



FOUNDED 1879

## THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO

Brian A. Hunt, FCA, President and Chief Executive Officer

### Submission to the Competition Policy Review Panel Sharpening Canada's Competitive Edge

To Whom It May Concern,

On behalf of our profession's 32,000-strong membership in this province, the Institute of Chartered Accountants of Ontario is pleased to respond to the Competition Policy Review Panel's request for submissions on sharpening Canada's competitive edge from an Ontario business and regulatory perspective.

Since 1879, the Institute has protected the public interest through the CA profession's high standards of qualification and the enforcement of its rules of professional conduct. During that time, we have also developed a solid record of advising various levels of government on business and economic issues. In fact, and consistent with this record, we recently consulted extensively with the Competition Bureau of Canada on its report *Self-regulated professions: Balancing competition with regulation*, and plan to continue to assist them in developing positions that balance the need for a competitive regulatory environment respecting professional services that continues to protect the public and meets its stated public policy goals.

You will be aware that among the Bureau's key recommendations respecting accounting services in Canada is the need for regulators "in each province and territory" to "consider establishing the minimum necessary competencies that public accountants should have". We agree with this recommendation whole-heartedly. Indeed, the CA profession in Ontario and Canada has advocated for nationally consistent standards of qualification and conduct for public accounting for many years. Owing to the findings of the Competition Bureau, and related developments of late, we have reason to believe that our position is gaining recognition and support among a variety of stakeholders. This policy recommendation is detailed in the following submission to you, in the context of ensuring a business and regulatory environment for Canada that enables us to keep pace with our competitors in an increasingly globalized economy.

A second area of focus in this submission is the need for legal liability reform respecting finance and accounting professionals. This is to ensure that businesses of every size have continued access to the quality financial expertise that they increasingly require in order to expand, obtain capital and financing, compete and create jobs, while helping foster an environment that enables Ontario and Canada to attract and retain top-level talent in the financial services sector – which increasingly is the engine driving our major urban centres and overall economy.

We welcome the opportunity to assist the Panel in evaluating the opportunities and hurdles that Canada faces as it competes globally. For the purpose of this exercise, however, we will focus our response on the questions 2 and 4 from the *Canada in a Global Context* part of your consultation document, as well as questions 1, 2 and 3 from the *Becoming a Destination for Talent, Capital and Innovation* section. We will leave it to others, including our members acting individually or on behalf of their various organizations, to address the other important questions raised in your document.

We believe this country is blessed with great talent and resources, and that Canada is well placed to become an even more prominent international business leader as we progress further into the 21st Century. To assist with that evolution, however, we believe Canada's governments need to consider two wide-ranging areas for attention – legal liability reform for financial service professionals and nationally consistent qualification and conduct standards for the practice of public accounting – to match best practices found in our international trading partners' jurisdictions.

By answering your questions with these issues as our focus, we believe we will make the case that both changes are vital if Canada is to continue to attract investment and top professional talent, create jobs and compete in an increasingly globalized economy.

Thank you for this valuable opportunity to provide you with our profession's ideas on making our country more competitive. We look forward to following up on this submission by taking part in your stakeholder consultations during 2008.

Sincerely,

A handwritten signature in blue ink, appearing to read "Brian Hunt". The signature is fluid and cursive, with the first name "Brian" being larger and more prominent than the last name "Hunt".

Brian Hunt, FCA  
President and CEO  
The Institute of Chartered Accountants of Ontario

## Canada in a Global Context – Questions 2 and 4

1. *How important are company headquarters to Canada's economic prospects and ability to create jobs and opportunities for Canadians? How important are global divisional head offices? What factors influence their location?*

It is, of course, vitally important for Canada to continue to attract and retain its share of company headquarters. Any country benefits when it hosts the head office of an international organization – in terms of top-quality jobs, market access, investment and decision-making clout.

We believe that one of the under-appreciated factors that impacts on investment and head offices is the liability regime of the country. Currently, Canada is saddled with an antiquated system known as joint and several legal liability. Under such a system, a party that is found to be just one per cent responsible for a financial loss can be held to account for fully 100 per cent of a claim.

This risks a tremendous negative impact on doing business in a jurisdiction as it increases the threat of being held responsible for disproportionately heavy costs in a legal case. This is especially relevant to the audit profession and is increasingly threatening to shut off access to vital financial and accounting services for businesses of every size and, with it, access to the investment capital they need to grow and create jobs, owing to the needless risk posed by joint and several liability.

The current regime also acts as a restraint on Canada's ability to attract and retain top professional talent, due to the fear of exposure to an unreasonable degree of legal liability.

