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THIRD PUBLIC REPORT

ON QUALITY INSPECTIONS OF PUBLIC ACCOUNTING FIRMS

SUBJECT TO THE

**CANADIAN PUBLIC ACCOUNTABILITY BOARD
OVERSIGHT PROGRAM**

DECEMBER 2005

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Executive Summary

This, the third public report by the Canadian Public Accountability Board (CPAB), covers CPAB's 2005 quality inspections of the four largest public accounting firms in Canada: Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. Together these firms audit more than 4,000 entities that are public companies or other reporting issuers in Canada, representing about 63% of the total market by number of clients and, we estimate, more than 90% if measured by the market capitalization of the entities audited.

Progress has been made by each firm since our initial quality inspections in 2004, and substantially all of the recommendations made to the firms following those initial quality inspections have been implemented. In particular, the firms have strong quality leadership and tone at the top, and generally effective controls over client acceptance and continuance, human resources and quality monitoring.

On the other hand, in two areas, all the firms have more work to do to improve quality and achieve consistent adherence to firm and professional standards. One is auditor independence, where all firms are testing the investment holdings of their partners and senior staff for compliance with their policies and procedures and finding an unacceptable rate of exception. While high-quality audit work was evident throughout our inspections, there is also a need for continued improvement with respect to performance on audit engagements. Out of a total of 87 audit engagements selected by us for review in the four firms, five engagements had such serious deficiencies that we concluded that those audits were not conducted in accordance with generally accepted auditing standards. A significant number of other engagements had departures from firm and professional standards.

The scope of our reviews of some individual audit engagements was restricted by our lack of access to documents because of legal privilege. While we understand concerns about legal privilege, any restrictions on our reviews are contrary to the objectives of CPAB, and we are urgently seeking statutory authority to have access to privileged information without negating that privilege.

Apart from this issue, CPAB is encouraged by the continuing co-operation it is receiving from all four firms and, given the improvements required in a number of areas, their understanding that the public interest requires them to place greater emphasis on audit quality.

Each firm inspected has received a private report from CPAB that includes specific recommendations. Each firm has accepted CPAB's recommendations and has provided written commitments that problems identified will be remedied. The firms have 180 days or less to implement the recommendations.

Over the past two years, CPAB has instigated a number of changes in public accounting firms to improve the quality of audits in this country. It has inspected the public accounting firms that account for the bulk of the audits of public companies in Canada and made recommendations for the improvements that were needed for more consistently high quality audits. These improvements are now being implemented and should enhance

the credibility of financial statements of public companies and confidence in Canada's capital markets.

Introduction

1. CPAB was created by the provincial securities commissions, the Office of the Superintendent of Financial Institutions (OSFI) and the Canadian Institute of Chartered Accountants (CICA) to promote high quality external audits of entities that are reporting issuers in Canada. In carrying out that role, CPAB conducts quality inspections of the firms subject to its oversight, either directly or in cooperation with provincial or foreign regulatory authorities.
2. In Canada, there are approximately 7,000 reporting issuers, as defined in provincial securities legislation. A public accounting firm wishing to serve as an auditor of an entity that is a reporting issuer in Canada is required by the Canadian Securities Administrators' National Instrument 52-108 to become a participant in the CPAB oversight program. As of September 30, 2005 a total of 263 Canadian accounting firms and 26 foreign accounting firms had completed the registration process, signed Participation Agreements with CPAB and had become participating audit firms. Some details about these firms, including their own descriptions of their quality control policies and procedures, may be found on the CPAB Web site at www.cpab-ccrc.ca.
3. The four largest public accounting firms in Canada are Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. Together these firms audit more than 4,000 entities that are public companies or other reporting issuers in Canada, representing about 63% of the total market by number of clients and, we estimate, more than 90% if measured by the market capitalization of the entities audited. This report covers CPAB's 2005 quality inspections of these firms, which took place between April and September this year.

