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VIA EMAIL

Consultation Process

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December 22 2015

Capital Markets Act
Audit Firm Comments

Dear Sirs/Mesdames:

I write on behalf of the Canadian audit firms Deloitte LLP, KPMG LLP, Ernst & Young LLP and PricewaterhouseCoopers LLP (the "Audit Firms"). We welcome the opportunity to provide comments on the revised consultation draft of the *Capital Markets Act* (the "CMA").

You will recall that the Audit Firms provided a comment letter dated December 8, 2014 regarding Part 2 of the CMA during the previous comment period.

We repeat those comments here only to the extent necessary for context. Regrettably, many of the concerns expressed in that letter continue to apply to the revised consultation draft.

Existing Auditor Regulation

Since 2004, the national auditor oversight organization in Canada has been the Canadian Public Accountability Board ("CPAB"). Every audit firm which audits a Canadian reporting issuer is party to a participation agreement with CPAB, as required by National Instrument 52-108, and pursuant to which a body of rules has been established ("CPAB Rules"). CPAB was subsequently given statutory authority pursuant to various provincial legislation, which in Ontario is the *Canadian Public Accountability Board Act (Ontario), 2006*, S.O. 2006, c.33, Sch. D ("CPAB Act"). The CPAB oversight system works well and is a counterpart to the public audit firm oversight system in the United States operated by the Public Company Accounting Oversight Board ("PCAOB") established in 2002 pursuant to the *Sarbanes-Oxley Act.*

Unlike other self-regulatory organizations contemplated by the CMA (but similar to the PCAOB), the CPAB oversight framework is premised on the free flow of confidential communications and reports between the CPAB and participating audit firms concerning the inspection of audits of reporting issuers (CPAB Rule 413), subject to public disclosure if the audit firm does not satisfactorily address weaknesses or deficiencies identified in systems of quality control or specific audit engagements (CPAB Rule 414) and subject to notice or disclosure in defined circumstances to regulatory authorities including the provincial Institutes, securities regulators, OSFI and foreign audit oversight authorities (CPAB Rule 417; CPAB Act, ss. 13, 14; and NI 52-108, ss. 5, 6). While auditors have wide powers to obtain documents and information from reporting issuer clients as necessary to carry out their role as auditor (e.g. OBCA, s. 153(5)), they are under a professional obligation to maintain

confidence over client information obtained in the course of a professional engagement (e.g. Chartered Professional Accountants of Ontario Rule 208).

In light of these considerations, we comment as follows on the revised consultation draft of the CMA:

Scope of Regulation

Our over-arching concern is with the breadth of legislative powers given to the Authority. By virtue of the overlapping definitions and powers in CMA sections 2 and 9(1)(d), an auditor oversight organization such as CPAB can be both a "recognized entity" and "market participant" under the Act. Accordingly, recognized auditor oversight organizations are theoretically subject to regulation under almost every part of the CMA, even those parts clearly intended for other market actors such as reporting issuers.

CMA section 202(1) provides the Authority with broad power to make regulations governing both "recognized entities" (including auditor oversight organizations) and "auditors of issuers and registrants". These powers are not limited on the face of the CMA and far exceed the jurisdiction over auditors currently enjoyed by provincial securities commissions such as the Ontario Securities Commission.

CMA section 12 permits the Chief Regulator to make "any decision" respecting a by-law, regulatory instrument, policy, procedure, interpretation or practice of a regulated entity or the manner in which a regulated entity carries on business, providing the Chief Regulator considers it would be in the public interest to do so.

These powers cover ground already occupied by a mature and effective system of auditor regulation. Moreover, the existing system has been recently modernized. Public accounting and auditing in Canada have been regulated by statute since 1902. Pursuant to harmonized provincial and territorial legislation enacted since 2012, the accounting profession is now unified across the country. Similarly, CPAB has been in place as a national audit regulator since 2004, and with a statutory mandate since 2006. Within this updated framework, organizations such as CPAB, the OSC and CPA Ontario ensure a robust and coordinated audit regulatory system.

We fully support the need for harmonized capital markets legislation in Canada, and we recognize the role that the audit industry plays in those markets. However, we encourage you to reconsider the extent to which the CMA overlaps and, in many cases, contradicts the existing system of auditor regulation.

One example of overlap is the review of decision-making. The CMA provides a process for the review of decisions of recognized entities (section 13), including the review of decisions made within CPAB as an auditor oversight organization. However, CPAB already has a detailed procedure for review proceedings and decisions (CPAB Rules, Sections 700-720), including the review and appeal of those decisions by arbitration (CPAB Rules, Sections 900-907). The CMA does not indicate if it is intended to replace the existing CPAB procedure, or to provide for an additional review process after the CPAB procedure has been exhausted. Different limitation periods for the review of decisions are provided under the two systems (15 days under the CPAB Rules; 30 days under the CMA). Accordingly, under the CMA it is unclear both where and when a given decision should be reviewed.

Further anomalies exist. CMA section 13(1) would permit the Chief Regulator to apply for the review of any CPAB decision. However, the Chief Regulator is not party to CPAB review proceedings and such proceedings are held in camera (CPAB Rule 701), so it is unclear how the Chief Regulator would know about a decision in order to apply to review it. Moreover, CMA section 13(3.1) protects privileged information from disclosure to the Chief Regulator during review proceedings, but fails to protect privileged information from disclosure to other persons.

The prejudice caused by confusing and inconsistent regulation falls not only on auditors, but also on their clients and the investing public. This result would be inconsistent with the stated intent of the CMA process, which has been "to maintain continuity and minimize disruption for market participants" and to "propose initial regulations that substantially maintain the harmonization achieved under the current structure".

