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The Honourable Norman Sterling,
Attorney-General and Minister Responsible for Native Affairs
720 Bay Street
11th Floor
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Dear Minister,

I am writing to you pursuant to the mandate that the Honourable David Young, then Attorney-General and Minister Responsible for Native Affairs, conferred on me in relation to the reform of public accounting regulation in the Province of Ontario. Specifically, Minister Young invited me to:

- Design the changes necessary to policy, standards and legislation to make public accounting accessible to all CAs, CGAs, and CMAs who qualify.
- Develop standards that are recognized by international accounting bodies and ensure continued public and business confidence, optimum consumer protection, and institutional transparency and accountability.
- Advise on a clear definition of public accounting and the design of a framework for a professional examination that tests the core skills and competencies required to perform public accounting at a high standard.
- Recommend a structure to administer and regulate the new public accounting standards that is efficient, effective and transparent.
- Ensure that the current level and methods of access CAs have to the practice of public accounting would not be diminished by reform.

I am writing to you with my final recommendations in relation to this matter. These recommendations (and the rationale for them) have been developed in consultation with the Certified General Accountants Association of Ontario (the "CGAAO"), the Institute of Chartered Accountants of Ontario (the "ICAO"), and the Society of Management Accountants of Ontario (the "SMAO") (in aggregate, the "Designated Bodies") and the Public Accountants Council for the Province of Ontario (the "PAC"). I am pleased to report that a substantial consensus amongst the Designated Bodies has been achieved on the matters set out within my mandate. Specifically, the CGAAO and the SMAO have endorsed the report in its entirety on the basis that it contains a balanced and principled set of recommendations. The ICAO has endorsed the entire report save

for Recommendation 6. The reasons for the ICAO's reservations are set out in the discussion respecting Recommendation 6.

The Consultative Process

In submitting these recommendations to you, I want to inform you of the consultative process that I used to solicit advice and feedback from the Designated Bodies.

Representatives of each of the Designated Bodies scheduled a preliminary meeting with me in December 2002 . During those meetings, the organizations had an opportunity to outline their various interests in public accounting regulation. Subsequent to these meetings, my colleague, Mr. John Leddy of the law firm of Osler, Hoskin & Harcourt LLP and I were afforded an opportunity to meet with staff and elected representatives of each of the Designated Bodies at their premises. During these meetings, I was briefed extensively on the various regulatory activities conducted by each of the Designated Bodies in relation to admission standards, education, practice inspection, and professional discipline. These meetings lasted several hours, and allowed me to understand the complex and sophisticated manner in which each of the Designated Bodies discharges its statutory mandate. Following these meetings, each of the Designated Bodies furnished me with extensive written materials detailing their structure and regulatory activities. Each of the Designated Bodies also provided me with detailed written submissions on matters relating to my mandate.

On the basis of the consultations I conducted with the Designated Bodies and others (the PAC, the Ontario Securities Commission, the Chair of the Canadian Public Accountability Board, and various provincial and international accounting regulators), I then prepared an options document for review and analysis by the Designated Bodies. That document was sent to the Designated Bodies and the PAC on March 6th, 2003, and is attached to this letter as Appendix I (the "Discussion Document"). On March 17th and 18th, I once again visited the Designated Bodies to solicit their reactions to the Discussion Document. The Designated Bodies subsequently sent me written submissions that clarified their views. On the basis of this feedback, I then prepared a draft of this letter, which was circulated in draft form to the Designated Bodies and PAC for comment and reaction. I met in person with each of the Designated Bodies and the PAC on March 27th and 28th, and received final comments.

The Evaluative Criteria

In this section, I discuss the various criteria that I believe are appropriate for evaluating alternative ways of protecting the public interest in relation to provision of public accounting services. As I stated in the Discussion Document, the public interest in this policy area is based on the existence of what economists call "endemic informational asymmetries". This means that consumers of public accounting services may not have sufficient information or understanding in order to gauge the accuracy and reliability of those services. This concern is particularly acute given events over the last several years that have, in some circumstances, undermined public confidence in financial statements

prepared for several public companies, and which have spawned efforts in a number of industrialized democracies (including Canada) to enhance the integrity of financial reporting.