Scope of CPAB Quality Inspections

4. The 2005 quality inspections were planned and carried out to:
 - Confirm our understanding of the design of each firm's system of quality control, organized under the following principal elements:
 - Tone at the top/leadership;
 - Independence and ethics;
 - Client and engagement acceptance and continuance;
 - Human resources policies and procedures;
 - Engagement performance; and
 - Quality monitoring.

- Test the effectiveness of the implementation of each firm's system of quality control.
 - Test each firm's compliance with relevant accounting, auditing and auditor independence standards and with the firm's own policies.
 - Confirm that the firms had implemented their responses to the recommendations made in CPAB's 2004 quality inspection reports.
5. As part of each inspection, interviews are carried out with the senior executives in each firm who have management responsibilities relating to audit quality. These interviews allow CPAB to update its understanding of the design of the firms' systems of quality control. On average, approximately 30 individuals were interviewed in each firm.
6. The inspections also involve an examination of a variety of evidence to better understand the design of a firm's system of quality control and the effectiveness of its implementation. This evidence includes:
- Policy and procedures manuals;
 - Quality-related communications from a firm's leadership to its partners and staff;
 - Independence confirmations;
 - Client acceptance and continuance documentation;
 - Personnel files;
 - Training curricula and attendance records;
 - Staff satisfaction survey results;
 - The results of the firm's own quality monitoring program; and
 - The working papers for a sample of completed audit engagements.
7. In total, the working papers for 87 engagements were reviewed in various offices that included, for every firm, Vancouver, Calgary, Greater Toronto and Montreal and for some firms, depending on the location of particular clients selected for inspection, Edmonton, Saskatoon, Winnipeg, Halifax and St. John's. The engagements were selected to satisfy a number of criteria including size, complexity and assessed levels of risk and a balance between SEC and non-SEC registrant companies.
8. Following each inspection, CPAB provides the firm inspected with a private report that includes findings, recommendations and other observations. Recommendations are impositions that firms are expected to implement to CPAB's satisfaction within a prescribed period of time – normally 180 days. When a stronger message is needed, CPAB imposes requirements instead of recommendations. If a firm failed to do what had been recommended or required, CPAB would consider making that fact public and, in certain cases, could choose to impose restrictions or sanctions on that firm to protect the public interest. Were

CPAB to impose restrictions or sanctions upon an audit firm, in these circumstances, there would be notification to Canadian securities regulators and the audit committees of the firm's reporting issuer audit clients. In the most extreme case, CPAB could declare that an audit firm is not a participant in good standing, meaning that firm could no longer audit public companies in Canada.

9. While CPAB has the power to impose requirements, restrictions or sanctions to achieve the changes it considers necessary, its intent is to work with the participating firms in a positive and constructive manner to bring about audit quality improvements where they are appropriate. As a consequence of the 2005 quality inspections, and notwithstanding the recommendations that have been made to the firms, CPAB is not proposing to impose requirements, restrictions or sanctions on any of the four firms.
10. The scope of our review of individual audit engagements was restricted by the firms' removal from their audit files of documents that were said by them or their clients to be subject to legal privilege. While we understand the reasons for the removal of documents that are genuinely subject to legal privilege, any restriction on the scope of our review is unsatisfactory to CPAB and contrary to its purpose. Accordingly, CPAB is urgently seeking statutory authority to have access to privileged information without the privilege attaching to that information being negated.
11. In one firm, the documents removed by engagement teams from certain audit files on the basis of legal privilege included memos to file, Power Point presentations, inter office memos and other documents that clearly had not been written for the purpose of obtaining legal advice, which could have rendered them subject to legal privilege. In the same firm, in other situations, engagement partners claimed privilege over certain working papers on the grounds that they were regulatory-related or not relevant to our review. Analysis by the firm's in-house legal counsel at CPAB's request resulted in the majority of the previously removed documents being restored.
12. In two firms, CPAB had difficulty gaining access to the audit and related working paper files of other auditors, including foreign firms that are members of the same global network as the Canadian firm, on whose work the Canadian firm had placed substantial reliance in rendering its opinion on a reporting issuer. We have recommended that the firms obtain waivers from clients and member firms that will permit CPAB to review, when necessary, the audit working paper files of other firms on whose work the Canadian firm has placed reliance in rendering its opinion on the consolidated financial statements of a reporting issuer. The waiver should be similar to those already being obtained for the PCAOB with respect to audits of SEC registrants.

