



# Report of the Auditor General on the Alberta Securities Commission's Enforcement System

---

October 2005





Ms. Janis Tarchuk, MLA  
Chair  
Standing Committee on Legislative Offices

I am honoured to send you my report entitled “Report of the Auditor General on the Alberta Securities Commission’s Enforcement System” dated October 2005.

This report responds to a request of April 13, 2005 from The Hon. Shirley McClellan, Deputy Premier and Minister of Finance to answer questions raised regarding the Alberta Securities Commission’s enforcement processes.

[Original signed by Fred J. Dunn, FCA]  
Fred J. Dunn, FCA  
Auditor General

Edmonton, Alberta  
October 19, 2005



# Contents

Summary.....	1
Recommendations and management responses .....	4
Background.....	11
Detailed findings and recommendations.....	17
Appendix—Staff and agent resources	



# Summary

This report identifies three areas where the Alberta Securities Commission (ASC or Commission) can strengthen its management control systems and processes for enforcing Alberta's securities laws.

## **Improving the enforcement system**

This report contains five recommendations designed to improve the enforcement system. Considering the regulatory environment in which ASC operates, the enforcement system must be rigorous enough to ensure that all evidence and information obtained through enquiries, discussions and analysis during the enforcement process is recorded and adequately reviewed. Files must clearly indicate the conclusions reached on an enforcement matter and the supporting rationale for the conclusions. The Commission's leadership must not tolerate anything but the highest standards of regulatory behaviour.

Generally, we concluded that the enforcement system needs more discipline. Management needs to:

- review and clarify enforcement policies, guidelines and standards,
- ensure more consistency in enforcement processes, particularly in the recording of information gathered through enquiries, discussions and analysis to support conclusions and recommendations,
- improve controls in the enforcement system to ensure enforcement decisions are independently reviewed and files are brought to a conclusion in a timely manner, and
- measure and report on the effectiveness of the enforcement system.

## **Improving systems and policies to manage conflicts of interest**

We observed one instance where the Director of Enforcement did not comply with the Commission's conflict of interest policies and this non-compliance was not detected by the Commission's Executive Director. We also found that Commission Members' investment disclosures were not being monitored by the Commission's Chair, and the Commission Chair's investment disclosures were not being monitored by the Chair of the HR Committee. The lack of a control to monitor staff and Member investment disclosures is serious and increases the risk that staff and Members could be in a conflict of interest

which was not detected by the Commission. This report contains two recommendations to help identify conflicts of interest and lessen the risk of problems arising from actual and perceived conflicts. As indicated in Members' and employee policies:

*“everyone associated with ASC must comply with a higher standard of conduct than other market participants.”*

### **Improving the Commission's governance**

In this report, we make three recommendations to improve the governance of the Commission. Efficient, effective and ethical organizations usually have strong leaders supported by strong governance processes. Strong governance requires that Directors (Commission Members) have sufficient experience and skills to effectively challenge and provide oversight direction to management.

The *Securities Act* designates the Chair of the Commission and the Chief Executive Officer to be the same individual. This places a great deal of power in the hands of this one individual. A recent amendment to the *Securities Act* provides for the establishment of a lead independent Commission Member and provides an opportunity for more effective oversight of the enforcement system by a non-executive Commission Member. However, the powers, duties and functions of the lead independent Commission Member have not as yet been established.

The Commission Members should be receiving sufficient assurance about the internal controls in the enforcement system to satisfy themselves, and the regulated entities and public, that they can rely on the system. Also, the Commission's Human Resource Committee should improve its oversight of the human resource function.

### **Allegations of an inadequate enforcement system**

Before starting this examination, we became aware of public allegations that the Commission was not consistently enforcing Alberta's securities laws. We reviewed 82 case files, of which eleven were brought to our attention by former and current staff of the Commission and members of the investing public.

From the time a matter is first identified as an issue by the Commission, decisions are made to either terminate or continue to progress the case. Because of the need to use the collective wisdom, experience and knowledge of the Commission in assessing a potential violation of the securities legislation, differences of opinion among enforcement staff and senior management sometimes will arise concerning decisions reached. Our examination of several complex files identified situations where individual staff members reached different conclusions or recommended different courses of action based on the evidence acquired. This does not necessarily imply that one staff member was right and another wrong. Rather, it demonstrates that different individuals based on their assessment of the facts and their own experiences and knowledge can arrive at different yet supportable conclusions.

Therefore, we did not examine the case files with the objective to determine if we agreed with the conclusions reached on a file. Rather, our objective was to determine if an appropriate process was followed and if adequate evidence and information was gathered to support the conclusions reached. We discussed the files where we had concerns, arising from our review, with the former Chair of the Commission and the Commission's Executive Director. The information and representations obtained from the former Chair were received under oath. When taken in the context of the information in the case files and our interviews with other individuals, the explanations for the actions taken on the files provided to us by the former Chair and the Executive Director were reasonable. In our opinion, there is not sufficient evidence to recommend to management that any case file we examined be re-opened.

The former Chair confirmed under oath that he did not interfere in the enforcement process in an inappropriate or biased manner. He indicated that he was more involved in cases which were sensitive in order to understand the circumstances surrounding the case and ensure the cases were progressing in a manner consistent with the evidence acquired. He also indicated that he was involved in cases that were significant to the Commission from a policy perspective. The Executive Director has a role defined in legislation and, therefore, his involvement in enforcement matters is expected. We concluded that the involvement of the Chair and the Executive Director in the case files that we examined was appropriate.

# Recommendations and management responses

## **Recording support for decisions—Recommendation No. 1**

**We recommend that the Alberta Securities Commission improve the recording of its inquiries, discussions and analysis to support the decisions made on case files.**

### Management response:

We agree with the recommendation. It is the usual practice for ASC to provide sufficient documentation to support significant decisions reached on case files. Nevertheless, ASC will implement formal steps to review stages where additional documentation should be completed to articulate the rationale for key decisions and actions taken on case files. Such steps will be undertaken as part of addressing Recommendation No. 4. We acknowledge the delinquency in previous years in the preparation of specific action plans in Case Assessment. Since April 1, 2005, written Action plans have been normal practice for all Case Assessment files.

## **Independent review and segregation of duties—Recommendation No. 2**

**We recommend that the Alberta Securities Commission ensure the results of enforcement activities are independently reviewed and appropriate segregation of duties exists in the enforcement system.**

### Management response:

ASC has instituted a practice to ensure an independent review of every case closure assessment and the documentation of same. The practice commenced September 15, 2005 and documentation will follow as part of addressing Recommendation No. 4.

## **Timely action—Recommendation No. 3**

**We recommend that the Alberta Securities Commission ensure enforcement processes are completed in a timely manner.**

**Management response:**

ASC agrees that the completion of enforcement processes in a timely manner is extremely important. We will continue to take steps to promote this objective including further developing and implementing appropriate key performance indicators. The establishment and application of key performance indicators will be targeted for completion within twelve months of completion of the matters addressed in Recommendation No. 4.

