The Globe and Mail

Print
Email
Post
Republish

February 21, 2012

Canadian audits of China firms had major gaps: regulator

By JANET McFARLAND
From Wednesday's Globe and Mail

Review by Canadian Public Accountability Board found failure to follow basic audit procedures required in Canada

Canada's audit regulator has demanded accounting firms fix deficiencies in their audits of 12 China-based companies whose shares trade on Canadian stock exchanges, saying their work has been a "disappointment."

The Canadian Public Accountability Board released results Tuesday of a three-month review of work done by Canadian audit firms with Chinese clients, and said it found major gaps, including a failure to follow basic audit procedures required in Canada. CPAB is calling its report "a wakeup call" for Canada's auditing profession to improve its work in foreign jurisdictions.

One unidentified audit firm has been restricted from doing further audits of Chinese companies until it improves its procedures. Other firms have been told to fix flaws in audits of 12 of the 24 companies examined.

"The disappointment we had was a lot of things that we felt were fundamental auditing processes and procedures were just not applied," CPAB chief executive officer Brian Hunt said in an interview Tuesday.

"It's just a disappointment on our part that things we would consider fundamental here in Canada just were not done, and I'm at somewhat of a loss to explain it."

CPAB's review, launched in October, comes amid widespread concerns about the quality of financial reporting by Chinese companies listing their shares on the Toronto Stock Exchange. In 2011, 56 companies from China and other parts of Asia were listed on the TSX or TSX Venture Exchange, many of which gained their listings through reverse takeovers of dormant shell companies.

The review highlights the wide gulf in auditing standards between Canada and China, says University of Alberta accounting department chairman Karim Jamal. Canadian audit firms have to rely on local partners who are licensed to audit in China, he says, and those partners don't appear to have the training or experience to meet Canadian standards.

However, he says if CPAB can spot weaknesses and errors after reviewing the Canadianaudit files, so should the Canadian partners who sign the audits after reviewing the work done in China. He said the report will give audit partners a greater excuse to pressure their local partners for better work.

"It gives them an additional club to wave in front of the partner in China," Prof. Jamal said.

There have been calls for years for audit firms to level out the quality of work done in other countries, says Lynn Turner, former chief accountant at the U.S. Securities and Exchange Commission who now writes extensively on audit regulation. Mr. Turner says there are legitimate questions about whether global accounting firms should put their names on audit work that is done to different standards in Asia and elsewhere, because investors assume the work is done to North American standards.

"It's a different culture [in Asia]," Mr. Turner argues. "Auditors are much more reluctant to challenge management."

The CPAB review does not identify the audit firms whose work was reviewed, but Mr. Hunt said they include the major national audit firms as well as a number of smaller firms that offer auditing of Chinese companies. CPAB noted that it could not review all the documentation for six of the audits involving major national firms because the work was performed by affiliated firms in foreign countries and the paperwork was not available.

That problem is a "red flag" to Toronto forensic accountant Charles Smedmor, a former auditor with a global firm who worked in Central Europe in the 1990s. He says audit partners in Canada should have full documentation of the work done in China, and should be able to share it with CPAB.

Mr. Smedmor said the pressure from CPAB should compel Canadian firms to improve their standards. "You can do high-quality work in an emerging environment if you want to," he said.

Mr. Hunt would not comment Tuesday on whether Sino-Forest Corp. was one of the audits scrutinized.

The Chinese timber firm, whose shares collapsed in June amid fraud allegations, has sent shock waves through the investment community and focused attention on its audit firm, Ernst & Young LLP. The audit firm would not comment Tuesday on the CPAB report.

Mr. Hunt said he does not believe the problems identified are unique to audits of Chinese companies, and said CPAB plans to expand its review this year to companies based in other developing countries whose shares trade in Canada, including Russia, India and Brazil.

With files from reporter Andy Hoffman in Vancouver