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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince
Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Dear Sirs and Mesdames:

NATIONAL INSTRUMENT 52-108 AUDITOR OVERSIGHT

Thank you for the opportunity to comment on “CSA Notice and Request for Comment Proposed Repeal and Replacement of National Instrument 52-108 *Auditor Oversight*” (“Request for Comment”)¹. This comment letter is restricted to issues relating to the proposed Amended Auditor Oversight Rule, as defined in the Request for Comment.

1. Introduction

1.1 The subject matter of the Current Auditor Oversight Rule and of the Amended Auditor Oversight Rule covers only notice requirements by a participating audit firm after an inspection by the Canadian Public Accountability Board (“CPAB”) has found an “audit deficiency” in the audit firm’s quality control systems or in a

¹ (2013), 36 OSCB 10147 (2013-10-17).

failure to comply with professional standards. Notwithstanding the heading, “Auditor Oversight”, these Rules have only a very limited scope in addressing the broad and important topic of regulation, supervision, oversight and accountability of auditors of reporting issuers across Canada. These *post hoc* notice requirements by an audit firm are only the tip of the iceberg in considering the current multi-jurisdictional and cooperative system of the regulation of auditors of reporting issuers across Canada. The goal of enhancing public confidence in the integrity of financial reporting in Canada requires further regulatory supervision that extends well beyond the adoption of the Amended Auditor Oversight Rule, the text of which is only a modest upgrade from the original version of the 2004 Current Auditor Oversight Rule.

1.2 The Amended Auditor Oversight Rule does not deal with the regulation, supervision, accountability or transparency of the underlying operations of the CPAB, issues which are central to the CPAB’s declared mandate of protecting the investing public’s interest as Canada’s audit regulator.²

2. CPAB

2.1 The mandate, role, function, transparency and accountability of the CPAB are essential and underlying core matters to the broad question of the effectiveness of the important subject of ‘auditor oversight’ that is raised by the Request for Comment. Established without legislative empowerment by the Canadian Securities Administrators, the Office of the Superintendent of Financial Institutions and the Canadian Institute of Chartered Accountants as a private, self-regulatory, not-for-profit organization, the CPAB has taken on the important national responsibility for the regulation of auditors of public companies. CPAB’s Letters Patent mandate it to “contribute to public confidence in the integrity of financial reporting of public companies by promoting high quality, independent auditing” The by-laws of CPAB, which were approved by the Council of Governors, which is effectively controlled by the Canadian Securities Administrators, direct CPAB, among other things, to “promote, publicly and proactively, the importance of high quality external audits of Reporting Issuers; ... report publicly on the means taken to oversee the audit of Reporting Issuers and the results achieved; ... ensure appropriate transparency in the conduct of [CPAB’s] activities;”³ CPAB states that it is “the national body responsible for the regulation of public accounting firms that audit Canadian reporting issuers.”⁴ CPAB’s website declares that it “is Canada’s audit regulator, protecting the investing public’s interest.” CPAB expresses that its “mission is to contribute to public confidence in the integrity of financial reporting of reporting issuers in Canada by effective regulation and promoting quality,

² CPAB website. The CPAB describes itself as providing “world-class audit regulation”.

³ CPAB By-Law No. 1 – Amended and Restated (approved by the CPAB board on January 7, 2009), s. 3.1.

⁴ CPAB “Statement of Accountability and Governance Practices”, p. 1.

independent auditing”.⁵ The CPAB accepts that “public confidence in the integrity of financial reporting is fundamental to the effective operation of our capital markets. This confidence depends on quality financial audits. ... The investing public trusts auditors to attest to the integrity of the financial statements. ...”⁶

2.2 From its inception as a private, not-for-profit company incorporated under the federal *Canada Corporations Act* in April 2003, and denied any federal authority or recognition, the CPAB has sought auditor oversight legislation and regulatory recognition from provincial and territorial assemblies in order to acquire the empowering jurisdiction necessary to carry out its self-declared mission throughout Canada. As the CPAB has acknowledged: “A robust regulatory framework is critical to CPAB’s ability to perform as a strategic regulator.”⁷

2.3 At its inception, the CPAB commenced operations with only a veil of authorization and scant formal accountability. By the end 2012, the CPAB had evolved into a pro-active regulator undertaking annually root-cause-focused, risk-based inspections of 15 participating audit firms who audited the financial statements of 6,703 Canadian reporting issuers with an aggregate market capitalization of \$2 trillion. With a budget of only about \$16 million, in 2013 the CPAB inspected 61 audit firms, examined complex parts of the files of 236 audit engagements, and required five restatements of financial statements.⁸

2.4 In Ontario, the CPAB subsequently received legislative authorization under a statute “to promote the integrity of financial reporting in Ontario’s capital markets”, and to “oversee the audit of financial statements of reporting issuers.” The *Canadian Public Accountability Board Act (Ontario) 2006*, S.O. 2006. c. 33, Schedule D (“CPAB Ontario Act”), which became effective June 30, 2009, provides that the CPAB, in carrying out its mandate and exercising its powers and duties under that Act, is “accountable to” the Ontario Securities Commission (“OSC”) and “the Government of Ontario as set out in this Act” (s. 5(2)). In addition, the CPAB is required under the CPAB Ontario Act, “subject to this Act, its by-laws and its rules”, to “account to the [OSC] and the Government of Ontario on its activities in the manner set out in this Act” (s. 6(2)(f)). (In several of its documents, the CPAB describes the CPAB Ontario Act as the “CPAB Act”.)

2.5 The Council of Governors⁹ of the CPAB, which is effectively controlled by the Canadian Securities Administrators, has the authority to appoint the 11 members of

⁵ CPAB 2011 Public Report, p. 3.

⁶ CPAB 2012 Public Report, p. 3.

⁷ CPAB 2011 Public Report, p. 28.

⁸ Brian Hunt, CEO of the CPAB, presentation to Conference for Audit Committees, November 28, 2013, p. 4.

⁹ The Council of Governors of the CPAB is effectively controlled by the Canadian Securities Administrators. The letters patent dated April 14, 2003 of the CPAB as a not-for-profit company under Part II of the *Canada Corporations Act* adopted by-laws filed with the application for letters

the board of directors of the CPAB, subject to providing notice to and receiving comments and suggestions from the Provincial Audit Regulatory Members of the CPAB.¹⁰

2.6 The CPAB Ontario Act requires the CPAB's Council of Governors to "certify" to the OSC that "the [CPAB] Board has carried out its mandate in a manner that is consistent with the public interest in maintaining the integrity of financial reporting by reporting issuers and the objectives of" the [Current Auditor Oversight Rule] or such other instrument that may be named by regulation (s. 9(3)). The OSC is then required to assess CPAB's annual report, determine if there are any issues arising therefrom that require action and to provide a copy of CPAB's annual report and the OSC's assessment thereon to the Ontario Minister of Finance, who is the Minister responsible for the CPAB Ontario Act (s. 9(6)). The Ontario Minister of Finance is required to lay the reports before the Ontario Assembly by delivering them to the Clerk (s. 9(8)).

2.7 On March 30, 2013, the Council of Governors of the CPAB issued its certificate to the OSC that in its view, based on the review it made, the CPAB carried out its mandate in 2012 "in a manner consistent with the Public Interest¹¹ and the 52-108 Objective." The certificate was signed by Howard Wetson, Chair, Council of Governors of the CPAB. Mr. Wetson is also the Chair of the OSC and as such is a member of the Council of Governors under the by-laws of the CPAB. This perceived conflict is statutorily recognized and sanctioned.¹²

2.8 On April 30, 2013, the OSC reported its assessment to the Minister of Finance of Ontario on the 2012 Annual Report of the CPAB. The OSC relied, among other things, on the certificate of the Council of Governors signed by the Chairman of the OSC in his capacity as the Chair of the Council of Governors. The OSC reported to the Ontario Minister of Finance that its assessment was that there were no issues

patent. The CPAB has not disclosed the by-laws filed with its application for letters patent. Under the CPAB's By-Law No. 1 - Amended and Restated and approved by the CPAB board on April 20, 2004, a majority of the then five Governors of the Council of Governors were members of or selected by the Canadian Securities Administrators. Under what appears to be the current situation, under By-Law No. 1 - Amended and Restated and approved by the CPAB board on January 7, 2009, a majority of four of the six Governors are members of or selected by the Canadian Securities Administrators (s. 8.1).

¹⁰ The Council of Governors must "consult" with the Provincial Auditor Regulatory Members of the CPAB in "respect of the composition of the Board and candidates to be considered for appointment as a Director, Chair or Vice-Chair...". The Council of Governors may by a resolution approved by four Governors remove any director.

¹¹ The "Public Interest" was defined in the certificate as "maintaining the integrity of financial reporting by reporting issuers".

¹² The CPAB Ontario Act permits the Chairman of the OSC to be a member of the Council of Governors, notwithstanding that the CPAB is accountable to the OSC in Ontario: s. 4. The CPAB Ontario Act also provides that the Chairman of the OSC shall not participate in the OSC's assessment of the CPAB's annual report submitted to the OSC: s. 9(7).

arising from the CPAB 2012 Annual Report that required action, and that the OSC had no recommendations to the Minister arising from its assessment.

2.9 On July 12, 2013, the Ontario Minister of Finance filed the CPAB 2012 Annual Report and the assessment report of the OSC with the Clerk of the Legislative Assembly of Ontario, as required under s. 9(8) of the CPAB Ontario Act.

