



Certified General  
Accountants Association  
of Canada

# **The Regulation of Public Accounting and Accounting and Auditing Standard Setting Under a Common Securities Regulator in Canada**

**A DISCUSSION PAPER PREPARED FOR CGA-CANADA BY  
PROFESSOR POONAM PURI**

**FEBRUARY 2007**

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## About CGA-Canada

CGA-Canada is a professional accounting body, representing 68,000 Certified General Accountants and students in Canada and abroad. The Association sets professional standards, develops education programs, publishes professional materials and develops national policy.

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The issue of a national securities regulator has been on the public policy agenda for over 50 years. As this debate continues, Canada remains the only developed economy without a common securities regulator.

Advocates of the current system say it is accessible as well as responsive to local and regional concerns. However, opponents say the current system is fragmented and uncoordinated, unnecessarily costly, inefficient, and impedes Canada's competitiveness.

A number of organizations have recently released position papers and spoken out on this important public policy issue. Several consultation processes have taken place — including the Wise Persons' Committee, the Crawford Panel and the Task Force to Modernize Securities Legislation in Canada. Provinces have come forward to express their views and concerns. The federal government has made many pointed statements since coming to office in February 2006, all of which reaffirm the Government of Canada's commitment to create a common securities regulator. In its 2007 pre-budget report to Parliament, the House of Commons Standing Committee on Finance recommended that *“the Conservative government conclude an agreement with the provincial/territorial governments on a single securities regulator no later than 31 March 2007”*, and furthermore, that *“the regulator should begin operations no later than 30 June 2007”*.

***CGA-Canada believes there is a need for reform, and that the principles of regulatory efficiency, professional inclusion, transparency, accountability and regional concerns should form the basis of a new model.***

CGA-Canada is committed to actively participate in this debate, and to make a meaningful contribution to the policy process.

With these goals in mind, CGA-Canada commissioned a paper by Professor Poonam Puri of Osgoode Hall Law School. As a well-known expert in this field, she is sought out by governments and regulators both in Canada and internationally. Professor Puri was Co-Research Director for the Task Force to Modernize Securities Legislation in Canada, and she is also a member of the Ontario Securities Commission's newly created Investor Advisory Committee. Among her many distinctions, she was named one of Canada's Top 40 under 40 in 2006.

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The discussion paper which follows specifically focuses on what the mandate of a common securities regulator could be in relation to standard setting and auditor oversight. The paper analyzes how a structure for standard setting and oversight of the accounting and auditing functions could be designed to better meet the objectives of the public capital markets, and how investor confidence in the accounting and auditing functions could be achieved. The paper proposes three models for discussion.

Professor Puri's paper was the subject of the CGA Roundtable Discussion, convened in December 2006. CGA-Canada is now publicly releasing the paper, and distributing it to additional stakeholders, with a view to stimulating discussion and obtaining input on this significant public policy issue. We would be honoured to have your comments on the issues at hand, and we invite you to participate in this interactive process by referring to the Discussion Guide at the end of this paper.

I wish to take this opportunity to thank Professor Poonam Puri for her valuable contribution to this ongoing debate. Appreciation is also extended to our stakeholders for participating in the advancement of this important process.

*Anthony Ariganello, CPA (Delaware), FCGA*  
*President and Chief Executive Officer*  
*The Certified General Accountants Association of Canada*

The Wise Persons Committee (WPC), in its review of the structure of securities regulation in Canada, noted that “Canada is the only major industrialized country without a common regulator”.<sup>1</sup> The WPC acknowledged the benefits of the existing system of 13 provincial and territorial regulators, which include the proximity of regulators to regional capital markets participants and responsiveness to local interests and issues. However, the committee also highlighted that the current system is plagued with ineffective enforcement, duplication of regulatory effort, and high costs for market participants, all of which affect the cost of capital, investor confidence in the Canadian capital markets and Canada’s international competitiveness. In its report entitled *It’s Time*, the WPC recommended the creation of a common securities regulator in which both the federal and provincial governments would have a significant role.<sup>2</sup>

High quality financial reporting and disclosure play an important role in ensuring the integrity of the public capital markets. Credible standard setting and effective public oversight of the accounting and auditing function are critical to ensuring a fair, efficient and transparent market with high levels of investor confidence.

Currently, the regulation of public accounting in Canada is fragmented. Accounting and audit standard setting and oversight in Canada are based much more on a self-regulatory model than a direct governmental regulation model, in comparison to other leading jurisdictions around the world. In particular, the accounting and assurance standard setting bodies as well as the audit oversight board in Canada are dominated by one of the three professional accounting designations that are qualified to conduct public accounting in Canada. The governance structure of the existing institutions leads to concerns about lack of independence, lack of transparency to capital markets stakeholders and lack of accountability to the public.

This discussion paper moves the debate forward on a common securities regulator by specifically focusing on what its mandate could be in relation to accounting and auditing standard setting and oversight. This paper analyzes how a structure for standard setting and oversight of the accounting and

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1 See *It’s Time: Wise Persons Committee Final Report*, prepared by the Wise Persons Committee to review the structure of securities regulation in Canada at page vii of WPC report. Available at [http://www.wise-averties.ca/main\\_en.html](http://www.wise-averties.ca/main_en.html). (Last accessed October 29, 2006.)

2 *Ibid* at ix. The WPC proposed that the federal government would enact a new Canadian Securities Act (CSA) that would comprehensively regulate capital markets activity in Canada. The new CSA would be administered by a single Canadian Securities Commission (CSC), consisting of nine full-time regionally representative Commissioners. Commissioners would be appointed by the federal minister of finance. A Securities Policy Ministerial Committee would be established to provide policy and administrative input. Any adjudication would be the responsibility of a separate body independent of the Commission.