Audit firms – not just the large firms but also smaller practices in smaller communities (*See Appendix A – An Issue for Bay Street and Main Street*) – are often the targets of huge and growing claims even though they may have little responsibility for a financial loss. Essentially, they are being asked to “insure” our country's capital markets by being available as a “deep pocket” for investor lawsuits.

Our members tell us that the current liability scheme is:

- *driving them out of the marketplace for their services because of skyrocketing insurance costs and exposure to disproportionate liability*
- *shutting off access to vital audit services for enterprises of every size, which in turn deprives those companies of the investment capital they need to compete, grow and create jobs, and*
- *pushing Chartered Accountants and other financial professionals out of the audit and assurance field and, sometimes, right out of Canada.*

(For examples of the types of problems this causes Canadian business, see *Appendix B – Real Businesses – Real Impacts*).

How does joint and several liability hurt our competitiveness when pursuing or retaining head offices? Many companies, including international audit firms, are becoming increasingly wary of litigation costs and are looking for safe harbours for conducting their work. By that standard, the increasingly litigious environment in Canada can look like a daunting place to establish or maintain an organization.

The competitive situation for Canada is not getting better. Currently, our major trading partners in the U.S., U.K., Europe and Australia and elsewhere have acknowledged the problem and are at various stages of addressing the liability issue with reforms, such as moving to a proportionate liability system. Under proportionate liability, responsibility for a financial loss is apportioned according to the extent of an individual's responsibility for that loss.

Reforms already underway in other jurisdictions will ultimately lead investors to ask: Why would I place my head office in Toronto, Halifax or Vancouver? Why take that risk? This is particularly true in the Ontario context, where neighbouring Great Lakes States (and many others) have already moved to various forms of proportionate liability – creating a distinct competitive disadvantage for this province in one of the most wealthy and concentrated consumer markets in the world (*See Appendix C – Keeping up with the Neighbours*).

In the case of international audit firms, the temptation to establish your business and the high-paying jobs that come with it outside of Canada will only grow if we fail to address this crucial business issue. The reality is that, in a tightly interconnected world, high value financial services for a client in Montreal can often be provided by professionals in Memphis or Mumbai.

Canada needs a well-designed liability regime that protects the interests of investors, professionals, the business community and the general public.

*2. Do Canada's economic policies appropriately reflect our increased integration with the North American and global economy? How might these policies be changed to better reflect this new competitive environment?*

From a global standpoint, Canada is seen as an anomaly in that its economic policies are set at various levels by our federal, provincial and territorial governments. In contrast with the United States and the European Union, Canada's economic policies are often a confusing and occasionally conflicting maze of legislation and bureaucratic red tape that hampers the business community's ability to compete.

As an example of this in action, the Institute would like to highlight our inconsistent and, in some jurisdictions, non-existent standards for public accounting qualification and conduct in Canada.

Public accounting is the business of expressing independent assurance on financial statements and other financial information of enterprises of every size, to ensure that the information truly reflects their financial condition. Large and small investors, financial institutions and other third parties then use that assurance to help them make informed investment and lending decisions. Many of those decisions involve investments in RSPs, mutual or pension funds – making the practice of public accounting relevant to nearly all Canadians.

Naturally, international investors also rely on financial statements when they are deciding on whether to allocate capital, resources and talent to a particular country. When they view statements from most of our peers in developed nations, they have the assurance that those financial statements have been signed off by auditing and assurance professionals who have met the highest standards for education, experience and conduct.

In Canada, it is not that simple. While Chartered Accountants in every province and territory must meet the CA profession's uniformly high and internationally recognized standards, there is an underlying "patchwork quilt" of 13 differing forms of regulation for entry into the field of public accounting by people who are not Chartered Accountants.

In some provinces, notably Ontario and Quebec, where the majority of our public companies reside and the bulk of securities trading take place, the standards for conducting public accounting are high and recognized internationally. In other provinces, however, regulations allow people with accounting designations that are not internationally recognized to practice public accounting and, in some Canadian provinces, anyone who can get a client can sign off on financial statements, even if they have no relevant designation, education or professional standards oversight whatsoever.

Some have argued that if low (so-called "minimum") or non-existent standards suffice in some jurisdictions, perhaps these should be the starting point for benchmarking nationally consistent standards. However, this ignores Canada's obligations to investors and the general public, both at home and abroad, and risks starting a "race to the bottom" that will render Canadian standards for the practice of public accounting unacceptable to other major industrialized

nations. It would also risk nullifying our international trading partner commitments with respect to public accounting services, which are founded on Mutual Recognition Agreements (MRIs) between major accounting bodies in each jurisdiction. These MRIs serve to certify that public accounting qualification and conduct standards among signatory jurisdictions have been found to be substantially equivalent in depth, breadth and rigour.