2.10 The CPAB Ontario Act also requires the CPAB to conduct its oversight program in accordance with its rules (s. 10(1)). The CBAB rules include regulations made under the Act “which specify that they shall be deemed to be rules of the [CPAB] Board for the purposes of this Act (s. 10(3)(d)). The Minister of Finance may make regulations “prescribing rules in relation to the oversight program of the [CPAB] Board and providing that they shall be deemed to be rules of the Board” (s. 16(1)(c)). These regulations prescribing rules of the CPAB have effect only in Ontario. The Ontario Government thereby has the authority to regulate the oversight operations of the CPAB in Ontario regarding the audit of financial statements of reporting issuers in Ontario.¹³

2.11 The CPAB Ontario Act has a section regarding confidentiality that is publicly referred to frequently by the CPAB as a factor for its inability to disclose its inspection results of participating audit firms of reporting issuers. The Act provides that the CPAB board is entitled to obtain all documents and information that an audit firm obtained or prepared in order to perform its audit of a reporting issuer. This includes the production of documents that are the subject of solicitor-client privilege if access “is absolutely necessary to the purpose of the review of the audit.”¹⁴ S. 11(2) of the CPAB Ontario Act provides that:

“All documents and other information prepared for or received by the [CPAB] Board in the exercise of its mandate and all deliberations of the Board and its agents and employees and agents, in connection with an inspection, investigation or review panel proceedings carried out under the Board’s oversight program, are confidential and may not be disclosed without,

(a) *the written consent of all persons whose interests might reasonably be affected by the disclosure; or*

(b) a court order authorizing the disclosure.” [emphasis added]

This provision does not apply to the CPAB providing information, other than privileged information, to a “foreign audit oversight body” that is relevant to that

¹³ CPAB notes that the scope of its investigations is limited as it does not inspect the entire audit file of an audit firm subject to an inspection. It reviews only between two and four specific focus areas which are generally material, high-risk financial statement items. CPAB’s inspection findings are not intended to identify all weaknesses that may exist in an audit. CPAB’s findings do not represent a balanced scorecard.

¹⁴ CPAB Ontario Act, s. 11. The disclosure of solicitor-client privilege documents does not constitute a waiver of any privilege that continues for all other purposes: s. 11(5).

body's review of an audit carried out on a reporting issuer that carries on business in that body's jurisdiction.¹⁵

2.12 British Columbia has relied on Ontario for British Columbia's oversight and accountability with respect to the operations of the CPAB and has recognized the CPAB as a self-regulatory body until July 31, 2014. British Columbia's recognition is dependent, among other things, on CPAB's compliance with the CPAB Ontario Act.¹⁶ CPAB has also been formally recognized in Manitoba and New Brunswick on the same terms as British Columbia.

2.13 On May 21, 2013, in Montreal, the CPAB entered into a "*Cooperation agreement between the Ordre des comptables professionnels agréés du Québec and the Canadian Public Accountability Board*", CQLR c C-48.1, r 15.1 ("Quebec-CPAB Agreement"). The Quebec-CPAB Agreement, entered into by the Ordre of Quebec professional accountants under the authority of the *Professional Accountants Act* (Quebec), acknowledges that CPAB may operate a program in Quebec to monitor, inspect and investigate participating audit firms. The Quebec-CPAB Agreement provides that the parties will exchange confidential and other information between them and that the Quebec chartered professional accountants may disclose information to CPAB despite the professional secrecy to which they are subject under Quebec law, in order that the receiving party may execute independently its separate inspection, discipline, review proceeding, dispute resolution process and any investigation or inquiry functions under its respective mandate.

3. OSC-CPAB MOU

3.1 Effective as of November 27, 2013, the OSC and the CPAB entered into a "*Memorandum of Understanding Concerning Consultation, Cooperation and the Exchange of Information*" ("OSC-CPAB MOU").¹⁷ Irrespective of and beyond the legal requirements to provide notifications to the OSC under the Current Auditor Oversight Rule or the Amended Auditor Oversight Rule, by private agreement, referred to in the OSC-CPAB MOU as "a statement of intent", the OSC and the CPAB agreed to share information, including "Confidential Information", relating to public accounting firms and reporting issuers. With respect to the CPAB, "Confidential Information" is defined in the OSC-CPAB MOU as information "reasonably identified as confidential" by the CPAB and "is not information that is, at the time of disclosure, or has become, part of the public domain. ..." The OSC-CPAB MOU does state that it is a 'statement of intent' to exchange information "in connection with the inspection, supervision, investigation and oversight of Public Accounting Firms and Reporting Issuers in a manner consistent with and permitted by the Law that governs" the CPAB and the OSC (s. 9).

¹⁵ CPAB Ontario Act, s. 14.

¹⁶ *Canadian Public Accountability Board (Re)*, 2011 BCSECCOM 357 (CanLII, July 20, 2011).

¹⁷ OSCB, Issue 36/49 (2013-12-05).

3.2 Presumably, the terms of the OSC-CPAB MOU requires compliance by the OSC and the CPAB with the confidentiality constraints of s. 11(2) of the CPAB Ontario Act. There may be several problematic legal issues arising out of applicable multiple statutory and other confidentiality provisions of different jurisdictions that will be raised with respect to the sharing of “confidential information” between these two authorities and with third parties.

3.3 In addition to the legal obligations of audit firms to report to the regulators under the Current or Amended Auditor Oversight Rules, following findings of “audit deficiencies” by the CPAB, the CPAB agreed in the OSC-CPAB MOU to provide directly to the OSC a notice and a particulars of any “requirement” (which is not required to be disclosed under the Current Auditor Oversight Rule) that the CPAB imposed on a participating audit firm.¹⁸ A small loophole closed with respect to the secrecy of the CPAB’s operations, but only for the non-public benefit of this single though important regulator, and not for sharing with audit committees or the reporting issuers involved. (It is unclear whether the CPAB has or will enter into similar MOUs with the other provincial and territorial regulators, beyond Quebec, or whether the OSC intends, or is permitted by the other regulators to act, as the “principal jurisdiction” in collecting and sharing information and cooperating with the CPAB on behalf of the other members of the Canadian Securities Administrators, subject to legal confidentiality issues.) Strikingly, the OSC-CPAB MOU does not impose on the CPAB an obligation to share a “mandatory recommendation” with the OSC that the CPAB has required an audit firm to comply with.¹⁹

3.4 Of further broader interest than the contractual commitment to provide privately to the OSC particulars of “requirements” imposed by the CPAB, the CPAB has agreed to share with the OSC notice and particulars of:

“... a situation where CPAB has identified, or becomes aware of a violation, or a series of violations, of Professional Standards or CPAB Rules at a Participating Audit Firm, relating to an audit or audits of one or more Reporting Issuers performed by a Participating Audit Firm, which violation, or series of violations, *creates a heightened risk to the investing public.*”²⁰ [emphasis added]

Interestingly, for an undisclosed reason, the OSC made a determination under s. 153 of the *Securities Act* (Ontario) that the information it receives under paragraph 12(a)

¹⁸ OSC-CPAB MOU, s. 12(c).

¹⁹ The CPAB generally makes “recommendations” to an audit firm following an inspection “arising from deficiencies related to engagement performance. These recommendations are applicable to either systemic/firm-wide processes or specific engagement files that were inspected. Deficiencies noted in the other elements of quality control may also result in recommendations.” A “mandatory recommendation” is a significant ‘remedial action’ imposed by the CPAB because it “must” be implemented within 180 days of the inspection report to CPAB’s satisfaction, the failure of which would give rise to ‘disciplinary action’ on the audit firm. CPAB 2012 Public Report, p. 16.

²⁰ OSC-CPAB MOU, s. 12(a). Under s. 12, the CPAB has undertaken other new and additional information sharing obligations to the OSC, all of which are beneficial to protecting the public interest.

of the OSC-CPAB MOU “shall be maintained in confidence” for the next three years.²¹ That ‘confidence determination’ does not apply to the other confidential and non-confidential information received by the OSC from the CPAB under the MOU.

3.5 The CPAB takes the position publicly that it does not wish to intervene in the client relationship between the audit firm and the reporting issuer, and that it would be “rare” and “unusual” for the CPAB to agree to meet with a reporting issuer or its audit committee. In any such meeting, the CPAB stated that it would not share its inspection findings of the reporting issuer’s audit firm with the reporting issuer because of the confidentiality restraints. It would be the audit firm and not the CPAB who would advise the reporting issuer that the CPAB was inspecting the audit files of its external auditor.²²

3.6 It is interesting to note s. 12(d) of the OSC-CPAB MOU which provides that the CPAB will share with the OSC notice of situations “in which the CPAB has required a Reporting Issuer to seek the views of the [OSC] regarding a matter in question.” This implies a direct communication between the CPAB and the reporting issuer. It is not clear when and under what circumstances that the CPAB would or has “required” a reporting issuer to seek the views of the OSC, or under what provision the CPAB has the authority to so “require”. From a practical point of view, if the CPAB advised the reporting issuer to do so, there would be little reason for a reporting issuer, so requested, if not “required”, not to follow the advice of the CPAB. (If the CPAB cannot “require” a reporting issuer to seek the views of the OSC, does paragraph 12(d) have any effect?)

3.7 The OSC-CPAB MOU is a positive development for the OSC to allow it, through this non-statutory consensual agreement, to increase its visibility and information into the inspection, supervision, investigation and oversight of public accounting firms. That such an agreement with a regulator was appropriate reflects, however, a lack of effectiveness resulting from a fragmentary and disjointed scheme and the absence of a national uniform regime to provide for proper regulatory supervision, accountability and transparency of an agency mandated or recognized, in the public interest, by multiple provincial and territorial authorities to regulate and oversee auditors of public issuers across Canada with the very important mission to instill public confidence in the integrity of financial reporting.

3.8 Interestingly, the CPAB has entered into a cooperation agreement with the United States Public Company Accounting Oversight Board (“PCAOB”), but the terms of the statement of protocol have not been disclosed and remained private. Memoranda and protocols of cooperation that the PCAOB has entered into with, among others, China, the United Kingdom, Japan, Israel, Dubai, and Switzerland have

²¹ OSC-CPAB MOU, s. 22.

²² CPAB webcast held on January 8, 2014 on the “*CPAB Protocol for Sharing Information with Audit Committees*”.

been publicly disclosed by the PCAOB with the consent of those contracting jurisdictions.

4. CPAB Supervision and Accountability

4.1 A fundamental question for the Canadian Securities Administrators is whether the Amended Auditor Oversight Rule, or another future National Instrument, should contain provisions that are more specific than the general terms of the CPAB Ontario Act regarding the supervision, oversight, accountability and transparency of the conduct of CPAB in fulfilling its important mandate and role as “Canada’s audit regulator” which include responsibilities to regulate public accounting firms in the public interest.