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auditing functions could be designed to better meet the objectives of our public capital markets. Public and investor confidence in the accounting and auditing functions is one of the cornerstones of efficient capital markets and this paper proposes that a more participatory approach that captures the various perspectives of multiple stakeholders, in a democratic setting, will serve to enhance public and investor confidence in the reliability and accuracy of the auditing and accounting standards. To that end, this paper seeks to advance this vision by proposing three models, which themselves, ought to be subject to the scrutiny and input from a participatory discussion involving all relevant stakeholders.

The paper proceeds as follows: It first reviews and analyses the existing institutional structures in Canada. It then follows with a brief discussion of the regulatory framework in other jurisdictions. The paper then proposes three possible models for public accounting and standard setting in Canada based on criteria which are set out in Part 8 of this paper. Finally, the paper sets forth several discussion questions which may be relevant in evaluating the proposed models in future dialogues and inquiries.

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## Public Accounting and The Role of Auditors

Auditors play a critical role in the Canadian economy. By attesting to the accuracy of a company's financial statements, the auditor lends its credibility to that company and its financial health.<sup>3</sup> The public accounting function is critical to enhancing investor confidence in the Canadian marketplace.

How can we ensure reliable, high quality audits? Market-based, self-regulatory and legal mechanisms serve important and complementary roles in ensuring that auditors perform high quality audits. Since their reputation is a key asset, the market for auditors propels them toward high quality audits. Auditing and assurance standards that auditors must comply with in their engagements also play an important role. The self-regulatory bodies for accountants impose standards for entrance and membership and can threaten disciplinary action against members. Potential legal liability to clients and third parties also acts as an incentive.

The focus of this paper is limited to public accounting services performed in relation to public companies, even though public accounting services can be performed for private companies. This paper adopts the definition of public accountant contained in the Daniels Report (2003), and as such defines public accounting so as to include assurance based activities such as review engagements and audits, but excludes compilations accompanied by a notice to the reader.<sup>4</sup>

In Canada, there are three professional accounting designations: Chartered Accountants (CAs), Certified General Accountants (CGAs), and Certified Management Accountants (CMAs). Each of these designations is regulated by a provincial or territorial self-regulatory body as well as a common association.

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- 3 See Adam C. Pritchard and Poonam Puri, "The Regulation of Public Auditing in Canada and the United States: Self-Regulation or Government Regulation" (Fraser Institute, February 2006) at 2 and 5. Available at [www.fraserinstitute.ca/shared/readmore.asp?sNav=pb&id=824](http://www.fraserinstitute.ca/shared/readmore.asp?sNav=pb&id=824) (Last accessed on October 29th, 2006). See also, See generally, John C. Coffee, *Gatekeepers: The Professions and Corporate Governance* (Oxford University Press: 2006) at 108-191; See also George Benston, Michael Bromwich, Robert Litan and Alfred Wagenhofer, *Worldwide Financial Reporting: The Development and Future of Accounting Standards* (Oxford University Press: 2006).
- 4 Ronald J. Daniels, *Public Accounting Report*, (April 1, 2003) at 16-17. Report available at [www.attorneygeneral.jus.gov.on.ca/english/about/pubs/daniels/danielsreport.pdf](http://www.attorneygeneral.jus.gov.on.ca/english/about/pubs/daniels/danielsreport.pdf). (Last accessed on October 29th, 2006.) The report defines public accountant as: "a person who either alone or in partnership provides, or offers to provide, the following types of services:  
(a) audit or review engagements which may or may not include the rendering of an opinion or other positive or negative statement by the service provider as to the correctness, fairness, completeness or reasonableness of a financial accounting statement or any statement attached or relating thereto, and  
(b) compilation services where it can be reasonably expected that all or any portion of the work product prepared by the service provider will be relied upon and/or used by a third party; provided however that compilation services which would otherwise be within the scope of this paragraph (c) will be excluded from the definition if the work product prepared by the service provider includes a notice to reader which provides that any assurance given by the service provider is limited to the accuracy of the computations required in order to complete the compilation (the specific wording of the notice to reader would be as set forth under current CICA 9200<sup>3</sup>, unless and until alternative wording is approved by the re-constituted PAC)."
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The relevant self-regulatory bodies for each of the professional designations are responsible for establishing standards for education, certification, admission, continued membership to the profession as well as ethics and independence, and discipline and practice. As a general matter, all CAs, CGAs and CMAs who qualify may practice public accounting in most provinces.

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# Accounting Standard Setting in Canada — The Current Position

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**Observation: Accounting standard setting and oversight in Canada lack independence from the chartered accounting profession. Both the standard setting and oversight institutions are funded directly and wholly by the CICA, which creates a reasonable concern that the CA profession may actually be or perceived to be regulating in its own interests rather than the public interest. In the case of the standard setting body, it is dominated by individuals who have the CA accounting designation. These deficiencies in the governance structure of accounting standard setting and oversight in Canada undermine the legitimacy of these institutions to act in the public interest. To the extent that even a reasonable perception of a conflict of interest may exist or potentially exist, such a perception would ultimately serve to undermine investor and public confidence.**

Federal and provincial corporate statutes as well as provincial securities legislation requires financial statements to be prepared in accordance with GAAP as set out in the CICA Handbook — Accounting.<sup>5</sup>

The Accounting Standards Board (AcSB) is responsible for setting standards of financial reporting and accounting for Canadian public companies, private companies as well as organizations in the public sector. These principles are generally referred to as Canadian Generally Accepted Accounting Principles (GAAP). The current formulation of AcSB was established by the CICA in 1999; its predecessor organizations date back to 1945.

The AcSB has a maximum of nine voting, volunteer members who are drawn from the business and accounting community as well as the academy. Two thirds of the current members of the AcSB have a CA professional accounting designation.<sup>6</sup> The chair of the AcSB is a full-time paid position. The CICA's vice president, standards, director, accounting standards, and the IASB liaison board member for Canada hold non-voting positions on the AcSB. Issues come before the AcSB either through the members themselves, through research conducted by the staff as well as through the Accounting Standards Oversight Council, discussed below. For each project proposal, two thirds of the members of the AcSB must vote in favour of proceeding. The completion of a project proposal results in an exposure draft being written that allows for

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5 See, for example, s.71(1) *Canada Business Corporations Act Regulations*. Canadian securities laws do, however, allow SEC issuers to file financial statements prepared in accordance with US GAAP and audited in accordance with US GAAS. See National Instrument 52-107: *Acceptable Accounting Principles, Auditing Standards and Reporting Currencies*.

