

December 5, 2023

Canadian Public Accountability Board  
150 York Street, Suite 900  
Toronto, Ontario, M5H 3S5

This letter is in response to the September 2023 “Request for comment on the Canadian Public Accountability Board’s (“CPAB”) proposed rule changes”. The officers and directors of small cap (under \$250 million) reporting issuers listed in Appendix A have been consulted in preparing this submission.

Since CPAB’s inception in 2003 it has worked collaboratively with the accounting profession, the audit firms, similar bodies around the world and others to foster audit quality and transparency. Audit quality has improved significantly over this period with much of that improvement attributable to CPAB’s leadership not just as a regulator but through education and communication. This emphasis on education and communication through thought leadership, educational forums and how it conducts its work with audit committees, audit firms and audit partners is no doubt a major driver for this improvement. CPAB is encouraged to continue this focus on education, communication, and collaboration, including in how it manages its relationships with the audit firms and audit partners.

Our concern is the unintended impact that disclosure changes related to audit firm inspection reports may, in the long run, undermine the drive for quality. The recent and proposed changes may result in certain firms reducing their portfolio of public company audits (or eliminating public company engagements), reduced recruitment to and retention of individuals in the audit profession or strained relations with audit firms. There is support for the emphasis on audit quality but a belief that education, communication, and collaboration is the best long-term approach to fostering audit quality while preserving thriving public capital markets. The potential unintended cost to the audit profession and to small cap reporting issuers outlined in this submission cannot be overlooked.

This submission addresses general matters of principle rather than the specifics of the proposed rule changes.

**(i) Proportionality**

Prior respondents have raised this principle as noted from the applicable highlights in Appendix B. Appendix C documents the significant size differences between TSX, TSXV and CSE. This submission asks that CPAB further consider modifying the proposed rule changes to apply differently to Venture and Non-Venture issuers, consistent with the principle of proportionality as reflected in existing continuous disclosure legislation (e.g., National Instrument 51-102). One possible revision to the proposed rule changes may be a deferral (see below) of Phase 2 for TSXV and CSE reporting issuers. It is noted that in the UK, regulation of audit firms by the Financial Reporting Council (to be replaced by the Audit, Reporting and Governance Authority) excludes issuers listed on the Alternative Investment Market except for those deemed to be Public Interest Entities due to size (Market cap > 200 million Euros + annual turnover > 750 million pounds + # of employees > 750). Appendix D makes the general case for proportionality as a principle to guide all policy decisions. Consistent with the principle of proportionality, CPAB is encouraged to seek Board Members and staff with significant small cap reporting issuer experience, for an appropriate portion of its positions.

**(ii) Deferral**

Prior respondents have raised the issue of audit firm availability and reduced audit competition as noted in Appendix B. This is a significant concern for small cap reporting issuers. In response, CPAB has focused on availability and notes that fewer than ten reporting issuers appear to be without an audit firm. Availability is critical but other very negative factors are now apparent:

- Many reporting issuers dismissed by their audit firms have been forced to incur the costs and hassle of issuing a request for proposal (RFP) to engage a new audit firm as audit firms have been reducing their portfolios of

reporting issuers. Since January of 2022 the annually inspected audit firms have reduced their collective portfolios by over 200 audits,

- Some reporting issuers have found it necessary to make changes solely to attract an audit firm – e.g., change of year-end, and/or
- In addition to the costs of the above, audit fees are increasing significantly and well above inflation.

This submission recommends that CPAB defer Phase 2 for at least two and preferably three years to allow sufficient time to fully assess these risks stemming from Phase 1. Canada has benefited greatly from its small cap reporting issuers, as documented in Appendix C. These small cap reporting issuers are disproportionately affected by the negative factors listed above. Several of the directors and officers listed in Appendix A have had firsthand experience dealing with a forced change of auditors.

While less than ten reporting issuers are without audit firms at this time, approximately two hundred TSXV and CSE issuers were subject to management cease trade orders in 2023 due to delays in finalizing audited annual financial statements. The delays were primarily due to audit firms not able to deliver on time as a result of reduced staff resources or the audit firm resigning after the issuer's yearend as the firm consciously reduced their portfolio of reporting issuers.