Recommendations Arising from the Inspections

Tone at the Top/Leadership

13. All four firms have a number of strategic priorities that, as we would expect, include an emphasis on audit quality. Their reputations depend, more than anything else, on being able to achieve and sustain a consistently high level of quality in their audit work.
14. The leaders of all of the firms, in their internal communications to partners and staff, emphasize the need to make an uncompromising effort to do the highest quality work on every audit engagement. Furthermore, we are satisfied that each firm's leadership is prepared to take strong action where necessary to deal with serious quality shortcomings.
15. One firm needs to do a better job of articulating operational responsibility for effective implementation of the various facets of its quality systems. In this firm, job descriptions for individuals with important national leadership tend to be cursory or non-existent. We have recommended that proper job descriptions be prepared for all partners and senior staff with national responsibilities.

Independence and Ethics

16. Each of the four firms has extensive independence policies and procedures that have been updated to reflect major changes in the profession's independence standards that came into effect at the beginning of 2004. We have recommended some further enhancements or clarification to certain firms' policies – for example, the requirement to document on every audit any threats to independence and the safeguards employed to reduce such threats to an acceptable level.
17. The firms all operate electronic investment monitoring systems into which individual partners and certain staff must enter their personal investment portfolios and transactions. The systems compare individuals' investments against a firm's master list of audit client securities that are ineligible investments for some or all of the firm's partners and staff. Any exception that is revealed by this comparison is typically reported to independence specialists in the firm, who work with the affected individual to ensure that the situation is investigated and resolved in a timely and appropriate manner, if necessary by disposal of the securities in question. Other independence exceptions may come to the firm's attention from the annual independence confirmations that they obtain from their partners and staff.
18. Pursuant to requirements of the SEC, these four firms must undertake internal compliance audits of partners and managerial employees to ensure that the portfolios entered by individuals into their independence monitoring systems are

- accurate and complete, and do not include prohibited client securities. As part of these audits, individuals provide the firm with brokerage statements and other documentation related to their personal investments.
19. One firm conducted a compliance audit of all of its partners in 2004 and a second firm expects to have completed such an audit by the end of 2005. The two remaining firms are proceeding by way of successive audits of samples of partners and managerial staff. In these two firms, we expect that all relevant individuals will have been covered by a compliance audit no later than the end of 2007.
 20. The results of the audits to date are startlingly poor in all firms. In each of the four firms, more than 50% of the individuals subject to audit were found to be in violation of at least one aspect of firm policies. Most of the exceptions involved the failure of individuals to input into the investment monitoring system some of their investments. However, each firm found cases where the non-reported investments were securities on the firm's prohibited investment list. For example, in one firm, the compliance audit revealed that there were 49 clients whose securities were held by partners. There is no evidence in any firm of improper motivation in holding or failing to report holdings of client securities.
 21. All four firms are acting with resolve to deal with this unsatisfactory situation. CPAB will continue to monitor the results of the compliance audit programs, the appropriateness of actions taken against individuals incurring infractions, and steps taken by the firms to reduce the frequency of infractions in the future.
 22. We expect each firm to report to the audit committee of the relevant client when the firm determines that a partner or staff member holds an investment in that client that is prohibited by professional standards or the firm's own policies. Some of the firms need to implement new controls to ensure that engagement partners are informed of independence infractions relevant to their clients – whether measured against firm or professional standards – for onward communication to client audit committees. In some firms there seems to be a view that minor infractions need not necessarily be reported to clients. Our view is that every infraction must be reported and the audit committee can decide whether the infraction is minor or not.
 23. We note that some clients, in their Annual Information Form under the heading "Interests of Experts", state that no partner of the audit firm owns securities of the client. Each firm needs to have controls to ensure that such client statements are capable of being substantiated.
 24. All four firms prepare an annual engagement letter that sets out the roles and responsibilities of the various parties involved with the audit. It is customary for management of the client entity to sign such letters as an acknowledgement of their agreement with the contents. Auditors' concerns about the extent of their liability have in recent years caused some firms, including these four, to make increasing use in such letters of provisions designed to limit their liability in certain circumstances. Such provisions may include a cap on the maximum liability of the auditor to the client entity and/or indemnification by the client of