**Policies and guidelines—Recommendation No. 4**

**We recommend that the Alberta Securities Commission review and clarify its policies and guidelines for enforcement activities.**

**Management response:**

Enforcement will undertake a comprehensive review of its enforcement procedures manual and update it as warranted. Responsibility for the undertaking will be allocated among senior enforcement staff with input from the general counsel and other executive management; the effort be underway by December 1, 2005; and completion will be targeted within six months of commencement. In particular, revisions and updating will address the recommendations raised by the Auditor General concerning investigatory processes which are not uniform between Investigations and Case Assessment branches, and more directive criteria to express rationale of closing files.

In respect of the specific audit findings, the sample cases from Case Assessment were reviewed by management. We did not find there to have been any deficiency evident in the conduct of the cases cited by the Auditor General as a result of their complete investigation by Case Assessment. The ability of Case Assessment to assist with achieving closure of cases when appropriate increases the efficiency of ASC's enforcement capabilities. However, we agree that the prerequisites to closure of a case by Case Assessment should be articulated in the enforcement procedures manual to ensure that the process is no less rigorous than that applied by Investigations branch.

**Performance measurement—Recommendation No. 5**

**We recommend that the Alberta Securities Commission measure the performance of its enforcement program.**

**Management response:**

ASC agrees with this objective and will continue to strive to measure performance in this challenging area. Management is in the process of developing key performance indicators for implementation and expects these to be in place within 12 months of completion of addressing the matters raised in Recommendation No.4. The Commission recognized in 2003 that there were inadequacies in the management of the Enforcement Department and took steps to remedy that circumstance. Enforcement activity increased dramatically by the end of fiscal 2005 and has since then consistently produced credible results.

**Conflict of interest—Recommendation No. 6**

**We recommend that the Alberta Securities Commission improve its monitoring of Member and employee compliance with conflict of interest policies by:**

- **comparing investment disclosure reports from Members and employees to cases being investigated, and**
- **ensuring investment disclosure reports are provided by Members and employees within the required timeframe.**

**Management response:**

The issue of reporting all Members' trades of securities was a matter that was debated at some length over the past year by the Members. The previous practice, which is that proposed to be reinstated by the Auditor General, was dispensed with and the new policy was implemented in May 2005 requiring the reporting of trades in securities where the holder has 5% or more of a class of securities. This was done on the basis it would significantly reduce the volume of relatively insignificant trades reported, but maintain a level of transparency where there exists a greater potential for conflicts of interest. We will revisit the policy with the Members having regard to the recommendations of the Auditor General and determine if any changes are appropriate.

We note that although the Auditor General did not identify any activity influenced by a conflict of interest, he did identify a breach of policy. As to the single breach of policy identified by the Auditor General, we note the following. The Director was not aware of the investigation at the time the purchase was made. The Director's broker advised him to make the purchase at least two days prior to March 10, 2005 (which was the settlement date). In accordance with his normal practice he reviewed the file inventory when he met with the Case Assessment manager in late March. The Director delivered his report of the trade on March 11, 2005 and did not sell until his broker

provided an unsolicited recommendation in June. Reports of each trade were made by the Director in accordance with ASC policy and were provided to the Auditor General. We are satisfied that there was no use of confidential information or actual conflict of interest in the Director's conduct. Nevertheless, the Director acknowledged to the Auditor General that he was not in compliance with the policy restricting trading. Management has satisfied itself that notwithstanding there was a breach of the policy, there was no wrongful intention on the part of the Director. The matter has been addressed and it is acknowledged that greater discipline should forthwith be introduced into our processes to both prevent and detect breaches. This will have the result of a greater burden being placed on each of the Chair, the Executive Director and the Chair of the Human Resources Committee in the monitoring of policies.

Management will investigate the benefits and costs of implementing a system which will trigger automatic notice of every reported sale of securities of any entity under investigation.

More rigour will be applied to all requirements that reporting deadlines be met.

**Conflict of interest—Recommendation No. 7**

**We recommend that the Alberta Securities Commission strengthen its conflict of interest policies by:**

- **requiring employees to complete annual declarations that they comply with the policies,**
- **requiring Members to provide investment disclosure reports respecting all securities transactions they complete, and**
- **requiring Members to document reasons why they cannot participate in a specific enforcement proceeding due to a conflict of interest.**

Management response:

Management will implement a policy, to be effective for the 2006 fiscal year, requiring an annual declaration by employees that they are in compliance with all conflicts of interest policies.

Please refer to first paragraph in response to Recommendation No.6.

**Human resources—Recommendation No. 8**

**We recommend that Alberta Securities Commission improve its governance process by:**

- **ensuring the terms of reference for the Human Resources Committee provide for adequate oversight of the human resources function,**
- **providing sufficient information to the Human Resource Committee to enable the Committee to meet its mandate, and**
- **ensuring that the Human Resources Committee monitors the development of a process to identify, investigate, report, and act on employee issues and concerns.**

Management response:

ASC believes that the terms of reference for the Commission's Human Resources Committee are appropriate for the mandate of the Committee. The Committee is charged with review and oversight of HR policies for employees. Management will ensure that the HR Committee is informed of the plans and strategies developed by the Director of Corporate Services and HR and approved by management of the ASC. The Director will be requested to regularly inform the HR Committee of steps taken and progress made in respect of those plans and strategies in order that the HR Committee may readily fulfill its oversight duty. A procedure will be implemented forthwith whereby the Director will meet with the Chair of the HR Committee prior to each of the monthly meetings of the Members of the Commission.

As set out in your report, a recommendation of our consultants is to develop a policy in addition to the respectful workplace policy dealing with anonymous complaints. ASC has a new Director of Corporate Services and HR who is conducting a review of all of our employee policies. It is intended that a "whistleblower" policy be in place in January 2006.

**Governance—Recommendation No. 9**

**We recommend that the Minister of Finance, working with the Alberta Securities Commission Members, request the Lieutenant Governor in Council to designate a Member of the Commission as the lead independent Member and prescribe the powers, duties and functions of the lead independent Member as provided for in the Securities Act.**

**Management response:**

We appreciate the importance of the ASC both being and being perceived to be independent and free of conflicts in all aspects of its operations, and in particular, enforcement. The subject of lead directors is one on which a wide variety of views have been expressed. We would welcome the research which the Auditor General will have done and the analysis which the Auditor General will have applied in formulating his recommendation that the ASC would be best served by a Lead Member. Questions which need to be considered in the context of enforcement include:

- will another layer of decision making improve the chances for a better decision?
- to what extent will further process detract from timely and consistent decision making?
- will the addition of a Lead Member result in negative perceptions that Members having an adjudication role are too closely associated with the ASC's enforcement function?
- is there evidence to suggest that management personnel in the enforcement division, who already must account to all of the Executive Director, the Chief Executive Officer and the Commission Members, are not fully accountable for their decisions and conduct unless there is a part-time Lead Member to whom they would account and with whom they would share responsibility?
- will the addition of one more decision maker in the enforcement process ensure that there will no longer be disagreement among staff in respect of difficult decisions made by the decision makers?
- should an oversight board or individual member of it intervene in the day-to-day operational decisions of the body that it is called upon to oversee?
- will a Lead Member be better qualified than the Chair and Chief Executive Officer to ensure that all decisions are made in a consistent, even-handed and unbiased manner?
- will the appointment of a Lead Member raise concerns regarding the independence of the ASC from government?

