



CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

150 York Street, Suite 900, Box 90, Toronto, Ontario M5H 3S5
Tel 416.913.8260 Fax 416.850.9235 www.cpab-ccrc.ca

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Inquiry Manager Statutory Audit Investigation
Competition Commission
Victoria House
Southampton Row
LONDON
WC1B 4AD

Email: auditors@cc.qsi.gov.uk

Re: Provisional decision on remedies – Statutory audit services market investigation

The Canadian Public Accountability Board (CPAB) is pleased to comment on the provisional decision on remedies of the Competition Commission's statutory audit services market investigation.

CPAB is Canada's independent audit regulator and is responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality, independent auditing that contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into how audit quality might be improved. In responding to the provisional decision on remedies we have focused on the implications to audit quality and provided an independent audit regulator perspective on how to improve audit quality.

Mandatory Tendering

We agree with the Commission's findings that audit firms need to improve audit quality and support increased competition in the audit market based on quality. However, we are concerned that implementing a mandatory tendering regime may have unintended consequences leading to diminishing audit quality and undermining the role of the audit committee which is not in the interests of the capital markets. We are not aware of compelling evidence that mandatory tendering has led to improved audit quality and strongly encourage the Commission to reconsider the appropriateness of this approach.

Our specific concerns with mandatory tendering include:

- Moving to mandatory tendering will likely lead to increased price competition and our concern would be that the audit becomes a commodity to be differentiated on price and not quality. In our experience, the tendering of an audit usually results in a significant reduction in the audit fee, whether or not the incumbent is retained. A race to the bottom on fees would not be in the shareholders' interest.

- Audit firms will devote more resources to business development, proposal activities and managing the tendering process which will likely mean there are fewer resources available to support audit quality.
- A fixed mandatory tendering period will reduce the audit committee's flexibility to make decisions about auditor appointment based on audit quality.
- Mandatory tendering may limit choice in specialized industries thereby negatively impacting audit quality. In circumstances where a non-auditor firm is providing substantial consulting services to a company it might not be willing to forego this work to become the auditor, thereby actually reducing the potential choices to only one or two others. Such a limited choice among alternatives may actually lead to reduced audit quality in the longer term.
- Tendering can be a costly exercise for prospective auditors of larger companies with little corresponding benefit, especially if the audit committee intends to retain the incumbent audit firm. Over time, unless a high percentage of tenders result in a change from the incumbent, the process will cease to be effective as firms will just "go through the motions", if they choose to participate at all.
- In an environment of mandatory tendering there may be less incentive for auditors to take a tough stand on material issues when that could impair their chances of success in the upcoming tendering process.

As discussed in our March 18, 2013 letter on the Commission's Notice of Possible Remedies, we highlighted the work performed by the Enhancing Audit Quality Initiative (EAQ) in Canada. One key recommendation from the EAQ initiative to address the threat of institutional independence and enhance auditor professional scepticism is for the Audit Committee to enhance its oversight of the work of the external auditor and perform a Mandatory Comprehensive Review. We believe strengthening the audit committee's oversight of the work of the external auditor and enhancing the evaluation of the auditor through a Mandatory Comprehensive Review is a superior alternative to mandatory tendering.

Mandatory Comprehensive Review and the Role of the Audit Committee

To safeguard the auditor against institutional familiarity threats at the audit firm level the audit committee should perform a comprehensive review of the issuer's relationship with the auditor on a periodic basis. This review would include, among other items, evaluation of audit quality including the auditor's level of professional skepticism, the quality of the engagement team, and the length of tenure of the firm and key engagement team members, and consideration of audit regulator inspection findings. This review would require the audit committee to carefully consider the quality and value of their current auditor and would include reporting to shareholders of the process followed and conclusion of the review. A mandatory comprehensive review process may lead to tendering or a change in auditor as a consequence of this review. The mandatory comprehensive review would require both the audit committee and auditor to focus significant attention on indicators of audit quality and the exercise of professional scepticism and challenge

to management, which mandatory rotation and tendering may not. This will drive behavioural and cultural change in the interaction between audit firms, audit committees and management.

Consistent with this mandatory review, we support other measures to strengthen the audit committee's annual assessment of the auditor, including the development of guidance and tools for audit committees to strengthen the accountability of the external auditor to the audit committee. Based on our inspections, we believe audit committees can, and should be important contributors to audit quality. Consideration should be given to developing a set of guidelines for audit committees, or an "audit committee code" to strengthen audit quality and global consistency in this area. In our view, with the current focus on audit quality, it would be beneficial if audit committees had at least one member with relatively recent experience in auditing public companies.

Additional information can be found in the EAQ's final report that was issued in May 2013 at:

<http://www.cica.ca/enhancing-audit-quality-canadian-perspective/item74564.pdf>

Transparency of Inspection findings

We are supportive of increased transparency of inspection findings with the objective to improve audit quality. 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).

We are concerned that the publishing of grades for individual RI audit files could lead to confusion about the role and scope of work of the audit regulator. Generally, audit regulators such as CPAB do not inspect the entire audit file and therefore the findings from the inspection of an individual RI audit file do not represent a balanced scorecard. The focus of the RI audit file inspection is on the audit work performed in selected areas of the RI's financial statements and not an assessment of the quality of the RI's financial reporting. If individual RI audit file grades and related findings are to be publicly disclosed it is critical for stakeholders to have an appropriate understanding of the context to avoid misinterpretation.

The work of the Commission is being closely followed in many jurisdictions and will influence actions taken by policy makers and regulators around the world. CPAB supports the need for change and improvement in the audit process. The status quo is not an option. Change needs to be responsive to the needs of shareholders, and should be implemented in a thoughtful, balanced way such that audit quality is enhanced and in no way diminished.

We appreciate the opportunity to respond to the provisional decision on remedies, and would be pleased to discuss any of the above comments with you at your request.

Yours very truly,



Brian Hunt, FCPA, FCA
Chief Executive Officer