- settlements by the auditor to third parties. It appears that the firms encourage their partners to use indemnities and liability restrictions except where specifically prohibited - namely by the SEC for engagements for SEC registrants and by the Code of Ethics of the Ordre des Comptables Agréés du Québec (the Ordre) for all engagements.
25. We noted that for a period of approximately six months from late 2003 to early 2004, one firm, in its engagement letters, had a liability-limiting clause that was required on all engagements, including engagements for SEC registrants. The policy was subsequently changed and the engagement letter template for SEC registrants appropriately amended. We have recommended that the firm consider what action might be required to ensure that the firm's independence is not considered by the SEC to have been impaired on audits of SEC registrants that were carried out during under the terms of engagement letters issued during the period in question.
 26. We also noted that the same firm on several occasions had limited its liability in engagement letters carried out by its offices in Québec, contrary to the Ordre's Code of Ethics. We have recommended that this practice be discontinued and have informed the Ordre that this firm was in contravention of its Code of Ethics.

Client and Engagement Acceptance and Continuance

27. All of the firms have effective controls, of varying sophistication, to approve new or continuing audit engagements. Clients are rated as to the risk that the client is likely to prepare financial statements containing material error. A rating of higher risk does not necessarily mean that client management has the incentive, inclination or opportunity to misstate the financial statements deliberately, although in some cases it may. More often it is the result of other client characteristics such as limited accounting capability, weak internal controls or an ineffective audit committee. Each firm's senior management is giving increasing attention to ensuring that higher risk clients are acceptable to the firm and to the way that engagement teams manage the risks of audit engagements for such clients. However, in one firm there is a need for greater consistency and rigour of new client investigations. In the same firm, we concluded that the risk classifications of certain new and continuing clients appeared to be understated.
28. CPAB encourages participating audit firms to be selective about the clients they accept and retain. An independent audit is an important part of the securities regulatory process. By requiring clients to have satisfactory levels of ability and willingness to comply with securities regulation and other laws, auditors can make an important contribution to investor protection.
29. For some of the firms, we noted that the detailed consideration of the factors that affect a decision to continue an existing client audit relationship normally occur after the firm has been appointed as auditor at the client's Annual General Meeting, but before detailed audit planning commences. We have recommended

that the firms advance the continuance decision to be made as soon as possible following the completion of the prior year's audit so that any decision to discontinue the relationship can be made and communicated to the client before the firm is nominated for reappointment at the AGM.

Human Resources Policies and Procedures

30. All of the firms have extensive policies and procedures related to their human resources, and their HR systems appear in general to be operating effectively. In particular, compared to 2004, the firms have made progress with respect to the timeliness and effectiveness of their performance evaluation systems. We made only minor recommendations in this area. We note that two of the firms were recently included in a list of Canada's top 100 employers.