4.2 On the other hand, in light of the disappointing decision of the Supreme Court of Canada dealing with the legislative authority of the Canadian Parliament to regulate Canada’s efficient national and interprovincial securities markets under its trade and commerce power²³, if the mission of the Canadian Securities Administrators does not extend to effective and *de facto* supervision and oversight of the important functions of “Canada’s audit regulator”, should the Province of Ontario and the OSC, which have the responsibility to regulate the largest and most robust capital market in Canada, not accept that leadership responsibility through the exercise of its provincial jurisdiction?²⁴

4.2 The Amended Auditor Oversight Rule does not deal with the effective oversight, supervision, assessment, review, public reporting requirements or regulation of the critical role of the CPAB in the fulfillment of its important mandate to act in the public interest which the CPAB has been granted and its board of directors has accepted.

(a) To whom is the CPAB accountable?²⁵

(b) To what extent is the CPAB accountable to the Canadian Securities Administrators, and how are the Canadian Securities Administrators

²³ *Reference re Securities Act*, 2011 SCC 66; [2011] 3 S.C.R. 837.

²⁴ The market capitalization of TSX-listed reporting issuers was \$2.1 trillion as at December 31, 2012: CPAB 2012 Public Report, p. 13. The majority of reporting issuers in Canada have headquarters in Ontario, with the next largest number, which is less than half of the number registered in Ontario, being headquartered in British Columbia. Over 75% of Canadian reporting issuers headquartered in Canada are in Ontario and British Columbia: CPAB 2011 Public Report, p. 5. British Columbia has already effectively delegated its supervision of the CPAB to Ontario: *Canadian Public Accountability Board (Re)*, 2011 BCSECCOM 357 (July 21, 2011).

²⁵ The OSC states that the CPAB’s authority in Ontario to carry out its inspections and audit oversight program is set out in the CPAB Ontario Act: OSC-CPAB MOU, s. 2. Under the CPAB Ontario Act, the CPAB is accountable, in Ontario, to the OSC and the Ontario Minister of Finance: s. 5(2). To whom is the CPAB accountable in the rest of Canada?

fulfilling their responsibility to supervise and assess the performance of the CPAB as Canada's national audit regulator?

- a. How does the Canadian Securities Administrators exercise its clear and effective control of the business and affairs of the CPAB that is provided to them through the authority of the CPAB's Council of Governors?²⁶
- b. How are directors of CPAB that are nominated by the Canadian Securities Administrators through the Council of Governors identified, reviewed, and selected?²⁷
- (c) The CPAB is "accountable" to the OSC under the CPAB Ontario Act. How does the OSC exercise its oversight responsibility under the terms of the CPAB Ontario Act? Is the nature, scope and extent of that supervision disclosed in and reflected by the OSC's assessment of the CPAB's annual report that the OSC delivers to the Ontario Minister of Finance?
- (c) Is there adequate transparency and reporting to the public of the operations, activities and inspection results undertaken by the CPAB?

5. Deficiencies of the Current Auditor Oversight Rule

5.1 Following an inspection of an audit file, CPAB holds an exit interview with the audit firm and later provides a private inspection report to the audit firm, as well as an overall report on the firm. These are private communications between the CPAB and the audit firm. Inspection findings during an inspection are set out in an Engagement Findings Report ("ERF") that identifies audit deficiencies, which are separated into two types of findings, EFR 1 and EFR 2. An EFR 1 finding is "a significant GAAS or GAAP [audit] deficiency that - relates to a material financial balance or transaction stream, - has the potential to result in a material misstatement in the financial statements, - will be included as a file-specific finding in the inspection report." EFR 1 findings require the audit engagement team to respond to the CPAB in writing setting out how it plans to address the identified audit deficiencies. An EFR 2 is a significant finding communicated to the firm that does not require a written response.²⁸ The inspection report to the audit firm accumulates all EFR and element findings and generally contains non-reportable

²⁶ The 11 member board of directors of the CPAB is appointed by the six member Council of Governors, a majority of whom are members of or appointed under the control of the Canadian Securities Commissioners. The identification of potential directors and the selection and nominating process for directors of the CPAB by the Canadian Securities Administrators have not been disclosed.

²⁷ In the case of a member of the United States Public Company Accounting Oversight Board ("PCAOB"), the five members are appointed to staggered five year terms by the Securities and Exchange Commission, after consultation with the Chairman of the Board of Directors of the Federal Reserve System and the Secretary of the Treasury of the United States federal government.

²⁸ CPAB 2012 Public Report, p. 19.

“recommendations” to improve audit quality based on the firm-specific ‘deficiencies related to engagement performance’ and ‘quality control’. Before moving to disciplinary actions, the CPAB’s private report to an inspected audit firm would provide three to five “major recommendations” to improve audit quality. If there are “serious deficiencies”, CPAB would provide additional non-reportable “*mandatory recommendations*” that the audit firm is “*required to implement to retain its registration status*”.²⁹ [emphasis added] These “recommendations” are to be implemented by the audit firm within 180 days. Where there may be a potential restatement of the financial statements, the deadline for implementing the CPAB’s ‘recommendations’ may be much shorter than 180 days. Failure to implement a mandatory recommendation would be escalated to give rise to disciplinary action on the audit firm in the form of “requirements, restrictions or sanctions”. Disciplinary action arises where the CPAB finds that “the number and nature of audit deficiencies is unsatisfactory and that the investing public could be at risk”.

5.2 The disciplinary action usually starts with a non-reportable “requirement”, which limits the scope of the audit work the firm can undertake until the identified deficiencies have been corrected within a time frame determined by the CPAB. The most common “requirement” restricts the firm from taking on any new reporting issuer audits until the CPAB conducts a follow-up inspection and is satisfied with the quality of the audit work. More serious cases require a reportable “restriction” on the firm. The third level of discipline is a “sanction”. CPAB By-Law No. 1 empowers the CPAB to oversee a system “for the imposition of requirements, restrictions and sanctions directly on” participating audit firms.³⁰

5.3 Under s. 3.1 of the Current Auditor Oversight Rule, a participating auditor firm is required to provide notice to the regulator in the limited circumstances where CPAB “imposes *restrictions*” on the firm “intended to address defects in its *quality control systems*”. [emphasis added]

5.4 Unfortunately, the Current Auditor Oversight Rule omitted any disclosure obligation when the CPAB imposed “mandatory recommendations” or “requirements” where the CPAB found that the number and nature of “audit deficiencies” were unsatisfactory and that the investing public could be at risk. Many “requirements” are in substance *de facto* “restrictions”. The CPAB advised that, when it “believes that the *quality of auditing in an audit firm is so substandard that the investing public is at risk*, CPAB places a *Requirement* on the firm that *restricts* the manner in which it operates its reporting issuer practice. A Requirement is between CPAB and the audit firm.”³¹ [emphasis added – note: the CPAB confirms that a “requirement” “restricts”.] There was no transparency to the reporting issuer or its audit committee in these situations regarding defects in quality control systems.

²⁹ CPAB 2012 Annual Report, p. 16.

³⁰ CPAB By-Law No. 1 – Amended and Restated, s. 3.1(k).

³¹ CPAB 2012 Public Report, p. 17.

5.5 Under s. 3.2 of the Current Auditor Oversight Rule, where a participating firm is “subject to CPAB restrictions intended to address defects in its *quality control systems*” [emphasis added] and is informed by the CPAB that it has failed “to address [not the higher standard of ‘failing to correct’ – one can ‘address’ but not ‘correct’] defects in its quality control systems”, the participating firm must provide a notice to the audit committee of its reporting issuer and to the regulator.

5.6 Under s. 3.3 of the Current Auditor Oversight Rule, where a participating audit firm is subject to “sanctions imposed by the CPAB”, it must provide notice to the audit committees of the reporting issuers with which it is involved and to the regulator.

5.7 Sections 3.1 and 3.2 of the Current Auditor Oversight Rule require limited notice where the audit firm is subject to “restrictions” to address defects in its “*quality control systems*”. Where, however, a “restriction” may be imposed on an audit firm that failed to meet “*professional standards*” in conducting the audit of the financial statements of the reporting issuer involved, there is not any third party disclosure required under the Current Auditor Oversight Rule, neither to the regulator, to the reporting issuer involved or its stakeholders or to the investing public. Nor is there any obligation on the CPAB to disclose in a report to the public that an external audit firm had defects in its quality control systems, nor a summary of such defects, even where the identity of the reporting issuer involved is not disclosed.

5.8 Under the Current Auditor Oversight Rule, if an accounting firm had “restrictions” imposed on it by the CPAB that were intended to address “defects in its quality control systems”, the auditor is simply required to notify the securities commission of the “restrictions” imposed and a description of the “defects in the quality control systems identified by the CPAB.” The audit firm is not required to inform any reporting issuer or its audit committee, notwithstanding that, after an inspection, the CPAB considered it appropriate, in light of the “audit deficiencies” the investigation produced, to discipline the auditor by imposing “restrictions” on its activities. An auditor, however, who is subject to CPAB “restrictions” but who fails to address the defects in its quality control systems, to the satisfaction of the CPAB, is then required to notify the audit committee of each reporting issuer for which it was appointed auditor describing the defects in its quality control systems identified by the CPAB, the “restrictions” imposed by the CPAB to address such defects, and the reasons the auditor was unable to address the defects to the satisfaction of the CPAB.³²

5.9 During the last nine years ended in 2013, the CPAB has disclosed that it imposed disciplinary measures, many of which were not reportable under the Current Auditor Oversight Rule, as follows:

³² Current Auditor Oversight Rule, ss. 3.1 and 3.2.