6 See CICA website at [http://www.cica.ca/index.cfm/ci\\_id/19613/la\\_id/1.htm](http://www.cica.ca/index.cfm/ci_id/19613/la_id/1.htm). (Last accessed on October 29th, 2006.)

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comments to be made, however this requires two-thirds of the AcSB to vote in favour of having the exposure draft made public.

The AcSB is overseen by the Accounting Standards Oversight Council (AcSOC). The Accounting Standards Oversight Council (AcSOC) was created by the CICA in 2000, to serve the public interest by overseeing and providing input into the activities of the AcSB. The AcSOC appoints members to its own council as well as to the AcSB. The AcSOC is comprised of 20 to 25 volunteer voting members. The AcSOC also includes six non-voting members including several senior staff members of the CICA<sup>7</sup>.

The CICA directly funds the AcSB and the AcSOC and provides administrative and other supports. The AcSB is accountable to the AcSOC and the AcSOC is accountable to the Board of Directors of the CICA to ensure that it has fulfilled its oversight mandate. The AcSOC is also required to report to the public annually on its activities as well as the activities of the AcSB. The reporting to the public is an acknowledgement of the principle that the public has a vital interest in these issues. But, this is merely a beginning, and this paper proposes for a more participatory approach in the entire process of standard setting and oversight.

It should be noted that the AcSB has embarked on a plan, in the context of public Canadian companies, to converge Canadian GAAP with International Financial Reporting Standards (IFRS).<sup>8</sup> It has made this strategic decision on the basis of the increasing globalization of capital markets and the international movement towards global convergence of accounting standards. At the end of the transition period, “a separate and distinct Canadian GAAP will cease to exist as a basis of financial reporting” for Canadian public companies. In taking this strategic direction, “the AcSB will cease to make final decisions on most matters affecting the technical content and implementation of standards applied in Canada.”<sup>9</sup>

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<sup>7</sup> *Ibid.*

<sup>8</sup> See the AcSB's 2006 Strategic Plan entitled “Accounting Standards in Canada: New Directions”. Available at [http://www.cica.ca/multimedia/Download\\_Library/Standards/Accounting/English/e\\_NewDirections.pdf](http://www.cica.ca/multimedia/Download_Library/Standards/Accounting/English/e_NewDirections.pdf). (Last accessed October 29th, 2006.)

<sup>9</sup> *Ibid* at 3. For non-public companies, the AcSB has indicated that it will undertake a comprehensive examination of the needs of users of the financial statements of such companies and assess and implement the most appropriate financial reporting model. *Ibid* at 4.

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# Auditing Standard Setting in Canada — The Current Position

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**Observation: Auditing and assurance standard setting and oversight in Canada lack independence from the chartered accounting profession. Auditing and assurance standard setting and oversight are funded directly and wholly by the CICA, which creates a reasonable concern that the CA profession may actually be or perceived to be regulating in its own interests rather than the public interest. These deficiencies in the governance structure of auditing and assurance standard setting and oversight in Canada undermine the legitimacy of these institutions to act in the public interest. To the extent that even a reasonable perception of a conflict of interest may exist or potentially exist, such a perception would ultimately serve to undermine investor and public confidence.**

In Canada, public accounting must be performed according to the standards set by the Auditing and Assurance Standards Board (AASB). These standards are known as Canadian Generally Accepted Auditing Standards (GAAS) and they govern the conduct of independent audit and review engagements by all three sets of professional accountants engaged in public accounting. All three designations of accountants in Canada engaged in public accounting are trained to meet these common standards.

The AASB is comprised of 13 voting members including a chair and a vice-chair. Currently, all voting members of the AASB have a CA designation.<sup>10</sup> There are also two CICA staff members who also hold non-voting seats on the AASB. The long-term goals of the AASB are to set and maintain assurance standards as well as to participate in the creation of global assurance standards. The AASB follows due process when setting standards and has a six step approach: obtaining stakeholder input, identifying projects, approving project proposals, approving statement of principles, approving the exposure draft (requires two thirds voting in favour) and finally approving the standard.

The AASB is subject to the oversight of the Auditing and Assurance Standards Oversight Council (AASOC), which is a body that was created by the CICA in October 2002 to provide oversight of the AASB.<sup>11</sup> The AASOC appoints its own members as well as members of the AASB. The AASOC's mandate includes responsibility for ensuring that the AASB's standard setting process is appropriate and responsive to the public interest. The AASOC is comprised of 9 to 12 voting volunteer members, a majority of whom may not be

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<sup>10</sup> See Auditing and Assurance Standards Board website at [http://www.aasb.ca/index.cfm/ci\\_id/3675/la\\_id/1.htm](http://www.aasb.ca/index.cfm/ci_id/3675/la_id/1.htm). (Last accessed on October 29, 2006.)

<sup>11</sup> Pritchard and Puri, *supra* note 3, at 14.

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Chartered Accountants. There are currently 12 voting members. The AASOC also includes several non-voting members, including two CICA staff members, the chair of the AASB, and resident Canadian IAASB members. The CSA, the OSFI and the CPAB are normally each permitted to have one representative on AASOC.<sup>12</sup> The AASOC is required to report on its activities and the activities of the AASB to the public at least once a year.