It is notable that we are not aware of the introduction of a Lead Member in the structures of other North American securities regulators for the purpose of enhancing structure or processes. Nevertheless, with the importance of these priorities in mind, we will consider the governance issues which are raised in the context of the ASC's enforcement responsibilities and evaluate the suggestion proposed. We will compare the pros and cons of all of our current structure, the lead director model and other structures proven effective

elsewhere. We will complete our review during the course of the 2006 calendar year, making appropriate adjustments as we progress and with the intent that we be in a position to recommend that our current model be either confirmed or amended by the first quarter of calendar 2007.

**Internal controls—Recommendation No. 10**

**We recommend that the Alberta Securities Commission establish a process to assess the adequacy of the enforcement system’s internal controls. This process should include reporting the results of the assessment to the Commission Members.**

**Management response:**

ASC fully supports adequate internal controls in its operations and has instituted this in respect of its financial systems the past year. A report was provided to the Audit Committee and there were recommendations made for implementation going forward. In terms of the enforcement system’s internal controls, this audit and the recommendations emanating therefrom will assist with ensuring the adequacy of such controls. The Commission Members will be kept fully informed in relation to implementation of the relevant recommendations.

ASC agrees with the suggestion that an independent review be conducted on enforcement on a regular basis every three to five years. Such a review was commenced this year by a consultant who is recognized as one of the foremost authorities in Canadian securities regulatory enforcement. His findings will be considered by the Commission as soon as the final report is presented.

---

# Background

## **Audit objectives**

Our objectives for this audit were to determine:

- a) If ASC's enforcement system adequately:
  - identifies and tracks matters that ASC should investigate,
  - effectively prioritizes investigations,
  - determines the scope of investigations and methodology,
  - maintains independence of investigations,
  - develops recommended actions,
  - adequately records key decisions and conclusions at the appropriate level of authority, and
  - measures and reports on the effectiveness of securities law enforcement.
- b) The adequacy of ASC's human resource processes to recruit, select and train staff for enforcement roles, as well as its processes to direct concerns and issues to the appropriate management level.
- c) The role of Commission Members in the enforcement process and the training they receive to help them carry out their responsibilities.

## **Role and organizational structure**

ASC is the industry-funded organization responsible for overseeing the capital market in Alberta. It administers the *Alberta Securities Act*, the *Securities Regulation* and *Securities Commission Rules*.

This legislation is designed to ensure that Alberta's capital market operates fairly and efficiently for participants, and that investors have timely, accurate information on which to base investment decisions. It is also designed to ensure that those who sell securities in Alberta are registered and that they conduct themselves according to applicable laws and professional standards.

ASC has two operational levels, Commission Members and staff. Members are appointed by the Lieutenant Governor in Council and provide governance oversight of management as ASC's Board of Directors. Currently, there are 12 Members, including the designated Chair, two full-time Vice-Chairs, and nine part-time Members. The Chair also acts as the Chief Executive Officer and is responsible for the overall operation of ASC.

---

In addition to their management oversight role, Members set policy and recommend changes to the Act and the Regulation. They are also empowered to hear enforcement matters, in administrative tribunals, that affect the public interest in Alberta's capital market.

The Executive Director is ASC's chief administrative officer and reports to the Chief Executive Officer. The Director of Enforcement reports to the Executive Director, and directs enforcement actions against persons and companies who may have contravened securities laws. The enforcement staff consists of the Case Assessment, Investigations and Litigation branches, which report to the Director of Enforcement.

ASC tasks the enforcement of Alberta securities laws to its enforcement staff, who receive and assess information from a variety of sources. Staff then exercises judgment at various stages in the enforcement process by assessing and recommending:

- if the matter warrants an investigation,
- if the results of the investigation warrant sanctions or some other action, and
- what form those sanctions or further action may take.

### **Chronology of events**

On February 8, 2005, we advised ASC's audit committee that, during the 2005-2006 fiscal year, we intended to examine ASC's system for enforcing Alberta securities laws. We intended to audit systems for identifying and tracking complaints, the procedures for determining the extent of investigations, and the processes for ensuring that conclusions and decisions are adequately recorded.

On March 23, 2005, we learned from media reports that in January 2005, ASC's part-time Members had commissioned an investigation into allegations about ASC enforcement. This investigation, conducted by Calgary lawyer Perry R. Mack, QC, was underway on February 8, 2005 when we presented our audit plan to the ASC audit committee. However, the audit committee did not inform us of this.

Mr. Mack provided two reports to the part-time Members dated February 16, 2005 and March 21, 2005. The results of these reports were included in a report (the McLeod Report) dated March 31, 2005 from R.J. McLeod, QC, a part-time Member, to the Deputy Premier and Minister of Finance.

On April 13, 2005, we received a letter from the Hon. Shirley McClellan, Deputy Premier and Minister of Finance requesting that our examination of the enforcement system be complete and timely, and that a separate report be made available to the Legislative Assembly and through the Assembly to all Albertans.

To fully prepare for our audit, on April 14, 2005, we asked ASC's lawyer to provide us with all information, including reports and other records, of Mr. Mack's investigation (the Mack reports). We repeated this request to the ASC Chair on April 19, 2005. ASC's legal counsel told us that the Mack reports were protected by solicitor-client privilege, which ASC's part-time Members would not waive.

On April 22, 2005, we provided a draft audit plan for the examination of the enforcement system to ASC management and planned to start the audit on April 27, 2005. ASC, through its lawyer, attempted to negotiate limits to the scope of our proposed audit, which we rejected. On May 3, 2005, ASC filed an Originating Notice and Notice of Motion in the Court of Queen's Bench of Alberta<sup>1</sup> asking the Court to declare that the *Auditor General Act* does not:

- permit the Auditor General to conduct any activity or examination that would cause the Applicant to breach its obligations under the *Securities Act*,
- authorize the Auditor General to conduct a review of the ASC's procedures for developing information on suspected violations of securities legislation, enforcement procedures or the affairs of the ASC's Human Resources department, or to review or examine any aspect of ASC's affairs other than that which is necessary for the performance of the annual audit of the ASC's annual financial statements, and
- authorize the Auditor General to compel the disclosure of any information, documents, or records of the Applicant, except insofar as they are both necessary for carrying out the Auditor General's duty to audit the ASC's annual financial statements and are not confidential or privileged.

---

<sup>1</sup> Originating Notice, Alberta Securities Commission, Applicant, v. Fred Dunn, The Auditor General of Alberta, Respondent, dated May 3, 2005

---

ASC also asked the Court to grant a permanent injunction prohibiting the Auditor General from obtaining:

- information, documents or records that are not necessary for carrying out the Auditor General's duties as the auditor of the ASC's financial statements, and
- any confidential or privileged information, documents or records.

