

January 23, 2014

Canadian Public Accountability Board (CPAB)
By email to: Consultation@cpab-ccrc.ca

Submitted by: Calvista LLP Professional Accountants
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Re: Consultation paper
Protocol for Audit Firm Communication of CPAB Inspection Findings

We have reviewed the proposed protocol issued by CPAB in November 2013 in respect of communication of CPAB findings to Audit Committees of Reporting Issuers in Canada. We are of the view that the proposed protocol includes some requirements that are likely to result in improved oversight and understanding of the audit process by Audit Committees generally. However, the proposal to disclose specific file inspection results will have very limited usefulness, creates serious confidentiality concerns, and is more likely to damage the auditor-client relationship, and thus audit quality in the long term, than it is to enhance it.

The reasons for this view are addressed as part of our responses to the specific questions posed in the Consultation Paper.

Question 1. Will the information shared under this Protocol assist Audit Committees in their oversight role and improved audit quality? If not please explain why you are of that view.

The requirement to provide the Audit Committee with CPAB's public report which describes common findings about systemic issues within the audit profession generally is likely to be of value to both the Audit Committee and the Auditor. By ensuring that discussion of this report is on the Audit Committee agenda, the Auditor has an opportunity to assess the extent to which the Audit Committee understands and appreciates the audit process and Auditor role.

Including Management in all or part of this discussion will provide the Auditor an opportunity to also educate Management about areas of common audit weaknesses, and provide support for the Auditor's explanation and request for further and more objective evidence than what Management may have expected to provide.

For these reasons we support the proposal that Auditor both provide Audit Committees with the CPAB public report and take the time to discuss the report with the Committees, giving specific focus to matters in the CPAB public report that may affect the particular client and audit in question.

We do not believe that the recommendation to share file specific findings with Audit Committees will generally enhance audit quality, for the following reasons: the limited number of files selected, the potential for misuse of the information, and the effect on a number of trust relationships.

Limited number of files selected:

According to its public reports, CPAB inspects several hundred audit files annually out of a pool of many thousands. The described sample selection process is risk based, which suggests that audit files of less quality are more likely to be selected

for inspection than audit files of better quality. However, this is not a certainty, and in light of the large number of files not inspected, it is probable that a material portion of the non-inspected files are also of poor quality. One might even consider whether the Audit Firms, knowing that a particular file is more or less likely to be selected for inspection, may increase or decrease their audit efforts accordingly. If so, the average audit quality might actually be lower in files that seem unlikely to find their way into the CPAB sample.

Is an Audit Committee to infer from the fact that their audit file was inspected in Year 2 (when audited by Firm B) but not in Year 1 (when audited by Firm A) that Firm B's audit quality is inferior, while the real reason for the learning of audit deficiencies in Year 2 and not Year 1 is primarily a result of the intrinsic limitations of sampling? Unless CPAB intends to select 100% of audit files for inspection, there will always be an element of chance involved in file selection, and poor quality audit files will escape CPAB's attention for reasons not related to the merits or quality of the audit file itself, which of course remains unknown until selected for inspection.

This puts Audit Committees on an unequal footing, with some Committees learning about audit deficiencies that were found in the course of CPAB's inspection of a mediocre quality audit file, and others hearing nothing about audit deficiencies in a poor quality audit which was simply not selected for inspection.

Potential for misuse of the information:

While the intention is that any party with whom the inspection findings are shared will be able to take steps to keep it confidential (this point is addressed in more detail in our response to Question 2), there are a number of opportunities where individuals or entities that are "entitled" to the information by virtue of being an Audit Committee or Board member, or a member of Senior Management, may have opportunity to use it in ways that are not intended. For example, an individual may be on the Board of Directors or Audit Committee of more than one Reporting Issuer. How can he or she ignore "inside" information about Audit Firm A, which was obtained confidentially in the course of serving on Corporation X's Audit Committee, when Corporation Y is evaluating a possible change in auditor? This might create be an extremely prejudicial situation, with the individual having conflicting fiduciary duties to two different Corporations.

Another situation may occur where a conflict arises between the Auditor and Management after CPAB inspection findings have been disclosed to the Audit Committee. Management is likely to be aware of this discussion and the details of the findings, and may even have participated in the Committee meetings. The facts of the alleged audit "deficiency" may now potentially be used against the Auditor in unrelated matters and claims.

Finally, a third example of possible misuse of the information. Should the Auditor provide the CPAB findings to the Audit Committee, these facts and reports become part of the record of the Audit Committee minutes and meetings. Should the Corporation change auditors, these then are subject to inspection by a successor Auditor as part of their review of governance documentation. This possibility should be of concern to the entire profession.

Effect on trust relationships:

The existing statutory confidentiality permits and encourages candid discussion and debate among the Auditors and CPAB of audit issues that may be subject to considerable debate and dispute even among highly competent professionals. Candour and even discussion of controversial issues will become risky and may be suppressed if it becomes subject to the possibility of disclosure to third parties. Removing the protection of confidentiality may thus suppress rather than encourage frank and candid discussion of audit issues between CPAB and the Auditor.