Similar to the AcSB, the AASB has also spent much time harmonizing Canadian auditing and assurance standards with international standards. For example, AASB released General Standards of Quality Control for Firms Performing Assurance Engagements and Quality Control Procedures for Assurance Engagements, which closely mirrored those developed by the IAASB, with few changes being made to accommodate the Canadian landscape. The AASB also developed a standard on Reporting on Internal Control over Financial Reporting, equivalent to the US auditing standard developed by PCAOB (as required by s.404 of the US Sarbanes-Oxley Act of 2002), in anticipation of the CSA's implementation of a similar rule. However, the CSA recently withdrew proposed MI 52-111. In light of the AcSB's strategic plan to achieve full convergence with IFRS by 2010, the AASB is considering whether it should also focus on convergence with international assurance standards.<sup>13</sup>

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<sup>12</sup> See AASOC Terms of Reference available at [http://www.aasb.ca/index.cfm/ci\\_id/24675/la\\_id/1.htm](http://www.aasb.ca/index.cfm/ci_id/24675/la_id/1.htm). (Last accessed on October 29th, 2006.)

<sup>13</sup> See AASOC Annual Report for year ended March 31, 2005 at 17, available at [http://www.cica.ca/multimedia/Download\\_Library/Standards/AASOC/English/e\\_AASOCAR04-05.pdf](http://www.cica.ca/multimedia/Download_Library/Standards/AASOC/English/e_AASOCAR04-05.pdf). (Last accessed on October 29, 2006.)

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## Oversight and Inspection Program of Accounting Firms that Audit Public Companies in Canada — The Current Position

**Observation:** The auditing inspection and oversight board in Canada lacks independence from the chartered accounting profession. The governance structure is dominated by representatives of the CICA and Provincial Institutes of Chartered Accountants (PICAs), creating a perception of access and influence unavailable to other stakeholders. The board is also funded directly by the member audit firms that it regulates, creating a perception that the board may not be carrying out its function with as much vigour as necessary to protect the public interest. These deficiencies in the governance structure of the board undermine its legitimacy and ability to act in the public interest. To the extent that even a reasonable perception of a conflict of interest may exist or potentially exist, such a perception would ultimately serve to undermine investor and public confidence.

The Canadian Public Accountability Board (CPAB) was created in 2003 on the heels of the creation of the U.S. Public Companies Accounting Oversight Board (PCAOB) as a result of the Sarbanes-Oxley Act of 2002. CPAB was created through an agreement between the Canadian Securities Administrators (CSA), the Office of the Superintendent of Financial Institutions (OSFI) and the CICA. CPAB is responsible for overseeing and inspecting accounting firms that audit public companies. Common Instrument 52-108 Auditor Oversight requires that auditing firms that conduct audits of reporting issuers be “participating audit firms” in CPAB’s inspection program. Unlike PCAOB, CPAB is not vested with the authority to set auditing and assurance standards. The AASB continues to have authority in this regard. CPAB Rule 301 indicates that Canadian GAAS, as set out in the CICA Handbook — Assurance, applies in connection with public company audits.<sup>14</sup>

CPAB is comprised of three levels of governance: a Council of Governors, a Board of Directors, and Industry Members. The five member Council of Governors has oversight responsibility for the operation of CPAB. The Council of Governors comprises the chair of the CSA, the chair of the Ontario Securities Commission (OSC), the chair of the Quebec Autorité des marchés financiers, the federal superintendent of financial institutions and the president and the CEO of the CICA. The Council of Governors is responsible for

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<sup>14</sup> See also CPAB Rule 304.

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appointing the independent directors on the CPAB Board as well as the chair and vice-chairs. The CPAB Board of Directors comprises 11 members, four of whom are from the CA profession. There are currently 11 Industry Members: 10 from the provincial Institutes of Chartered Accountants and one from the British Columbia CGAs.<sup>15</sup> CPAB is funded directly by the audit firms that participate in its oversight program, leading to concerns about a lack of independence from those that it oversees.

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<sup>15</sup> CPAB website, "Board" accessed at [http://www.cpab-ccrc.ca/Frames/WHO%20WE%20ARE\\_Board.htm](http://www.cpab-ccrc.ca/Frames/WHO%20WE%20ARE_Board.htm).

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## Other Jurisdictions — International Trends in the Regulation of Public Accounting, Accounting and Auditing Standard Setting and Oversight

### (a) United States

**Observation: Auditing and assurance standard setting and inspections in the U.S. are now subject to direct governmental oversight, while accounting standard setting continues to be based on a private-sector model. The federal Securities and Exchange Commission (SEC) oversees the newly created PCAOB, which is authorized to set auditing standards and conduct inspections of accounting firms that audit public companies. Accounting standards continue to be set by the Financial Accounting Standards Board (FASB) which is overseen by the Financial Accounting Foundation (FAF).**

When federal securities laws were enacted in the US in 1933 and 1934, the SEC was charged with the supervision of the auditing of public companies. However, prior to the adoption of the Sarbanes-Oxley Act of 2002, the SEC used its power sparingly and instead delegated the formulation of GAAS to the US accounting profession, in particular the American Institute of Certified Public Accountants (AICPA) and its predecessors.<sup>16</sup> AICPA further delegated the setting of auditing standards to the Auditing Standards Board (ASB) which was directly overseen by AICPA but then was briefly shifted in 2001 to the Public Oversight Board (POB), an independent entity that was funded by the AICPA.<sup>17</sup>

Following the Enron scandal, the regulation of public auditing in the US became much less self-regulatory and much more directly overseen by governmental regulators. PCAOB was created and charged with protecting “the interests of investors and further[ing] the public interest in the preparation of informative, accurate and independent audit reports.” PCAOB is responsible not only for registering and overseeing public accounting firms, similar to the CPAB, but also for setting standards for audits of public companies in the US. PCAOB was provided with much broader authority to establish “auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports” for public companies.<sup>18</sup> PCAOB is subject to the SEC’s direct

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<sup>16</sup> Pritchard and Puri, *supra* note 3, at 11; see also Benston et al, *supra* note 3, at 49-81.

<sup>17</sup> Pritchard and Puri, *supra* note 3, at 12.