To ensure our competitiveness and ability to attract investment, Canada needs internationally recognized, nationally consistent standards for qualification and conduct for both CAs and non-CAs who wish to practice public accounting, in order to safeguard our existing international trading partner commitments. (*See Appendix D - Proposed National Standards: A Principled Approach*). Those commitments currently are anchored by Mutual Recognition Agreements between Canadian CA Institutes and their peer accounting bodies in our major trading partners. These agreements determine “substantial equivalence” in standards among the bodies, thereby ensuring that the qualification and conduct standards for public accounting are internationally recognized.

As an example of how this works in practice today, we would draw the Panel’s attention to the system in Ontario. Our province’s competitiveness benefits from internationally recognized high standards for public accounting that are mandated in legislation – the *Public Accounting Act, 2004* – that was passed with support of all parties in the Legislature (*See Appendix E - Chronology: The New Public Accounting Act, 2004*).

The Act sets out the required qualification and conduct standards for public accountants. They are benchmarked against internationally recognized standards to ensure financial statements signed off on in Ontario are accepted in other jurisdictions across Canada and around the world.

Competition between accounting designations is allowed on the basis that, once the standards set out in the Act are met, other accounting bodies in Ontario will be allowed to license their members to practice public accounting alongside CAs.

The *Public Accounting Act, 2004* complements the U.S. *Uniform Accountancy Act*, which extends consistent public accounting standards across more than 40 U.S. States and territories in similar ways for the same reason.

To compete globally, our country needs nationally consistent public accounting standards that match those of our international competitors. Investors, in Canada and abroad, deserve nothing less than the reassurance that they can trust the education, experience and conduct of the professionals who are doing vital audit and assurance work.

## Becoming a Destination for Talent, Capital and Innovation – Questions 1, 2 and 3

1. *How can Canada better promote inward foreign direct investment (FDI)? What policy change could contribute to this objective?*

As noted to our submission regarding *Canada in a Global Context – Question 2*, nationally consistent standards for practicing public accounting that match those of our major sources of FDI are vital to securing and receiving much needed investment.

Investors on Wall Street have the certainty that the Certified Public Accountants (CPAs) who sign off on American financial statements are among the most highly educated and tightly disciplined in the world. That is also true of Chartered Accountants in the U.K. and the leading accounting designations working in other major nations.

The Canadian Chartered Accountant designation is the only one currently recognized as equivalent to the highest local designation in the U.S., U.K., France, Japan, Hong Kong and numerous major economic powers (*See Appendix F – Recognized Accounting Bodies*). That reciprocal recognition allows audit and assurance professionals in Canada to more easily work with their peers in other countries and assures investors that professional standards are not compromised in any one country.

Currently, international business people and investors can rest assured they are dealing with internationally recognized audit and assurance professionals if they have the Canadian CA designation. The Institute believes that we can enhance Canada's global reputation by using a public accounting licensing system similar to the one found in Ontario as the basis for similar systems in other provinces and territories.

As with Ontario, this would provide high internationally recognized standards and allow other designations to enter the field of public accounting if they choose to meet those standards. In that way, the public is protected, competition is facilitated and our ability to continue to attract and service FDI is enhanced.

2. *In particular, what mix of policy changes would be required to make Canada the preferred point of entry to, and location in, the North American market for high-value activities of non-North American business entities?*

As described in our submission regarding *Canada in a Global Context – Question 4*, Canada's joint and several liability regime is a growing barrier to investment and is increasingly out of step with other North American and overseas jurisdictions.

In our previous answer, we focused on how joint and several liability is deterring audit firms from doing needed work and, therefore, hurting investment in our communities. The Institute also pointed out how other jurisdictions are either ahead of Canada in investigating liability reform or are actually making changes that will give them a competitive advantage. For example, every Great Lake State bordering Ontario has already taken steps towards liability reform.

However, the Institute would also like to point out that professional liability risk is especially important if a jurisdiction wishes to attract business entities engaged in high-value activities, most of which require access to a deep pool of senior-level professional talent.

Our members work in public accounting, industry, public service, academe, not for profits and elsewhere. Liability issues are a factor for all, but none more so than those engaged in the practice of public accounting.

Every time a CA signs off on a financial statement – whether they are working for an international firm on Bay Street or at a one-person practice on Main Street – they are currently “betting the firm.” Because of the severe repercussions of losing a lawsuit under a joint and several liability system, where being found even one per cent responsible for a loss can leave a firm or individual accountant responsible for all of the damages, the pressure is enormous (*See Appendix G – How Big is the Problem?*).