I believe that the following criteria should be invoked to assess the capacity of a regulatory model to fulfil the primary role of public accounting regulation, which is to ensure that the public has access to reliable, high quality public accounting services:

(a) Efficiency:

- Allocative efficiency - greater consumer choice and lower consumer prices within an adequate regulatory regime that mitigates the impact of informational asymmetries. Allocative efficiency is promoted by the creation of regulatory regimes that support informed, rational consumer choice;
- Dynamic efficiency – creation of strong incentives for service innovations on the part of professional suppliers. This requires a regulatory regime that is responsive and innovative; and
- Regulatory efficiency – regulation should be cost-justified, i.e., the costs of regulation should be commensurate with the benefits realized. Implicitly, policy-makers should, to the extent possible, avoid the creation of duplicative, overlapping and confusing regulatory regimes that generate excessive and avoidable costs. In the case of professional self-regulatory regimes, regulatory efficiency requires that the benefits of industry expertise and experience be effectively harnessed in the creation and administration of nuanced, responsive regulation.

(b) Fairness – Any model for the regulation of public accounting should provide for equality of access for any person who is sufficiently qualified to perform the regulated activities. The corollary of this is that no person who is inadequately qualified should be granted access to the market (otherwise the model will be unfair to those who are adequately qualified).

(c) Regulatory transparency, independence and accountability – To ensure public confidence in professional regulation, it is essential that the system of regulation be transparent to the public, be accountable to the overarching public interest in public accounting regulation, and that regulatory decision-making be independent of supplier interests while nevertheless seeking to capitalize on the expertise and experience of regulated professionals in the development of regulation.

- (d) Harmonization with evolving national and international accounting standards and regimes - As evidenced by the recent changes and proposed changes to the regulatory regimes in place in the United States¹, the United Kingdom and Australia, there is a trend internationally towards a higher degree of regulatory oversight in respect of certain types of public accounting work (i.e., audit work performed for “public-interest” entities such as public companies and pension funds). The creation of the Canadian Public Accountability Board, which will regulate audit work performed for Canadian public companies, is consistent with this trend². Regulatory reform in Ontario should be consistent with national and international trends in public accounting regulation and should be responsive to the high expectations of the business community, public market investors and Ontario’s trading partners. Furthermore, regulation in Ontario should seek to facilitate professional mobility across provincial and international boundaries.
- (e) Transition costs - The application of this criterion requires a consideration of the likelihood of a timely and low-cost transition from the current regulatory model to the proposed model. New regulatory structures and institutions should seek to utilize the expertise of existing structures and institutions.

¹ In the United States, the Public Company Accounting Oversight Board (the “PCAOB”) was recently established pursuant to the Sarbanes-Oxley Act (the “SOA”) to oversee the audit of public companies that are subject to U.S. securities laws administered by the Securities and Exchange Commission (the “SEC”). The PCAOB replaces the current system of self-regulation in this area. It is comprised of five members appointed by the SEC after consultation with the Chairman of the Federal Reserve Board and the U.S. Secretary of the Treasury. No more than two of the appointees may be professional accountants. The SEC has oversight and enforcement authority over PCAOB. Generally, the duties of the PCAOB include: (a) the registration of public accounting firms that prepare audit reports for public issuers; and (b) the establishment and enforcement of rules regarding auditing, quality control, ethics, independence and other standards applicable to the preparation of audit reports. The PCAOB’s authority does not extend to accounting firms that do not audit public companies. The PCAOB is funded by assessments on public companies with stock traded on U.S. exchanges.

² The Canadian Public Accountability Board (the “CPAB”) is a joint initiative of the Canadian Securities Administrators, the Office of the Superintendent of Financial Institutions, and the CICA together with the provincial CA institutes. It will be organized as a not-for-profit corporation without share capital under the *Canada Business Corporations Act*. The general mandate of the board will include the (i) enforcement of auditor independence rules, (ii) oversight of Canadian public company auditor inspections, and (iii) enforcement of quality control requirements applicable to Canadian public company auditors. It will be comprised of eleven members, seven of whom must be from outside the profession. The composition of the CPAB provides for independent control, although the overall independence of the body comes into question given that it will be funded by member firms. The CPAB will have the ability to impose sanctions on auditors (including denial of the right to provide services to publicly traded entities), although it will depend significantly on the provincial self-regulating bodies in respect of the investigatory and discipline functions.