<sup>18</sup> Pritchard and Puri, *supra* note 3 at 12.

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oversight and control. AICPA continues to set auditing standards for non-public companies and is working towards convergence with the ISAs.

The Financial Accounting Standards Board (FASB) sets accounting standards in the U.S. for public and private companies. FASB was established in 1973 and has seven, full-time board members, all of whom are appointed by the Financial Accounting Foundation (FAF).<sup>19</sup> FASB meets weekly and its meetings are open to the public. FASB's funding is derived from capital markets stakeholders and the sale of publications. FAF is a not-for-profit private organization that is responsible for overseeing FASB, including selecting FASB members.<sup>20</sup> It is prohibited from involvement in FASB technical matters. The Board of Trustees of FAF is made up of nominees from sponsoring private sector organizations.

### **(b) Australia**

**Observation: Australia has established a government oversight model for both accounting and auditing standard setting. Australia's Financial Reporting Council (FRC) is an independent government body that has been established to oversee the accounting and auditing standard setting bodies.**

As a result of the passage of the *Corporate Law Economic Reform Programme (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9 Act), the Financial Reporting Council (FRC) has direct responsibility for overseeing the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB). The FRC is also responsible for monitoring the effectiveness of auditor independence requirements in Australia.

The FRC is a legislatively established council. Members of the FRC are appointed by the federal Minister of the Treasury and are nominated by stakeholders such as the Australian Stock Exchange, the Certified Public Accountants of Australia, state governments and the Business Council of Australia. Funding for the FRC is provided by the government and the accounting profession.

With the passage of CLERP, the AUASB was reconstituted as a Commonwealth body. AUASB is comprised of an independent chair, appointed by the Federal Treasurer, and 12 members, appointed by the FRC.. Auditing standards promulgated by AUASB are now legal instruments and have the force of law.

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<sup>19</sup> See FASB website available at <http://www.fasb.org/facts/index.shtml#structure>. (Last accessed on October 29, 2006.)

<sup>20</sup> See Financial Accounting Foundation Annual Report 2005 available at [http://www.fasb.org/annualreport/FAF\\_2005\\_AR.pdf](http://www.fasb.org/annualreport/FAF_2005_AR.pdf). (Last accessed on October 29, 2006.)

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The reconstituted AUASB has continued to use, where feasible, International Standards on Auditing (ISAs) as a base for its proposed Auditing Standards, so as to achieve conformity with international auditing standards.

In respect of accounting standard setting, there are nine part-time members on the AASB and one full time member, all of whom are appointed on the basis of their expertise and knowledge of accounting, law, government and the larger policy framework within which accounting standards operate. The FRC is responsible for appointing the nine part-time members and the Federal Treasurer is responsible for appointing the full-time chair.

In 2002, the Accounting Professional and Ethical Standards Board (APESB) was established to set the code of professional conduct and professional statements by which CPA Australia and CA members are required to adhere to. The board of APESB consists of up to eight members, comprised of representatives from the public sector, the corporate sector, the audit profession, academia and the general public. Half of the board is comprised of members of professional accounting designations: two CPA Australia members and two Institute of Chartered Accountants (ICAA) members.<sup>21</sup>

### **(c) United Kingdom**

**Observation: The UK has established a government oversight model for both accounting and auditing standard setting. The UK's Financial Reporting Council is an independent government body that has been established to oversee accounting and auditing standard setting. Accounting and auditing standard setting is the responsibility of the FRC's operating arms, the Accounting Standards Board and the Auditing Practices Board.**

As a result of the collapse of several large companies in the UK in the late 1980s, the UK Government commissioned a review of accounting standard setting and enforcement. As a result of this review, in 1990, responsibility for accounting standard setting was taken away from the accounting profession and entrusted to an independent standard setting board, the Accounting Standards Board (ASB). The ASB was created as a subsidiary of a new organization which was also created in 1990, entitled the Financial Reporting Council (FRC).

On the setting of auditing standards, there have been other developments in the UK which, as Paul Boyle of the FRC states, underscore the theme of the "progressive move away from entirely self-regulation of auditing by the

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<sup>21</sup> See APESB website available at [http://www.apesb.org.au/APESB\\_Board.htm](http://www.apesb.org.au/APESB_Board.htm).

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accountancy profession towards independent regulation in a statutory framework.”<sup>22</sup> In the 1990s, the setting of auditing standards and the regulation of auditors remained primarily with the accounting profession, with some government oversight. In the early 1990s, the accounting profession agreed that 50% of the members of the Audit Standard Setting Board should be non-auditors. In 2000, the government and the accounting profession agreed to the transfer of responsibility for setting auditing standards and ethical standards to a non-statutory regulator, the Accountancy Foundation that was funded entirely by the profession. In 2002, the UK Government commissioned four reports on different aspects of further strengthening the financial disclosure regulatory regime in the UK and as a result, significantly expanded the role of the FRC by taking over the functions of the Accountancy Foundation.

The FRC is responsible now, inter alia, for setting, monitoring and overseeing accounting and auditing standards, and overseeing and regulating auditors in the United Kingdom. The FRC Board is responsible for setting its budget and securing funding for the FRC’s activities. A key funding source is annual levies on publicly listed companies. Directors of the FRC Board are appointed by the Secretary of State for Treasury and Industry. The FRC Council is comprised of up to 30 members from industry, investor groups, professional groups, and others. The Council also includes the members of the FRC Board and heads of the ASB and APB.

Within the FRC, there are several operating bodies.

