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

Via email: comment@ccmr-ocrmc.ca

December 22, 2015

RE: Comments on Revised Consultation Draft CMA

The Canadian Public Accountability Board ("**CPAB**") welcomes the opportunity to provide comments with respect to the Part II of the provincial Capital Markets Act Revised Consultation Draft ("**Draft Act**"). CPAB provided a comment letter on December 8, 2014 on the initial draft of the provincial Capital Markets Act and recognizes that many of our suggested changes and recommendations were accepted. We are pleased with many of the changes that were made to the Draft Act as a result. Nonetheless, we believe there are certain key issues which must be considered by the Implementation Team in the context of the Consultation Draft and addressed in the Draft Act.

Access to Privileged Information

We remain fundamentally concerned regarding CPAB's access to information that is the subject of solicitor-client privilege. The Draft Act in its current form could seriously impair our ability to carry out our mandate. We reference the two letters sent to members of the Implementation team on November 3, 2015 and December 4, 2015.

Reporting issuers are statutorily obliged to provide their auditors with access to privileged information. A sound oversight process should contain the same requirement, subject to appropriate privilege and privacy protections. It is fundamental that the statutorily mandated authority has the ability to review the same material that the auditor relied upon and retained in its work papers to substantiate its audit oversight opinion.

The consent model will not be effective once it becomes applicable to the vast majority of Canadian reporting issuers soon to be regulated by the new provincial Capital Markets Act. We believe this concern is shared by auditors, reporting issuers and audit committees. The process of getting consent could become very burdensome (for all involved – CPAB, the reporting issuer, as well as the audit firms). Leaving aside the burdensome nature of routinely seeking consents, denial of such consents would, again, undermine the effectiveness and integrity of the oversight process. Several major issuers have already suggested that there may be legitimate reasons why they would deny consent if it were to be sought from them (particularly given uncertainty as to the protection of privilege extra-jurisdictionally). In such instances, CPAB has no direct recourse against the reporting issuer, and can only impose disciplinary action upon the audit firm unfairly caught in the middle. As a result, the integrity of the oversight process would be undermined.

If forced into a "consent" model, audit firms would effectively be required to seek ex-ante consent in their engagement letters. The risk of facing a challenge to such a practice (especially given the stated views of certain issuers) would be significant and highly disruptive. The other alternatives – going to court or amending the legislation – will be expensive, time consuming and won't address the immediate problem (i.e., they are only prospective solutions).

We are concerned that, in many instances, we may not be able to see everything in the auditor's working papers that we need to see to complete our review of the audit. This effectively neuters CPAB's ability to discharge its statutory mandate as we may not be able to form an appropriate opinion, and we may be required to issue a report indicating a scope limitation. The damage to public confidence and the integrity of the oversight process could be significant.

I would remind you of the protections afforded to such privileged information. In Phillip Services Corp., the Ontario Divisional Court concluded that, given a company's statutory obligation to cooperate with its auditor and the public policy rationale for encouraging full and frank disclosure, when a company provides a privileged document to its auditor for the purpose of the audit the document remains protected by the privilege against any further disclosure. The Ontario CPAB Act (and the Draft Act) extend the logic of that decision by mandating that such disclosure to CPAB does not negate or constitute a waiver of any privilege. The Ontario CPAB Act (and the Draft Act) also restricts the ability of CPAB to disclose privileged documents or information.

CPAB takes additional precautions (e.g., not taking copies of privileged materials) to protect privileged information. In any event, the focus of CPAB's review always relates to the work of the auditor to ensure that any material risks and uncertainties contained in privileged documents and information have been properly accounted for in the financial statements, rather than the details of a reporting issuer's legal issues (or information of or concerning individuals).

No one has ever attempted to obtain privileged client information from CPAB and we believe any such attempt would be unsuccessful under the current legislation.

CPAB has counterpart regulators in other parts of the world, including the United States, the European Union and Japan. These regulators have access to privileged materials in their jurisdictions. Many of Canada's reporting issuers are registered in some or all of those jurisdictions, particularly in the United States. Our objective is to establish equivalency arrangements with these regulators, which will enable us to rely upon each other's work so long as we all have met common inspection standards. If our inspections are limited as proposed, we anticipate that the foreign regulators may choose to become directly involved with Canadian reporting issuers registered in their jurisdictions, requiring such issuers to make full disclosure of privileged documents to them or to CPAB as a condition of continuing registration. It would be preferable in our view, to provide CPAB with the access we require so that these regulators can rely upon our work, rather than have these regulators directly involved with Canadian reporting issuers as outlined above.

The following are several examples of actual situations CPAB has already encountered, which illustrate the necessity for CPAB being able to access any and all documents and information included in the auditor's work papers. Without revealing any specific information relating to the business, affairs, or financial condition of any audit firm or client of any audit firm, we can say these situations include:

- A manufacturing company which has engaged in material tax transactions has received legal opinions to support the positions it has taken in its financial statements with respect to those transactions. The auditor accesses such privileged legal opinions, and retains copies of them in his audit work papers. Again, CPAB's mandate to oversee how the audit firm handles this financially material component to the financial statements requires CPAB to determine whether the audit firm obtained, assessed and documented the financial implications of the legal issue in accordance with auditing standards. The task cannot be fulfilled without reviewing all of the documents and information that the auditor has decided are necessary to retain in the audit working papers to satisfy those standards.