The Proposed Regulatory Regime Governing Public Accountancy

Background

The Discussion Document that I circulated to the Designated Bodies outlined two different options for the development of the public accounting regulatory regime in the Province, namely a “Parallel Licensure Model” and a “Public Interest Entity Licensure Model”. The former model, the Parallel Licensure Model, would confer primary responsibility on the Designated Bodies to regulate entry into the public accounting field and professional conduct within it. However, in contrast to the regulatory regimes in place in certain other provincial jurisdictions, and reflecting the Province’s leadership role in business regulation, the Parallel Licensure Model contemplates a re-focused and re-invigorated role for the PAC as the guardian of public accounting standards in the province. The latter model, the Public Interest Entity Licensure Model, builds on the Parallel Licensure Model, but would render the PAC the direct and primary regulator of public accounting activity for public interest entities (e.g., publicly traded companies, mutual funds, pension funds). The rationale for this model is based on the greater risks (and consequences) of accounting failure in the context of Public Interest Entities.

My consultations with stakeholders respecting the desirability of these two models revealed strong general support for the Parallel Licensure Model. Stakeholders generally regarded the model as an effective and principled compromise between the desirability of common standards for public accounting and the desirability of using the expertise, experience and distinct mandates of the Designated Bodies in regulation. The same general support was not expressed by the stakeholders in relation to the Public Interest Entity Model. Concerns raised in respect of that model include the risk (and commensurate costs) of overlap and confusion that would emanate from having the PAC and the Designated Bodies serve as primary regulators in respect of different types of public accounting activity. Certain stakeholders were also concerned with the risk of costly overlap and confusion between the PAC and the recently established Canadian Public Accountability Board – although members of the CGAAO and the SMAO require assurance that their members will be able to participate in the governance of CPAB as warranted by the level of public entity accounting activity conducted by their members. Finally, stakeholders were anxious that vesting the PAC with direct regulatory responsibilities in certain areas of activity would undercut its capacity to serve as a general oversight body of the Designated Bodies. For these reasons, my recommendations focus exclusively on the Parallel Licensure Model.

The Proposed Ontario Parallel Licensure Model

The regulatory regime that I am proposing for the Province contains several distinct elements that are discussed below.

- 1. A re-constituted PAC that will stand at the apex of the public accounting profession in the Province of Ontario. The PAC will ensure that the Province enjoys internationally respected public accounting standards which reflect the public interest in high quality services and in promoting an appropriate level of competition and service innovation within the Ontario public accounting profession. The PAC will oversee the regulation of the public accounting profession in the public interest.**

Standing at the heart of the grant of regulatory power that will be conferred on each of the Designated Bodies under the Parallel Licensure Model is the general oversight role of the re-constituted PAC. The PAC will stand as an independent, transparent, and expert overseer of the system of public accounting in the Province. The PAC will nurture strong, internationally respected accounting standards in the Province, and will also ensure that the public interest in promoting competition and service innovation within the profession is realized. The PAC, however, will not be a primary regulator of the profession. That role will be remitted to the Designated Bodies, who will be required to regulate in the public interest. However, it is the oversight role of the PAC that will enable the Designated Bodies to enjoy considerable regulatory flexibility and scope for innovation in the context of a framework of strong, common standards.

The PAC board members will be subject to an explicit duty to regulate the public accounting profession in the public interest.

- 2. The re-constituted PAC will be governed by a board of thirteen members, seven of whom are independent of the accounting profession and six of whom represent the Designated Bodies (two from each Designated Body). Each Designated Body will be responsible for appointing its allotted representatives to the board, and the Government will appoint the independent board members.**

The PAC will be governed by a board of directors whose membership emanates from the accounting profession and the public at large. The size and composition of the board reflects a desire to balance the industry expertise and experience that can be obtained from having direct professional representation on the board with the heightened public accountability that can be obtained from having a significant number of independent public representatives on the board. In light of growing international practice and the need to promote constructive and cooperative interaction amongst the Designated Bodies, I am recommending a board that has seven independent representatives (out of a total of thirteen members). An individual will qualify as an independent director of the PAC if he or she is not directly affiliated in any manner with a Designated Body or a public licensee (i.e., an individual who has been a consumer of

public accounting services, or who has been an employee of a consumer of public accounting services, would not be excluded on this basis). Since I am recommending that the Chair of the PAC would typically be non-voting (see Recommendation 4 below), the PAC's board will effectively be divided equally between representatives of the profession and the public.