That risk means auditors must put more time and effort into each assurance assignment, which is reflected in higher costs that must be passed onto the client. It means insurance, when available at all, is also reflected in higher costs. It means that assignments for good companies that entail some risk of liability are being turned down, which costs the broader community in terms of missed opportunities for investment, growth, jobs and competitiveness.

For individual professionals, liability risks can drive them out of higher-risk work, such as auditing and assurance, into other areas of practice while also deterring recruitment at the partnership level. In the near future, as Canada’s global competitors move forward on liability reform, this trend may draw professional talent out of the Canadian market altogether.

Because of reciprocity agreements with our global trading partners, Canadian CAs can currently attract accounting professionals from many other jurisdictions and Canadian CAs can and do work around the world. But, if we fall behind in terms of protecting our professional talent pool with fair and effective liability reform, that two-way flow could quickly result in a “brain drain” of Canadian financial professionals seeking employment in other jurisdictions. The result would be a decline in Canada’s ability to compete for the high-value jobs and investments that are the keystone to success in the 21st Century.

*3. Is the modernization of Canada’s competition and investment laws sufficient for successfully attracting foreign direct investment in Canada? What other priorities and policy issues should governments address?*

The modernization of Canada’s competition and investment laws would be welcome by the CA profession and are certainly a good start towards successfully attracting foreign direct investment. However, as previously stated in our submission, legal liability reform and the establishment of nationally consistent and internationally respected public accounting standards are also vital to attracting FDI.

Simply put, a country with a risky and increasingly uncompetitive liability regime will have significant problems in retaining or attracting both highly skilled professionals and needed foreign investment. International talent and capital are freer to pick and choose where to “land” than ever before. Canada needs a fair liability regime that continues to protect investors while also meeting the needs of the wider business community and general public.

Similarly, a country without high standards for the practice of public accounting would be at a tremendous disadvantage in attracting FDI, which requires assurances that financial statements are signed off by people who are both highly qualified and held accountable for their work. Canada’s current situation, where provincial and territorial standards are a patchwork quilt and legislated standards in some jurisdictions fall well below those of the country’s only internationally recognized accounting designation, is only marginally better.

Mandating high, internationally recognized standards of qualification and conduct for public accounting from coast to coast will help Canada maintain its international reputation as a safe and competitive place to invest.

## **Recommendations:**

1. Stakeholders from government, business, the professions and the general public should continue to be consulted on ways to make Canada more competitive. As part of that undertaking, the Institute of Chartered Accountants of Ontario seeks to play an active role in any upcoming stakeholder consultations.

2. The Competition Policy Review Panel should undertake subsequent inquiries that would include an examination of the effects on our country's ability to compete internationally through the adoption of both nationally consistent, internationally recognized public accounting standards of qualification and conduct and legal liability reform.
3. The Competition Policy Review Panel should take the position that efforts to make Canada more competitive should focus on keeping our country's policies, standards and legislation at or above the international norm so as to remain competitive globally.

## Appendix A – An Issue for Bay Street and Main Street

It is a fact that the legal liability problem for Canadian auditors is getting sharply worse for the larger public accounting firms. But how big is the issue for practitioners in small and medium-sized firms, and among sole practitioners, many of whom serve smaller clients in our smaller communities?

According to a spring 2007 online survey conducted in Ontario, the need for legal liability reform is indeed as big an issue on “Main Street” as it is on “Bay Street”. The survey of practitioners in these segments\*, conducted in June 2007 by the Institute of Chartered Accountants of Ontario, is identical to one conducted exactly two years before. Both netted high response rates (nearly 20 per cent). On the major measures, respondents in the most recent survey said the liability crunch, both for practitioners and for smaller Ontario enterprises, is worse now than it was then. Key excerpts, as expressed by percentage of respondents:

“To what extent are liability related issues deterring your firm or practice from taking on assurance engagements?”

Moderate or significant extent, 2005: 64%

Moderate or significant extent, 2007: 71%

“To what extent are liability-related issues making it increasingly difficult for clients to access quality assurance services?”

Moderate or significant difficulty, 2005: 58%

Moderate or significant difficulty, 2007: 69%

Additionally, 73 per cent of 2007 respondents report a moderate-to-significant increase in professional liability insurance costs over the past five years.

Here is a sampling of written comments submitted by survey respondents:

“Significant numbers of public accountants are walking away from audits. Others are simply declining engagements where risk is significant, because if an audit client fails economically, the auditor is often seen by investors and creditors as a way to recover, even when auditors may not have had any role in such failures and have only partial responsibility regarding inadequate reporting.”