On May 11, 2005, Mr. Justice Hart heard the case and on May 24, 2005 declined to make the declarations or grant the injunction sought by ASC. He found that the *Auditor General Act* does not permit the Auditor General to conduct any activity or examination that would cause ASC to violate the *Alberta Securities Act*. However, he ruled that ASC would not violate the *Securities Act* by disclosing confidential information to the Auditor General.

The preliminary phases of the audit then proceeded, with ASC reviewing and providing comments on our draft audit plan. ASC's lawyer suggested a number of changes to our draft audit plan with which we disagreed. On June 21, 2005, the matter was again before the Court when Mr. Justice Hart settled the form of the May 24, 2005 order.

On June 29, 2005, we met with the Executive Director to clarify the scope, objectives and approach of our audit. We provided a final audit memorandum to ASC on July 12, 2005, and started audit field work on July 18, 2005.

During the course of our examination, we:

- reviewed ASC documents, including case files, policies and human resources documents,
- interviewed current and former Commission Members and employees, including some interviews conducted under oath pursuant to the *Auditor General Act*, and
- interviewed members of the investing public.

To assist us in reviewing case files and conducting some interviews, we used the services of two PricewaterhouseCoopers LLP partners, each with extensive previous experience at senior levels with the Ontario Securities Commission. From June 29, 2005 and throughout the examination, our staff received full access to required information from Commission Members and employees, with the exception of the two Mack reports and the McLeod report.

---

We interviewed current and former employees and reviewed responses by ASC's former Chair and the Executive Director to the allegations in the Mack reports. On October 17, 2005, we gained unrestricted access to the Mack and McLeod reports. Our review of these reports did not reveal any new matters or provide any additional evidence to that which we had identified during our examination.

During interviews with current and former employees, we received details of allegations that were widely reported in the media. We were told about two basic types of allegations:

- improper human resource management practices and behaviours, and
- inappropriate interference in enforcement matters by senior management.

These allegations related principally to the conduct of the former Chair and the Executive Director and have been categorically denied by each. At the time, there was a confrontational and fragmented atmosphere between senior management and certain employees. Six of these employees discussed their concerns with a Commission Member in December 2004, which resulted in the Mack investigation and reports. Five of these six employees are no longer with ASC; four were terminated and one resigned.

The results of the Mack investigation into the allegations were referenced in the ASC 2005 annual report as follows<sup>2</sup>:

*“The part-time Members retained an independent professional to examine the anonymous complaints. After examining the results of his investigation, the part-time Members reported to the Minister of Finance their conclusion that the allegations were groundless.”*

We considered the allegations of improper management practices in the context of our audit plan and our objective to review the enforcement system. Our examination focused on the enforcement system and did not investigate matters of improper human resource management practices and behaviour. The Commission has contracted with management consultants to consider the allegations and make recommendations for improvement to the work environment and the enforcement system. As part of our follow up to the recommendations in this report, we will also follow up the actions taken by the Commission in response to recommendations from the consultants.

---

<sup>2</sup> Alberta Securities Commission, 2005 Annual Report, Page 4

### Costs

ASC expects to spend approximately \$1.2 million, (including fiscal 2004–2005 expenses) on legal, consulting and other expenses related to the investigation of allegations against management and the subsequent court action with our office. These expenses are detailed as follows:

<b>Expense</b>	<b>Paid</b>	<b>Accrued<sup>3</sup></b>	<b>Total</b>
Legal fees, Members	\$559,723	\$ 32,700	\$ 592,423
Consulting fees	145,600	135,000	280,600
Members' time and expenses for special meetings	148,950	21,500	170,450
Legal fees and communications for staff	85,972	55,900	141,872
<b>Totals</b>	<b>\$940,245</b>	<b>\$245,100</b>	<b>\$1,185,345</b>

We also expended considerable resources in attempting to resolve the ASC challenge to our authority prior to the legal action, and worked extensively with our legal counsel to defend our legislation in court. In total, we spent approximately \$132,000 in costs plus senior personnel time, in order to defend our legislated authority to complete the audit as planned. Expending these resources has forced us to postpone other projects that we had planned to complete during this time period.

<sup>3</sup> Per ASC Controller: Accrued to August 31, 2005.

# Detailed findings and recommendations

## 1. Overview of the enforcement process

### 1.1 Case assessment

The Case Assessment branch receives complaints from various sources including members of the investing public, law enforcement agencies, and other securities commissions. The complaints are assessed for breaches of the *Securities Act*, and verified for corroborating evidence. If the complaint warrants a full investigation, it is forwarded to the Investigations branch. If the existing evidence is sufficient, the complaint is expedited to the Litigation and Prosecution (Litigation) branch.

The Case Assessment branch can also close a case file if, in their opinion, there is insufficient evidence to justify taking enforcement action, if the complaint is not in ASC's jurisdiction (for instance a police matter), or if the complaint has been resolved. A warning letter can also be issued.

In addition to ASC's mandate to oversee the capital marketplace, there are also other organizations working to ensure the capital markets in Alberta are fair, competitive and efficient. The Case Assessment branch often receives information from the following organizations:

- Market Regulation Services Inc (RS)—an independent regulation services provider for Canadian equity markets. RS ensures market integrity by regulating the buying and selling of securities with electronic surveillance systems that provide statistical and rule-based alerts to ensure trades are proper, fair and in compliance with the rules. If a rule is breached, RS investigates the trade, and if necessary, can reverse the trade and take disciplinary action.
- Investment Dealers Association of Canada (IDA)—regulates the activities of investment dealers in terms of both their capital adequacy and business conduct. All investment dealers and brokers are required to be registered with the IDA.

- Mutual Fund Dealers Association of Canada (MFDA)—responsible for regulating all sales of mutual funds by registered mutual fund dealers. The MFDA is also responsible for regulating the activities of its members.

## **1.2 Investigations**

The Investigation branch receives case files from the Case Assessment branch, when a full investigation is necessary. The Investigation branch reviews the initial evidence already obtained and develops an investigation plan with the view to impose discipline early in the investigation process by focusing on the essential breaches of the *Securities Act*.

Once the investigation has been completed, and if there is sufficient evidence to justify taking enforcement action, a litigation brief is prepared, and the case file is forwarded to the Litigation and Prosecution branch. If the investigation reveals the complaint was unfounded, or the investigation failed to produce the necessary evidence to prove the case, then the case file may be closed. The case file may also be concluded if the investigation should be handled by another jurisdiction, or if further investigation does not warrant the incurrence of additional resources and expenses.

## **1.3 Litigation and prosecution**

The Litigation and Prosecution branch receives case files from either the Case Assessment branch or the Investigation branch. When case files are received, the Litigation branch reviews the file and drafts an action plan. The action plan outlines the steps the Litigation branch will take to proceed with resolving the case file.

Case files can be resolved through either a staff settlement, a Notice of Hearing, or by prosecution. Also, the case file may be sent back for further investigation.

