

# Audit profession's critic got it wrong

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In an Aug. 9 *Financial Post* article by Al Rosen — National Securities Regulator Needed — Mr. Rosen made a number of misleading statements regarding this country's audit profession. While the article's title implies Mr. Rosen seeks to build the case for a national securities regulator, the bulk of the article is actually devoted to impugning the reputation of Canada's highly professional auditors with allegations that can only serve to shake the confidence of small investors in our capital markets. We cannot let that stand without setting the record straight.

Mr. Rosen states that auditors can't be held legally liable for their work, referring to a Supreme Court of Canada decision without specifically naming it. Based on his prior articles, we assume that Mr. Rosen is alluding to either *Hercules Managements Ltd. v. Ernst & Young* or *Waxman v. Waxman*.

The Hercules case is an interesting one that clarifies the responsibility of auditors to investors, rather than shielding an auditor from liability. Keeping in mind that investors in public companies have different entitlements under various provincial securities legislation, which Hercules did not address, what Hercules did clarify

with respect to investors was the need to communicate with additors.

Hercules does oblige investors to make their intention to rely on a financial statement and the purpose of that reliance known to the auditor in advance, so the auditor can make an informed decision as to whether to take on that responsibility by accepting the engagement. In fact, investors need not personally alert the auditor — it is sufficient that the company informs the auditor that it intends to use the financial statements in the context of a transaction with third parties and plans to show the financial statements to those third parties.

Regarding the Waxman decision, the court ruled that the plaintiff did not ask the auditor to protect his interests or make his concerns known to the auditors, which understandably relieved the auditor of liability.

The Waxman and Hercules cases do not create special favours for auditors — these decisions were merely factual applications of a long-standing rule as to what it takes to establish liability. To suggest that these decisions, made by independent courts, are wrong means either you seek to change a fundamental precept of law or to have a different regime apply to auditors than applies to other defendants.

It is possible that Mr. Rosen knows of another Supreme Court of Canada case

that somehow gives auditors carte blanche with regard to liability. If that is the case, we'd be happy to examine it. However, his assertion flies in the face of overwhelming evidence that Canada's audit firms are operating in an increasingly litigious environment without many of the legal protections enjoyed in competing jurisdictions.

Finally, I would address Mr. Rosen's assertion of "accounting rule-setters and rule-followers" being part of the "same

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## THE VAST MAJORITY OF AUDITS SERVE ALL PARTIES WELL

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organization" and the need for "two new, fully independent and externally financed accounting and auditing rule-setting bodies."

In Canada, the Accounting Standards Board (AcSB) and the Auditing and Assurance Standards Board (AASB) are the "rule-setters." Both are independent and have oversight bodies that include prominent individuals, including a majority of members who are not accounting practitioners, as well as representatives from the appropriate regulators.

Their work is internationally recognized for both rigour and transparency.

Here we would ask that Mr. Rosen be more specific with his criticisms. How are these organizations, set up to protect the public interest, failing to uphold their mandates? Both organizations are designed to have financial independence. We're interested in how Mr. Rosen came to the conclusion that they are "easily controlled" by the auditors.

The Chartered Accounting profession has been working to continually improve Canadian accounting and auditing standards for more than a century and welcomes direct and specific input on how to better protect the public interest.

While Mr. Rosen has long been a critic of the audit profession, he has rarely provided concrete and detailed suggestions for fixing the alleged problems he cites. We are happy that he has set out a four-point plan in his latest piece. So let us examine his suggestions one by one.

1. Separate the accounting rule-setters and the auditors: This has already been done. The AcSB, as currently constituted, is separate and independent from the influence of auditors.

2. Separate the auditing rule-setters and the auditors: This has already been done. Like the AcSB, the AASB is already independent from the influence of auditors.

3. Legislate that auditors owe a duty of care to investors: Auditors are already fully liable for their work and, it must be added, further burdened with the onerous provisions of a system of joint and several liability that can make them pay 100% of damages even if only found to have 1% of the responsibility in a judgment.

4. Form a national securities commission that has the ultimate authority to set accounting rules and a clear mandate to prosecute misleading financial reporting: There may well be good reasons to consider a national securities commission, but the reasons cited by Mr. Rosen are superfluous as both objectives are already being accomplished. Canada's accounting and auditing rules are accepted around the world and, whether the regulators are provincial or become national, the mandate to prosecute misleading financial reporting has already been mandated by legislation.

It is possible that in his role as a forensic accountant, Mr. Rosen's view of the audit profession has been dimmed by his focus on the small minority of audits that have faults, as opposed to the vast majority of audits that serve all parties so well. However, all chartered accountants owe a duty to their chosen profession of being accurate and measured before leveling charges that blacken the reputation of Canada's auditors and call into question the safety of investing in its capital markets. Constructive criticism is necessary and welcome, but we are obligated not to inappropriately undermine the investing public's confidence.

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