- (a) 2005: five firms were “required” not to take on any new reporting issuer clients; five firms were “required” to have an external firm review their files before issuing audit reports; and one firm was “required” to take additional training;
- (b) 2006: one firm was “required” not to take on any new reporting issuer clients; two firms were “required” to have an external firm review their files before issuing audit reports; one firm, Moen & Company LLP, had its participation status terminated pursuant to CPAB Rule 601; Moen & Company had failed to implement ‘recommendations’;
- (c) 2007: six firms were “required” not to take on any new reporting issuer clients; two firms were “required” to have an external firm review their files before issuing audit reports;
- (d) 2008: the CPAB reported that no “restrictions” and no “sanctions” were imposed, but did not disclose “requirements” that it may have issued;
- (e) 2009: two “requirements” were issued;
- (f) 2010: five “requirements” were issued;
- (g) 2011: seven “requirements” were issued”;
- (h) 2012: five “requirements” and two “restrictions” were issued;
- (i) 2013: required five restatements of financial statements out of the 236 audit engagements examined in that year.

Following the 2011 inspections, the CPAB had “requirements” on seven firms (2010 - 5), one of which was converted to a “restriction” in 2012. No “sanctions” were placed on participating firms in the last five years of inspections.³³ (In 2011, when no “restrictions” or “sanctions” were imposed, the CPAB determined that its inspection results were “unacceptable” and expected that the high deficiency rate would not be tolerated by audit committees or the investment community.)

5.10 Following the 2012 inspections, the CPAB had placed “requirements” on five firms (2011 – six) and “restrictions” on two firms.³⁴

5.11 The Ontario Securities Commission (“OSC”) has not received any notice in the past five years ended 2012 of a “restriction” or “sanction” pursuant to s. 3.1(1), s.

³³ CPAB 2011 Annual Report, p. 14.

³⁴ CPAB 2012 Annual Report, p. 15.

3.2(1)(b) and s. 3.3(1)(b) of the Current Auditor Oversight Rules.³⁵ No one, not even this regulator, let alone the reporting issuers involved, received notice of a “requirement” or “restriction” when the investing public was at risk.

6. Amended Auditor Oversight Rule

6.1 The Amended Auditor Oversight Rule attempts to address the extremely narrow reporting obligations contained in the Current Auditor Oversight Rule that have existed since March 30, 2004 when NI 52-108 became effective.

6.2 There is no definition of a “remedial action” for the Part 3 Notice of the Amended Auditor Oversight Rule. A “remedial action” is ... [an action in response or in relation to what]?

6.3 The CPAB Ontario Act imposes an obligation on the CPAB that the CPAB “shall”, subject to that Act, its by-laws and rules, “require *remedial action* by participating audit firms when necessary or appropriate, following an inspection.” [emphasis added] This levies an objective standard on the CPAB to “require remedial action ... when necessary or appropriate”. The CPAB Ontario Act also provides that the CPAB “shall ... impose, where indicated, restrictions, sanctions or requirements to upgrade supervision, training or education” and recognizes that the CPAB can make “recommendations” which can be contested by the audit firm.³⁶

6.4 While there is no definition of a “remedial action” in that statute, it is suggested that there should be a broad one in the Amended Auditor Oversight Rule, which would be consistent with the CPAB Ontario Act and could include, without limitation, the cited ‘remedial actions’ in that Act. A broad definition would also prevent the avoidance of reporting requirements such as occurred under the Current Auditor Oversight Rule when the CPAB imposed a “requirement” and not a “restriction”. Proposed Companion Policy 52-108CP, Annex B, “Subsection 5(1)-Remedial Action Imposed by CPAB” attempts to deal with this point; however, it would be preferable to have a definition in the National Instrument, rather than express a “view” in a policy.

- (a) One way to think about a definition for a “remedial action” is to consider is as a “cure”, or a “*remedialis*” (Latin), of a situation, namely, an action, means, process, plan or approach: to respond to a recommendation³⁷ or

³⁵ Correspondence from the Ontario Securities Commission dated 2013-10-25.

³⁶ CPAB Ontario Act, ss. 6(2)(c)(ii), 6(2)(d) and 6(2)(e).

³⁷ The word or concept of “recommendation” is important to include in the definition of “remedial action” as the CPAB acknowledges that, after it issues a “private report” to the audit firm following an inspection, it “includes [mandatory] recommendations to improve audit quality which must be implemented within a specified time period.” CPAB, “*Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees, Consultation Paper*” (November 2013), p. 2, and Appendix A, s. 2. A mandatory “recommendation” is meant to cure a defect that will “improve audit quality”

a finding; to correct or cure a deficiency, a failure to comply, a defect, mistake or fault; to lessen the impact or effect of a deficiency, failure, defect, decision, action or event; or to remove a cause, threat or source to a future deficiency or failure.

6.5 There are only four “remedial actions” specified in s. 5(1)(a) which requires a mandatory notice. S. 5(2)(a) implies that a “remedial action” in this section is related to failure to comply with “professional standards”, which are defined in Section 300 of the Rules of the CPAB. “Professional standards” include auditing standards, ethical standards, auditor independence, and quality control standards and procedures.

- (a) Is it clear or intended that a “remedial action” in s. 5(1) only refers to a failure to comply with professional standards?
- (b) Is a “requirement”, “condition”, “request” or a “recommendation” that is put forward by the CPAB to an audit firm to deal with any of the “professional standards” referred to in Section 300 of the Rules a “remedial action”, including recommendations to upgrade supervision, training or education?³⁸
- (c) The CPAB has defined an “audit deficiency”.³⁹ When “audit deficiencies” are noted in inspection findings, audit firms are required to implement CPAB’s “recommendations to rectify them.”⁴⁰ Why not include in s. 5(1)(a) of the Amended Auditor Oversight Rule all Engagement Findings Report 1 (EFR 1) “audit deficiencies”, which are file-specific significant GAAS or GAAP deficiencies that require the audit firm to respond in writing and which have the potential to result in a material misstatement in the financial statements?⁴¹

6.6 There are many additional “remedial actions” that the CPAB may require a participating audit firm to undertake other than the four specific ones cited in s. 5(1)(a). As currently drafted, in the case of the many other “remedial actions”, the audit firm is not required to notify the regulator unless the CPAB decides that the audit firm must do so.

and which “must be implemented within a specified time period.” It should also be clear that any “requirement”, “restriction” or “sanction” is a “remedial action”.

³⁸ The CPAB notes that items recommended or imposed on audit firms include additional professional education, the design, adoption or implementation of policies to ensure compliance, prohibition of designated individuals from doing reporting issuer audits, and ‘other (as required)’: CPAB 2012 Public Report, p. 17.

³⁹ An audit deficiency is defined as the failure to obtain sufficient appropriate audit evidence to support a financial statement assertion for a material account balance or transaction stream: CPAB 2011 Public Report, p. 3.

⁴⁰ CPAB 2012 Public Report, p. 16.

⁴¹ CPAB 2012 Public Report, p. 19.

- (a) Why is this discretion left to the CPAB under s. 5(1)(b)? What are the principles, policies, procedures and processes pursuant to which the CPAB will exercise its discretion in this paragraph (b)?
- a. Proposed Companion Policy 52-108CP, Annex B, "Paragraph 5(1)(b)- Notice at Discretion of CPAB" cites one example when the CPAB "may" exercise its discretion.
 - i. The Canadian Securities Administrators should consider adding to the items in paragraph 5(1)(a) requiring mandatory notice (including the failure of an audit firm to comply with a remedial action within the time period specified by the CPAB and the suggested failure and defects referred in (b) immediately below), as well providing supervisory and governance principles to the CPAB when the CPAB is to exercise its discretion un paragraph 5(1)(b).
- (b) What are not **all** "remedial actions" relating either to failure to comply with professional standards or to a defect in quality control provisions that the CPAB imposes on an audit firm required to be notified to the regulator? Would this accumulated information in the hands of the regulator not be an effective risk management tool to attempt to lessen injury to the investing public?
- (c) Why is the CPAB not obligated to require the audit firm to notify the regulator (as well as the reporting issuer) at the time that the CPAB identifies a defect in the audit firm's "quality control systems", as referred to in s. 6(1), and imposes a "remedial action" on the audit firm to "address" the defect?
- (d) Are the four specific "remedial actions" in s. 5(1)(a) sufficient? Why only these four?
- (e) Of the 25 "requirements" imposed by the CPAB in the five years ended 2012, how many would be encompassed within s. 5(1)(a) and in the future would become reportable and how many would not be specifically covered by paragraph (a) and remain secret?

6.7 The CPAB is given broad discretion in s. 6 of the Amended Auditor Oversight Rule in respect of a defect in the audit firm's "quality control systems". The fact that the CPAB has identified that a defect in the "quality control systems" of the audit firm exists is, regrettably, itself not made a reportable item by the audit firm to the audit committee or the reporting issuer, even on a confidential basis.

6.7 The CPAB also has the authority in s. 6 to determine the time period for the audit firm to “address” the defect. This is in an appropriate ‘business judgment’ for the CPAB to make depending on the circumstances. This time period, however, may overlap a year-end or quarter financial reporting period of the reporting issuer. The reporting issuer and its audit committee are in the dark and unaware that the audit firm has a defect in its “quality control systems” at the time the reporting issuer is preparing, approving and releasing its financial statements to its shareholders and the public and filing them with the regulator. The defect in the “quality control systems” of the audit firm may pose a significant risk of a material financial misstatement by the reporting issuer with resulting legal liabilities, reputational impairment and loss of investor confidence. It is only after the period determined by the CPAB and only if the audit firm “has not *addressed* the defect in its quality control systems” [emphasis added] that the reporting issuers for whom the audit firm has been appointed to prepare an auditor’s report are required to be notified of this material fact.

- (a) If public confidence in the integrity of financial reporting is fundamental to the operation of our capital markets and the mandate of the CPAB is to promote, publicly and proactively, high quality external audits of reporting issuers, which the CPAB says is the basis of the public’s confidence in the integrity of financial reporting, is it not in the public interest that the reporting issuer and its audit committee be informed at the time when the CPAB has identified a defect in its audit firm’s “quality control systems”?
- (b) Is it in the public interest that the CPAB may set a time period for the audit firm to “address” an identified defect in its quality control systems that overlaps and extends beyond a financial reporting period of the reporting issuer, without informing the reporting issuer and its audit committee?
- (c) What does it mean in s. 6(1) that the audit firm “has not addressed” the defect in its quality control systems with the time period set by the CPAB? “Addressing” is ambiguous and is a low level of response. A recommendation can be “addressed” even though the failure or defect in question is not cured for some period of time.