I am recommending that the professional representatives on the PAC board be based on a formula that would give each Designated Body two representatives. For sake of greater clarity, two representatives from each Designated Body would be appointed to the PAC board as soon as it is re-constituted (i.e., prior to the time that the PAC formally reviews and approves the license granting capacity of the Designated Bodies see Recommendation 7 below).

There may, at some future time, be merit in allocating the board seats earmarked for the profession to representatives of the Designated Bodies on the basis of the relative percentage of licensed accountants affiliated with each Designated Body (as one stakeholder has suggested), but in my view, at least in the initial stage of the PAC's activities, this model would not be appropriate. Given the role of the PAC in setting initial standards that will have a significant impact on the entry of members of the CGAAO and the SMAO to the field of public accounting, it is a matter of fundamental fairness that these two organizations be accorded a fair and equal opportunity (comparable to the ICAO) to participate in the development of these standards. A model that weights governance participation rights on the basis of the percentage of existing licensees would not be conducive to equal participation. Further, to the extent that the proportion of current licensees among the Designated Bodies reflects the role of historic barriers of entry to the profession, the fairness of relying on such proportions to allocate governance rights becomes problematic.

The selection of representatives from each of the Designated Bodies will be the responsibility of the Designated Bodies. In contrast, the selection of the independent members will be the responsibility of the Government. I am, however, recommending that the Government consult with each of the Designated Bodies, among others, in its development of a roster of the first set of independent nominees to the board of the PAC. Once the PAC is established, I am further recommending that the Government consult with the Designated Bodies and the full board of the re-constituted PAC, among others, in filling independent board vacancies.

The independent board seats should be allocated in a manner that reflects a spectrum of consumer and public interests in public accounting regulation, including, for example, representatives from large (public and private), medium, and small businesses, the not-for-profit sector, the financial sector, other regulated professions, and a representative from the academy (such as a university president or the head of a business faculty or other leading academic in a field related to business and accounting). I am not recommending the adoption of a precise algorithm for allocating these independent seats, but only a requirement that the Government endeavour to recruit to the PAC a balanced

group of men and women with demonstrated intelligence, judgement, and integrity, and expertise in business, regulation or governance.

Given the expanded and important role to be played by the members of a re-constituted PAC, the indemnity and other liability protection arrangements which are currently in place for the benefit of members of the PAC should be reviewed and updated (if necessary).

- 3. The term of appointment for PAC board members will be three years and members will be eligible for one renewal. The initial terms of appointment of the board will be staggered, so as to ensure a steady renewal of PAC membership. A supermajority of PAC board members will be entitled to terminate any director for manifest failure to carry out his or her duties. If the terminated director was an appointee of one of the Designated Bodies, then that Designated Body would have a right to appoint a replacement for the remainder of the term.**

To ensure responsiveness to changing economic circumstances and to national and international trends in regulatory best practices, it is essential that the board of the PAC be subject to the renewal of perspective that comes from new membership. However, it is also important that this renewal of perspective not undermine the institutional coherence and memory of the PAC. Accordingly, I am recommending that PAC board members be appointed for a three year term and be subject to renewal for one subsequent term.

To ensure steady, staged renewal, I am recommending that lots be drawn by the initial independent board members other than the Chair (see Recommendation 4 below for my proposal as to the term of appointment of the Chair) to determine whether their first term of appointment shall be for a one, two or three year term. Upon the completion of their initial one, two or three year terms, these independent board members will be eligible for one three year renewal. In the case of the initial slate of Designated Body representatives on the PAC board, I am recommending that one of the two initial representatives be ineligible for renewal, thereby ensuring a steady renewal of professional representation on the PAC board.

- 4. One of the independent PAC members shall serve as Chair of the PAC. The Chair of the PAC will normally be non-voting (unless his or her vote is necessary to break a tie on the PAC). The Chair will initially be appointed by the Government (as one of the seven independent members of the PAC) for a three year term. After the expiration of this initial term, the Chair will be elected directly by the board (from the seven independent members of the PAC) for a two year term (Chair nominees must therefore have at least two years remaining in their terms as independent members of the PAC). The incumbent Chair of the PAC, including the first Chair, would be eligible for**

a second term as Chair (so long as he or she is otherwise eligible to serve as an independent director).