“(This is) particularly an issue as we try and expand our partner base. Further, we’re dropping potential work due to risk.”

“I do not perform audits and even try to avoid review engagements. It is the ever-increasing cost of liability insurance that concerns me.”

“Our firm refuses audits because of the liability issue.”

“There is NO INSURANCE market for firms our size.”

\* About the respondents:

- 64 per cent sole practitioners, 28 per cent two-to-five partners, eight per cent over five partners
- 75 per cent have one-to-seven full-time staff, 14 per cent eight-to-twenty, 11 per cent 21 to 40 or more
- 95 per cent have no public companies as clients
- 7 per cent in business 21 years or more, 31 per cent 11 to 20 years, 20 per cent one to 10 years

Note that while this survey was conducted in Ontario, the liability issue is a Canadian-wide one and similar results could be expected in other provinces.

## Appendix B – Real Businesses – Real Impacts

The pressures on the audit and assurance market aren't hypothetical. Here are just three accounts of actual Ontario business transactions that could not proceed because of the risk of the audit assignments involved. These case studies were provided to the Institute by audit firms. For business confidentiality reasons, all references to the actual companies in question have been removed.

### **Example 1**

*“A company involved in leasing fixed large assets for many years had maxed out its finances and had used securitization to pool assets and come up with needed funding. It was still a decent company but it was highly leveraged, although not to the point of breaching its debt covenant. Normally we would have accepted an engagement to work with the management and help them turn the company around. The company required an audit, which we wouldn't accept because the risk of failure might expose the firm to litigation even if the audit wasn't negligent. They were denied access to the audit they needed to help obtain required financing.”*

### **Example 2**

*“We were approached by a relatively new company in the audio networks business. They were proposing to enter a new field and wanted to set up a system to charge people for uploading and downloading music from a website. To do so, they'd need to go public to raise funding. They were honest and capable people and the business looked viable. But, in today's environment for assessing risk, this business still looked too new and unproven. Emerging industries are always vulnerable, whether it is to changes in technology or other unknown factors. We wouldn't take their business or help with their IPO.”*

### **Example 3**

*“An established business selling household soft goods wanted to hire our firm as auditors. We looked and found that, while they were well capitalized, they had engaged in some inventory financing. Their market was increasingly competitive and, in Canada, a mature one, which necessitated the product having to be sourced offshore. We felt that the commoditization of the product was resulting in declining profit margins and that, at some future point, this company could face financial difficulties. If that occurred, and a lender had to realize on the inventory, the lender could sustain significant losses. That could in turn result in the lender coming back and look at the audit, with the intention of tagging the auditors to recoup some of their losses. The risk in that scenario was too high, so we declined the audit work, even though the company was not currently in any trouble.”*

## Appendix C – Keeping up with the Neighbours

Canada is in business competition with many countries around the world, none more so than the United States. For example, Ontario's economy lies at the heart of the Great Lakes basin, where more than 60 per cent of the population of the United States is within a 90-minute flight of Toronto. We should be ideally situated to compete in one of the largest and wealthiest marketplaces in the world. But as the accompanying map and chart shows, these neighbouring jurisdictions are well ahead of us in legal liability reform – and with it, in maintaining a competitive edge for business and investment.



- **Indiana:** Prohibits the application of joint and several liability in recovery of all damages.
- **Illinois:** Eliminated the rule of joint and several liability and provided for contribution among responsible parties.
- **Michigan:** Bars application of the rule of joint and several liability in the recovery of all damages, except in certain instances that are prescribed in the statute.
- **Minnesota:** When two or more persons are severally liable, contributions to awards shall be in proportion to the percentage of fault attributable to each, except in specific circumstances set out by legislation.
- **New York:** Limits joint and several liability by establishing that defendants found 50% or less at fault are only severally liable for noneconomic damages.
- **Ohio:** For each defendant determined responsible for fifty per cent or less of the tortious conduct, that defendant shall be liable to the plaintiff only for that defendant's proportionate share of the compensatory damages that represent economic loss.
- **Pennsylvania:** Abolishes joint and several liability.
- **Wisconsin:** Abolishes joint liability for defendants found less than 51% at fault.

It bears noting that these are just a handful of the 42 U.S. states that have enacted some type of liability reform legislation. Other major states that have addressed the issue include **California, Connecticut, Florida, New Jersey, Texas** and **Washington**.