Yours very truly,

(Signed) “HG Emerson”

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January 22, 2014

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**PROTOCOL FOR AUDIT FIRM COMMUNICATION OF CPAB INSPECTION
FINDINGS WITH AUDIT COMMITTEES**

Dear Sirs/Mesdames:

Thank you for the opportunity to comment on the consultation paper, "*Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees*" ("Protocol"), issued in late November 2013 by the Canadian Public Accountability Board ("CPAB"). These comments are made in recognition and support of the important and vital mission of CPAB's role as Canada's audit regulator and its dedicated public interest mandate to improve the public's confidence in the integrity and quality of financial reporting.

Recommendation I

"Audit committees have a critical role to play in achieving audit quality, and integrity of financial reporting. Accordingly, audit committees need to receive high quality, relevant and timely communication from the auditor in order to effectively evaluate the quality of the audit."¹

¹Brian Hunt, CEO of CPAB, comment to Public Company Accountability Board on PCAOB Rulemaking Docket Matter No. 30, (2012-03-05).

It is this commentator's submission that, order to achieve "high quality, relevant and timely communication from the auditor in order to effectively evaluate the quality of the audit", the audit committee must have the right to require that its audit firm communicate to and discuss with it (1) information of the results of CPAB's investigation of any review of the engagement of the audit firm with the reporting issuer as part of the CPAB's overall inspection of the audit firm, and (2) information of the audit firm's responses and remedial actions to the CPAB's findings and the CPAB's determinations with respect thereto.

Recommendation II

The right of audit committees to receive the information and communications from their audit firms referred to in Recommendation I should be legally secured and enforced by amendment to CPAB's rules and by a National Instrument of the Canadian Securities Administrators or under the regulatory authority of the *Canadian Public Accountability Board Act (Ontario) 2006* (the "CPAB Ontario Act").²

Recommendation III

Compliance with the Protocol should not be voluntary by participating audit firms in CPAB's regulatory regime and they should be required to adopt and comply with the final Protocol by the CPAB and by the Canadian Securities Administrators or regulatory authority under the CPAB Ontario Act.

Recommendation IV

Participating audit firms in CPAB's regulatory regime should be required by the CPAB and by the Canadian Securities Administrators or regulatory authority under the CPAB Ontario Act to communicate to audit committees the actual text of the inspection findings of CPAB specific to its inspection of that audit firm's engagement with the reporting issuer, the audit firm's actions and responses to those findings, and the CPAB's determinations with respect thereto.

1. Introduction

1.1 Compared to National Instrument 52-108 *Auditor Oversight*³, which is designed to require, in limited cases, the audit firm to report its audit deficiencies to the regulator, and, in even more limited cases, to the audit committee of the reporting issuer involved, the Protocol is drafted to deal with audit firm communications of file level information directly to audit committees. While these different channels of conveying information do not overlap, each is nevertheless bound by a shared public interest to "contribute to public

²S.O. 2006, Ch. 33, Schedule D. The CPAB refers to this Act as the "CPAB Act".

³The Canadian Securities Administrators have the original NI 52-108 under reconsideration: (2013), 36 OSCB 10147 (2013-10-17), the 90 day comment period for which expired January 15, 2014.

confidence in the integrity of financial reporting of public companies by promoting high quality, independent auditing ...”⁴

1.2 While the CPAB has, to date, abstained from sharing, or allowing audit firms to share, important information from its inspections directly or indirectly with reporting issuers and its audit committees and, in contra distinction to national audit regulators in the United States and the United Kingdom, does not issue public reports on audit firms, the CPAB is still subject to a mandate, approved by the Canadian Securities Administrators, to “promote, publicly and proactively, the importance of high quality external audits of Reporting Issuers; ... report publicly on the means taken to oversee the audit of Reporting Issuers and the results achieved; ... ensure appropriate transparency in the conduct of [CPAB’s] activities.”⁵ The CPAB has acknowledged that “public confidence in the integrity of financial reporting is fundamental to the effective operation of our capital markets. This confidence depends on quality financial audits. ... The investing public trusts auditors to attest to the integrity of the financial statements. ...”⁶ In Ontario, the CPAB Ontario Act, the purpose of which is to “promote the integrity of financial reporting in Ontario’s capital markets”, authorizes the CPAB to fulfill its Letters Patent mandate in that province, and makes the CPAB “accountable to the [Ontario Securities] Commission and the Government of Ontario as set out in this Act.”⁷

1.3 The critically core work of the CPAB, Canada’s national audit regulator dedicated to protecting the investing public’s interest in the integrity of financial reporting, has remained cloistered for too long. Sharing the results of CPAB’s inspection reports privately with only participating audit firms has drawn an opaque veil of secrecy over those audit deficiency findings for public stakeholders who are directly concerned. Sheltering the outcome of the CPAB’s valuable work, which is undertaken in the public interest with regulatory sanction and recognition, has prevented the directly affected key stakeholders, particularly audit committees of the reporting issuers in question, from contributing to the further advancement of the enhancement of the audit quality of financial statements issued to investors in Canada’s capital markets.

1.3B The sheltering of this important information by the audit regulator and the audit firms prevent those directly affected stakeholders from their due share of the benefit from CPAB’s operations which are carried out in the public interest, from being able to exercise their responsibilities to the fullest extent and from contributing adequately to the continuous improvement of audit quality and financial disclosure. The public’s confidence in the audit quality of financial statements of public companies in Canada is restrained because of the inability of reporting issuers to be appropriately informed of the specific inspection findings and remedial actions that the CPAB has required of the audit firms that audit their financial statements for the benefit of their stakeholders, investors and other users of the financial statements of their public companies.

⁴CPAB letters patent dated April 14, 2003.

⁵CPAB By-Law No. 1 – Amended and Restated (approved by the CPAB board on January 7, 2009), s. 3.1.

⁶CPAB 2012 Public Report, p. 3.

⁷CPAB Ontario Act, s. 3 and s. 5(2).

1.3 The past and current private scope of the disclosure of the operations of CPAB may be viewed as overly protective of the interests of the participating audit firms and not to balance, fairly and appropriately, the CPAB's public interest accountabilities to other affected participants in Canada's capital markets, namely, reporting issuers (board, audit committee, management) which are required to prepare, approve and issue financial statements to and for the benefit of its security holders, investors and other users.

1.5 CPAB's findings from its 2012 annual inspections of 236 audit engagement files of 61 audit firms (including the Big Four firms, which audit 98 per cent of reporting issuers by market capitalization, and 10 other firms that each audited more than 100 reporting issuers⁸) are, as a matter of CPAB's policies, not available to key stakeholders, even on request. This lack of disclosure has continued since the CPAB commenced operations in late 2003.

1.6 In its 2012 Annual Report, which provides high-level generic and not specific information, the CPAB noted that inspection results for that year indicated an overall 30 per cent decline in "audit deficiencies"⁹ from 2011. The CPAB 2012 Annual Report noted, however, that the CPAB's findings did not result from "a lack of documentation", nor a "difference of professional judgment". "More than 80 per cent of CPAB's 2012 inspection findings required the audit firm to carry out additional audit procedures to verify there was no need to restate the financial statements due to material error." This requirement for additional audit procedures resulted in "five restatements, of which two were in files inspected at Big Four firms." The 2012 inspections resulted in CPAB placing "requirements" on five firms and "restrictions" on two firms.¹⁰

1.7 The 2011 inspection results of the participating audit firms were, in CPAB's words, "disappointing and demonstrate [that] a greater focus is needed on execution, especially in higher-risk areas of the audit. CPAB is particularly concerned that, in many cases, the same systemic inspection findings are identified year after year without significant improvement." The CPAB found deficiencies in Generally Accepted Auditing Standards (GAAS) in firms of all sizes. The Big Four Firms, which audited 94 per cent of reporting issuers by market capitalization in 2011, had a GAAS deficiency rate of 20-26 per cent on the files inspected. The rate was considerably higher on other national, regional and local firms (47 per cent for the other 10 firms annually inspected). Because of the high risk of restatement of financial statements as a result of these deficiencies, the CPAB concluded that these inspection results were "unacceptable".¹¹

1.8 With respect to the 2011 year, the CPAB concluded that the results of its 2011 audit inspections found "audit deficiencies" that exceeded "tolerable limits". The CPAB commented on the high deficiency rate of 20-26 per cent of the 114 audit engagement

⁸These 14 audit firms audited more than 100 reporting issuers each, representing 99 per cent of the total market capitalization audited by CPAB participating firms in 2012.

⁹"Audit deficiencies" are defined by the CPAB as a "failure to obtain sufficient appropriate audit evidence to support a financial statement assertion for a material account balance or transaction stream."

¹⁰CPAB 2012 Annual Report, p. 15.

¹¹CPAB 2011 Public Report, p. 3.

files of the Big Four firms that it inspected that year:

“These deficiencies arose on the audits of TSX60 companies, the mid-tier and small market reporting issuers. CPAB has told the firms that this deficiency rate exceeds what CPAB considers to be a tolerable limit. The firms concur with CPAB’s assessment and, as a result, are implementing short-term and long-term action plans to improve audit quality.”¹²

1.9 The CPAB said it “is disconcerting to note that most GAAS deficiencies occurred in what one would normally consider to be basic auditing procedures, not in the audit of complex transactions”.¹³ The CPAB concluded that it “would not expect Audit Committees and the investment community to tolerate such a high deficiency rate.”¹⁴ Unfortunately, the affected stakeholders were not provided with the facts related to the audit firm auditing their financial statements.