The audit firms are also dealing with a growing shortage of staff and a worrisome decline in accounting majors in our universities. This is a critical factor affecting the availability and costs of auditors (now and in the future) and more importantly, it will have a negative impact on audit quality over the longer term. The public naming of sanctioned audit firms may further reduce interest in audit careers and exacerbate the recruiting and retention challenges faced by the audit firms. As well as allowing a full assessment of auditor availability and costs, a deferral allows time to fully assess the staffing issue, which will also be significantly impacted by the pending demand for ESG reporting and assurance.

### **(iii) Disclosures to audit committees**

As a general principle, this paper is supportive of the existing and proposed disclosures to audit committees and believes this will provide strong motivation for audit firm improvement.

### **(iv) Last resort**

The principle of “name and shame” should be a last resort after CPAB has exhausted all other avenues to foster audit quality. Pervasive changes to the audit firms’ quality control systems, staff training, cultural factors, and other core elements of quality take time. Is CPAB confident that it has allowed sufficient time for such changes before evoking public disclosure? Audit firms with which this group of officers and directors interact believe there has been a vast improvement in audit quality over the approximately two decades that CPAB has been in place. Audits require the exercise of judgment at every stage and therefore the assessment of overall quality is highly subjective and no doubt there is a spectrum of acceptable outcomes with perfection an elusive objective. After these two decades of substantial improvement, it may be that any further small gains in quality are not worth the high incremental costs.

The pervasive impact on reputation of an audit firm subjected to “name and shame” may result in one or more of these or other audit firms significantly downsizing their public company audit portfolios or potentially exiting the market altogether. Already there has been a large downsizing by the annually inspected firms as described in Appendix D. The call for a 3-year deferral of phase 2 will allow time to determine if the market is further impacted by continued shifting of the audit portfolios and the risk of one or more firms exiting the market. It would be very unfortunate if access to the public capital markets was a function of audit firm accessibility, rather than more substantive factors.

Thank you for the opportunity to provide input.

Yours truly



Steven Glover FCPA

## Appendices

Appendix A – Officers and Directors of Small Cap Reporting Issuers Consulted

Appendix B - Extracts from previous CPAB consultations

Appendix C – Profile of Canada’s capital markets

Appendix D – Comments regarding public interest issues and proportionality

## Appendix A

### Officers and Directors of Small Cap Reporting Issuers Consulted

- Steven Glover, Director and Chair, Audit Committee, Genesis Land Development Corp. (GDC - TSX)
- David Antony, Director and Chair, Audit Committee, Grounded Lithium Corp (GRD – TSXV)
- Steve Bjornson, Director and Chair, Audit Committee, Cematrix Corporation (CVX – TSXV)
- Ruth Chun, Director, Board Chair and Chair, Audit Committee, Slang Worldwide Inc. (SLNG – CSE)
- Mahendra Naik, Director, Board Chair and Chair, Audit Committee, Fortune Minerals Ltd. (FT – TSX)
- Brian McGill, Director and Chair, Audit Committee, Zedcor Inc. (ZDC – TSXV)
- Steve Vanry, Director and Chair, Audit Committee, DeepMarkit Corp. (MKT – TSXV)
- Doug Thomson, Director, Board Chair and Chair, Audit Committee, OneSoft Solutions Inc. (OSS-TSXV).
- Glenn Ives, Director and Chair, Audit Committee, NervGen Pharma Corp. (NGEN – TSXV)
- Max Satel – Chief Financial Officer, Battery Mineral Resources Corp. (BMR – TSXV)

## Appendix B

### Extracts from previous rounds of CPAB consultations on public disclosure (bold emphasis by author)

- (i) CPAB Publication - Update on feedback received and next steps for CPAB’s disclosures consultation – March 2022
- Respondents that were not supportive of these disclosures raised the following concerns:
- Public disclosure of inspection findings could lead to some **audit firms exiting** the audit of reporting issuers. This exit of certain firms could make it more challenging for some reporting issuers to engage an auditor.
  - Some respondents also questioned whether it would be beneficial to have a different approach to inspection findings for **reporting issuers listed on stock exchanges other than the TSX** reflecting different governance requirements for those companies
- (ii) CPAB’s disclosure recommendations - September 2022
- Some respondents did express concern that individual public inspection reports could have the following impacts:
- (i) **Reduce audit competition** and increase audit concentration as firms may be reticent to audit reporting issuers.
  - (ii) Create difficulties for reporting issuers in more complex industries (e.g., crypto companies, cannabis companies) who are trying to find auditors where there have been historically higher inspection findings.
  - (iii) A firm’s stakeholders may not understand CPAB’s risk-based selection process for audit file inspections and therefore could inappropriately assess a firm’s overall audit quality based on a single or limited data point.