• A mining company which has potential environmental liabilities has received legal opinions to support the positions it has taken in its financial statements with respect to those transactions. The auditor accesses such privileged legal opinions, and retains copies of them in his audit working papers. CPAB's mandate cannot be fulfilled without reviewing all of the documents and information the auditor has decided it is necessary to retain in the audit working papers to satisfy applicable auditing standards.

• A financial institution which has significant tax issues has received legal opinions to support the positions it has taken in its financial statements with respect to those issues. The auditor accesses such privileged legal opinions, and retains copies of them in his audit work papers. CPAB's mandate cannot be fulfilled without reviewing all of the documents and information the auditor has decided it is necessary to retain in the audit working papers to satisfy applicable auditing standards.

These are all examples of situations in which CPAB's access to privileged documents and information serves to ensure that any potential material risks and uncertainties therein have been properly accounted for in the financial statements, thereby protecting the best interests of the investing public relying upon such financial statements.

We caution against changing a framework which has worked effectively to date for no appreciable legal or practical benefit. The consent model used by certain provinces has not been problematic to date because the overwhelming number of reporting issuers are subject to the CPAB Act. To impart this model into national legislation risks creating confusion and uncertainty on the part of all actors involved, and will effectively block CPAB from performing its mandate in many situations. We believe that continuation of the current statutory regime would be a more sound legislative approach.

CPAB respectfully requests that given the importance of this matter, we be allowed by the Implementation Team to make further submissions in respect of alternative solutions in the event that the CPAB Act model is not retained. We expect that issuers, who may not have focused on this issue, will also want to express their concerns.

Scope of Regulation over CPAB

The recognized auditor oversight organization is defined as a "recognized entity" in Section 9 (1(d) of the Draft Act, followed by several provisions applicable to it alone. However, in Section 2, the definition of "market participant" also includes "recognized entity", thereby creating overlapping powers over the auditor oversight organization, and potentially rendering applicable many provisions that are only intended for other market actors. Section 202(1) also gives extensive regulation making powers over "recognized entities", which far exceeds any power currently held by any provincial securities commissions over CPAB at this time. We submit that the recognized auditor oversight organization should be carved out from the recognized entity definition, or in the alternative, removed from the definition of "market participant", to create a clear and stand-alone system of oversight over CPAB that reflects the level of oversight currently exercised by provincial securities regulators.

We recognize that the Draft Act is intended to serve as framework legislation and, assuming CPAB is recognized as an auditor oversight organization, feel it should retain its broad rule-making authority, subject to the conditions of its recognition.

Provision of Information to the Chief Regulator

Section 15 (3.1) allows the Chief Regulator to compel a recognized auditor oversight organization to produce "any information, record or thing within a prescribed class". As a general principle, the Chief Regulator should access information directly from reporting issuers, rather than indirectly through CPAB and the auditor. If the concern is one of ensuring that the recognized auditor oversight organization proactively alerts the Chief Regulator to potential breaches of the law, this might best be provided for by the inclusion of an equivalent to s.13 of the CPAB Act[1], and/or in an MOU (as in the case of the MOU between the CPAB and the Ontario Securities Commission)[2] instead of the broad language of Section 15 (3.1).

We also submit that when defining the prescribed class, if such language is retained, the framework that is currently reflected in the CPAB Rules, as well as National Instrument 52-108, be considered.

The protection of privileged material that would ultimately be provided to the Authority, as well as to any regulatory authority, law enforcement agency, or professional regulatory authority as per Section 16(5) in the previous version of Draft Act, should be reintroduced.

Protection of Documents Shared in the Context of International Cooperation

We thank the Implementation Team for the addition of Sections 15(4) and 15(5). We respectfully submit that language similar to that in Section 16(4) (stating that the consent given to sharing privileged information or records with foreign auditor oversight body does not negate nor waive privilege) be added to Section 15(5).

Testimony in Civil Procedures

Unlike Section 11(3) of the CPAB Act, which exempts CPAB and its representatives from giving evidence about information obtained in the performance of its duties in any proceeding (other than a proceeding

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[1] S.13(1) Despite subsection 11(2) [see fn. 1 above] if the Board is provided with any document or information that provides reasonable grounds to believe that any person or company may have contravened any law, the Board may notify the Commission, any regulatory authority, law enforcement agency or professional regulatory authority as the Board considers appropriate that it has discovered evidence of a contravention of the law, but the Board shall not disclose,

a) privileged documents, privileged information, or information based on privileged information or documents, or

b) any specific information relating to the business, affairs or financial position of a participating audit firm or the client of any participating audit firm except to the extent that the disclosure is authorized in writing by all persons and companies whose interests might reasonably be affected by the disclosure.

[2] An MOU covering Consultation, Cooperation and the Exchange of Information between the OSC and the CPAB (entered into on November 27, 2013) contemplates that the CPAB will share certain information with and provide assistance to the OSC in obtaining and interpreting information relating to potential violations of securities laws.

under the CPAB Act)[3], Section 16(6) of the Draft Act only provides for such an exemption in respect of civil proceedings in which the recognized auditor oversight body is not a party. The reason for this narrower exemption is not clear and we are concerned that it could impair the ability of the CPAB to obtain information from audit firms and issuers.

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We hope these comments are of some assistance and look forward to working the Implementation Team in refining the provincial Capital Markets Act and related regulatory instruments.

Yours truly,

Brian A. Hunt
Chief Executive Officer

[3] s.11(3) No member of the Council of Governors or the Board and no officer, employee, agent or representative of the Board shall be required in any proceeding, except a proceeding under this Act, to give testimony or produce any document with respect to documents or information that the person is prohibited from disclosing under this Act.