



March 15, 2013

Mr. Tom O'Neill  
Chair  
The Role of the Audit Committee Working Group  
Enhancing Audit Quality Initiative  
c/o The Canadian Institute of Chartered Accountants  
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**DISCUSSION PAPER *ENHANCING AUDIT QUALITY: THE ROLE OF THE AUDIT COMMITTEE IN EXTERNAL AUDITOR OVERSIGHT***

Dear Mr. O'Neill:

The International Federation of Accountants (IFAC) values the opportunity to comment on the Discussion Paper *Enhancing Audit Quality: The Role of the Audit Committee in External Auditor Oversight* (the "Discussion Paper"). Through its membership, currently 173 professional accountancy bodies in 129 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education.

**General Comments**

IFAC recognizes the important role that a well-functioning audit committee plays in governance, risk management, and internal control arrangements for a wide range of different entities. In particular, the outcomes of the global financial crisis, and the responses to it, have highlighted that appropriately structured and well-operated audit committees promote good governance and financial reporting practices within organizations, and improve the quality of reported financial (and potentially, non-financial) information. Critically, with respect to their relationships with external auditors, audit committees that are comprised of competent and independent members also play a key role in promoting and enhancing audit quality.

Furthermore, IFAC supports the views of the "The Role of the Audit Committee Working Group" (the "ACWG"), that a culture of integrity, respect, and transparency is essential in the key relationships between the external auditor, management, and the board of directors (including the audit committee) as part of an organization's financial reporting governance arrangements—refer Figure One on page 8 of the Discussion Paper.



However, it could be argued that the key relationships in this area should also include relationships with regulators (securities and audit regulators and prudential regulators as appropriate) and the users of financial reporting information. The relationship between the audit committee and the regulators is highlighted in the Discussion Paper in the chapter discussing the communication of inspection results, while the relationship with the users of financial reporting is emphasized in the chapter devoted to the public commentary by the audit committee.

IFAC believes that audit committees should be viewed as a necessary part of the organizational governance arrangements for all public interest entities.

### **Overseeing the Work of the External Auditor**

IFAC recognizes that a fundamental responsibility of an audit committee is overseeing—and as such, having responsibility for ensuring the regular assessment of—the work of the external auditor, the appropriateness and effectiveness of the company’s internal control systems, risk management systems, and the application of adopted financial reporting frameworks. It supports initiatives aimed at promoting and enhancing this role.

Specifically, in relation to the oversight of the external auditor, IFAC believes that a well-functioning relationship between the auditor and the audit committee will promote and enhance audit quality. The work of the audit committee, including recommending the appointment of auditors, assessing auditor performance and independence, and receiving and responding to matters raised by the auditor, can only be performed effectively where a professional relationship exists with the auditor, based on respect, integrity and transparency.

*Do you agree that audit committees should perform these activities each year?*

IFAC agrees that audit committees should perform the activities each year, as detailed in the Discussion Paper.

*Are there any other activities that audit committees should perform each year to contribute to the enhancement of audit quality?*

There are no other activities that IFAC suggests the audit committee should perform each year that would contribute to the enhancement of audit quality.

*Do you agree it would be helpful to develop a document for Canadian audit committees similar to the US publication in Appendix B to assist in the execution of annual assessments of the external auditors?*

A document that provides guidance on how an audit committee might undertake an annual evaluation of the external auditor would be a helpful resource for audit committees. The US publication shown in Appendix B of the Discussion Paper provides a good foundation for the development of a document for Canadian audit committees. However, like all guidance documents of this kind, it is important that the document is tailored to the relevant jurisdiction. For example, consideration would need to be given to how a guidance document might need to be structured to make it appropriate for use for issuers of different size, in particular smaller companies; a large number of which are operating in Canada.



Additionally, it is important to ensure that audit committees that make use of such a document are cautioned against using it in a manner which becomes a routine, checklist approach. That is, audit committees must be suitably familiar with the arrangements in their own organizations to ensure that the questions asked and evaluation performed are appropriately adapted to the organization's circumstances.

### **Conducting a Comprehensive Review of Audit Firm**

IFAC supports the notion that audit committees should periodically, as a matter of good practice, undertake a comprehensive review of the audit firm engaged to perform the organization's external audit. The suggestion that a comprehensive review be performed every five year seems appropriate.

IFAC recognizes the potential merits of undertaking periodic comprehensive reviews and supports a clearer role for the audit committee with respect to enhancing and promoting audit quality and auditor independence. Like other proposed measures that aim to enhance audit quality and auditor independence such as mandatory audit firm rotation and mandatory audit firm tendering, there is no clear evidence of the impacts of periodic comprehensive reviews. However, as an alternative, a comprehensive review that is directed towards assessing audit quality and auditor independence would be potentially more efficient, less costly, and more practical.

#### Determining the Scope of the Review

With respect to the process described in the Discussion Paper for determining the scope of the comprehensive review, IFAC questions whether the most appropriate manner in which to begin to determine the scope would be for the audit committee chair to meet with a senior partner of the audit firm that is neither involved in the audit engagement, nor in providing other professional services to the issuer. This suggests that the audit firm that is being reviewed could potentially have undue influence over the scope of the review.