## Appendix C

### Canada’s Unique and Successful Small Cap Capital Market

#### Small cap reporting issuers are Important to Canada

- Canada is unique in the number, diversity and roles played by small cap reporting issuers.
- Small cap reporting issuers serve as incubators for innovative technologies, new resource development, and new ways of doing business. They provide avenues for growth for entrepreneurs and risk takers that larger or more established entities cannot replicate.
- A 2023 publication of TMX entitled *Venture Forward – Commitments to Accelerate the Evolution of Canada’s Public Venture Market* states: “*TSX Venture Exchange, or TSXV, is the world’s leading ecosystem for launching early-stage companies, funding primary growth, and providing investors access to unique small cap investment opportunities.*”
- This dynamic group of companies are the source of innovation and growth crucial to Canada’s future.

## TSX, TSXV and CSE

Below is background information regarding the TSX, TSXV and CSE. Key is the size distinction between the TSX, TSXV and CSE as evidenced by the following average market capitalization:

- *TSX (Nov 1, 2023, excludes ETF's) - \$4.1 billion*
- *TSXV (Nov 1, 2023) - \$39.0 million*
- *CSE (Nov 30, 2023)- \$22.2 million*

These differences in size between the TSX and TSXV/CSE reporting issuers raise the issue of proportionality. Current securities regulation does utilize “venture” and “non-venture” to apply proportionate regulation, e.g., filing deadlines, governance requirements, etc. Is there a further opportunity to apply the principle of proportionality? Is the principle appropriately applied in auditor oversight?

The TMX Group provides the following background information:

- *“Toronto Stock Exchange (TSX) ranks as one of the 10 largest stock exchanges in the world in terms of market capitalization. Investors around the world want exposure to Canadian-listed stocks, as the country boasts one of the most secure financial and banking systems in the world, a strong middle class, political stability, and an unrivaled entrepreneurial spirit.*
- *Behind TSX is a smaller TSX Venture Exchange (TSXV) that caters exclusively to small and early-stage companies looking for alternative options to private equity or venture capital funding.*
- *Unlike many premier markets, TSX and TSXV cater to small- and mid-market companies looking for access to growth capital.*
- *The average financing size for new TSX-listed companies in 2019 was \$68 million, while the smaller junior exchange oversaw an average financing size of \$2.7 million.*
- *Given Canada’s close proximity to and economic ties with the United States, global companies also view Canada as a venue for reaching U.S. investors, both individual and institutional. In fact, a significant portion of the daily flow of trading volume in Canadian markets comes from U.S.-based investors.*
- *Canada is also home to a highly diversified economy with notable strengths in manufacturing, financial services, energy, and technology. Canada was named by the Economist Intelligence Unit as the best country in the G-20 group for doing business.*
- *As such, global investors want exposure to innovative companies that operate in one of the world’s largest economies.*
- *As of December 31, 2020, TSX and TSXV were home to 3,289 public companies. The total market capitalization of all companies listed on the two exchanges stood at \$3.477 trillion.*
- *A total of 228 international companies are listed on a Canadian exchange, of which 20 were added in 2020. U.S.-based companies dominate global listings and account for 50% of all international listings, followed by the United Kingdom and Europe at 13, followed by Israel at 5%.*
- *The average market capitalization of a TSX-listed company was \$2.072 billion, while the average value of a TSXV-listed company was \$47 million.”*

The CSE provides the following background information:

*“CSE Financings 2023 YTD (to October 31, 2023)*

- *758 financings completed for \$1,051M, compared to 663 financings for \$1,983M for same period in 2022, to 977 financings for \$7,354M for the same period in 2021.*

- Sectors: mining – 328 financings (43%) for \$375M (36%); cannabis/hemp – 89 financings (12%) for \$299M (28%); technology – 121 financings (16%) for \$133M (13%); life science – 88 financings for \$80M; diversified - 65 financings for \$61M; oil & gas – 11 financings for \$53M; cleantech – 30 financings for \$33M.
- Deal Types: non-FT – 460 financings (61%) for \$565M (54%); FT – 42 financings for \$103M; convertible debt – 64 financings for \$136M; debt – 29 financings for \$180M; IPO – 15 IPOs for \$15M; debt settlements – 139 transactions for \$46M.
- US: issuers with US HQ raised \$160M (15%); with major US assets raised \$336M (32%).
- US cannabis/hemp: issuers with US HQ raised \$139M (46% of cannabis/hemp); with major US assets \$225M (75%).