The ASB is responsible for accounting standard setting. The ASB is composed of up to 10 members, with the chairman and technical director being full time paid positions and the other eight being part time members. Appointments to the ASB are made by the Nominations Committee of the FRC. Three observers also attend each meeting. The ASB can issue accounting standards on its own authority without the approval of any other body, although the general practice is to consult widely on all proposals.<sup>23</sup>

The APB is comprised of 15 members, including a chairman, vice-chairman and executive director. Forty percent of the APB membership must be persons who can be appointed as a company auditor under the Companies Act 1989. Of the remaining 60 percent of the membership, any person who is an accountant cannot hold office of any accountancy body or be actively involved in the

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22 Statement of Mr. Paul Boyle, Chief Executive, Financial Reporting Council (UK) before the Committee on Banking, Housing and Urban Affairs of the United States Senate (Washington, DC, September 9, 2004). Available at: <http://www.asb.co.uk/images/uploaded/documents/Speech%20by%20Paul%20Boyle%209%20September%202004.pdf>. (Last accessed on October 29th, 2006.) For a detailed account of Corporate Financial Reporting and Regulation in the UK, see also Benston et al, supra note 3 at 82-105.

23 See ASB website available at <http://www.frc.org.uk/asb/about/>. (Last accessed on October 29, 2006.)

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governance of any accountancy body or be a partner in a firm authorised to conduct audits. Three observers from the UK Department of Trade and Industry, the Republic of Ireland Auditing and Accounting Supervisory Authority and the Financial Services Authority are permitted to attend and speak but not vote.<sup>24</sup>

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<sup>24</sup> See APB website available at <http://www.frc.org.uk/apb.about/procedures.cfm>. (Last accessed on October 29, 2006.)

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## Proposed Models for the Regulation of Public Accounting and Standard Setting under a Common Securities Regulator

While the WPC proposed the structure and design of a common securities commission for Canada, the report was silent on the role that the CSC could play in the regulation and oversight of public accounting, in the context of public companies. This part of the paper proposes three models for regulation of public accounting and standard setting bodies. In the development of these models, six criteria were identified as being relevant to the public interest. These criteria were:

**Independent Governance Structure:** The relevant institutions should be independent from the accounting profession and all three of the professional accounting designations in Canada. Independence is both a matter of fact and perception. Institutions that are not independent can result in actual or perceived conflicts of interest that can be detrimental to the integrity and legitimacy of the institution and more generally to investor confidence in the capital market markets.

**Independent Funding:** Funding for the institutions should be structured so as to avoid perceptions of bias or a lack of independence from those individuals or groups which the institution regulates.

**Transparency:** The activities, operations and decisions of the institutions should be transparent. Transparency is critical in addressing key issues of public perception as well information costs.

**Fairness:** All interested stakeholders should have equal access to the institution, including an ability to be heard and comment on proposed courses of action.

**Accountability:** The relevant institutions should be accountable to the public, by requiring annual reporting to the public and through direct governmental and/or administrative agency responsibility/oversight.

**Consistency with other leading jurisdictions:** The Canadian structure should be consistent with other significant jurisdictions in the regulation of public accounting and standard setting.

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**Proposed Model 1: The Canadian Securities Commission (CSC) would have direct responsibility for setting accounting and auditing standards and inspecting firms that audit public companies. These responsibilities would be delegated to three institutions which would be granted SRO status: the newly created Canadian Accounting Standards Board (CAcSB), the Canadian Auditing and Assurance Standards Board (CAASB), and a redesigned CPAB.**

Under Proposed Model 1, the CSC would have responsibility under the Canadian Securities Act to regulate accounting and auditing, including standard setting, in the context of public companies. The CSC would then grant legal SRO status to a new, statutorily created Canadian Accounting Standards Board (CAcSB), a Canadian Auditing and Assurance Standards Board (CAASB), and a redesigned CPAB. This legal SRO status would be similar to the status that the CSC would presumably give to organizations that currently have SRO status from the provincial securities commissions under the existing securities regulatory structure. Details of the CAcSB, CAASB and CPAB are set out below.

**Accounting Standards:** The CAcSB would be created by statute with a mandate to set accounting standards in the context of public companies. It would be granted SRO status by the CSC. The CAcSB would be governed by an independent board that is comprised of 8-10 individuals who would cut across from accounting, law, management, economics and the academy as well as other individuals who are well informed in the public policy importance of accounting standards to strong and vibrant public capital markets. CAcSB board members would be appointed by the CSC commissioners or by the federal minister of finance in consultation with provincial/territorial governments. The existing AcSB and the AcSOC would no longer be responsible for standard setting and oversight, respectively, in relation to accounting standards for public companies. The CSC would be directly responsible for overseeing the activities and operation of the CAcSB; CAcSB would also be responsible for reporting to the public at least once a year. Funding for CAcSB would be derived from the CSC (which would presumably be self-funding through fees/levies on issuers and others) or directly from a wide range of capital markets participants.

**Auditing Standards:** The CAASB would be created by statute with a mandate to set auditing and assurance standards in the context of public companies. It would be governed by an independent board that comprises 8-10 individuals who would cut across from accounting, law and the academy, as well as other individuals who are well informed in the public policy importance of auditing and assurance standards to strong and vibrant public capital markets. The members of the board would be appointed by the CSC or directly by the federal

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minister of finance in consultation with provincial/territorial governments. The existing AASB and the AASOC would no longer be responsible for standard setting and oversight, respectively, in relation to auditing and assurance standards for public companies. The CSC would be directly responsible for overseeing the activities and operation of the CAASB. CAASB would also be responsible for reporting to the public at least once a year. Funding for CAASB would be derived from the CSC (which would presumably be self-funding through fees/levies on issuers and others) or directly from a wide range of capital markets participants.

**Inspections of Accounting Firms that Audit Public Companies:** CPAB would be recreated by federal legislation. CPAB's current three-tier governance structure that is currently dominated in numbers and influence by the accounting profession would be replaced by a single 8-10 member independent board of directors who would be appointed by the commissioners of the CSC or the federal minister of finance in consultation with provincial/territorial governments. The directors would represent the broad range of stakeholders who have expertise in public company audits, and the public policy implications of strong and vibrant public capital markets. The CSC would be directly responsible for overseeing the activities and operation of the CPAB. CPAB would also be responsible for reporting to the public at least once a year. Funding for CPAB would be derived from the CSC (which would presumably be self-funding through fees/levies on issuers and others) or directly from a wide range of capital markets participants.