Performance on Audit Engagements

31. We reviewed the audit working papers for 87 engagements conducted by the firms. For each engagement selected, we normally consider the way that the firm planned, supervised and completed the audit as well as the specific audit work done by the firm with respect to certain aspects of the client's financial statements that appear to us to be particularly significant or complex or that may require the application of considerable professional judgement. CPAB does not review every aspect of audit engagements selected for consideration, because to do so would be prohibitively costly. The absence of significant findings in our review of a particular engagement cannot, therefore, be an endorsement that the client's financial statements were necessarily fairly presented or that all aspects of the audit were fully compliant with professional standards.
32. Overall, among the 87 engagements, there were five (one in each of three firms and two in the fourth firm) where we concluded that the audit was not conducted in accordance with generally accepted auditing standards. In all five cases, the common shortcoming was insufficient appropriate audit evidence to support the unqualified audit opinion that was given. One of these cases involved a material misstatement in the financial statements. The relevant securities commission is familiar with this case and has taken the action with respect to the issuer that it considers to be necessary.
33. In addition to the fundamental problem of insufficient evidence to support the opinion that was given, some of these audits had other areas of serious weakness. For example, one file had an incomplete summarization of errors detected during the audit, and a failure to follow the advice that was received from national office technical experts on the appropriate accounting for a particular issue that arose in the third quarter of the year. The correct answer was eventually reflected in the year-end financial statements but not until after the final meeting with the audit committee had been held. Another file had a large number of planned audit steps

that had not been completed and incomplete work papers that gave the overall impression of poor supervision and review.

34. For the five unacceptable audits, the firms responsible, at our request, are, to the extent possible, obtaining further evidence to support their audit reports, and are also conducting a quality review of selected other reporting issuer audit engagements for which the relevant engagement partners are responsible to determine whether quality deficiencies exist in these engagements as well. The firms will provide CPAB with a report on these review findings, and the actions they have taken as a consequence thereof.
35. Apart from the five unacceptable audits, there was a significant number of other engagements where, although CPAB was able to accept the file in its totality, the quality of the working paper files was below standard. For a number of these engagements, CPAB recommended that appropriate remedial action be taken, such as obtaining further evidence to support the firm's audit report, and that when completed, the file be cleared by a relevant partner of the firm with quality responsibilities.
36. CPAB made a number of other recommendations to one or more of the firms (in most cases, to more than one firm) with respect to engagement performance improvement in general, or by reference to specific engagements. Among the issues covered by our recommendations were the following:
 - All four firms have cultures that encourage consultation with technical accounting or auditing experts wherever appropriate on judgmental or contentious matters. However we noted failures to document properly the nature, scope or conclusions reached from some consultations when they occurred, and even more frequent failures to secure the written agreement of the party consulted, which is a requirement of auditing standards.
 - There is a need to improve the analysis of errors in the financial statements detected during the course of the audit. Such analysis should include not only the errors that were corrected, but the ones that were not, including known errors, most likely errors and the impact of prior period errors that had a reversing error effect on the current year. In addition, there is a need to improve procedures that track management estimates from year to year. It is normal for auditors to accept management estimates that fall within a "zone of reasonableness", but auditors need to take more care to ensure that estimates are not moving from period to period between one end of the zone to the other as part of a program of income measurement management.
 - In some cases, we had concerns that the amount of unadjusted errors, while not material to the income statement for the year subject to audit, had over several years accumulated to an amount that would be material to income if the cumulative errors in opening equity were corrected all at once. To avoid this, engagement partners need to be more proactive in encouraging

management and audit committees to adjust each year for all non-trivial known and most likely errors.