CSE Listings 2023 YTD (to October 31, 2023)

- 65 new listings and 8 fundamental change listings
- Pending Listings (as of 11/08/2023): 56 – 10 IPO, 38 non-offering, 4 RTO, 1 – Spinout, 2 TSX-V switch, 1 OTC.”

## Appendix D

### Canada’s Unique and Successful Small Cap Capital Market

#### Public Interest and Proportionality

#### Public Interest Issues

- The mission of the Canadian Securities Administrators (CSA) reads as follows: *“To give Canada a securities regulatory system that protects investors from unfair, improper or fraudulent practices and fosters fair, efficient and vibrant capital markets, by developing a national system of harmonized securities regulation, policy and practice.”*
- Managing this dual mission (a balance between vibrant capital markets and investor protection) is challenging. The CSA has effectively used the Venture (primarily TSXV and CSE)/non- Venture (primarily TSX) issuer distinction in its attempts to provide proportionality (e.g., National Instrument 51-102 stipulates later filing deadlines for Venture issuers). The regulation of Venture Issuers may benefit from further proportionality in the regulations for financial reporting, audits, and the regulation of auditors.
- Further proportionality will better serve all parties including the investor protection bodies whose limited resources should be focused on the large cap entities with broad-based shareholder groups.
- Investor protection bodies include the Exchanges as well as: Canadian Securities Administrators, provincial securities commissions, CPA Canada and provincial CPA bodies, Canadian Investment Regulatory Organization and Canadian Public Accountability Board (CPAB).
- Each regulation or rule imposes costs for public companies (and indirectly their investors). In addition to fees, levies and assessments imposed by the regulatory bodies, reporting issuers also incur compliance (external and internal) costs for legal, accounting, audit, and other services. For Venture issuers, the costs of compliance are a proportionately larger percentage of their revenue, earnings or market cap than is the case for non-Venture Issuers. Venture issuers absorb these compliance costs to maintain their public listing and their access to Canadian capital markets to finance their enterprises. A choice not to incur the compliance costs means de-listing, going private or other options all of which may undermine the ability to raise capital. What more can be done to reduce these costs?
- Every dollar directed to these general and administrative costs is a dollar not directed to value creation such as capital investments, research and development, or staff expansion/training. The high public interest value of such

investments is the argument presented by the federal government as to why it is imposing the 2% tax on stock buybacks which is effective January 1, 2024.

- The risk matrix for Venture issuers is well understood and well managed by investors, management, boards, and other stakeholders. There is no need for additional regulation. Instead opportunities to reduce regulation, while preserving market integrity, should be pursued. Market forces can work effectively and often more efficiently than regulation.
- Many investors who are Venture issuer shareholders have been vetted through rules for accredited investors; other investors are family offices or private equity firms who can dictate their own risk management options.
- Canadian regulators often refer to regulation in other countries as a rationale for new or changed regulation.
- The Canadian Venture market is unique, reflecting the natural resources, proven propensity for technology development and innovation, and successful Canadian entrepreneurs. Canadian regulators should not hesitate to pilot unique regulation to reflect the demography of the Canadian economy and capital markets. Given this uniqueness, proportionate approaches to audit oversight and other financial reporting regulations are critical to preserving the continued availability of Venture exchanges for capital raising and the public interest benefits thus generated.