SOURCE: The U.S. National Association of Mutual Insurance Companies. See: <http://www.namic.org/reports/tortReform/JointAndSeveralLiability.asp>

## Appendix D – Proposed National Standards: A Principled Approach

Increasing globalization and increasing integration of the Canadian economy with that of the United States of America, recent changes in public accounting legislation in some provinces and the general interest in higher accountability that now prevails are all factors that create an opportunity to develop and promote a principle-based model to achieve consistent, high minimum standards for the provision of public accounting services throughout Canada. With such a model, international investors and regulators will be able to judge Canada's ability to maintain confidence in business and capital markets in accordance with Canadian standards, rather than by region or province. As well, a principle-based model of uniform regulation will enable Canada to demonstrate that there can be minimum, high standards for public accounting qualification and governance standards, within multiple jurisdiction legal frameworks, that provide access to public accounting by a number of different accounting designations.

### Fundamental Principles

Public accounting qualification and governance standards must be based on fundamental principles:

- Protection of the public.
- High minimum standards that establish and maintain competencies and professional standards.
- A level-playing field for all those who are permitted to practice public accounting.
- Uniformity as to what activities are governed by such standards.

The cornerstone of the uniform public accounting qualification and governance standards must be the public interest. The requirements and processes established to govern public accounting must be predicated on high minimum standards that protect the public. These high minimum standards must be sufficient to engender the confidence of the parties that will rely on them – investors, regulators and financial institutions, among others. They must be recognized internationally and in particular by the public accounting bodies of Canada's major trading partners, especially in the United States, as providing the competencies necessary to practice public accounting. They also must ensure that all those who seek to be authorized to practice have fulfilled similar, rigorous competency requirements and are subject to uniform, mandatory standards of practice and regulatory processes.

Accordingly, the required high minimum standards must begin with entry-level qualification in education, examination and experience that those who seek to be permitted to practice public accounting must fulfill. But they also must involve standards of practice, measures of standards adherence and measures of standards enforcement to which all those who are permitted to practice public accounting are subject.

### Standards of qualification

Those who seek to be authorized to practice public accounting should:

- Satisfactorily complete similar, rigorous education requirements that meet the highest international standards, and in particular the standards established by Canada's major trading partner, the United States, and the other G7 countries. These would include a degree from an accredited Canadian university or a comparable university in another country, or the equivalent. They must also include prescribed university-degree credit courses in accounting, assurance and related subjects and a post-baccalaureate professional program emphasizing both technical skills and professional competencies specifically required for the performance of assurance engagements.

- Successfully complete a period of structured and monitored prescribed practical experience in public accounting under the supervision of authorized public accountants.
- Pass rigorous examinations that are both integrative and comprehensive in the testing of all the competencies necessary to practice public accounting.
- The standards for education, experience and examinations should meet or exceed international standards and be sufficient to earn reciprocity with the public accounting bodies of Canada's major trading partners.

## Standards adherence

All those who are authorized or permitted to practice public accounting should be subject to:

- Mandatory standards of practice: generally accepted standards of practice of the public accounting profession including the generally accepted accounting principles and generally accepted assurance standards that are set out in the *CICA Handbook – Accounting and the CICA Handbook – Assurance of the Canadian Institute of Chartered Accountants*.
- Rules of professional conduct which specifically prescribe the standards of conduct to which members practising public accounting must comply, and which are:
  - Founded on the principles of protection of the public (such as the requirement of independence, conflict of interest, confidentiality)
  - Intended to ensure protection of the reputation of all public accountants
  - Harmonized with the rules of other accounting bodies recognized under the applicable statute(s) as being permitted to authorize their members to practice public accounting
  - In compliance with international standards.
- Uniform, mandatory continuing professional development requirements specific to members practicing public accounting that involve minimum annual and other periodic hour requirements and reporting provisions.
- Mandatory and cyclical practice inspection within a uniform system that includes on-site inspections to ensure maintenance of an appropriate level of professional standards, through review of current accounting and auditing engagement files, and compliance testing of quality control procedures. The system must include the ability to compel the production of working paper files, books, documents or other materials and the power to make complaints of professional misconduct where warranted.
- Mandatory quality control requirements that comply with international standards.
- Mandatory and stringent professional liability insurance requirements.

## Standards enforcement

All those who are authorized or permitted to practice public accounting should be subject to:

- Rigorous complaints investigation and discipline powers and procedures based on sanctioning principles of specific deterrence, general deterrence and rehabilitation, and which have public representative involvement at all stages.
- Sanctions/discipline that are the result of thorough practice inspection.
- e-entry requirements if not active in the authorized activities for a prescribed period of time.

