

Corporate Governance Practices

As in the previous year, fiscal 2004 was marked by changes in the corporate governance landscape. More specifically, the Board of Directors and management continued to keep abreast of new Canadian and American regulatory requirements. Furthermore, the Audit Committee was very active throughout the year with the implementation of and compliance with various rules adopted by the Securities and Exchange Commission pursuant to the Sarbanes-Oxley Act of 2002 that apply to Canadian companies with shares registered in the U.S. In addition, the Board of Directors implemented procedures to monitor the effectiveness of the Board. New corporate governance rules for NASDAQ and the Toronto Stock Exchange are expected to come into force in the coming months and management is already analyzing their impact on the company. As this past year has demonstrated, achieving best practices in corporate governance is an ongoing process in an ever-changing context.

The Board of Directors believes that EXFO's corporate governance practices comply with current regulatory requirements. As new guidelines come into effect, we will comply with these requirements. Further details about our corporate governance practices are available in the proxy circular.

The present Board members were elected at our last Annual and Special Meeting of Shareholders, held on January 7, 2004, except for Mr. Guy Marier, who was nominated by the Board of Directors on January 7, 2004, pursuant to the General By-Laws of the Corporation.

Responsibilities of the Board

The Board is responsible for the stewardship of our business and affairs by reviewing, discussing and approving our strategic direction and organizational structure, as well as for the review and approval of management's strategic plan on an annual basis. The Board also identifies the principal risks of our business and reviews our risk management systems on an annual and ongoing basis.

In addition to matters requiring Board approval under applicable laws, the Board grants final approval with respect to each of the following: (i) the strategic direction of EXFO; (ii) material contracts, acquisitions or dispositions of our assets; and (iii) the annual operational plan, as well as capital and operating budgets.

The Board of Directors assumes direct responsibility for corporate governance practices and for monitoring the powers, the mandates and the performance of the committees.

The Board is also responsible for the establishment and functioning of all Board committees, the appointment of members to serve on such committees, their compensation and their good standing. At regularly scheduled meetings of the Board, the Directors receive, consider and discuss committee reports.

During the fiscal year ended August 31, 2004, the Board met a total of ten times. Attendance at all meetings was exemplary: Mr. Pierre Marcouiller was absent from one meeting, Mr. David Thompson was absent from one meeting and Mr. Michael Unger was absent from one meeting.

Mr. Michael Unger, Chairman of the Human Resources Committee and independent Director of EXFO, is the Lead Director. As such, he is responsible for ensuring that the Board properly discharges its duties, independent of management. The Lead Director is required to hold a minimum of two meetings of the Board of Directors without management members present, and additional meetings of independent Board members may be held at their request. During the fiscal year ended August 31, 2004, independent Board members met twice.

At the present time, EXFO has no formal procedures in place for recruiting new Directors.

Composition of the Board

Our articles of incorporation provide for a Board of Directors with a minimum of three and a maximum of twelve Directors. Our Board presently consists of six Directors, five of whom are independent of management and free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with a Director's ability to act with a view to the best interests of EXFO, other than interests arising from non-significant shareholding. Our Directors are elected at the Annual General Meeting of Shareholders for one-year terms and serve until their successors are elected or appointed, unless they resign or are removed earlier.

Our Chairman of the Board and Chief Executive Officer, Mr. Germain Lamonde, is a significant shareholder of EXFO as he has the ability to exercise a majority of the votes for the election of the Board of Directors. Since the other five Board members do not have interests in EXFO or relationships with either EXFO or Mr. Lamonde, except for non-significant shareholding in the company, we believe that the interests of investors in EXFO, other than Mr. Lamonde's, are fairly represented.

Committees of the Board

Board committees play a significant role in the discharge of Board duties and obligations; committee chairs submit items for Board agendas and report on committee activities. The members of these committees are appointed annually, and the Board may appoint additional ad hoc committees periodically, as needed. EXFO has a practice of permitting the Board, any committee thereof, and any individual Director to hire independent, external advisors at our expense. The Audit Committee and the Human Resources Committee are entirely comprised of unrelated Directors.

The following is a general description of the composition and general duties of each Board committee as contained in its mandate as at the fiscal year ended August 31, 2004.

Audit Committee

The Audit Committee reviews interim in-house financial statements and annual audited financial statements and related disclosure documents, including "Management's Discussion and Analysis of Financial Condition and Results of Operations", with management and external auditors and approves them prior to public release. The Audit Committee is responsible for reviewing our internal control systems with regard to finance, accounting, legal compliance and ethical behavior. The Committee meets regularly with external auditors, with and without management, to consider the scope and results of their audits, including analysis of the adequacy of the internal controls and the effect of the procedures relating to the outside auditors' independence. The Committee also recommends to the shareholders the selection of external auditors for their appointment by the shareholders. The Audit Committee is comprised of the following independent Directors: Mr. Pierre Marcouiller, Mr. Guy Marier, Mr. André Tremblay and Mr. Michael Unger. The Chair of the Audit Committee is Mr. Tremblay. During the fiscal year ended August 31, 2004, the Audit Committee met a total of five times and all members attended all meetings, except for Mr. Pierre Marcouiller, who was absent from one meeting.

Human Resources Committee

The Human Resources Committee is responsible for assessing the performance and establishing the annual compensation of all our senior officers, including the CEO. This Committee also reviews and submits to the Board the salary structure and the short-term and long-term incentive compensation programs for all our employees. The Committee is responsible for the review and approval of the employees who will receive options to purchase EXFO shares in accordance with policies established by the Board and the terms of the Stock Option Plan. In addition, the Committee reports annually to the Board regarding the organizational structure and succession plan for senior management. The remuneration to be paid by EXFO to the Directors is recommended to the Board by the Human Resources Committee. The Human Resources Committee is comprised of the following independent Directors: Mr. Pierre Marcouiller, Mr. Guy Marier, Dr. David A. Thompson, Mr. André Tremblay and Mr. Michael Unger. The Chair of the Human Resources Committee is Mr. Unger. During the fiscal year ended August 31, 2004, the Human Resources committee met a total of two times and attendance was perfect at all meetings.

Disclosure Committee

The Disclosure Committee is responsible for overseeing our disclosure practices. The Disclosure Committee consists of the Chief Executive Officer, Chief Financial Officer, Investor Relations Manager, Manager of Financial Reporting and Accounting, as well as Legal Counsel and Corporate Secretary.

Shareholder/Investor Communications and Feedback

The Chief Financial Officer assumes responsibility for investor relations. He is responsible for facilitating communications between senior management and EXFO's shareholders and financial analysts. Information to shareholders is disseminated through annual and quarterly reports, press releases, proxy circular, the Annual General Shareholders' Meeting and investor presentations. EXFO receives and responds to all shareholders' inquiries in an appropriate and timely manner. In communications to senior management, the Chief Financial Officer also provides feedback from shareholders.