To promote the trust and confidence of the public and the accounting profession in the PAC, I am recommending that the Chair of the PAC be elected by the board of the PAC. However, in the case of the initial board of the re-constituted PAC, I am recommending that the Government appoint the first Chair in advance of recruiting other prospective independent board members. I am further recommending that this appointment be made only after consultation with each of the Designated Bodies. This recommendation is designed to assist the Government in recruiting the strongest possible group of independent directors to the PAC. The recruitment of an outstanding individual to serve as the first Chair of the PAC will send a strong, credible signal to prospective board members of the status and importance of the PAC.

- 5. All members of the PAC should receive an appropriate and fair level of compensation that reflects the value of these services to the profession and is further competitive with other industry regulatory organizations (e.g., the Ontario Securities Commission, the Investment Dealers' Association, the Independent Market Operator of the Electricity Market). The Chair of the PAC should receive an appropriate supplementary stipend reflecting the additional responsibilities and duties of that office.**

This recommendation is straightforward. The re-constituted PAC will have a significant role to play in the oversight of the public accounting profession in the Province. In order to recruit the strongest possible board, all directors should be appropriately and fairly compensated for their service to the profession and the public. The level of compensation paid to directors should be reviewed regularly by a compensation committee of the PAC to ensure that the compensation is competitive with other similar regulatory organizations and commensurate with the responsibilities borne by PAC members. The conferral of fair compensation is particularly important given the very considerable demands that will be placed on the re-constituted PAC, and its members, in its initial phase of activity.

- 6. The PAC will be charged with the task of devising initial (strong) minimum standards of regulation in relation to public accounting. Each Designated Body will be required to demonstrate that the entry and post-entry standards to which its members are subject meet these (strong) minimum standards (the determination by the PAC of the sufficiency of current Designated Body standards is discussed further at Recommendation 7 below).**

The first and fundamental responsibility of the re-constituted PAC will be to devise appropriate (strong) minimum standards for public accounting that assure the public that a common core standard of regulation exists in the Province. In light of the PAC's role as guardian of these standards, it is essential that it take direct responsibility for the development of these standards. Indeed, it is only through the development of

these standards that the re-constituted PAC will acquire the expertise necessary to become a credible regulatory organization. However, in discharging this task, it is important that the PAC not attempt to devise complex or detailed regulations that subvert the Designated Bodies' status as primary regulator of public accounting. An obtrusive and interventionist PAC could easily undermine the desire (implicit in the Parallel Licensure Model) to harness the regulatory expertise, experience and autonomy of the existing Designated Bodies in the service of creating a dynamic and responsive public accounting regime.

The PAC should develop (and subsequently maintain) standards relating to:

- post-secondary education entry requirements (including courses which are relevant to the public accounting area;
- supplementary study requirements;
- pre-designation/licensure examination requirements (the PAC would consider the content/competencies tested by the examination administered by each Designated Body);
- pre-designation/licensure practical experience requirements;
- licensure requirements applicable (as a transitional measure) to current members of the CGAAO or SMAO who wish to obtain public accounting licenses;
- practice inspection requirements;
- professional standards which require Designated Body members to perform public accounting services in accordance with generally accepted accounting principles and generally accepted assurance standards;
- post-licensure practical experience requirements (i.e., currency requirements);
- post-licensure mandatory professional development;
- rules of professional conduct;
- discipline procedures;
- governance structure (factors to be considered should include level of public representation in the governance structure of the Designated Body);
- rules governing re-entry by a past-licensee into the public accounting field;
- mandatory professional liability insurance (with prescribed minimum coverage);

- licensee support programs (e.g., an ethics counsellor available to assist/advise licensees in respect of professional ethics issues); and
- consideration of the desirability of a mandatory professional compensation scheme similar to the scheme administered in connection with the activities of the members of the Law Society of Upper Canada (which provides relief in the event a member commits fraud in the course of his or her professional activities) (the premiums to be risk rated by, *inter alia*, the claims experience of the Designated Body with which an individual licensee is affiliated).

I would also invite the PAC to consider whether special standards should be developed and then apply to public accountants licensees performing assurance work for the types of public entities described in the Public Interest Entity Licensure Model. Any such standards should be developed with due regard for the role to be played by CPAB with respect to the audit of public companies in Canada.

To achieve this task, the PAC will require appropriate staff and external consulting support necessary to animate the standard setting process with appropriate technical advice and analysis. It is likely that the PAC will also want to establish a series of technical working groups comprised of representatives of each of the Designated Bodies to support the standard setting process. With a view to completing the transitional period as soon as possible while recognizing that the initial setting of minimum standards is likely the most difficult transitional task to be performed by the PAC, I recommend that a fixed timeline be set under which the PAC would complete this task within six months of its re-constitution (if not earlier).

