), 52-110.3.1.3 Audit committee composed entirely of independent directors. 52-110 F1.2(c), 52-110.3.1.4 Audit committee composed entirely of financially literate directors.</td>
</tr>
<tr>
<td>4.4</td>
<td>Financial reporting</td>
<td>4.4 The audit committee should have a formal charter.</td>
<td>52-110 F1.1 Disclose the text of the audit committee’s charter.</td>
</tr>
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### APPENDIX Continued

<table>
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<tbody>
<tr>
<td>6.1</td>
<td>Shareholders</td>
<td>6.1 Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings.</td>
<td>58-201-3.4(e) Board responsible for adopting the issuer’s communication policy.</td>
</tr>
<tr>
<td>7.1</td>
<td>Risk management</td>
<td>7.1 The board or appropriate board committee should establish policies on risk oversight and management.</td>
<td>58-201-3.4(c) Board responsible for the identification of principal risks and implementing a system to manage these risks.</td>
</tr>
<tr>
<td>7.2</td>
<td>Risk management</td>
<td>7.2 The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that: 7.2.1 the statement given in accordance with best practice recommendation; 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board; 7.2.2 the company’s risk management and internal compliance and control system is operating efficiently and effectively in all material respects.</td>
<td>52-109 F1-4 Require that the CEO/CFO have acknowledged in writing that they are responsible for establishing and maintaining internal control over financial reporting, and that such controls are designed effectively.</td>
</tr>
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<td>8.1</td>
<td>Board performance</td>
<td>8.1 Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives.</td>
<td>58-201-3.18 Board, committees, and individual directors should be regularly assessed for effectiveness considering (a) charter, (b) position descriptions and competencies.</td>
</tr>
<tr>
<td>9.2</td>
<td>Compensation</td>
<td>9.2 The board should establish a remuneration committee.</td>
<td>58-201-3.15 The board should appoint a compensation committee composed entirely of independent directors.</td>
</tr>
</tbody>
</table>

** Australian guidelines: ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations (ASX, 2003) were released in March 2003 and became effective for the first fiscal year subsequent to January 1, 2003. Australian principles and recommendations have been subsequently amended.**

*** Canadian guidelines are contained in the Canadian Securities Administrator's National Instrument 58-101 Disclosure of Corporate Governance Practices and the best practices are enumerated in the companion National Policy 58-201 Corporate Governance Guidelines that came into effect on June 30, 2005 for fiscal years ending after that date. All guidelines that are in common with Australia were also part of the preceding code in Canada based on the various updates to the Dey Report (1994). Canadian principles and recommendations have not been substantively amended since that time.**

Notes:

* The appendix illustrates the guidelines in place at the time of data collection. Paraphrasing was necessary due to space limitations.
REFERENCES


Dey, P. 1994. *Where were the directors? The TSE committee on corporate governance in Canada*. Toronto, Canada: Toronto Stock Exchange.