1.10 The CPAB acknowledged that management, audit committees, and boards, as well as auditors, are responsible for financial statements and should remain vigilant to ensure audit quality, but noted that audit committees “have little or no awareness of CPAB”.¹⁵

2. Public and Audit Committee Outreach by the PCAOB

2.1 The Public Company Accounting Oversight Board (“PCAOB”) was established by the *Sarbanes-Oxley Act of 2002* enacted by the United States Congress on July 30, 2002 and received Securities and Exchange Commission (“SEC”) determination on April 25, 2003 that it was appropriately organized, with the capacity to carry out the Act’s requirements. PCAOB inspects registered public accounting firms to assess compliance with the *Sarbanes-Oxley Act of 2002*, the rules of the PCAOB, the rules of the SEC, and professional standards, in connection with the firm’s performance of audits, issuance of audit reports, and related matters. The PCAOB prepares a written report on each inspection and provides it, in appropriate detail, to the SEC and to certain state regulatory authorities. The five member board of the PCAOB is appointed by the SEC.

2.2 PCAOB inspection findings are contained in two of the four parts of an inspection report. Part I describes audit deficiencies where inspection staff found that the auditor failed to gather sufficient audit evidence to support an audit opinion. These audit deficiencies may relate to the audit firm’s opinion that the financial statements are fairly stated or to its opinion that the company’s internal control over financial reporting is effective. Part I findings are made public and are available on the PCAOB’s web site and accordingly accessible to reporting issuers and audit committees in the United States. Part II of the PCAOB’s inspection report typically describes deficiencies in the audit

¹²CPAB Report on the 2011 Inspections, p. 17.

¹³*Ibid.*

¹⁴The CPAB 2011 Annual Report commented that “[t]hese deficiencies indicate too high a risk of material financial misstatements” (p. 5). The CPAB noted that “the firms recognize that the status quo is not acceptable and have responded positively” to its recommendations” (p. 6).

¹⁵CPAB 2011 Annual Report, p. 10.

firm's overall system of quality control where PCAOB has doubts that the system provides reasonable assurance that professional standards are met. PCAOB is prohibited by law from publicly releasing these Part II findings unless the firm fails to remediate these findings to the PCAOB's satisfaction within twelve months of issuance of the inspection report. The audit firms themselves have copies of this part of the report and are not prohibited by law from releasing this information at any time, though there may be other reasons they decline to do so.¹⁶

2.3 The Part 1 report of the 2012 inspection of PricewaterhouseCoopers LLP, headquartered in New York ("PwC U.S."), was publicly released on August 20, 2013, and included reviews of 52 public company audit engagements of which PwC U.S. was the principal auditor. The PCAOB publicly characterized 21 of those engagements as "audit failures", namely, situations in which, in the view of the PCAOB's inspection staff, PwC U.S. "failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting". In one of the 21 deficient engagements, the company involved restated its financial statements.¹⁷

2.4 PCAOB publicly re-released its 2010 report on its 2009 inspection of PwC U.S. This amended release included portions of the nonpublic Part II section of the original full report that was not included in the initial release that contained only Part 1. The Part II related to PwC U.S. quality control issues and PCAOB's concerns about potential defects in PwC U.S.'s quality control systems based on field work concluded in October 2009. The quality control issues discussed included deficiencies in the categories of auditing fair value measurements and assets in connection with impairment tests; and sufficiency of audit evidence in the areas of use of work of others, controls testing and evaluation, and auditing estimates.¹⁸

2.5 PCAOB also publicly disclosed the Part II quality control criticisms of PwC U.S. arising out of its 2008 inspection of PwC U.S. in a revised report.¹⁹

2.6 The PCAOB 30-page Part 1 inspection report of KPMG LLP, headquartered in New York ("KPMG U.S."), for 2012 and released July 30, 2013, reviewed 50 KPMG U.S. public company audits (in 48 of which KPMG U.S. was the principal auditor). PCAOB considered that 17 of those principal auditor engagements (35 per cent) were "audit failures", namely, where certain of the identified deficiencies were of such significance that it appeared that KPMG U.S., at the time it issued its audit report, had

¹⁶PCAOB Release No. 2012-003, "*Information for Audit Committees about the PCAOB Inspection Process*", (2012-08-01).

¹⁷"*Report on 2012 Inspection of PricewaterhouseCoopers LLP (U.S.)*", PCAOB Release No. 104-2013-148 (2013-10-20).

¹⁸"*Report on 2009 Inspection of PricewaterhouseCoopers LLP (U.S.)*", PCAOB Release No. 104-2010-131A (includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2010-131).

¹⁹"*Report on 2008 Inspection of PricewaterhouseCoopers LLP (U.S.)*", PCAOB Release No. 104-2009-038A (includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2009-038).

failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or the effectiveness of internal control over financial reporting. The 17 issuers in question were not identified, and were referred to as “Issuer A” through “Issuer Q”, with the identified audit deficiencies in each of those audit engagements identified and described. In one case, after the inspection team’s primary inspection procedures, KPMG U.S. revised its opinion on the effectiveness of the issuer’s internal control over financial reporting to express an adverse opinion. In another case, the issuer announced an intention to restate its financial statements.²⁰

2.7 Deloitte & Touche LLP (“Deloitte U.S.”) received a private Part II report dated April 16, 2009 from PCAOB on its 2008 inspection of Deloitte U.S. The Part II nonpublic report contained certain quality control criticisms of Deloitte U.S. Deloitte U.S. was provided a one year remediation period to ‘address’ the criticisms. At the end of the remediation period, PCAOB determined that Deloitte U.S. had not addressed five of the quality control criticisms to the satisfaction of PCAOB. On November 21, 2013, the PCAOB publicly released that portion of the report containing its Part II criticisms of the quality control defects of Deloitte U.S. The Deloitte U.S. audit quality control areas in which the PCAOB found inadequate remediation include auditing management estimates; use of service organizations and the work of specialists; exercise of due care and professional skepticism when performing audits; and supervision and review to assure audits are performed thoroughly and with due care.²¹

2.8 On September 27, 2012, PCAOB released Part I of its 2011 inspection report of Deloitte & Touche LLP, headquartered in Toronto (“Deloitte Canada”), which was conducted in cooperation with the CPAB. With respect to PCAOB’s inspection of certain of Deloitte Canada’s 2011 audit engagement files, the PCAOB identified audit deficiencies including failure to perform, or to perform sufficiently, certain necessary audit procedures. “The deficiencies identified included deficiencies of such significance that it appeared to the inspection team that, in six of the audits performed by [Deloitte Canada], the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer’s financial statements or ICFR [internal control over financial reporting].” The deficiencies included the failure, in three audits, to perform sufficient procedures to test revenue; the failure, in two audits, to perform sufficient procedures to test the effectiveness of controls relating to revenue; and the failure to perform sufficient procedures to test the estimated useful lives of property, plant and equipment. The PCAOB’s inspection findings with respect to Deloitte Canada’s practices, policies and procedures relating to its quality control system and audit quality were set out in the nonpublic Part II portion of its report, which were to remain nonpublic unless Deloitte Canada failed to address them within 12 months to the satisfaction of PCAOB.²²

²⁰“*Report on 2012 Inspection of KPMG LLP (U.S.)*”, PCAOB Release No. 104-2013-147 (2013-07-30).

²¹“*Re Deloitte & Touche LLP’s Quality Control Remediation Submission*”, PCAOB Release No. 104-2013-191 (2013-11-21).

²²“*Report on 2011 Inspection of Deloitte & Touche LLP (Canada)*”, PCAOB Release No. 104-2012-245 (2012-09-27).

2.9 The Part I portion of the report of the 2009 inspection of Raymond Chabot Grant Thornton L.L.P., headquartered in Montreal (“Raymond Chabot Canada”), was released by PCAOB on February 24, 2011. The inspection was undertaken with the cooperation of the CPAB. The inspection reviewed the financial statements of two reporting issuer audit clients and audit work on one other issuer where Raymond Chabot Canada played a role but was not the principal auditor. The audit deficiencies reported were the failure to perform sufficient audit procedures to evaluate the adequacy of deferred income tax valuation allowance and the failure to perform adequate audit procedures related to revenue.²³

2.10 On February 2, 2012, the PCAOB issued its public Part I report on its 2009 inspection of BDO Canada LLP, headquartered in Toronto (“BDO Canada”). PCAOB’s inspection was performed in cooperation with the CPAB. PCAOB reviewed six issuer audit clients, and identified significant audit deficiencies in five of them, in that it appeared to the inspection team that BDO Canada did not obtain sufficient competent evidential matter to support its opinion on the issuer’s financial statements. The deficiencies listed by the PCAOB included the failure to identify, or address appropriately, a departure from GAAP relating to a potentially material misstatement in the audited financials concerning non-disclosure of related party loans; failure to perform sufficient audit procedures to evaluate whether there was sufficient doubt about the issuer’s ability to continue as a going concern; and failure in two audits to perform sufficient audit procedures to test revenue. Four of the audit deficiencies related to auditing an aspect of an issuer’s financial statements that the issuer revised in a restatement subsequent to PCAOB’s inspection.²⁴

2.11 The Part 1 public inspection report of Ernst & Young LLP, headquartered in Toronto (“E&Y Canada”), for 2012 was released by PCAOB on October 1, 2013. The inspection was conducted in cooperation with CPAB. PCAOB reported that in three of its 2012 audits, E&Y Canada, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinions on the issuer’s financial statements or its internal controls over financial reporting.²⁵

2.12 PCAOB also issued its Part 1 public inspection report of PricewaterhouseCoopers LLP, headquartered in Toronto (“PwC Canada”), for 2012 on October 1, 2013. PCAOB’s inspection was performed in cooperation with CPAB. The PCAOB cited one instance of a significant audit deficiency where PwC Canada failed to perform sufficient procedures to test revenue.²⁶

2.13 The CPAB does not issue public reports on its participating audit firms, including a summary of its inspection results. The nature and scope of the information released by

²³“*Inspection of Raymond Chabot Grant Thornton L.L.P. (Canada)*”, PCAOB Release No. 104-2011-088 (2011-02-24).