What channels will exist for the new institutions to obtain valuable input from the accounting industry? Each of the self-regulatory bodies for the three professional accounting designations should certainly be permitted to make submissions to the new institutions. If more formal input is desired, the board of directors of each of the new institutions could have *minority* representation from each of the three professional accounting designations in Canada. To alleviate public and investor concerns about independence, members of the boards from the accounting professions could have non-voting status. Under this option, it is important to underscore that each professional accounting designation should be entitled to *equal* representation on the boards (i.e. one representative each) rather than representation based on the actual share of public accounting currently conducted by each professional accounting designation. While a case could be made at some later point for proportionate representation based on market share of audit services performed, the current public policy objective of encouraging competition and supplier entry into the public accounting field which is currently dominated by one accounting designation suggests that any formal representation in the governance structure of these institutions should be on an equal basis.<sup>25</sup>

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<sup>25</sup> See also, Daniels Report, *supra* note 4 for similar discussion.

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### **Proposed Model 1a — Consolidation of Auditing and Assurance Standard Setting in a Reconstituted and Reinvigorated CPAB**

A variation of Proposed Model 1 would be to consolidate responsibilities for assurance standard setting *and* inspections of accounting firms that audit public companies in a reconstituted and reinvigorated CPAB. There would then be no need for the creation of CAASB. This would give CPAB similar functions to PCAOB in the US.

### **Proposed Model 1b — Consolidation of Accounting Standard Setting, Auditing and Assurance Standard Setting and Oversight into a Single Institution**

Another variation of Proposed Model 1 would be to further consolidate responsibilities for accounting standard setting, auditing and assurance standard setting and inspections of accounting firms that audit public companies in one institution. Given the trend towards acceptance of and convergence with international accounting standards and possibly even international standards on audits, the common standard setting bodies would serve a much more limited role and function, and as such, it would be efficient to house them in one institution.

### **Proposed Model 2 — The CSC would have direct responsibility for accounting and auditing standard setting and an inspection program for accounting firms that audit public companies. These responsibilities could be delegated to existing but re-designed institutions, which would be granted SRO status, as appropriate.**

Under Proposed Model 2, the CSC would have responsibility under the Canadian Securities Act or other federal legislation to regulate accounting and auditing, including standard-setting, in the context of public companies. The CSC would then grant legal SRO status to a redesigned, statutorily created Accounting Standards Board (AcSB), an Auditing and Assurance Standards Board (AASB), and a Canadian Public Accountability Board (CPAB).

**Accounting Standards:** The AcSB would be re-born by federal statute. Its current mandate to set accounting standards would continue. It would be granted SRO status by the CSC which would be responsible for overseeing accounting standard setting in relation to public companies. The existing governance structure of AcSB would be dismantled and would be replaced by an independent board that is comprised of 8-10 individuals. The AcSOC would be dismantled as oversight would be provided by the CSC. The CSC would be directly responsible for overseeing the activities and operation of the AcSB. AcSB would also be responsible for reporting to the public at least once a year.

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Funding for AcSB would be derived from the CSC (which would presumably be self-funding through fees/levies on issuers and others) or directly from a wide range of capital markets participants.

**Auditing Standards:** The AASB would be re-born by statute. Its existing mandate would continue. It would be granted SRO status by the CSC which would be responsible for overseeing auditing and assurance standard-setting in relation to public companies. The existing governance structure of AASB would be dismantled and would be replaced by an independent board that is comprised of 8-10 individuals. The AASOC would be dismantled as oversight would be provided by the CSC. The CSC would be directly responsible for overseeing the activities and operation of the AASB. AASB would also be responsible for reporting to the public at least once a year. Funding for AASB would be derived from the CSC (which would presumably be self-funding through fees/levies on issuers and others) or directly from a wide range of capital markets participants.

**Inspections of Accounting Firms that Audit Public Companies:** CPAB would be recreated by federal legislation and would have the same key structural features as set out in Model 1 above.

If the formal governance structure of any of the redesigned institutions includes minority representation of the professional accounting, it should be done so on an equal basis, as discussed in Model 1 above.

**Model 3. A newly created Canadian Financial Reporting Council (CFRC) would have direct responsibility for overseeing accounting and auditing standard setting and an inspection program for accounting firms that audit public companies. The institutions responsible for accounting and auditing standard setting and inspections would be chosen from either Model 1 or Model 2 discussed above.**

In addition to the creation of a CSC, the federal (and provincial) governments would statutorily create the Canadian Financial Reporting Oversight Board (CFROB). The CFROB would have direct oversight responsibility for the new institutions outlined in Model 1 (CAcSB, CAASB, and CPAB) or the redesigned institutions created in Model 2 (AcSB, AASB and CPAB). The CFROB would be comprised of five to seven members who would be appointed by the federal minister of finance in consultation with provincial/territorial governments. CFROB would be responsible for appointing members to the boards of AcSB, AASB and CPAB. CFROB would report directly to the minister of finance on its activities and on the activities of the boards which it oversees. The structure in Proposed Model 3 would allow for a crisper, sharper focus for the oversight body as compared to Models 1

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and 2, which could be subject to criticism on the basis that the CSC will be overburdened with many responsibilities and that oversight responsibility for public accounting and accounting and auditing standard setting will not receive high priority.

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## Conclusion

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As was mentioned in the introduction, this paper aspires to propose three work-in-progress models that seek to improve the structure for standard setting and oversight of the accounting and auditing functions in Canada. These models, like the ideal structure for accounting and auditing standards, should be subject to a participatory process and scrutinized by all relevant stakeholders in a dialogue of constructive criticism. The author and sponsor welcome contributions to the discussion.