The PAC should also be charged with the transitional responsibility of making recommendations to the Attorney General for Ontario with respect to the amendments to the *Public Accountancy Act* (Ontario) (the “PAA”) which will be necessary in order to implement the proposals that are accepted by the Government. I would also invite the PAC to recommend the revisions that are necessary to update the administrative procedures under which the Council carries on its activities.

I should note that the ICAO supports the enterprise of developing (strong) minimum standards for the PAC in the areas enumerated above. However, in contrast to the process described above for initial standard setting, the ICAO believes that the PAC’s initial standards should be developed prior to the creation of the re-constituted PAC. These standards would then be remitted to the re-constituted PAC board. That process would involve the appointment of an eminent person (or persons) by the Government who would be invited to devise the PAC’s initial standards in consultation with industry representatives, among others. This person (or persons) would be independent of each of the Designated Bodies. The ICAO’s view is that this process would be less vulnerable to difficult and contentious debates that are likely to arise amongst the representatives of the Designated Bodies represented on the PAC were the re-constituted PAC board to be vested with the task of articulating new standards.

In contrast, the CGAAO and the SMAO are of the view that the re-constituted PAC board should be given the task of developing the PAC's initial standards. The presence of a significant number of independent directors will ensure that the standard setting process is responsive to the public interest in (strong) minimum standards that balance appropriate consumer and investor protection with the desire to promote competition and service innovation within the public accounting profession.

I concur with the CGAAO and the SMAO. The report contemplates that the re-constituted PAC will be the guardian of public accounting standards in the Province. As such, the PAC should be given the opportunity to develop the standards that it will ultimately be required to enforce. I have no doubt that the development of these initial standards (as, indeed, the amendment of these standards) will pose challenging technical and political issues. Nevertheless, it is my view that these issues are best resolved in the setting of a re-constituted PAC board where fair and transparent opportunities for industry and professional participation are afforded and further disciplined by an overarching duty to advance the public interest in public accounting regulation.

- 7. On the basis of these general standards, the PAC will evaluate the sufficiency of the regulatory regime proposed by each Designated Body to govern the qualifications, admission, and subsequent conduct of licensed members. Once the PAC is confident that the regulatory regime proposed by each Designated Body is sufficient, the PAC will permit the Designated Body to license its qualified members. There should be no grand-parenting of members of the CGAAO and SMAO into the public accounting licensure system.**

To build regulatory credibility and earn the confidence of licensees, it is critical that the PAC's standard-setting and subsequent sufficiency review process be undertaken in a timely, professional, and principled manner. This is particularly important given my decision not to recommend automatic licensure of members of the CGAAO and the SMAO prior to the PAC's review and approval of license granting and supervisory powers of these bodies. In recommending that there should be no grand-parenting of CGAAO or SMAO members into the licensure system, I mean that no current member of either organization should automatically be granted a public accounting license. Current CGAAO and SMAO members will be entitled to a licence upon the satisfaction of the transitional entry standards set by the PAC (and applicable to current CGAAO and SMAO members who wish to obtain a public accounting license, as noted in Recommendation 6 above). These transitional standards should be set such that the entry requirements applicable to this category of individuals are comparable to the entry requirements which will apply to a prospective member of a Designated Body (after that Designated Body has been granted licensing authority).

I recommend that the PAC engage external consultants to examine the current standards of the three Designated Bodies and submit a report to the PAC (which will either recommend that the Designated Body be granted the authority to issue licences or

detail the changes the Designated Body must make to meet its standards). The PAC should be required to complete this transitional task within a fixed period of three months after the adoption of minimum standards for the regulation of public accounting in Ontario.

- 8. Under the proposed model, the Designated Bodies will be the principal regulator of public accountants in the Province. As a consequence, it is essential that every current and future licensee be subject to regulation by one of the Designated Bodies. Consequently, all public accounting license applicants (including those from outside of the Province) will be required to become a member of one of the three Designated Bodies. The PAC will develop a protocol under which licensed public accountants who are currently not members of one of the existing Designated Bodies will become a member of, and subject to regulation by, an appropriate Designated Body. The PAC should be given the power (by regulation) to bind the Designated Bodies to this protocol. Once the CGAAO and the SMAO are recognized as license granting bodies, subsections 14(2) and 14(3) of the *Public Accountancy Act* (Ontario) should be repealed since the PAC will no longer play a direct role in the licensing of public accountants (see Recommendation 10 below for further detail as to the PAC's on-going role).**

One of the most perplexing features of the current regulatory regime is the fact that there are circumstances in which licensed public accountants may not be subject to direct regulation by any Designated Body, and the PAC lacks the mandate or the resources to supervise these individuals directly. For example, this situation may arise when individuals who were previously members of the ICAO are suspended from membership in that organization prior to the time that they are de-licensed by the current PAC.