## Legislative principles

1. Authorization to practice as public accountants should be mandatory under legislation.
2. Authorized activities should be audit, review and compilation services.
3. The legislation should specifically designate the bodies whose members may qualify to practice public accounting and prohibit the practice of public accounting by any other individuals.
4. The legislation should establish the framework for establishing and maintaining high minimum standards for qualification, admission and ongoing regulation (quality control requirements, practice inspection, discipline, etc.).
5. The legislation should establish a mechanism or process that is independent of any of the designated bodies to assess each designated body to determine whether it meets the high minimum standards in respect of both content and rigour, and has sufficient governance structures and regulatory processes, in order to be granted the right to authorize its members to practice public accounting.
6. Every authorized public accountant must be a member of a designated body and be subject to regulation by that body.
7. Members of more than one designated body must specify the body to which they will be subject for regulatory purposes.
8. Removal by one designated body of authorization to practice as public accountant must preclude being granted authorization to practice public accounting by another body.

## Conclusion

The establishment of nationally consistent public accounting qualification and governance standards as described in the foregoing would be a “win” for all stakeholders, resulting in:

- streamlined, more efficient and effective governance of public accounting in the public interest
- an enhanced climate for international investment
- consistency with U.S. regulation, with particular reference to the requirements of the *Sarbanes-Oxley Act* and evolving SEC requirements
- improved domestic labour mobility
- nationally higher practice standards for other accounting designations, resulting in a high level playing field for all practitioners

## Appendix E:

# Chronology: The New Public Accounting Act, 2004

The Attorney General's June 20, 2006 approval of high new public accounting standards for Ontario is the culmination of a four-year process that began under the previous Ontario PC government. Below are some of the more significant milestones along the way.

### **October 30, 2002**

The Progressive Conservative government announces a review of public accounting licensing in Ontario, appointing Ronald Daniels, Dean of the Faculty of Law at the University of Toronto, to study the issue and make recommendations for both a new governance model and new standards of practice for public accounting.

### **November 26, 2002**

The government tables Bill 213. The legislation states only that persons can have access to a public accounting license if they are members of one of the three accounting bodies, are of good character, and pass an unspecified examination. Additionally, no mention is made of standards adherence and standards enforcement requirements.

The CA profession asks for revisions to ensure that the necessary high, internationally recognized standards of qualification and regulation are clearly specified before public accounting licenses can be issued by any accounting body.

### **December 6, 2002**

Bill 213 receives second and third reading and is passed by the Legislature.

That same month, the U.S. National Association of State Boards of Accountancy (NASBA) submits an open letter to Premier Eves in major Toronto newspapers. The letter warns against an erosion of public accounting standards in Ontario without major changes to Bill 213. Such a development, NASBA cautions, could also call into question the mutual recognition agreements enjoyed by both countries, founded on the equivalency between Canadian CA and U.S. CPA public accounting standards.

### **February 2003**

Dean Daniels begins his consultations with the three accounting bodies while preparing his recommendations. In a discussion paper on how a new public accounting governance structure could work, he warns of the risk of “regulatory arbitrage”, which he says can arise “when regulatory organizations opt for less costly, more lenient and socially undesirable forms of regulation solely as a means of capturing increased market share for their members at the expense of members of competing, higher standard professional self-regulatory bodies.”

### **April 1, 2003**

Dean Daniels tables his report. While making substantive recommendations for a new governance structure, the need for “sufficiency tests” to ensure the other accounting bodies can meet the required standards and measures to combat illegal practice, his report does not fully address what the required standards themselves should be. Instead, he calls for the standards issue to be resolved by a new Public Accountants Council (PAC) made up of two representatives of each of the three accounting bodies.

### **September 2003**

A provincial election is called. The leaders of both the Ontario PC Party and the Ontario Liberal Party sign public documents committing them to enshrining Ontario's existing public accounting standard as the basis for licensure eligibility for all accounting bodies under the new system. The Party Leaders also commit to a PAC comprised of four CAs, two CMAs and two CGAs.

**June 9, 2004**

After extensive discussions with industry representatives, the McGuinty government repeals the public accounting provisions of Bill 213, and replaces them with a new *Public Accounting Act, 2004* (Bill 94), which is passed in the Legislature with the consent of all three parties. However, the Act is not proclaimed into law pending the advent of a new PAC and the appointment of its membership, and the development of supporting regulations.

**November 1, 2005**

The *Public Accountants Act, 2004 (PA Act)* is proclaimed.

**January 2006**

The PAC begins its deliberations on a new qualifying and regulatory standard for public accounting licensing in Ontario. The PAC's efforts would be guided by Section 19(4) of the new *PA Act*, which specified that the new standards must be no less rigorous than those in effect on June 9, 2004 (the day on which the legislation was tabled at Queen's Park).