- There is a need to improve compliance with the requirements of a relatively new auditing standard that deals with the auditor's responsibility to consider fraud. The standard has a number of prescriptive requirements that at times are being done by engagement teams in a cursory manner or, in a few cases, not at all.
- There is at times a need to improve compliance with firm procedures and auditing standards when substantive analytical procedures are used as a form of audit evidence. Too often we noted cases where analytical procedures were so superficial as to be of little evidential value.
- There is a need to improve compliance with the auditing standards applicable to the use of specialists in audit engagements, such as actuaries, petroleum and mining engineers, environmental assessment specialists and asset valuation specialists. Engagement teams at times seem unaware of their obligations with respect to the work done by the specialists.
- There is a need to improve compliance with the auditing standards for using the work of a client's internal auditors.
- There is a need to improve compliance with the auditing standards for reliance on another auditor (see also paragraph 43 below).
- There is a need to improve the documentation of discussion at meetings with audit committees. Normally the audit working papers document the information the engagement team presented to the committee but not what questions were asked, how these were answered, or particulars of any other audit-related discussions that took place.
- While the quality of reporting by all four firms to audit committees is generally satisfactory, there is one area that does need to be improved, namely the reporting of corrected and of known and most likely unadjusted errors in the financial statements. Understanding the nature and extent of corrected and unadjusted errors in the financial statements helps the audit committee to understand the effectiveness of the issuer's controls over financial reporting. We noted instances where corrected errors were not reported by the auditors to the audit committee, where most likely errors were not reported, where errors in opening equity were not reported and where the errors that were reported were summarized or grouped at a very high level – for example, in one file, more than 30 items were grouped into one item reported to the audit committee without disclosure of the number of items grouped together.
- There is a need to improve compliance with firm requirements and auditing standards covering engagement letters and management representation letters.
- Engagement teams must compare the financial statements filed by the client with the System for Electronic Document Analysis and Retrieval (SEDAR) or the Electronic Data-Gathering, Analysis and Retrieval system (EDGAR), or

posted to its Web site, with the financial statements that were audited. Some teams had failed to make such comparisons, notwithstanding that this procedure is required by auditing standards.

37. While high-quality audit work was evident throughout our inspections, we were nevertheless disappointed that our inspection work identified such a large number of instances where engagement teams did not fully comply with an aspect of GAAS, or with the firms' own policies and procedures. We expect that each firm will share our sense of disappointment and will work diligently to impress upon its partners and staff the need to improve compliance in future.
38. One important quality control that is part of the audit of a public company, prior to the signing of the opinion, is an independent engagement quality control review by a partner other than the partner responsible for the engagement. These reviews are required by the professional standards related to quality control and are an integral part of the internal policies and procedures of all four firms. Many of the engagement deficiencies revealed by CPAB's inspections should have been detected by a proper independent review by the audit firm prior to completing the engagement. The fact that the deficiencies existed, had not been identified and were not corrected demonstrates that there is room for improvement in this area. As a consequence of our findings on some of the audits we reviewed, we have recommended that certain firms select a sample of their larger or higher-risk audit engagements to assess whether the time being invested by independent review partners is sufficient to address the responsibilities assigned to them.

Monitoring of Quality Control

39. Monitoring of quality control refers to the compliance work done by the firms themselves to verify that their systems of quality control are appropriately designed and operating effectively. For example, all of the firms inspect a sample of their own completed audit engagements to test whether they were done in accordance with professional standards and their own policies and procedures.
40. The effectiveness of the monitoring activity varies from firm to firm. In two firms quality monitoring is done with evident rigour, there is transparent reporting of results to senior management of the firm, there are action plans with clear accountability and timely follow up, and there are consequences for those responsible for work judged to be unsatisfactory. For these firms, we had no recommendations for further improvement. A third firm made great improvements to its quality monitoring program following the results of our initial review last year, but we identified several opportunities for further enhancement and made recommendations accordingly. The fourth firm's program is effectively designed, but it appears to be the least effective in terms of implementation and we have made more substantive recommendations to this firm.