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## Appendix 1: Author Biography

### Poonam Puri

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Professor Puri is an associate professor of law at Osgoode Hall Law School, York University. Her expertise lies in corporate law, securities law, corporate governance, and corporate and white-collar crime. She is a prolific scholar, having co-authored three books in 2004 alone, including *Corporate Governance and Securities Regulation in the 21st Century* (with J. Larsen); and *Cases and Materials on Partnerships and Canadian Business Corporations* (with D. Harris, R. Daniels, E. Iacobucci, I. Lee, J. MacIntosh, and J. Ziegel). She has also written over 25 major scholarly articles, book chapters and reports. Professor Puri was a visiting professor at Cornell Law School in 2000-2001 and is currently a visiting professor at the Rotman School of Management at the University of Toronto.

Professor Puri has been sought out by governments and regulators both in Canada and internationally, including Industry Canada, the Ontario Securities Commission (OSC), the Canadian Senate, the Wise Persons Committee on Securities Regulation and the International Finance Corporation of the World Bank. Her advisory work is known to be academically rigorous and firmly grounded in the real-time and complexities of policy making.

In 2005-2006, Professor Puri was co-research director for the Task Force to Modernize Securities Regulation, sponsored by the Investment Dealers' Association of Canada. In 2005, Professor Puri was appointed a member of the OSC's newly created Investor Advisory Committee, providing input to the Commission on the concerns of retail investors. She is currently the president of the Canadian Law and Economics Association for 2006-2008. In 2006, she was named one of Canada's Top 40 under 40.

Professor Puri is a graduate of the University of Toronto Faculty of Law (LL.B. Silver Medalist) and Harvard Law School (LL.M.). She articulated at Tory Tory DesLauriers and Binnington and was a summer associate at Paul Weiss Rifkind Wharton and Garrison prior to joining the faculty at Osgoode Hall Law School.

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## Appendix 2: DISCUSSION GUIDE

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### **PART I: DISCUSSING SECURITIES REGULATION IN CANADA**

The subject of a national securities regulator has been on the public policy agenda for over 50 years. As this debate continues, Canada remains the only developed economy without a national securities regulator.

Many organizations and levels of government have made meaningful contributions to these discussions by advancing ideas on how the structure of a common or national securities regulator might evolve. Yet, in our view the discussion needs to be broadened. This is why CGA-Canada asked Professor Poonam Puri to specifically focus on the mandate of a common securities regulator could be in relation to public accounting, standard setting and auditor oversight.

In an effort to stimulate discussion, gain further understanding, and advance the debate, CGA-Canada invites you to participate in the following questionnaire.

We welcome your comments and appreciate your input from now until June 30th, 2007.

#### **Benefits of Responding to the Questionnaire**

This is an opportunity to get involved and contribute to the discussion. Securities regulation matters to all of us — it affects Canada's growth, productivity and competitiveness.

#### **Responding to the Questionnaire**

The questionnaire should take approximately 20 minutes to complete. Upon completion, please return the questionnaire to the Government Relations Department at CGA-Canada using the enclosed postage-paid envelope. Please note that this questionnaire is also posted on our website at [www.cga-canada.org](http://www.cga-canada.org).

#### **Confidentiality**

Unless specified in Questions 14 and 15, your response will be treated confidentially.

Company Name: \_\_\_\_\_

Respondent's Name: \_\_\_\_\_

Respondent's Position: \_\_\_\_\_

Email: \_\_\_\_\_

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**PART II: QUESTIONNAIRE — FOR CONSIDERATION AND COMMENT**

1) The current securities environment in Canada, consisting of 13 different regulators, has both its strengths and weaknesses. What do you think is the single most important positive feature and the single most important negative feature of the present-day model?

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2) Do you agree that regulatory efficiency needs to be improved?

\_\_\_ Yes     \_\_\_ No

3) Which of the following do you support?

- a) The status quo
- b) A single securities regulator
- c) Another model (please elaborate below)

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4) In the discussion paper, Professor Puri identifies SIX criteria as being important to the public interest in the development of the proposed models for regulation (independent governance structure, independent funding, transparency, fairness, accountability, consistency with other leading jurisdictions).

Are there **other** criteria that should be considered? If so, what are these criteria?

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5) Professor Puri analyzes a number of proposed models. Is there a specific model that would align better with the principles outlined above?

- a) Proposed Model 1 — the CSC with the newly created CAcSB, CAASB, and a redesigned CPAB
- b) Proposed Model 1a — a Reconstituted and Reinvigorated CPAB
- c) Proposed Model 1b — a Single Institution
- d) Proposed Model 2 — the CSC with added responsibility, delegated to existing but redesigned institutions
- e) Proposed Model 3 — a newly created CFRC
- f) Other model (please elaborate below)

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6) If you chose any of the models discussed in Professor Puri's paper, please briefly describe what factors contributed to your decision.

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7) In reference to the models proposed by Professor Puri, is there any specific model you believe is **not** functional, and why?

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8) If you support another model or the status quo, please briefly explain your reason.

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(OPTIONAL) A separate study conducted by CGA-Canada found that the duplicative nature of securities regulation in Canada was the overarching concern of publicly listed Small and Medium-sized Entities (SMEs).

9) Which model, if any, best addresses the problem of regulatory burden?

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10) Who do you think should be included in this discussion concerning securities regulation?

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11) How can stakeholders get more involved in and contribute to this discussion? How can stakeholders help advance the policy process?

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12) What are the next steps? As stakeholders, what are our immediate, medium and long-term objectives?

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13) Please feel free to comment below on any aspect concerning the issue of securities regulation.

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14) Would you like your organization to be identified as having participated in this questionnaire?

Yes     No

15) Should CGA-Canada release some of its findings on this issue, could we mention your contribution to this process?

Yes     No

**Please return questionnaire to:**  
**CGA-Canada Government & Regulatory Affairs**  
**1201-350 Sparks Street**  
**Ottawa ON K1R 7S8**

**Or email to [ottawa@cga-canada.org](mailto:ottawa@cga-canada.org)**

**For further information, please call 613-789-7771 x 227**

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