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Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 37 (Audit Firm Rotation)

Dear PCAOB Board Members:

I am writing on behalf of the Public Trust Committee (PTC) of the Canadian Institute of Chartered Accountants (CICA) in response to your request to comment on the Concept Release on auditor independence and audit firm rotation. The CICA together with the provincial, territorial and Bermuda Institutes/Ordre of Chartered Accountants, represents a membership of approximately 80,000 CAs and 12,000 students in Canada and Bermuda.

The CICA conducts research into current business issues and supports the setting of accounting, auditing and assurance standards for business, not-for-profit organizations and government. It issues guidance on control and governance, publishes professional literature, develops continuing education programs and represents the CA profession nationally and internationally. The PTC is responsible for overseeing the regulatory structures and processes across provincial jurisdictions in Canada. The PTC's goal is to achieve consistency between provincial CA bodies in Canada and to make sure that the processes and standards in Canada meet or exceed the international standards.

The PTC believes that auditor independence is a fundamental tenet of the auditing profession and we congratulate the PCAOB for keeping this issue top of mind for both the profession and the regulatory community. We believe that the issues raised by the PCAOB deserve wide discussion by stakeholders. We certainly appreciate the opportunity to provide our comments.

We would encourage the PCAOB to address this issue holistically. We do not believe that the financial crisis that the world has faced over the past few years has been caused by a lack of auditor independence. Therefore, we believe that solutions need to address how governance structures and processes can be improved, as well as auditor independence. Currently Canada's financial oversight system is strong. This is due in no small part to strong governance practices where directors and audit committees have developed the necessary skills to provide appropriate oversight.

The Need for International Independence Standards

We believe that the PCAOB plays a vital role in ensuring high quality audits in the international environment and it has taken a leadership role by developing the Concept Release. However, we believe it is important to recognize that the PCAOB is part of the global community and that extensive globalization is already embedded in the audit world. In establishing auditing standards to improve audit quality in the US, the PCAOB should be cognizant of developments taking place internationally so that solutions are appropriately consistent on a global basis.

As a member body of the International Federation of Accountants (IFAC), we are strong believers in the establishment of global standards for accounting, auditing, and ethics. As such, we support the work of the International Ethics Standards Board for Accountants (IESBA), which is an independent standard setter responsible (under the auspices of IFAC) for protecting the public interest by setting high-quality ethics standards, including independence standards, for all professional accountants, through the development of a robust, internationally appropriate code of ethics.

The Code of Ethics of the IESBA was last revised in July 2009 and adopts a principles-based approach requiring the evaluation of threats to an accountant's compliance with fundamental ethical principles and the application of safeguards to either eliminate those threats or reduce them to an acceptable level. In certain situations, particularly for public interest entities, the Code prohibits accountants from entering into certain interests or relationships and identifies situations where the IESBA has concluded that no safeguards would be sufficient to reduce threats to an acceptable level.

The IESBA Code contemplates a number of key measures to ensure auditor independence including, but not limited to:

- the rotation of key audit partners after an appropriate length of time on the engagement followed by a time-out period before they would be allowed to return to the engagement;
- the prohibition of a number of specific non-assurance services by the audit firm;
- the prohibition of auditors to hold financial interests in their clients;
- the prohibition of certain relationships between the audit firm and the client; and
- the appointment of the audit firm by an independent audit committee.

Audit Quality Could be Diminished

As the Canadian CA profession contemplated the adoption of the more recent changes to the IESBA Code on auditor independence, we carefully considered the issue of partner rotation. As we researched the partner rotation issue we found a significant amount of academic research addressing the issue of firm rotation. Study after study pointed to the fact that audit quality could be diminished as a result of audit firm rotation. In fact, there is evidence that the likelihood of audit failures or perhaps frauds being perpetrated increased significantly in the first two to three years of a new firm undertaking an engagement while the firm gains a sound understanding of the client. This problem is exacerbated for multi-national, multi-segment public companies or for companies in very specialized industries. A proper appreciation of such an organization's complexities is critical in evaluating audit risk and developing appropriate audit plans.