**April 20, 2006**

The PAC completes its work on the proposed new standards in accordance with Section 19(4) of the *PA Act*. The PAC submits the proposed new standards to Attorney General Michael Bryant for his consideration.

**June 20, 2006**

Following the conclusion of the review period, the Attorney General advises the PAC Chair and all three accounting bodies that he has no objection to the proposed new public accounting standards as submitted and that they are now in effect. Those standards are shown to be of equivalent rigour to the high standards that preceded them.

**November 1, 2006**

The PAC grants authorization to the CA Institute to license and govern the activities of its members as public accountants. The PAC's authorization follows a review of the Institute's qualification and regulatory standards, which determines that the Institute meets the PAC's Standards adopted under the *Public Accounting Act, 2004*.

## Appendix F – Recognized Accounting Bodies

Canadian Chartered Accountants have negotiated mutual recognition agreements with these international organizations:

- The Institute of Certified Public Accountants of Hong Kong
- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Ireland
- The Institute of Chartered Accountants of Australia
- The Institute of Chartered Accountants of New Zealand
- The Institute of Chartered Accountants of South Africa
- The Institute of Chartered Accountants of Scotland
- The Japanese Institute of Certified Public Accountants
- The Institute des Reviseurs d'Enterprises de Belgique
- The Netherlands Institute of Register Accountants
- Order des experts comptables et des comptables agréés, France
- The Instituto Mexicano de Contadores Publicos
- Any State Boards of Accountancy in the United States of America with CA-CPA Reciprocity which exempt Ontario CAs from the requirement to pass the AICPA final examination.

## Appendix G - How Big is the Problem?

The current system of joint and several liability makes audit firms in Canada today the de facto insurers of our capital markets. This is unsustainable – not least because of the competitive edge that Canada stands to lose if we do not keep pace with liability reforms underway elsewhere.

Some people ask, “Is this really a big and growing problem?” Here are the facts:

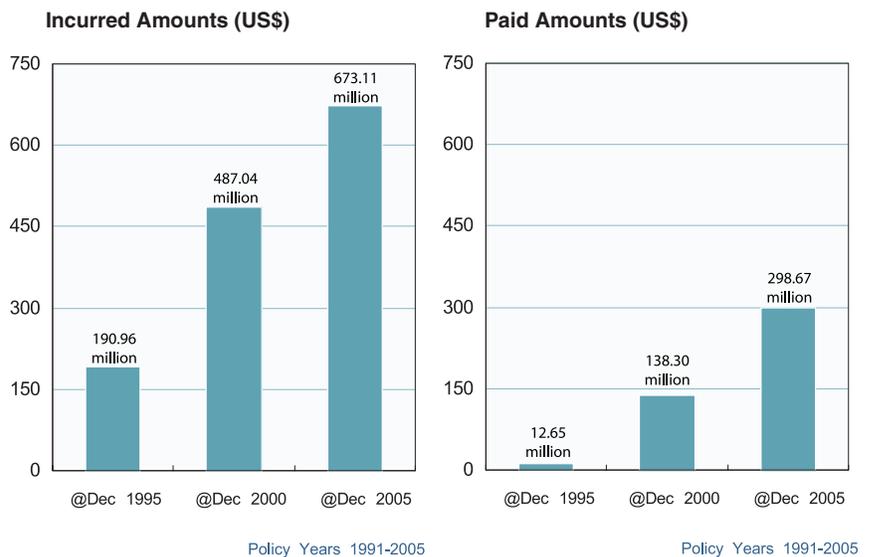
**Estimated number of suits claiming damages of over \$100 million filed in the last 10 years in Canada: 12**

**Estimated number of those suits claiming damages of over \$1 billion: 3**

It is important to note that we do not have a figure for the total amount of damages claimed in all actions that include auditors, as this kind of information is not always made public. And while some of these much larger suits may have been or may yet be settled for less, any one of them has the potential to do serious damage to the audit industry or to cause the failure of an audit firm. But that’s only part of the story:

As these charts indicate, because of these large claims and the accumulated totals of smaller ones, the dollar value of incurred claims against five of the biggest six audit firms in Canada increased from \$190.96 million, as at December 1995, to \$673.11 million as at December 2005. Incurred claims are not the total of damages sought but instead reflect the amounts firms must set aside in anticipation of prospective case settlements, plus amounts paid up to that point and related defence costs.

The trend line for the dollar value of amounts actually paid by those audit firms was even more ominous: The amounts paid out shot upward from \$12.65 million as at December 1995 to \$298.67 million as at December 2005.



Source: AON