Client Privileged Information

The Audit Firms are required by the CPAB participation agreement and by provincial legislation (e.g. CPAB Act, ss. 11(1) and (4)) to provide CPAB with all documents and information that the firm obtains or prepares in order to perform the audit of a reporting issuer, including that issuer's documents and information that are subject to solicitor-client privilege. When privileged documents and information are disclosed to CPAB, the privilege is not waived but continues for all other purposes (CPAB Act, s. 11(5)). The CPAB Act is thereby consistent with the strong protections repeatedly recognized for solicitor-client privilege by Canadian courts, including the Supreme Court of Canada which has held that solicitor-client privilege should be "as close to absolute as possible": *R. v. McClure*, [2001] 1 S.C.R. 445, paras 31-34.

We submit that it is critical that the CMA be consistent with this authority in both approach and terms. For that reason, section 16(5) in the previous draft was necessary and beneficial to ensure the appropriate protection for privileged materials. We urge you to reconsider the decision to delete section 16(5) from the revised consultation draft.

We continue to believe that the proper functioning of the CPAB oversight system is facilitated and enhanced by the statutory requirement to deliver privileged documents and information to CPAB (as in CPAB Act, section 11(4)), which avoids the creation of unnecessary tensions between the client and audit firm, or between the client and regulatory authorities.

It is worth noting that the CPAB Act applies to all reporting issuers as determined by Ontario securities law, which includes not only issuers that have issued securities in Ontario under a prospectus, but also issuers that have their securities traded on a stock exchange in Ontario. Accordingly, the CPAB Act (while Ontario legislation) applies to the vast majority of reporting issuers in Canada, regardless of their location or the law under which they are constituted. The statutory requirement in section 11(4) of the CPAB Act functions well.

In that regard, we continue to have serious concerns with the consent requirement in the CMA section 16(3). First, assuming the CPAB Act remains in effect, CMA section 16(3) is in direct conflict with CPAB Act section 11(4). Even if the CPAB Act is repealed as proposed in the Ontario implementation legislation, the Audit Firms are bound by the participation agreement with CPAB and the CPAB Rules to produce all documents to CPAB as required, without following an express client consent model. Second, given all of the other protections for privilege in the CPAB Act and existing

auditor regulatory framework, CMA section 16(3) is unnecessary. Third, it is contrary to the objective of effective auditor regulation based on the free flow of information. Finally, there is a risk that consent given voluntarily in Canada pursuant to the CMA could be found to waive the privilege under foreign laws in the United States and elsewhere, regardless of the purported protections under the CMA (under section 16(4) or otherwise).

Therefore, we urge you to reconsider the consent model for privileged information. In the event that CMA section 16(3) is retained, we encourage you to consider provisions to facilitate the delivery of client consent. As only one example, consent could be required by the Authority as a condition of registering or maintaining a listing. In this regard, we reiterate that it is most appropriate for the Authority to regulate and deal with reporting issuers directly, rather than via CPAB and/or via the auditor.

Confidentiality

The addition of CMA section 15(3) is commended. This section mirrors CPAB Act section 11(2) and is consistent with subsection 105(b)(5) of the *Sarbanes-Oxley Act* in the U.S. context. This section confirms that information in the hands of a recognized auditor oversight organization is confidential and not be disclosed by that organization without consent or court order.

However, we continue to have concerns with CMA section 15(3.1), which permits the Chief Regulator to compel a recognized auditor oversight organization to produce "any information, record or thing within a prescribed class". It is not possible to assess the adequacy of the impact or operation of this provision in the absence of regulations defining the prescribed class. As general proposition, we believe that it is most appropriate for the Authority to obtain information from reporting issuers directly, rather than via CPAB via the auditor. Further, we ask that the "prescribed class" be defined so as to preserve the balance between confidentiality of communications between CPAB and participating audit firms, and disclosure to the public and to regulators (including provincial Institutes, securities regulators and OSFI) that is reflected in the current framework and in particular in CPAB Rules 413 and 417, CPAB Act section 13, and NI 52-108 sections 5 and 6.

We are also concerned that the CMA does not contain a confidentiality provision similar to section 16(2) of the Ontario *Securities Act* to protect certain information provided during an investigation or examination from disclosure. This gap is prejudicial to anyone who provides testimony or documents in an investigation or examination, which could include a recognized audit oversight authority or an audit firm.

Foreign Bodies

CMA section 15(4) mirrors CPAB Act section 14(1) and is a workable reflection of international cooperation among auditor oversight bodies. The section permits, but does not require, a recognized auditor oversight body in Canada to provide information, records or things in certain circumstances to counterpart bodies in other countries.

However, we have concerns with CMA section 15(5). Rather than mirror the prohibition in CPAB Act section 14(2) against disclosing privileged information to foreign oversight bodies, CMA section 15(5) follows the consent requirement approach above. Again, assuming the CPAB Act continues in

effect, this presents a direct legislative conflict and introduces unnecessary tensions to the framework.

In the event that CMA section 15(5) is retained, please note that CMA section 195(2) is under-inclusive and fails to protect privilege when disclosure is made to anyone other than the Authority. More specifically, CMA section 195(2) provides that consent to disclosure does not negate or waive privilege, but it is restricted to circumstances of disclosure "to the Authority". There is no privilege protection when the disclosure is being made to foreign oversight bodies.

In the event that the consent model in CMA sections 16(3) and 15(5) is retained, we urge you to amend section 195(2) to provide that privilege is not negated or waived by any consent to disclosure made pursuant to the CMA.

If you have any questions or wish to discuss these issues with us, please contact Donald Hanna (donald.hanna@ca.ey.com) at your convenience.

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