Under the proposed regime, it is essential that all licensed public accountants be subject to regulation by one of the Designated Bodies that have been granted the authority to issue licenses and supervise licensees. Otherwise, the integrity of the Province's regulatory regime will be compromised through inconsistent regulation. The PAC will be required to develop a protocol under which existing licensees who are not ICAO members will be required to elect to become a member of (or otherwise become subject to oversight by) a Designated Body or will be assigned by the PAC to a Designated Body.

Once the CGAAO and the SMAO are recognized as license granting bodies, subsections 14(2) and 14(3) of the *Public Accountancy Act* (Ontario) should be repealed since the PAC will no longer play a direct role in the licensing of public accountants (see Recommendation 10 below for further detail as to the PAC's on-going role).

- 9. The PAC will develop a protocol governing the treatment by Designated Bodies of individuals whose licenses have been revoked by another Designated Body. The PAC will also develop a protocol under which a licensee who is a member of more than one Designated Body will be required to elect which of the relevant Designated Bodies will regulate his or her public accounting activities. In the event that the regulating Designated Body decides at the conclusion of a discipline proceeding to suspend or revoke a license, the licensee will be prohibited from practicing public accounting until re-instated by the regulating Designated Body.**

This recommendation is required in order to ensure that individual licensees who are disciplined by their Designated Body through, for instance, suspension or revocation of their license are not able to nullify their sanctions by migrating to another Designated Body. Again, the development of this protocol is necessary to ensure the integrity of the public accounting regulatory regime.

- 10. The PAC will no longer play any primary or direct role in either licensing accountants for public accounting activity or for disciplining individuals after they are licensed. These responsibilities will be the exclusive remit of the Designated Bodies, subject, of course, to the PAC's general oversight role. The PAC will continue to play the primary role in the discipline of individuals engaged in unauthorized public accounting practice. In this regard, the limitation period applicable to the filing of a charge by the PAC of unauthorized practice should be extended beyond the current six month period to two years.**

Under the Parallel Licensure Model, the re-constituted PAC will cease to play any direct role in the licensure of individuals for public accounting. Nor will the PAC play any role in the discipline of licensees. However, the PAC will continue to play the primary role in the discipline of individuals engaged in unauthorized public accounting practice. In response to concerns raised by stakeholders, I am recommending that the limitation period applicable to the filing of a charge by the PAC of unauthorized practice be extended beyond the current six month period to two years.

- 11. To ensure that the PAC is able to discharge its oversight role effectively, the Designated Bodies will be required to file an annual report with the PAC detailing their various regulatory activities, including reports of significant regulatory developments, admissions trends, practice inspection trends and findings, and professional disciplinary activities. In addition, each Designated Body with licensing authority will be audited by the PAC once every three years (as against the then current (strong) minimum standards for the regulation of public accounting in Ontario). Any deficiencies identified as a result of such audit must be corrected (i.e., the relevant**

standard must be raised) within a specific period of time (failing which, the Designated Body would lose its licensing authority).

The decision to vest the PAC with continuous oversight responsibilities will enhance the public's confidence in the integrity, responsiveness and consistency of the public accounting regime. To evolve into an effective and credible regulator, the re-constituted PAC will need to develop appropriate expertise. In this respect, the re-constituted PAC board will need to work closely with existing staff personnel to assist them in meeting the new expectations and challenges of the PAC's new role.

However, apart from developing new regulatory competencies, the PAC will require access to accurate, timely information from the Designated Bodies on the character of their regulatory activities. In the absence of such information, the PAC's oversight activities will be compromised. Here, I am recommending the filing of annual information by each of the Designated Bodies with the PAC as a condition for their continuing licensing and supervisory activities. I am also recommending that each Designated Body be subject to audit once every three years (on a rotating basis). If a Designated Body fails to respond in an appropriate manner to recommendations made by the PAC in its audit report, the PAC should have the power to order the Designated Body to adopt a proposed change. The PAC should also have the power, in extreme cases involving a serious threat to the public interest, to revoke the license-granting authority of a Designated Body.