Enhancement of Canadian Generally Accepted Auditing Standards (GAAS)

41. The Auditing and Assurance Standards Board (AASB) is responsible for setting GAAS in Canada. The AASB has been following an ambitious agenda to enhance GAAS. Various new or improved standards have been recently approved in final form, have been exposed for public comment or are under development. Among the subjects that have been addressed recently are audit risk, audit planning, engagement letters, management representation letters and reliance on service organizations. CPAB participates in the public oversight of the AASB through membership on the Auditing and Assurance Standards Oversight Council (AASOC). In addition, CPAB provides the AASB with comments on each exposure draft that it publishes. CPAB strongly supports the work that the AASB is doing to develop new and improved auditing standards.
42. A significant number of CPAB's recommendations for improved engagement performance have been related to incomplete documentation of work that was done, or was said by the engagement teams to have been done. The current Canadian auditing standard pertaining to audit documentation is not, in CPAB's view, sufficiently prescriptive or comprehensive. In September 2005, the AASB approved a major revision to Canadian audit documentation standards, which will be effective for audits of financial statements for periods beginning on or after November 1, 2006. CPAB is proposing to change its Rules to require the firms subject to its oversight to implement the new standards for audits of the financial statements of reporting issuers for periods beginning on or after January 1, 2006.
43. The other area where Canadian auditing standards require a major upgrade pertains to the precautions that should be taken by an audit firm relying on work done by another audit firm. For example, one firm (the primary auditor) may be appointed to audit an entity's consolidated financial statements, but a different firm (a secondary auditor) may be responsible for the audit of an important overseas operation that is part of the consolidation. The two firms may or may not be part of the same global network of accounting firms. Some Canadian primary auditors are signing opinions on consolidated financial statements while relying on one or more secondary auditors to do substantially all of the audit work on the underlying assets and revenues, and rarely is the reliance disclosed to shareholders. Where the primary and secondary auditors are part of the same global network of accounting firms, use the same audit methodology and are subject to substantially the same quality control policies and procedures, this reliance may not present a serious problem for the primary auditor. However, where the firms are not so closely linked, it may be difficult for the primary auditor to gain enough assurance to sign the opinion on the consolidated financial statements. Typically the four large accounting firms will not accept an audit of consolidated financial statements unless they and their affiliated network firms audit the majority of consolidated assets and revenues. The AASB should improve Canadian GAAS with standards and guidance on the required extent of

involvement by the primary auditor in the work of the secondary auditor, particularly when that work comprises a significant or predominant component of the consolidated entity. The standards should include requiring the primary auditor to not accept or continue the engagement when the required level of involvement is not possible or practical. The International Auditing and Assurance Standards Board (IAASB) has issued a re-exposure draft of a new International Standard on Auditing (ISA) on the audit of group financial statements. It is our understanding that the ISA will be used by the AASB as a primary reference source in developing a revised Canadian standard. We urge the AASB to ensure that updated Canadian standards on group audits are issued as soon as possible.

Conclusion

44. CPAB wishes to emphasize that it received the unconditional cooperation of all four firms during the course of its inspection activity. Except for information protected by legal privilege, as discussed in paragraphs 10 and 11, and some difficulties accessing working papers for certain foreign supporting auditors, as discussed in paragraph 12, we received the information that we requested and everyone whom we met was forthcoming in responding to our questions.
45. CPAB's 2005 quality inspections of the four largest firms showed that nearly all of our recommendations made in 2004 have been implemented effectively. The firms have sound tone at the top and strong quality leadership. Controls in the areas of client and engagement acceptance and continuance, human resources policies and procedures and quality monitoring are generally designed effectively and operating as designed. Policies and procedures over independence and ethics are also well designed in all four firms, but compliance audits have revealed an unacceptable level of exceptions with respect to firm policies and procedures related to both the entering of personal investments into the firms' investment monitoring systems and holdings of prohibited client investments. There also continues to be room for improvement in the performance of audit engagements. CPAB is encouraged by the firms' understanding that the public interest requires them to place greater emphasis on audit quality and "getting it right" every time, with no tolerance for substandard performance. CPAB expects the firms to implement its recommendations and will conduct further quality inspections of all four firms in 2006 to ensure that they have done so, or are doing so, to our satisfaction within the prescribed time period.

December 19, 2005