### **Audits and the Regulation of Audit Firms**

- A vibrant capital market is impacted by many factors. Venture issuers having access to a competitive marketplace of audit firms is important and a factor that regulators are asked to prioritize as they work to balance robust capital markets and investor protection.
- There appears to be an emerging problem of insufficient qualified accounting professionals interested in public audit careers. There is likely a connection between accounting and audit regulation and the attractiveness of public accounting careers to today's university graduates and newly qualified professional accountants.
- CPAB works to foster audit quality to contribute to investor confidence in capital markets. However ever-expanding regulation of audit firms (and particularly the recent move to publish inspection results) may further decrease the number of participating audit firms or cause them to abandon certain sub-markets.
- The cost of public company audits is rising rapidly due to higher staff costs for the audit firms but also expanding audit procedures, the use of specialists, and the audit firms building a risk premium into audit fees. Ever increasing CPAB regulation affects the behavior of Individual partners, causing them to become more risk averse to being engaged by junior issuers in high-risk enterprises or emerging industries. They wish to avoid the possibility of regulatory noncompliance or a publicly issued adverse investigation report. Audit partners defend their decision to refer a routine or uncontested matter to their valuations, tax, and/or professional standards group(s) as a risk management procedure to mitigate case file investigation by CPAB, not a function of their professional judgement or Generally Accepted Auditing Standards.
- The number and mix of audit firms providing audits to Venture issuers is shifting. BDO, Grant Thornton and RSM have significantly reduced the number of audits of reporting issuers, particularly junior issuers. Current information (September 2023) captured from SEDAR+ shows these three firms having a much-reduced portfolio of reporting issuer clients: Grant Thornton - 71, BDO - 55, RSM - 75. This is a substantial reduction as each of these firms was among the CPAB registrants with over one hundred reporting issuer clients just a few years ago.

- The reduction by the three firms was deliberate, and it appears in part, to position themselves under the threshold (auditing one hundred or more reporting issuers) which triggers annual CPAB inspections and the requirement to implement CPAB's Quality Management System (QMS).
- The analysis also shows that between January 2022 and September 2023 there has been a reduction of 221 audits performed by the dozen or so annually inspected CPAB registrants. So far most of those audit clients have moved to smaller firms, which have been capacity constrained due to retention issues since the pandemics.
- If the trend continues accessibility of audit firms may evolve to be a significant factor in determining access to Canada's public capital markets. CPAB inspections result in only a few financial statement restatements each year. Financial statements and audits play a significant role in the risk management matrix for the large cap segment but not to the same extent for the small cap segment, for which investors focus on other factors such as the record of the management team, the product concept, or other attributes.
- CPAB is encouraged to consider the impact of its current and proposed regulations and policies on the competitive market for audit firms. The reduced availability of audit firms willing to be engaged by small cap reporting issuers and the rapidly rising cost of public company audit services, has a disproportionate impact on the Venture issuers. The costs are significant and detract from initial listings on the Candain junior markets.

#### **Attractiveness of Accounting and Assurance Careers**

- The regulatory burden facing audit firms may trigger unintended consequences which in the long term weakens audit quality. Audit firms find it increasingly difficult to attract new entrants into their public company audit divisions.
- Anecdotally, audit firm partners have been heard to say that they would not choose the auditor career path if they had known at the beginning, the uncertainty they would face from CPAB and other regulatory inspections.
- Access to high-quality finance professionals is the key to high quality finance teams, analysts, auditors, and audit committee members. This is a growing challenge. The ever-increasing regulatory burdens on audit firms and audit professionals within those firms is very likely a factor. Today's commerce and accounting graduates and newly qualified professional accountants have many attractive career paths available and when weighing future risk and reward may well be deterred by the regulatory risk in private practice at audit firms.
- Audit firms have significantly expanded the use of technology and artificial intelligence (AI) in the performance of routine audit procedures. This combined with expanded offshoring of such work has reduced their need for junior audit staff. An unintended consequence is the significant reduction in the pool of future audit managers and partners. On the other hand, opportunities to develop or utilize technology or AI might be presented in a positive way to attract staff.
- Audit staff benefit immensely if their work experience includes exposure to multiple clients in a wide range of industries and/or applying a wide range of corporate strategies. It is this range of experience that builds judgment and business acumen which are key to roles as future audit managers, partners, and business leaders. Working on several small cap reporting issuers and greater exposure to the business models and executives of those enterprises would provide such an opportunity for audit staff. Audit firms are encouraged to consider this factor as they assess the value of individual clients in their audit portfolios.
- All relevant parties (CQAQ, CPAB, CSA, CPAB registrants, CPA bodies, Universities) are encouraged to work together to champion public accounting careers whether audit, tax, business valuation, or professional standards.