12. In addition to its role in framing general regulatory standards and in reviewing and approving Designated Bodies, the PAC will also serve as a forum for the development of new initiatives designed to maintain the responsiveness and vitality of the public accounting regulatory regime, particularly insofar as the need for the regime to respond to changing market conditions and national and international regulatory trends is concerned. To support this activity, the PAC will require expert, independent, and professional staff support. This capacity is not designed to supplant the regulation making activities of the Designated Bodies, but rather to complement them.

Under the proposal model, the re-constituted PAC is not merely a passive and reactive regulatory agency. Rather, the PAC is expected to play a vigorous role in promoting the strengthening of the public accounting regime. In this respect, I would expect that the PAC may wish to initiate reviews of certain regulatory activities that cut across each of the Designated Bodies, and are designed to usher in desirable regulatory changes to the system of public accounting in the Province.

13. The PAC will be funded by fees to be derived from the Designated Bodies. These fees will be set by the PAC at a level which ensures that it has an appropriate level of resources to regulate effectively (and in the manner described in this report) in the public interest. The fee burden for the re-constituted PAC will be levied across Designated Bodies in an equitable

manner (as approved by the PAC) which reflects the relative benefit that the Designated Bodies and the membership of each Designated Body receives from PAC regulatory oversight.

For the new PAC to serve as an effective and credible guardian of the system of public accounting regulation, it is essential that the PAC receive an appropriate resource base. This resource base should be determined by the PAC's board, having due regard for the role of the Designated Bodies as primary regulator. Once a revenue requirement for the budget has been defined, the fee burden for the re-constituted PAC will need to be levied across Designated Bodies in a fair and equitable manner which reflects the relative benefit that the membership of each organization receives from PAC regulatory oversight.

14. The field of regulated public accounting activity will be defined to include assurance based activities (such as review engagements and audits), but will exclude compilations accompanied by notice to reader (as described below).

Over the last several years, there has been considerable confusion surrounding the scope of the definition of public accounting. The ambit of that definition has important implications for the operation of the regulatory regime. The broader the definition of public accounting, the broader the scope of accounting activity that is subject to regulation by the PAC and the Designated Bodies (by, for instance, requiring licensure as a condition precedent to carrying out the activity). Since regulation typically raises the costs of supplying services to consumers (in this case, by restricting competition into the field of public accounting), the scope of the regulated sphere of activity should be defined with clear regard to the costs and benefits of regulation.

With this in mind, I recommend that "public accountant" be defined in statute or regulation 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 (b) 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 9200³, unless and until alternative wording is approved by the re-constituted PAC).

Bookkeeping or other accounting functions performed for management by an employee, and the preparation of income tax returns would also be expressly excluded from the definition. I also invite the re-constituted PAC to consider the proposal made by the SMAO that the scope of the definition should be expressly expanded to include the expression of any comment as to the reasonableness of any “Management’s Discussion and Analysis” disclosure made or to be made by a public company (recognizing that, to the extent the rendering of such comment involves assurance work, the related services will be within the scope of paragraph (a) of the proposed definition).

In conclusion, I would like to thank Mr. John Leddy of Osler, Hoskin & Harcourt LLP for his thoughtful advice and support throughout this process. I also want to express my sincere appreciation to the Designated Bodies for the constructive advice and direction that they have each provided to me in the course of discharging this mandate. As I mentioned in the Discussion Document, the Province is fortunate to have an accounting profession that is so firmly dedicated to the highest ideals of the profession and the public interest.

Let me finally note that if the regime adopted in this report is adopted in a timely manner, I am confident that the accounting profession in the Province will be better equipped to support the commercial needs and interests of Ontario’s citizens. It is to this task of building an enhanced system of public accounting regulation to which the Province must now turn with alacrity and determination.

Yours truly,



Ronald J. Daniels

³ The “Notice to Reader” (regarding compilation engagements) under CICA 9200 currently reads as follows: “I have compiled the balance sheet of Client Limited as at December 31, 19X1 and the statements of income, retained earnings and cash flows for the (period) then ended from information provided by management (by proprietor). I have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information. Readers are cautioned that these statements may not be appropriate for their purposes.”