²⁴“*Inspection of BDO Canada LLP*”, PCAOB Release No. 104-2012-072 (2012-02-02).

²⁵“*Report on 2012 Inspection of Ernst & Young LLP (Canada)*”, PCAOB Release No. 104-2013-203 (2013-10-01).

²⁶“*Report on 2012 Inspection of PricewaterhouseCoopers LLP (Canada)*”, PCAOB Release No. 104-2013-231 (2013-10-01).

the PCAOB relating to Canadian audit firms is not available from the CPAB, even though the CPAB cooperates with the PCAOB in its inspection of the Canadian audit firms.

3. PCAOB's Initiatives for Audit Committee Communications with the External Auditor

3.1 In the United States, as in Canada, the audit committee of a public company will annually review and evaluate the external auditor. As part of that discussion between an audit committee of a U.S. reporting issuer and the external auditor, the audit committee will be able to question the audit firm with respect to the results and implications of the audit firm's most recent inspection report by the PCAOB. The inquiry will include whether the audit firm has been inspected and, if so, whether the PCAOB made comments on the quality or results of the audit. The audit committee will also want to know how the audit firm responded, or plans to respond, to the PCAOB's comments in its inspection report, generally and to any internal findings regarding its quality control program.

3.2 A former SEC General Counsel, a founding member of the board of the PCAOB and the PCAOB's Acting Chairman (2009-2011) discussed PCAOB inspections and the audit committee, emphasizing the importance that the PCAOB places on the work of the audit committee and the goal of *Sarbanes-Oxley Act of 2002* to strengthen the role of the audit committee. To this end the PCAOB commenced two initiatives to support audit committees: updating and expanding the information that auditors are required to communicate to audit committees, and making sure that audit committees understand PCAOB inspections and how those inspections can assist audit committees in their oversight and evaluation of their external auditors. With respect to the latter, he suggested four broad but important questions that audit committees need to ask their external auditors about PCAOB inspections.²⁷

- a) Is the PCAOB reviewing your engagement with us to audit our financial statements as part of its inspection of your firm?²⁸
- b) Did the PCAOB identify issues with our audit in your inspection report?²⁹
- c) If the PCAOB did find a problem with the company's audit, what is the audit firm's response?³⁰

²⁷Daniel L. Goelzer, "Audit Committees and the Work of the PCAOB", 2011 NACD Board Leadership Conference, (2011-10-02).

²⁸The PCAOB does not notify the company that its audit is being reviewed. While sometimes the PCAOB interviews the chair of the audit committee as part of assessing the audit firm's relationship and communications with the committee, the audit committee and the reporting issuer may not be aware that its audit is or has been under review.

²⁹As the PCAOB does not identify issuers by name in its public Part I report on audit deficiencies and does not communicate with the issuer, the audit committee can only learn of a problem with its audit from the external auditor. In Canada, audit firms refuse to answer this importantly critical question from audit committees, as well as the question whether their audit is or has been reviewed by the CPAB, on the ground that they are bound by confidence with the CPAB.

³⁰Additional audit work may be required under professional standards if the PCAOB identifies a deficiency in the audit. The audit committee should understand what the audit firm intends to do to address the deficiency, especially if it says it intends to do nothing. Caution and skepticism are to be exercised by the

- d) Did the PCAOB identify any issues with your audit firm's quality controls that could affect our audit?³¹

3.3 With respect to the other significant initiative undertaken by the PCAOB of expanding communications and information to be provided to audit committees by the external auditors, PCAOB issued a new enhanced audit standard which is effective for audits of fiscal years beginning on or after December 15, 2012. PCAOB Auditing Standard No. 16, "*Communications with Audit Committees*", requires the audit firm to communicate with the audit committee regarding specified important matters related to the conduct of the audit.³²

3.4 In October 2013, the Office of the Chief Auditor of the PCAOB issued a Staff Audit Practice Alert because of the significant audit practice issues observed by the PCAOB in the past three years relating to deficiencies in audits of internal control over financial reporting ("audits of internal control"). While the practice alert deals mainly with auditing standards and procedures for audits of internal control, the alert also offers guidance to audit committees.

"Audit committees of companies for which audits of internal control are conducted might wish to discuss with their auditors the level of auditing deficiencies in this area identified in their auditor's internal inspections and PCAOB inspections, request information from their auditors about potential root causes of such findings and ask how they are addressing the matters discussed in this alert. In particular, audit committees may wish to inquire about the involvement and focus of senior members of the firm on these matters."³³

4. Weaknesses in CPAB's Current Regulatory Model

4.1 Audit regulators outside Canada have progressed measurably in improving and enhancing the scope and quality of the disclosure and transparency of significant issues affecting the integrity of financial statements of public companies for the benefit of stakeholders and their capital markets. In addition there are initiatives to improve the communications and reporting by audit committees of public companies to their

audit committee if the audit firm replies that the deficiencies are only a failure to document or are merely a 'matter of professional judgment'.

³¹Audit committees need to know if their audit engagement is included in the audit firm's nonpublic Part II report containing deficiencies in its quality control, how the audit firm intends to satisfy the PCAOB on these quality control matters and how changes in firm procedures and controls will affect audits in the future.

³²PCAOB Auditing Standard No. 16, "*Communications with Audit Committees*", Final Rule: PCAOB Release No. 2012-004 (2012-08-15).

³³PCAOB Staff Audit Practice Alert No. 11, "*Considerations for Audits of Internal Control Over Financial Reporting*", (2013-10-24), p. 36.

stakeholders to increase investor confidence, including by expanding the report of the audit committee in proxy statements.³⁴

4.2 The CPAB has publicly expressed its recognition of the important contribution that audit committees can make. “CPAB believes that audit committees can – and should – be key contributors to audit quality. Effective audit committees and auditors build confidence in the integrity of financial reporting. By doing so, they reduce financing cost and contribute to an efficient allocation of capital to fuel economic growth.”³⁵ Before, however, audit committees in Canada are in a position to strengthen their oversight process and reporting responsibilities, the CPAB has to act to provide them with needed and relevant information concerning their audit firm.

4.3 Currently, in Canada, audit committees have inadequate information from the CPAB and their external auditors to evaluate properly and to oversee effectively their external auditor. Without that base information, audit committees need to consider the degree to which they can effectively comply with the responsibilities that National Instrument 52-110 “*Audit Committees*” has mandated that they carry out, namely, that an “audit committee must be directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor’s report or performing other audit, review or attest services for the issuer... .”³⁶ This question of the current effectiveness of the audit committee’s annual assessment of the external auditor and the audit committee’s oversight responsibilities were noted in Chapter 4 of the 2013 joint report of the CPAB and the Chartered Professional Accountants of Canada (“CPA Canada”), “*Enhancing Audit Quality: Canadian Perspectives*”. The recommendation on “Annual oversight responsibilities” in that Chapter was only that CPA Canada “would undertake a project to further develop the guidance on overseeing the work of the external auditors, including performing annual assessments of the external auditors.”³⁷

4.4 The knowledge that its external auditor may have failed to attain professional standards and/or is operating with quality control defects and incurred “audit deficiencies” in performing an audit of the financial statements of a reporting issuer, as well as the nature and type of such deficiencies, is a critical piece of information that the audit committee, the board and the management of the reporting issuer need to know. The risk that financial statements of a reporting issuer that have been publicly released and filed may have to be publicly restated because of an audit deficiency in the conduct of the attest audit by the shareholder-appointed auditor is meaningfully increased where the CPAB becomes aware of a defect(s) in the audit quality of an audit and that critical fact is not disclosed by the auditor to the key stakeholders of the reporting issuer involved.

³⁴“*Enhancing the Audit Committee Report – A Call To Action*”, Audit Committee Collaboration (National Association of Corporate Directors; NYSE Governance Services, Corporate Board Member; Tapestry Networks; The Directors’ Council; Association of Audit Committee Members, Inc.; and The Center for Audit Quality) (2013).

³⁵CPAB 2012 Public Report, p. 9 (2013-04-04).

³⁶Section 2.3(3).

³⁷Page 17.

4.5 Where there has been a finding of an audit deficiency by the CPAB that remains undisclosed, audit committees, boards and management proceed unknowingly to review, recommend, approve and issue to its shareholders financial statements that are reviewed and reported on by an auditor who had failed to obtain sufficient audit evidence in a particular audit file. Not only are the audit committee, the board and management unaware that an audit has been found to have had an audit deficiency, these key stakeholders are also in the dark with respect to the type, nature and scope of the audit deficiency and audit quality issue, the short and long term ‘action plans’, ‘requirements’, ‘remedial actions’ or any ‘restrictions’ that the CPAB may have imposed on the auditor to upgrade to professional standards, and, importantly, whether the auditor has implemented and effectively complied with any CPAB ‘recommendations’, ‘requirements’ or ‘restrictions’ imposed on the audit firm.

4.6 Unlike the situation in the United States, referred to earlier, Canadian audit committees are constrained from having annual discussions with the external auditor of the results of its most recent inspection report by the CPAB. Audit committees in Canada should have the clear right and unambiguous ability to review with the audit firm issues including whether any audit deficiencies identified in the inspection report impact on the company’s audit and the nature and outcome of any findings of defects in the audit firms’ quality control systems. Audit committees would be better able to undertake their responsibilities, not only more efficiently but also move effectively for the benefit of the reporting issuer’s stakeholders and investors, if they are provided with the relevant information from CPAB’s inspection report on the audit firm. Such discussions between an informed audit committee and the auditor would contribute significantly to the improvement of audit quality and financial statement integrity.

5. CPAB’s Intentions for Transparency of Inspection Findings

5.1 While CPAB acknowledges the need for increased transparency of its inspection results to audit committees, it has conservatively qualified its direction to that end.

“One issue raised by various stakeholders and by the EAQ [Enhanced Audit Quality] initiative is the need to increase the transparency of CPAB’s inspection results.

