Enhancing Audit Quality: Canadian Perspectives

CPA CHARTERED PROFESSIONAL ACCOUNTANTS CANADA COMPTABLES PROFESSIONNELS AGRÉÉS CANADA

CPAB CCRC CANADIAN PUBLIC ACCOUNTABILITY BOARD CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

August 12, 2013

By email to auditors@cc.gsi.gov.uk

Inquiry Manager
Audit Market Investigation
Competition Commission
Victoria House
Southampton Row
London
WC18 4AD

Dear Sirs:

**Re: Statutory Audit Services Market Investigation**

We are pleased to provide comments on the *Summary of Provisional Decision on Remedies* (the Summary) dated July 22, 2013 resulting from the Competition Commission (CC) provisional findings report issued in February 2013. The CC detailed investigation on audit market concentration in the United Kingdom (U.K.) is of great interest given the global reach of the companies and their external auditors under review.

We responded in March to the *Notice of Possible Remedies Under Rule 11 of the Competition Commission Rules of Procedure* (March response). Our March response can be found at http://www.cica.ca/enhancing-audit-quality-canadian-perspective/item73630.pdf. In our March response we outlined the collaborative initiative of the Chartered Professional Accountants of Canada[1] and the Canadian Public Accountability Board (the Enhancing Audit Quality initiative) to consult with Canadian stakeholders on global proposals, and the Discussion Papers issued by our three working groups. Since March, we have completed our consultations and issued the final report. The final report can be found at http://www.cica.ca/enhancing-audit-quality-canadian-perspective/item74564.pdf. The result of our consultations, as outlined in the final report, substantially confirmed the conclusions and recommendations we shared with you in our March response.

[1] The Canadian Institute of Chartered Accountants (CICA) and the Society of Management Accountants of Canada (CMA Canada) joined together January 1, 2013 to create CPA Canada as the national organization to support unification of the Canadian accounting profession under the CPA banner.

**Views on Summary of Provisional Decision on Remedies**

While we support some of the remedies proposed by the CC, we believe that the imposition of mandatory tendering will result in a deterioration in audit quality. This proposal will be to the detriment of shareholders and make investment in U.K. companies riskier than investment in those not subject to mandatory tendering.

The following are our views on the Summary based on the conclusions and recommendations in the final report of the Enhancing Audit Quality (EAQ) initiative:

1. In our final report we identify the current significant role and responsibilities that audit committees play in overseeing the work of the external auditor. These are consistent with those activities the CC plans to stipulate that only an audit committee is permitted to perform – negotiate and agree audit fees and the scope of audit work, initiate tender processes and make recommendations for appointment of auditors, and authorize the external audit firm to carry out non-audit services. We support CC measures to strengthen the accountability of the external auditor to the audit committee.
2. Audit inspectors have a significant role to play in enhancing audit quality. The evaluation of external auditors by the audit committee will be more effective if audit committees have access to audit inspection results, both in relation to the specific entity and in terms of areas of systemic quality concern that may be relevant to their own audit firm and/or the entity. Therefore, we support a rigorous audit inspection process and see substantial benefits from transparency of the audit inspection process and communication to the audit committee of audit inspection findings.
3. We continue to be concerned that mandatory tendering will not enhance, and may detract from audit quality for the reasons outlined in our March response, which we repeat again below:
   (a) The timing for tendering of the audit is best left to the judgment of the audit committee, not based on an arbitrary rule. Using an arbitrary time frame for a change could cause hardship for a company if it would occur at an inopportune time (e.g., when a major transaction is occurring) and would not then be in the best interests of the company's shareholders.

   (b) The tendering process will inevitably put downward pressure on fees. While superficially this would seem to benefit shareholders, it is difficult to maintain, let alone enhance, audit quality at lower fee levels. The resulting messages to the firms are at best contradictory. The tendency thus will be to compromise, not enhance, audit quality.

   (c) There may be an increased self-interest threat as an auditor may not challenge management as aggressively as before because of the fear of losing the audit engagement as the firm approaches the tendering period.

   (d) The focus of the audit committee could be more on evaluating relationships and audit fees of potential new audit firms rather than on the audit quality and independence of the incumbent firm.

(e) Mandatory audit firm tendering would add time and costs for both management and the external auditor – even though the same external auditor may well be appointed. The company would also incur costs for educating new external auditors (if a new auditor is appointed) on the company's operations, systems, business practices, and financial reporting processes. Shareholders indirectly bear these costs. We recognize that paragraph 20 of the Summary contains an estimate of additional costs but, without further information, we have no basis for assessing its reasonableness.

**Concluding Remarks**

We reiterate our belief that any proposed changes should not negatively impact audit quality and should, preferably, increase audit quality because audit quality is a key factor in supporting credible, high-quality financial reporting. Further, we believe that periodic comprehensive review of the audit firm by the audit committee is the preferred alternative to address familiarity threats arising from long audit tenure, as outlined in our March response. It achieves the benefits of mandatory tendering with a much more direct focus on audit quality and likely at less cost.

Finally, many large U.K. companies and their external auditors operate in a global environment. We therefore believe that remedies need to be considered in relation to the global context as U.K.-centric solutions could have unintended consequences. In particular, there are various other global bodies that are in the process of considering many of the potential remedies in the Notice. If different bodies were to arrive at different conclusions as to such remedies we believe that this may cause significant friction in the functioning of audits globally. We therefore encourage efforts to reach consistent solutions on a global basis.

Please contact me if you have any questions or require clarification on our response.

David Brown, C.M., Q.C.
Chair
CPA Canada/CPAB Enhancing Audit Quality Steering Group

c.c. Mark Carney, Governor of the Bank of England