Auditors have generally been able learn and improve audit quality through participation in the CPAB inspection process, as we have from participation in our professional institutes' peer review programs and firm internal inspections. The opportunity to learn is greatly enhanced by knowing that one can ask questions and discuss file related matters with the practice reviewer/inspector in confidence and with a relative degree of candour. This relationship will necessarily be coloured, perhaps tainted, by the knowledge that anything said may make its way into the CPAB findings report, and thus to the client's Board of Directors and Senior Management.

Question 2: Will the confidentiality of RI specific file inspection findings to be shared under this Protocol be appropriately protected? If not, please provide your comments on changes that can be made to improve the confidentiality protection of the inspection findings.

Our primary concern with respect to CPAB's proposal that the confidentiality required by legislation may be waived is that any derogation from the statutory confidentiality and privilege provisions of the CPAB Act will undermine the effectiveness of CPAB and will significantly increase the exposure of both Auditors and Reporting Issuers to litigation and regulatory action that may be based on incomplete and disputed findings of a CPAB file review. We are also concerned about the potential that the Auditor's objectivity and independence may be threatened by potential consequences that may occur with wider dissemination of file specific inspection findings as well as the potential for other unintended and unforeseen consequences.

Proposal to waive legislated confidentiality provisions:

The CPAB Act mandates the confidentiality of documents which the Auditor is compelled to provide to CPAB and preserves the privilege that may attach to any of those documents. That legislation protects both CPAB and the Auditor from compulsory disclosure to any party.

We do not see any legal mechanism or remedy by which either CPAB or the Auditor can effectively compel any party to whom they may voluntarily disclose the confidential information, to maintain the confidentiality of information CPAB has itself disclosed, or has required the Auditor to disclose. The legislation does not protect third parties such as the Corporation, the Audit Committee or Management in the same way it protects the Auditor and CPAB itself.

Disclosure to the Reporting Issuer or its Audit Committee cannot be made with full assurance that it will be maintained on a confidential basis. Once the information is disclosed it will become corporate information and subject to compulsory disclosure by the Corporation and its officers and employees in litigation or regulatory action.

Potential threats to independence and objectivity:

The Auditor is subject to compulsory disclosure to CPAB. If matters that are provided to CPAB pursuant to this compulsory disclosure is subject to subsequent disclosure by CPAB (or by the Auditor under this Protocol) to the company and regulators we believe there is a significant potential that a threat to auditor independence may be introduced by subjecting the Auditor to increased risk of litigation or regulatory action. This threat will unnecessarily complicate and colour the audit risk assessment and independence assessments made in the course of client/audit acceptance and audit planning.

Competent auditors may be reluctant to take on high risk audits, driving high risk issuers to the lowest quality auditors who may not even appreciate the risks. As these files then become subject to a higher likelihood of CPAB inspection, and the inspection findings are disclosed to the Audit Committee, the likelihood of auditor replacement increases. Both of these scenarios (assumption of high risk audits by lower quality auditors, and frequent auditor turnover) in turn increase the information risk to the user of financial statements (investors) and ultimately the cost of audits generally.

The question posed is whether we have any comments on possible changes to the Protocol which could be made to improve the confidentiality of the inspection findings. Given that the two parties which are assured confidentiality under the CPAB Act (CPAB itself and the Auditor) are expected to voluntarily waive that right, it is difficult to envision steps that can be taken to effectively extend a right of confidentiality to other parties who were not subject to it in the first place.

Question 3: Do you have other comments on the proposed protocol?

We would recommend in light of the many unresolved issues around confidentiality, that the implementation of the Protocol be phased in. The proposed time frame is too short. We recommend that the requirement for Auditors to circulate

and discuss the CPAB public report with Audit Committees be introduced on the proposed schedule, but that the dissemination of the file specific inspection findings be deferred until the legislation can be modified to ensure the confidentiality of all parties is protected.

In conclusion, we believe that if the true goal is to support and improve audit quality the CPAB review process and detailed file inspection findings must stay confidential. An unintended consequence of diluting that confidentiality and abandoning the intended requirements of the CPAB Act will be to arm regulators or litigants with more ammunition to initiate or expand claims against Reporting Issuers and Auditors.

The goals of educating Audit Committees can be achieved without any file specific disclosures through discussion of applicable audit issues with Audit Committees as part of the audit planning process. The tabling and discussion of CPAB's public report is a useful tool to facilitate that education and discussion.

Auditors need to continue to be able to do their work with confidence that their independence and objectivity will not be undermined by disclosure of confidential documents that have arisen through discussions with CPAB and the file inspection process. Audit Committees do not need to be told of potential specific audit weaknesses that have been identified by CPAB, as long as there is effective follow up by the Auditor in response to the CPAB file specific inspections. Should the Auditor's follow up not occur, CPAB has other remedies available to enforce compliance and correction that do not require provisions of its own mandated legislation to be waived and disregarded.