Case files are resolved through a staff settlement if the respondents are willing to settle and they agree with the statement of facts determined through the investigation. Penalties for breaches of the *Securities Act* that are resolved through staff settlements are negotiated between the Litigation branch and the respondent's counsel. The agreed settlement is then approved by the Director of Enforcement without input from the Commission Members.

If a case file cannot be resolved through a staff settlement, then a Notice of Hearing may be issued by the Litigation branch and the hearings are heard by a panel of Commission Members. At the Hearing, the Litigation branch and the respondent's counsel will both present their cases. Commission Members will determine the appropriate penalties, if any, to be issued based on the evidence presented, and on precedence set by previous hearings and court cases.

If the complaint matter is of a serious nature and there is solid evidence against the respondent, the Litigation branch may ask the Department of Justice for approval to prosecute the respondent in the Provincial Court of Alberta. The penalty, if any, will then be determined by the Court.

The case file can also be closed through the issuance of a warning letter to the respondent or by referring the case file to another jurisdiction.

#### **1.4 Enforcement statistics**

During fiscal years 2003, 2004 and 2005, ASC received 1,951 complaints<sup>4</sup>. Through our discussions with management, we learned that approximately 80% of all complaints received are closed by the Case Assessment branch, with the remaining complaints being forwarded to the Investigations branch and the Litigation branch. From fiscal 2003 to fiscal 2005, the Litigation branch resolved 26 complaints through staff settlements and the Commission Members made rulings on 38 complaints through Hearings.

**Recording support for decisions—Recommendation No. 1**  
**We recommend that the Alberta Securities Commission improve the recording of its inquiries, discussions and analysis to support decisions made on case files.**

Criteria: the standards we used for our audit

1. There should be a process in place to record, assess, prioritize, investigate and report on complaints.
2. All steps taken in an enforcement action should be documented and retained in the case file, including the rationale for all key decisions and actions.

---

<sup>4</sup> ASC 2005 Annual Report

### Our audit findings

**General file review**—Our overall audit objective was to examine the enforcement system. As part of that examination, we reviewed a sample of 82 case files, including 11 case files that were identified to us through interviews with former and current employees, and investors. The issues in several of these files were complex. Some files had been closed and some were under current investigation. It was not our intention to re-investigate these matters, but to consider if adequate processes were followed when following up complaints.

During our review of these 82 case files, we found there was a general lack of information in the files to support key decisions. The Case Assessment branch has screening criteria to determine whether or not to pursue a complaint. However, we did not see evidence of the screening criteria being used in any of the 82 case files we reviewed. Most complaints are assessed and prioritized by the Case Assessment manager, but this process is generally not recorded.

The Case Assessment branch's performance objectives require action plans be completed and approved within 30 days of receiving a complaint. We did not find any action plans in our review of the 82 case files.

Investigations branch staff are required to prepare an investigation plan within 30 days of receipt of the file. This investigation plan should outline the main issues and the investigator's intended course of action. Most of the 18 files we reviewed that had been forwarded to the Investigations branch from the Case Assessment branch had investigation plans; only two files did not contain an investigation plan.

We also found several instances where the reason for a decision to close a case file was not adequately recorded. For the files closed by the Case Assessment branch, we found eight files where a decision was made to either conclude a file with no enforcement action or to conclude a file and issue a warning letter, but the rationale in support of these decisions was not adequately recorded.

For the files closed by the Investigation branch, we found 7 files which did not contain sufficient evidence to allow us to fully follow the sequence of events and reasons for key decisions including the decision to close the file.

**Specific file review**—We reviewed 11 case files that had been identified to us through interviews with former and current employees, and investors. Some of these 11 case files had been the subject of media attention as representing potentially inappropriate practices of the former Chair and the Executive Director. We were told that these cases were either:

- the subject of inappropriate management discretion, or
- concluded without action in the face of promising evidence.

The enforcement process, by its nature, includes the application of professional judgment from the initial receipt of the complaint to the final disposition. A subjective decision is made at each stage of the process about the suitability for furtherance to the next level. Whenever a decision is made, there is a possibility that a party connected with the decision will take a contrary view. The allegations we received about inappropriate handling of these 11 case files were from people who took that contrary view.

We considered the involvement of senior management in these cases. We found the role of the Executive Director to be consistent with his legislated responsibility, through his staff, to enforce the provisions of the securities laws. The oversight of the Chair in his role as Chief Executive Officer was reasonable considering his overall responsibility for the operations and policies of ASC.

We conducted thorough reviews of each case file. If recorded evidence on a case file appeared insufficient to support a key decision, we interviewed investigators, litigation counsel, senior management or Members to obtain further information.

We found that information in the files supporting decisions tended to diminish at higher levels; decisions made at the investigator level were generally more often recorded than decisions made at the director level or above. Further, we found the most sensitive or potentially high-profile cases to be the most poorly documented, likely due to more involvement by senior level staff and Members, whose views were sometimes sought on a matter. Senior staff and Members tended to provide their views verbally.

From our follow-up interviews with investigators, litigation counsel, senior management and Members, we gained a fuller understanding of each case file, and the circumstances involved in the disputed decisions. For each case, we considered the information in the case file, the information provided by the person making the allegation and the follow-up interviews we conducted with decision-makers. In this way, we saw evidence supporting each side of disputed decisions and recognized that different professionals may arrive at different conclusions based on the same facts.

We interviewed the former Chair under oath, pursuant to the provisions of the *Auditor General Act*. We also separately interviewed the Executive Director at length. During each interview, we discussed the roles of the former Chair and the Executive Director respecting enforcement matters, and discussed in detail any instances where the Chair or the Executive Director were alleged to have inappropriately interfered with the enforcement process.

We were provided detailed and plausible explanations of the former Chair and the Executive Director's involvement respecting each case file we discussed. When taken in the context of the information in the case files and our interviews with other individuals, the explanations for the actions taken on the files provided to us by the former Chair and the Executive Director were reasonable.

Although evidence in some files was not consistently obtained or recorded, as a result of our interviews and follow-up work, we concluded that there was not sufficient evidence to recommend to management that any case file be re-opened.

#### **Risks and implications if recommendation is not implemented**

If information supporting key decisions is not recorded, there is risk that:

- sufficient work may not have been done to support a decision,
- an incorrect decision could be made, or
- evidence to respond to allegations of improper practices or to support potential legal proceedings may be inadequate.

**Independent review and segregation of duties—Recommendation No. 2**

**We recommend that the Alberta Securities Commission ensure the results of enforcement activities are independently reviewed and appropriate segregation of duties exists in the enforcement system.**

Criteria: the standards we used for our audit

All key decisions made should have approvals from appropriate levels of management or Members of the Commission.

Our audit findings

We found nine instances, during our review of 82 files, where there was no evidence of an independent review of work and approval of decisions for concluded files. In these nine files, the Case Assessment manager performed the duties of an investigator, and then performed the duties of a manager and approved the case files for closure. These responsibilities are not compatible with each other as the independent management oversight function is lost. Although we were told that the Case Assessment manager consulted with the Director of Enforcement on the majority of these case files, we did not find any evidence of this consultation in the file.