“CPAB understands and supports the desire for greater transparency. Enhanced transparency in the communication of our inspection results, and about the key drivers of audit quality, would help key stakeholders in the audit process perform their roles more effectively. That being said, it is essential that transparency be enhanced in a way that preserves the effectiveness of CPAB’s regulatory approach and does not create unintended consequences for audit quality or for reporting issuers. This issue will be a high priority for us in 2013.”³⁸

³⁸Nick Le Pan, Chairman, CPAB 2012 Annual Report, p. 3.

5.2 The CPAB 2012 Annual Report outlined its new strategic plan and vision for 2013-2015 and four priorities for that period. One of the methods to operationalize these priorities, the CEO wrote in that Annual Report, was by:

“Providing greater transparency in CPAB’s communication of inspection results and the key drivers of audit quality and audit risks, to help key stakeholders in the audit process perform their roles more effectively.”³⁹

5.3 The theme of “enhanced stakeholder engagement” was specifically identified by the CPAB in its 2012 Annual Report. This new thrust was expanded further in the report of the CEO which seemed to acknowledge that the interests of investors were also protected by other participants in the process of preparing and approving financial statements and that knowledge by those other participants of the results of the CPAB inspections of the quality of the audits was a critical factor in the procedures to prevent material defects and deficiencies and to benefit investors. The CEO of CPAB wrote:

“Audit firms and financial statement preparers are not the only participants in the audit process. Audit committees, institutional investors and analysts also play important roles. By providing all stakeholders with better information on audit quality issues, and by engaging them in a dialogue about CPAB’s findings, all stakeholders, including CPAB, can perform their roles more effectively.

“To address the core issue of enhanced audit quality, CPAB must communicate more strategically with key stakeholders to better influence the changes required to drive sustainable improvement in audit quality. Specifically, we must engage with key stakeholders on the implications of challenges to audit quality and the range of appropriate responses.

“Feedback from CPAB roundtables with audit committees in 2012 indicated that more transparent reporting of inspection results could help audit committee members exercise their audit oversight responsibilities more effectively, improving audit quality.

“Audit committees want to know if there are any audit quality issues with the audits of their reporting issuers.”⁴⁰

However, these statements indicating a move towards transparency were qualified, as was the Chairman’s statement quoted above, with cautions that increasing transparency of CPAB’s findings could not undermine CPAB’s “regulatory approach” or cause “unintended consequences for audit quality or for reporting issuers.”

³⁹Brian Hunt, CPAB CEO, p. 7.

⁴⁰*Ibid.*, p. 9.

5.4 Some understanding of the hesitancy of CPAB to recommend clearly that audit committees have access to inspection findings, both in relation to a review of their auditors engagements of their financial statements and in terms of areas of systemic quality concerns, is reflected in a comment letter of the CPAB to the U.K. Competition Commission. While stating that the CPAB was “supportive of increased transparency” to improve audit quality, it continued:⁴¹

“However, there needs to be appropriate balance between transparency and the publication of inspection findings and trust and confidence in auditing in the capital markets. Such reporting should be balanced to ensure that the information provided to the public and audit committees enhances audit quality while also allowing audit regulators flexibility to make private impactful recommendations to regulated firms that have the greatest potential to improve audit quality. Transparency should be enhanced in a way that preserves the effectiveness of the regulatory approach and does not create unintended consequences for audit quality or for reporting issuers (RIs).”

5.4B In CPAB’s Report of the 2012 Inspections, the CPAB acknowledged that the audit committee is a true contributor to audit quality.⁴² The CPAB also understood the requests of audit committees for information on the CPAB’s inspection findings. It commented in this section of the Report:

“Audit committees have told CPAB they want more transparency with respect to inspection findings in order to improve the effectiveness of their oversight role. In 2013 CPAB will be reviewing how it can increase transparency of inspection findings to audit committees in a way that will have a positive impact on audit quality.”

6. Enhancing Audit Quality: Canadian Perspectives

6.1 The CPAB and the Chartered Professional Accountants of Canada (“CPA Canada”) issued a final report, “*Enhancing Audit Quality: Canadian Perspectives*”, dated May 30, 2013, for its Enhancing Audit Quality ‘stakeholder consultation’ initiative (the “EAQ Report”). Chapter 5 dealt with “Communication of Inspection Results”.

6.2 In noting that in the past and currently the CPAB inspection reports on quality control processes, individual file review findings and recommendations for improvement are provided only to the audit firms on a private basis, and are not available for audit committees nor the reporting issuers audited by such firms, even on a confidential basis, the EAQ Report acknowledged that although “access to CPAB inspection insights would boost the ability of audit committees to oversee and evaluate their audit firms, CPAB’s annual public report does not permit audit committees to learn what findings, if any,

⁴¹Brian Hunt, CEO of CPAB, letter to the U.K. Competition Commission, p.3 (2013-08-12).

⁴²CPAB Report of 2012 Inspections, pp. 9-10.

pertain to their auditors or their entities if they were selected for inspection in a particular year.”⁴³

6.3 In addition to recommending modestly enhanced disclosure of the CPAB’s inspection findings in its Annual Report to include a more specific summary of key issues identified during the most recent inspections, the Audit Committee Working Group recommended that the CPAB, audit firms and audit committees “should develop a protocol for increasing the inspection information made available to audit committees.” That protocol would address, among other things, that the auditors provide the audit committee, “on a confidential basis”, with “a summary of any significant findings of the inspection” and the auditors response to those findings.

7. Consultation Paper – Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees

7.1 Allowing participation by an audit firm in the Protocol on a voluntary basis puts the shoe on the wrong foot. There is clear and compelling evidence that sharing CPAB’s inspection findings with audit committees, on a confidential basis, has substantial public interest benefits, among other things, by strengthening audit committees’ effectiveness in evaluating external auditors and in overseeing the audits of their financial statements, thereby increasing audit quality and public confidence in the integrity of the audit process. In Canada, audit committees do not have the information and capacity to assess the quality of the audit. This is the important role of the CPAB. Audit committees need to be able to see the CPAB’s report on its inspection of their company’s audit and related quality control systemic issues concerning their audit firm in order for audit committees to carry out their regulatory responsibilities. The public interest in making this information accessible to audit committees, as of right, outweighs the audit firm’s interest in maintain control over the inspection findings.

7.2 Audit committees should not have to negotiate with their external auditors to obtain this information. As the CPAB inspects the audit firms, the audit firms are in a conflict of interest if they are allowed to decide whether or not to communicate the CPAB’s inspection findings with the audit committees concerning their compliance with professional, auditing and assurance standards and their own quality control systems.

7.3 All audit firms participating in CPAB’s audit regulatory program and over which it has oversight responsibility should be subject to the requirement to provide designated information from the CPAB’s inspection report of their audits to the requisite audit committees of the reporting issuers they audit and to discuss such information, and their responses and actions to such findings, with the audit committees.

7.3 The draft Protocol is too ambiguous and subject to varying interpretations of the nature, scope and extent of the specific findings of an inspection of an audit file of a

⁴³“*Enhancing Audit Quality: Canadian Perspectives-Conclusions and Recommendations*”, (May 2013), p. 23.

reporting issuer that the audit firm is to communicate to the audit committee. Paragraph 7 says that the audit firm will provide:

- “a *description of the focus areas selected for inspection by the CPAB*”;
- “an *indication of whether or not there are any significant inspection findings*”
- “any *significant inspection findings*” as reported by the CPAB in its EFR and the audit firm’s response to the findings and CPAB’s disposition. [emphasis added]

7.4 There are broad and unclear interpretations for “a description” of “focus areas” and “an indication”. Paragraph 11 does set forth a definition of a “significant inspection finding” as: “a *significant* deficiency in the application of *generally accepted auditing standards* related to a material financial balance or transaction stream where the audit firm must perform additional audit work in the current year to support the audit opinion and/or is required to make significant changes to its audit approach.” [emphasis added]

- (a) Does a “significant deficiency” arise only from a defect in the application of GAAS?
- (b) Does a “significant inspection finding” or a “significant deficiency” include a failure in the application of GAAP, a defect in the audit firm’s quality control systems, and a failure to comply with “professional standards”?
- (c) How is “significant” interpreted and by whom?
- (d) Will the CPAB’s EFR to the audit firm for the purposes of the Protocol include “insignificant” inspection findings or other categories or types of “audit deficiencies” that will not have to be reported to the audit committee under the Protocol?
- (e) Will the terms, definitions, scope, classifications and categories of the findings in the inspection reports of CPAB change as a result of the implementation of the Protocol?

7.5 The CPAB Ontario Act requires the CPAB, among other things, to conduct inspections of participating audit firms to assess the compliance of each audit firm “with professional standards, [CPAB’s] rules and the firm’s own quality control policies” for the issuance of audit reports, to evaluate reports and require “remedial action” by the audit firm where necessary. The CPAB is required to account to the Ontario Securities Commission and the Government of Ontario on these activities.⁴⁴

7.6 The Protocol and the CPAB rules should require the audit firm to make the report of CPAB’s investigation of the firm’s audit of a reporting issuer, which must be made in accordance with the CPAB Ontario Act, available to the audit committee of that reporting issuer.

⁴⁴CPAB Ontario Act, s. 6(2).

7.7 A “significant inspection finding” for purposes of the Protocol and reporting to the audit committee appears different from an “audit deficiency” that has been previously reported in the CPAB’s annual Public Report. An “audit deficiency” has been defined “as the failure to obtain sufficient appropriate audit evidence to support a financial statement assertion for a material account balance or transaction stream”.⁴⁵

- (a) Is there a difference between the formerly reported “audit deficiencies” in the Public Reports and a “significant inspection finding” for the purposes of reporting to audit committees under the Protocol?

7.8 To keep it simple, why not require the audit firm to provide the actual and unchanged EFR that the CPAB has provided to the audit firm to the audit committee? There should be no ambiguity, interpretation or ‘translation’ of the inspection findings that the CPAB makes to the audit firm from those that the audit firm communicates to the audit committee. With full disclosure, there can then be a candid and open discussions between the audit firm and the audit committee.

Respectfully submitted.

Yours very truly,

(signed) HG Emerson

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⁴⁵CPAB 2100 Public Report, p. 16.