It is likely that, at some later stage in the process, a discussion with a senior partner of the audit firm would be beneficial, probably necessary, to ensure that the comprehensive review is thorough and complete. However, from a public perception perspective, the involvement of the audit firm in these early stages would potentially have observers of the process questioning the objectivity of the review and whether it is an appropriate way to promote and enhance auditor independence and audit quality.

The ACWG may wish consider whether paragraph 57 of the Discussion Paper should be revised to exclude the reference to initial discussion between the audit committee chair and a senior partner of the audit firm.

*Do you agree with the recommendation that comprehensive reviews of external audit firms, on which retention recommendations will be based, be conducted at least every five years?*

IFAC supports this recommendation, subject to the comments made in the preceding paragraphs in this section.



*Do you believe the comprehensive review should be made a requirement under securities legislation?*

The decision to make the comprehensive review a requirement under securities legislation will depend on the manner in which other measures aimed at promoting and enhancing audit quality are addressed. That is, whether it is part of a package of requirements that are embodied in legislation, a series of best practice recommendations, or some other type of arrangements.

*Do you agree that it would be helpful to develop a document to assist Canadian audit committees in executing the comprehensive reviews of external auditors? If so, please share any suggestions on what guidance audit committees would find helpful.*

IFAC agrees that it would be helpful to develop a document to assist Canadian audit committees in executing the comprehensive reviews of external auditors. However, as noted in response to an earlier question, like all guidance documents of this kind, it is important to ensure that audit committees that make use of such a document are confident that the document is tailored to the organization and are cautioned against using it in a manner which becomes a routine, checklist approach.

*What needs do you identify for resources, education, guidance and tools? What other implementation concerns do you have?*

Refer discussion in preceding paragraphs and answers to previous questions in this section.

### **Communication of Inspection Results**

Inspections of auditors by independent oversight bodies form an integral element in a jurisdiction's arrangements to promote and enhance audit quality. IFAC recognizes that the extent to which the results of inspections should be made public, including to what level of detail (e.g., aggregated for all audit firms, by audit firm, by audit engagement, etc.), is a contentious issue and will vary by jurisdiction.

In principle, IFAC supports the view of the ACWG that there is merit in considering the confidential reporting of inspection findings to audit committees. However, it recognizes that there are a number of important matters that need to be carefully considered in the application of such a principle. These include matters such as ensuring that the auditor is made aware of the information being communicated and ensuring that if only components of an inspection report are being provided to an audit committee the proper context is described and explained for those components (for example, if only shortcomings or negative issues are being communicated, that the audit committee is given a sense of whether these represent endemic issues or exceptional circumstances).

*Do you agree that components of the CPAB inspection findings should be communicated to audit committees to facilitate their comprehensive reviews?*

IFAC supports, in principle, the view that relevant components of inspection findings should be communicated to audit committees to facilitate the performance of their responsibilities on an ongoing basis, not just with respect to the performance of comprehensive reviews. Refer comments in the preceding paragraphs in this section.



*What elements of the inspection results do you believe should be communicated?*

Elements of the inspections results that should be communicated are those which assist an audit committee in assessing the audit quality associated with the relevant audit firm. While having due consideration for confidentiality concerns, the inspection results that might be of most relevance to audit committees relate to relevant quality control and independence issues within the firm, audit engagement performance issues (for all engagements of the firm reviewed by the CPAB), and specific audit engagement performance issues relating to audit engagement for the organization.

*Do you believe inclusion of such a protocol in the Participation Agreement is appropriate?*

The decision to include a protocol in the Participation Agreement will depend on the manner in which other measures aimed at promoting and enhancing audit quality are addressed.

However, IFAC questions whether it is the audit firm that “*should educate the audit committee about the nature of the CPAB inspections*” (refer paragraph 91, dot point 1, of the Discussion Paper). From a public perception perspective, it might be seen as inappropriate for the audit firm to be explaining the manner in which the independent oversight body has conducted its inspection of the firm.

#### **Public Commentary by the Audit Committee**

IFAC supports initiatives aimed at enhancing audit quality, including those which promote greater transparency of the audit process. As such, it supports the view that the audit committee should be more transparent, and disclose information publicly about its operations and considerations, subject to any restrictions pertaining to confidential or commercially sensitive information.

*Do you agree that audit committees should report on comprehensive reviews?*

Subject to any confidentiality concerns, IFAC agrees that audit committees should report publicly on the comprehensive reviews it performs.

*Do you agree the disclosure requirement should be mandated through securities legislation?*

The decision to mandate a disclosure requirement, with respect to the comprehensive review, in securities legislation will depend on the manner in which other measures aimed at promoting and enhancing audit quality are addressed.

*Do you believe there should be additional audit committee commentary beyond the report on the comprehensive review?*

Refer discussion in preceding paragraphs in this section.

Please do not hesitate to contact us should you wish to discuss any of the matters raised in this letter, or require any further information.

Sincerely,

A handwritten signature in black ink, appearing to read "Faye Choudhury", written over a light blue horizontal line.

Fayezul Choudhury  
Chief Executive Officer