As previously mentioned in this report, we noted instances where files were assessed and investigated by the Case Assessment branch. Controls would be improved if investigations were completed by the Investigation branch on all files thereby involving two branches in the process.

Risks and implications if recommendation is not implemented

If enforcement activities and decisions are not independently reviewed, there is a risk that case files will not be handled in a consistent, sufficient and fair manner.

**Timely action—Recommendation No. 3**

**We recommend that the Alberta Securities Commission ensure enforcement processes are completed in a timely manner.**

Criteria: the standards we used for our audit

Investigation and other enforcement processes should be completed in a timely and consistent manner.

**Our audit findings**

During our review of the 82 case files, we found six files which were not handled in a timely manner by the Case Assessment branch and six files which were not handled in a timely manner by the Investigations branch. Many of these files were open for a year before closure without any evidence of work being done during that time.

**Risks and implications if recommendation is not implemented**

If files are not concluded in a timely manner, there is a risk that investors may not be adequately protected against ongoing issues, and evidence may be lost with the passage of time.

**Policies and guidelines—Recommendation No. 4**

**We recommend that the Alberta Securities Commission review and clarify its policies and guidelines for enforcement activities.**

**Criteria: the standards we used for our audit**

There should be documented policies, guidelines, standards and procedures for enforcement as well as a system to ensure they are current, complete and consistent.

**Our audit findings**

The Enforcement Policy Procedures manual contains policies on various enforcement activities to assist enforcement staff to carry out their responsibilities. However, we found the manual is not comprehensive and does not contain a description of the enforcement process. Some of the policies do provide very specific procedures staff should follow to perform an enforcement activity, but do not provide guidance on when it is appropriate to conduct the activity.

We noted instances where the Case Assessment branch fully investigated case files instead of forwarding them to the Investigations branch. During our review of 82 case files, we found seven case files which were completely investigated by the Case Assessment branch. Although the Case Assessment staff has comparable training, experience and investigatory skills as the Investigation staff, based on our review of the case files, we found that when case files were completely investigated by the Case Assessment staff, they did not follow the same investigatory processes as required by the Investigation branch.

For example, Investigation staff are required to complete an investigation plan identifying the main issues and the means by which the case will be proven. We did not find any evidence of an investigation plan in the seven case files which were investigated by the Case Assessment branch.

We also found there were no policies requiring enforcement staff to record their rationale for their conclusions and recommendations. During our review of the case files, we generally found that when a case file was recommended to another branch, the rationale for the decision was disclosed in the file. However, when a case file was recommended for closure, the rationale for the decision to close was not always contained in the file.

We understand that the Enforcement Policy Procedures Manual was reviewed by management earlier in the year. We were informed that the recommended changes have yet to be implemented.

ASC oversees the Investment Dealers Association (IDA) and requires the IDA to have procedure manuals in place for the IDA's Complaints and Inquiries Department and Investigation Division. The manuals should be up to date and contain written guidelines on how case files are to be opened, managed, and approved for closure, and to have documentation standards. We believe that the ASC should have policies requiring them to perform to at least the same standard that they expect of the IDA.

**Risks and implications if recommendation not implemented**  
Having clear and complete policies, guidelines and standards for enforcement activities will help ensure that sufficient evidence is acquired and appropriately recorded to support management decisions and Members involved in hearings.

**Performance measurement—Recommendation No. 5**

**We recommend that the Alberta Securities Commission measure the performance of its enforcement system.**

Criteria: the standards we used for our audit

The performance of the enforcement program should be measured.

**Our audit findings**

ASC has a goal to have an effective and visible enforcement program. However, ASC does not measure the effectiveness of the program. ASC's performance measures focus only on the timeliness of enforcement activities and not the quality of the results arising from those activities.

There are no performance measures to report if thorough investigations are being completed, appropriate evidence is being acquired or whether settlement agreements or hearing results are being successfully concluded.

Further, the enforcement branch does not have a system to capture the information needed to measure its existing performance measures. To date, the enforcement branch has implemented prompts in its file recording and tracking system to remind staff about the performance objectives. However, the system has not been upgraded to allow staff to enter the dates required to measure timeliness.

**Risks and implications if recommendation is not implemented**

If ASC does not measure performance, there is a risk that its goals will not be achieved.

**Conflict of interest—Recommendation No. 6**

**We recommend that the Alberta Securities Commission improve its monitoring of Member and employee compliance with conflict of interest policies by:**

- **comparing investment disclosure reports from Members and employees to cases being investigated, and**
- **ensuring investment disclosure reports are provided by Members and employees within the required timeframe.**

**Conflict of interest—Recommendation No. 7**

**We recommend that the Alberta Securities Commission strengthen its conflict of interest policies by:**

- **requiring employees to complete annual declarations that they comply with the policies,**
- **requiring Members to provide investment disclosure reports respecting all securities transactions they complete, and**
- **requiring Members to document reasons why they cannot participate in a specific enforcement proceeding due to a conflict of interest.**

### Overview

ASC has established policies to address the perception that Members and employees may take personal advantage of confidential information, thus reducing public confidence in the integrity of ASC.

These policies govern Members' and employees' ability to make investments in, and be directors or officers of, publicly traded companies. The Chair is responsible to administer the policy relating to Members, and the Executive Director is responsible to administer the policy relating to employees. The Chair of the HR Committee is responsible to administer the policy relating to the Chair.

Both Members and employees have separate, yet similar policies<sup>5</sup> that prohibit:

- engaging in short-term, speculative trading with rapid turnover, of ASC regulated securities,
- investing in issuers that are known, or ought to be known, to be under investigation by ASC,
- employees from being directors in issuers,
- Members from being directors in an unreasonable number of issuers, and
- Members from adjudicating a proceeding in which they have an investment, unless the investment is so small that it could not be expected to influence the Member.

Both Members and employees are required to:

- disclose their personal securities holdings to ASC at the time of taking office or employment, and
- report in writing if they find themselves in a position where their personal interests conflict with matters assigned to them.

Employees are required to file disclosure reports on all changes in their holdings within 10 days of a transaction; Members are only required to report changes in securities within 10 days where holdings exceed 5% of a class of securities of any reporting issuer.

---

<sup>5</sup> Alberta Securities Commission, Members' Code of Conduct Policy (May 2005) Section 2.1 and Alberta Securities Commission, employee Handbook – employee Conflict of Interest (July 2005) Section 1.1

**Criteria: the standards we used for our audit**

There should be a system to effectively identify and manage actual, alleged, apparent or perceived conflicts of interest among Commission Members, employees, contractors or agents, and subjects of investigation. Instances of actual, alleged, apparent or perceived conflicts of interest should be recorded.

**Our audit findings**

We found evidence of ineffective systems monitoring of Members' and employees' investments. We found an instance where the Director of Enforcement did not comply with the Commission's Code of Conduct policy. In addition, pursuant to existing policies, several senior employees and Members disclosed significant personal securities trading activities. Generally, we found a lack of discipline devoted to ensuring that there were no actual or apparent conflicts of interest arising from these trading activities.