While there is considerable evidence that the rotation of audit firms could result in diminishing the quality of audits, we are not aware of any evidence that the rotation of audit firms would improve audit quality. Even though it can be argued that this could result in a stronger appearance of independence, simply because a client has not changed audit firms in the past 10 years does not mean that the audit firm is not independent, especially if the firm has complied with the requirements of the IESBA Code, including the rotation of the key partners on the engagement.

Costs Would Outweigh the Benefits

Audit firm rotation would be costly and we are not convinced that the benefits would outweigh the costs. The time needed to acclimatize the new audit firm to the company's operations, business processes and critical reporting areas would be extensive. Certainly for large multi-national corporations, ensuring that audit teams around the world are properly transitioned to provide seamless coordination of the audit would require extensive efforts every time the audit firm is changed. From a client perspective, the amount of time and effort needed to deal with the new audit firm every time a firm rotation is introduced would serve as a time-consuming and costly exercise.

Root Causes of Audit Failures

We note in the Concept Release that the PCAOB has suggested that audit failures or other audit deficiencies may have, in part, been caused by a lack of proper skepticism. This problem is not unique to the PCAOB as we understand that a lack of skepticism has been noted by the independent audit regulators in a number of countries. The Canadian Public Accountability Board has raised this concern in its latest public report. We do not dispute this finding but we are not convinced that a lack of proper skepticism is a direct result of a lack of independence or would be solved by mandatory audit firm rotation.

We support efforts being made by the PCAOB to identify the root causes of audit failures. Doing so may provide concrete evidence where specific changes to auditing standards might be made to address professional skepticism concerns if indeed this is actually part of the root causes. The CICA is also considering ways in which professional skepticism and professional judgement can practically be improved. We therefore encourage the PCAOB to continue and enhance its efforts in this respect.

Firm Rotation for Large Public Interest Entities

One of the possible solutions to auditor independence concerns that has been suggested in the Concept Release is to introduce mandatory firm rotation but limit the rotation requirement to only the largest of public interest entities. We believe such an approach would be less problematic than having such a requirement for all public interest entities but we still do not believe that this would necessarily provide a solution. There are some significant concerns that are only exacerbated if mandatory audit firm rotation were to apply to the largest of public interest entities.

Most of the very large public interest entities are currently audited by one of the Big Four international audit firms. We believe that if these very large public interest entities are required to rotate their audit firms on a regular basis, the choice of audit firms would be very limited especially if one of the other Big Four firms has already been engaged to provide non-audit services to the client that would preclude them from becoming the auditors. Once again this choice becomes even more

difficult if the client is operating in a specialized industry where not all firms may have the expertise to undertake the engagement.

Mandatory Tendering

Another possible approach that has been identified is to require the clients to tender their audits on a regular basis, say at least once every five to 10 years. The benefit of this solution is that it would force the independent audit committee to consciously consider, on a regular basis, the quality of the audit and who the auditor should be. Presumably the concerns about the audit firm and management being too familiar with each other would be considered by the audit committee in determining whether or not to change auditors. There are, however, a number of concerns that should be considered with a regular tendering proposal.

Firstly, it is a costly undertaking for a firm to respond to the tender process and one that many firms would not want to undertake if they felt that they did not have a serious chance of being successful. The larger and more complex the client, the more costly it is for a firm to prepare a proper and comprehensive response.

Secondly, in order for a firm to increase its chances to be successful in the tendering process, it may reduce the level of fees it would be prepared to charge. Audit firms are also businesses who wish to make a reasonable profit on their efforts. We would not want to see firms reduce the quality of audit work that they ultimately perform as a result of lower fees being charged in the early years of taking on the engagement.

In Closing

We would be remiss if we did not acknowledge the proposals recently released by the European Commission that deal, in part, with the issue of firm rotation. While they have concluded that audit firms should rotate every six years, we do not believe there is evidence that the quality of audits will be improved as a result. We firmly agree that the principle of auditor independence must be of paramount importance but rather than impose mandatory rotation of audit firms we would encourage the PCAOB to follow the lead of the IESBA where the rotation of key audit partners is identified as an important component of the solution.

Yours truly,



G.B. Hannaford, FCA
Chair, Public Trust Committee