



CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

150 York Street, Suite 200, Box 90, Toronto, Ontario M5H 3S5
Tel 416.913.8260 Fax 416.850.9235 www.cpab-ccrc.ca

December 19, 2011

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington D.C. 20006-2803
USA

Dear Sir:

**Request for Comment: Concept Release on Auditor Independence and Audit Firm Rotation
PCAOB Rulemaking Docket Matter No. 37**

The Canadian Public Accountability Board (CPAB) is pleased to comment on the Public Company Accounting Oversight Board (PCAOB) *Concept Release on Auditor Independence and Audit Firm Rotation* (the “Concept Release”). The independence of the external auditor is fundamental to both audit quality and investor confidence in financial reporting. We commend the PCAOB for engaging with stakeholders on ways to enhance auditor independence, objectivity and professional scepticism and for bringing these issues to the forefront for debate.

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 the application of auditing standards and how they might be improved.

In the course of our inspections of audit files we have seen examples of a lack of professional scepticism being exercised by auditors, which has also caused us to question whether auditors are appropriately independent and objective. This is a complex issue and we believe a holistic approach should be taken to understand its root causes prior to developing solutions and we commend the PCAOB for the outreach activities it has undertaken in this regard. There is clearly a need for change and measures should be taken to enhance auditor independence, however, it is important that any changes are implemented in a way that actually improves audit quality. We believe audit firms, audit committees and audit regulators all have a role to play in this process.

There is much merit in the PCAOB exploring mandatory audit firm rotation as a policy option. Long standing tenures, especially for larger reporting issuers, do increase the risk of familiarity and

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the accompanying possible lessening of professional scepticism. However, such a policy change may bring with it unintended consequences with the potential to negatively impact audit quality.

It is with this in mind that we suggest the PCAOB explore mandatory audit firm review as an alternative to mandatory audit firm rotation. This process would require the audit committee to formally evaluate the effectiveness of the auditor on a periodic basis, and to report the results of this evaluation to the shareholders. In this report, the audit committee would, among other things, justify why the existing auditor has been reappointed or why a new auditor has been appointed. The frequency of this process and the contents of the report would need further study. For this process to work effectively there must be appropriate structure, rigour and transparency applied by the audit committee. Furthermore, there is a need for greater transparency with respect to disclosure of auditor changes. In our experience disclosure of the reasons for auditor changes are usually boilerplate and the signaling mechanism that this could provide financial statement users should be made more effective.

We also believe there is merit to exploring longer minimum term appointments for auditors that would restrict the ability of a reporting issuer to remove an auditor before the end of a fixed term. We agree with the comment in the Concept Release that some measure of tenure protection might further bolster the auditor's ability to resist management pressure.

Another way to improve auditor independence and the application of professional scepticism at the engagement team level would involve extending the existing partner rotation rules to include senior managers and managers. In our inspections we have seen examples of experienced managers being on the same engagement team for 15 years or more, which clearly creates a heightened familiarity risk.

It is important that audit committees act independently and objectively in their audit oversight role. There is a need to explore ways in which audit committees can more effectively evaluate the performance of both the auditor and management. It is imperative that audit committees exercise appropriate professional judgement and scepticism in their interactions with both auditors and management, and they should not be seen to be acting as advocates for management, as sometimes appears to be the case currently. The Financial Reporting Council in the UK is providing thought leadership in this area of corporate governance and we understand will shortly be issuing detailed proposals for changing the UK Corporate Governance Code. We encourage the PCAOB to consider these proposals in developing a holistic solution to the issue of auditor independence.

CPAB has been expanding its outreach activities, including organizing roundtables with audit committees across Canada, to discuss issues impacting audit quality and we believe audit regulators can do more to educate and inform stakeholders, including audit committees, on matters impacting audit quality.

In December 2011, CPAB held an Audit Quality Symposium to engage with stakeholders on policy proposals impacting audit quality, including the PCAOB Concept Releases on Auditor Reporting and Auditor Independence, as well as the recent regulatory proposals issued by the European Commission. We thank the PCAOB for their support and participation in helping CPAB engage

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with stakeholders in Canada on these important issues and we strongly support the PCAOB's efforts to enhance auditor independence, objectivity and professional scepticism.

We appreciate the opportunity to respond to the Concept Release, and would be pleased to discuss any of the above comments with you at your request.

Yours very truly,

A handwritten signature in cursive script, appearing to read "Brian Hunt".

Brian Hunt, FCA
Chief Executive Officer