**Monitoring of Members' trading activity**—We found evidence that at different times between 2003 and 2005, two Members were actively buying and selling ASC regulated energy industry securities. These investments were not short-term or speculative in nature, but in some cases the issuers of these securities were under investigation by ASC's enforcement branch. We found no evidence that the Members improperly profited from their position at ASC as a result of these transactions, and they were not involved in the investigations. However, these transactions gave the appearance of conflicts of interest, and also appeared to be violations of the Members' policy.

We interviewed the Members involved, and they each advised us that they were not aware any of their transactions were with issuers under investigation, and that these transactions had not been brought to their attention. They each confirmed that they did not know that the issuers were under investigation. Therefore, we can conclude that neither Member violated the Members' policy, as the policy requires their knowledge of an investigation, when shares are acquired or sold, to be in non-compliance with this policy.

Our expectation in this case would have been that the party responsible to monitor the conflict of interest provisions of the Members' policy, in this case the Commission Chair, would have identified these transactions and taken action to ensure potential conflicts of interest were avoided.

However, in our interview with the former Commission Chair, he advised us that although Members reported their securities transactions to him, he did not monitor the disclosure reports. We concluded from the analysis of these transactions that although there was a control in place to manage potential conflicts of interest, it was not being effectively applied.

We also reviewed disclosure reports prepared by the former Commission Chair relating to securities trading activity between 2001 and 2005. We concluded that his trading activity did not violate the Members' conflict of interest policy.

However, we learned that the party responsible to monitor the Chair's trading activity, in this case the current Chair of the HR Committee, was unaware of his responsibility to monitor the Commission Chair's trading activity. As a result, there was no monitoring or effective control applied.

**Trading activity by employees—the Director of Enforcement (the Director)**—We found that the Director bought and sold shares in a company that was under investigation by his staff. On February 2, 2004, a complaint of insider trading was received by the Case Assessment Branch, relating to trading activity by the wife of a principal of a public company. The Case Assessment manager assigned the file to himself, and entered details into a file inventory report that was prepared for the Director on March 2, 2004. On March 10, 2004, the Director signed an Investigation Order under section 41(1) of the *Securities Act*, which directed his staff to investigate the insider trading allegations about this same public company's securities.

On March 11, 2004, the Director submitted a declaration report to the Executive Director stating that on March 10, 2004 he bought shares of this same public company. The Director sold all the shares approximately three and one-half months later on June 21, 2004, realizing a significant gain. The investigation was closed on September 1, 2004 for lack of evidence. We reviewed the investigation case file and found the conclusions of staff to be reasonable and the evidence on the file to be adequately recorded.

Although we found no evidence that the Director had reported in writing to the Executive Director that he may be in a conflict situation, as he is required to do under the employees' policy, the Director told us that he recalled advising the Executive Director verbally. The Executive Director told us that he does not specifically recall a conversation with the Director about this matter, but that it may well have occurred.

The Director also told us that it was his view that the complaint did not relate to the issuer or its principals; rather, the complaint related to an allegation of a principal's wife telling her neighbour about confidential information. The Director further told us that notwithstanding the preparation of a file inventory by his staff he was unaware that the public company was under investigation by his staff. He added that both the purchase and sale transactions were completed on the advice of his broker. Accordingly, the Director concluded that although he violated the employees' policy, he did not take advantage of confidential information and was not in a conflict of interest.

The merit of the Director's argument will need to be weighed by ASC management pursuant to the employees' policy. However, we concluded that the purchase and sale of shares in an issuer under ASC investigation is in any event contrary to the employees' conflict of interest policy.

Our expectation in this case would have been that the party responsible to monitor the conflict of interest provisions of the employees' policy, in this case the Executive Director, would have identified this transaction, confirmed whether or not the Director was aware that the issuer was under investigation and taken steps to ensure that any potential conflict was managed. We would have also expected to see the review of this matter documented.

The Executive Director told us that there is no process in place to ensure that employees follow the policy. The onus is on employees to disclose their trading activity to the Executive Director; however, there is no on-going monitoring to ensure that disclosures do not breach the policy.

The Executive Director further told us that he does not routinely compare employee declarations to current investigation cases. However, he stated that he reads the disclosures presented to him, and would follow up if he thought that an employee had bought or sold shares in a company he recognized as being under investigation. We also concluded from the analysis of this transaction that although there was a control in place to manage potential conflicts of interest, it was not being effectively applied.

**Reporting requirements**—Members are required to complete an annual declaration that they comply with the policy; there is no such requirement for employees. Effective May 1, 2005, Members are not required to report transactions relating to holdings that amount to less than 5% of a class of securities of any reporting issuer. Employees, on the other hand, must report all securities transactions.

The disclosure of only holdings in excess of 5% of a class of securities of any reporting issuer would have little value in many organizations. Although Members may have some administrative burden relieved as a result of not being required to report smaller holdings in their portfolio, a small position in a large company may be more financially significant to the Member than a large holding in a smaller company. Accordingly, the risk of conflict of interest or loss of objectivity would seem to be more directly linked to the extent, rather than proportion of holdings.

**Participation by Members in proceedings before the Commission**—Members told us that they seriously consider the Members' policy before taking part in a proceeding before the Commission. However, the process is informal and unrecorded. We were unable to review situations where Members may have declared themselves in conflict and withdrawn from proceedings because they don't have to report when they make such decisions.

#### Risks and implications if recommendations not implemented

Without effective and transparent systems to ensure and demonstrate objectivity, Members and employees will not fulfill their principle of complying with a higher standard than other market participants, thus potentially undermining the public's confidence in the fairness of the Alberta capital market.

### **Human resources—Recommendation No. 8**

**We recommend that Alberta Securities Commission improve its governance process by:**

- **ensuring the terms of reference for the Human Resources Committee provide for adequate oversight of the human resources function,**
- **providing sufficient information to the Human Resource Committee to enable the Committee to meet its mandate, and**
- **ensuring that the Human Resources Committee monitors the development of a process to identify, investigate, report, and act on employee issues and concerns.**

#### Overview

ASC has an HR Committee, made up of Commission Members. The HR Committee provides some oversight of HR processes.

Under the Commission's HR Committee Terms of Reference, the HR Committee is required to:

- periodically review management polices and action with respect to compensation, including benefit, bonus and incentive plans, conditions and contracts of employment, hiring and termination practices of employees generally to ensure that compensation and benefit plans are competitive, soundly conceived and properly executed and maintained,
- annually review and recommend to the Members, salary ranges for all other employees of the commission on an aggregate basis, and
- periodically review and approve, where appropriate, changes to the Commission's corporate organization, human resource policies and employee benefits including pension arrangements.

Criteria: the standards we used for our audit

There should be effective oversight of human resource policies and procedures by the Commission Members.

#### Our audit findings

The HR Committee:

- reviews compensation for senior management and Members,
- identifies and recommends new Member candidates for the Commission for referral to the Minister, and
- reviews exit interviews of managerial level employees and considers problems that may be associated to the departures.

We found that there was very little oversight of HR matters by the HR Committee. Notwithstanding the HR Committee terms of reference, its role is concentrated more on Member matters and little work is being done to review HR policies and issues and ensure strategies are in place to deal with identified issues.

ASC has a Respectful Workplace Policy that outlines a complaint process for harassment issues. However we found no policy for employee complaints other than harassment.

Management is currently reviewing draft recommendations from an external consultant report that includes recommendations to implement a “whistle blowing” mechanism. There is no evidence of the involvement of the HR Committee in this process.

Risks and implications if recommendation not implemented

ASC has a strategic objective to:

*“be recognized as an attractive employer based on quality of work, training, remuneration and potential for career development”<sup>6</sup>*

The HR Committee can assist ASC meet this objective by fulfilling the oversight role contemplated by its terms of reference. Without this oversight role, human resource management policies and practices may not be effectively addressing identified issues, thereby reducing the ability to attract and retain suitable employees.

#### **Governance—Recommendation No. 9**

**We recommend that the Minister of Finance, working with the Alberta Securities Commission Members, request the Lieutenant Governor in Council to designate a Member of the Commission as the lead independent Member and prescribe the powers, duties and functions of the lead independent Member as provided for in the Securities Act.**

---

<sup>6</sup> ASC 2006 Fiscal Plan and Operating Budget

### Overview

Currently, there are 12 Commission Members, including the Chair and two full-time Vice-Chairs. The Chair also acts as the Commission's Chief Executive Officer and is responsible for the overall operation of ASC.

The Members are empowered to hear matters that affect the public interest in Alberta's capital market. In addition, the Members act as the Commission's Board of Directors.

An amendment to the Securities Act in May, 2005 allows the Lieutenant Governor in Council to designate a Member of the Commission as the lead independent Member and prescribe the powers, duties and functions of the lead independent Member. The independent Member may not be the Chair or a Vice-Chair of the Commission.

### Criteria: the standards we used for our audit

There should be an effective governance process in place to oversee the enforcement system. Corporate governance, among other things, defines the division of power between management and a board

### Our audit findings

Administering the enforcement system requires employees to use their professional judgment when making decisions about enforcement matters. For example, decisions to investigate matters brought to their attention, to terminate an investigation, to recommend that a matter go forward to a hearing or propose a settlement must be based on the employee's assessment of the merits of each individual situation. Because significant judgment is involved in the process, certain matters can be assessed differently by staff and, at times, staff may disagree with a conclusion reached by senior staff. In our review of the responses to the Mack Reports and interviews with the previous Director of Enforcement, it is clear that opinions differ on the decisions reached on certain enforcement matters, and that the differing opinions are a significant factor in the dissatisfaction expressed by some individuals about ASC.

The Chair/CEO, Executive director and Director of Enforcement meet weekly to discuss the status of enforcement files and make decisions with respect to the files. On significant matters, they may decide to discuss the merits of a specific file with a Commission Member to obtain the benefit of that Member's counsel on the file. However, once Commission Members are used in this way, they cannot subsequently have any further involvement in the file should it go forward to a hearing. As a result, management is hesitant to use Commission Members in this manner.

Ideally, the positions of Chair and Chief Executive Officer are held by different individuals. This allows for an appropriate division of responsibilities and power between senior management and the oversight board. In ASC, the positions of Chair and CEO are defined in legislation to be held by the same individual. As a result, there is no effective independent oversight of the enforcement system by non-executive, independent Commission Members. All power with respect to enforcement decisions, with the exception of the involvement of Commission Members in hearings, rests in effect, with senior management.

Good governance requires the appointment of a lead independent Commission Member when the Chair is also the Chief Executive Officer. The recent amendment to the Securities Act provides for such a position. However, the powers, duties and functions of the lead independent Member have not yet been prescribed by the Lieutenant Governor in Council. In order to bring effective governance to the enforcement process, terms of reference need to be established for the independent Member. This Member should be given the authority to question senior management, including the Chair/CEO, about any significant enforcement decisions made by management. The independent Member should not be involved in the day-to-day enforcement decisions, but should receive sufficient information to determine if enforcement decisions are made in a consistent, even-handed and unbiased manner. The independent Member should be satisfied that there is no conflict between managements' personal, financial and professional interests and their decisions with respect to enforcement matters.

Risks and implications if recommendation not implemented

Without independent oversight by a Commission Member, there is a risk that management will not be held accountable for enforcement decisions and it is more difficult for ASC to demonstrate that it is making decisions in a consistent, even-handed and unbiased manner.

**Internal controls—Recommendation No. 10**

**We recommend that the Alberta Securities Commission establish a process to assess the adequacy of the enforcement system’s internal controls. This process should include reporting the results of the assessment to the Commission Members.**

Criteria: the standards we used for our audit

The Commission Members should receive an assessment of the adequacy of the internal controls in the Commission’s significant systems.

Our audit findings

The Commission Members do not currently receive adequate information about the effectiveness of internal controls in the enforcement system. The Commission Members need to receive an assessment from management about the effectiveness of internal controls in the enforcement system and they must be satisfied that internal controls are sufficient to ensure ASC is in compliance with its extensive legislation.

Assessing and reporting on the adequacy of internal controls is the responsibility of management. The Commission Members should ensure that management reports to them about the effectiveness of controls in the enforcement system. The Members should also ensure that an independent party reports to them on management’s assertions to give the Members additional assurance about controls. Normally, the assessment of management’s assertions is done by an internal audit function. Since the Commission does not have an internal audit function, management needs to implement alternative processes. This could be done by tasking this work to independent staff in ASC or hiring an independent outside party to do the work.

**Implications and risks if recommendation not implemented**

Commission Members need to know that controls in the enforcement systems are effective. Without a periodic assessment of the controls, the Members cannot be sure that enforcement activities are complete, consistent, unbiased and in accordance with established policies, procedures and standards.



## Staff and agent resources

### Office of the Auditor General

Fred J. Dunn, FCA	Auditor General
Jim Hug, CA	Assistant Auditor General
Ed Ryan, B.Comm, DIFA	Audit Principal
Karen Chan, CA	Audit Manager
Michelle Fleming, CA	Audit Manager
Patrick Doyle	Audit Manager
Audrey Hayward	Audit Manager
Roger Elvina	Staff Auditor
Diana Potapovich	Staff Auditor

### Agents

Brenda Eprile, FCA	Partner, Regulatory Advisory Services, PricewaterhouseCoopers, LLP
Dorothy Sanford, FCA, MBA	Partner, Regulatory Advisory Services, PricewaterhouseCoopers, LLP



For additional copies of this publication, please contact:

Office of the Auditor General  
8<sup>th</sup> Floor, 9925 – 109 Street  
Edmonton, Alberta, Canada T5K 2J8

Phone: 780-427-4222  
Fax: 780-422-9555

[www.oag.ab.ca](http://www.oag.ab.ca)