BAY STREET VIEW

FROM MAJOR INVESTMENTS TO HUMAN RESOURCES, LIABILITY ISSUES HIT ONTARIO'S ECONOMY

Canada's economic competitiveness depends on business growth, which in turn relies on access to high-quality financial advisory services. If that access is threatened, it creates a competitive disadvantage for business and provides a disincentive to business investment in Canada.

"We operate in an international economy," says Keith Farlinger, managing partner of BDO Dunwoody LLP's Toronto Region and chair of the Institute of Chartered Accountants of Ontario, "so when businesses decide where they're going to set up and what stock exchange they're going to list with, they consider the business environment in that jurisdiction. If they look at a jurisdiction such as Ontario, which has laws like joint and several liability that have demonstrably negative aspects for financial professionals, they may well choose to set up and work elsewhere."

Joint and several liability means that there is incentive for plaintiffs to take action against the party with the most resources. In a global marketplace, that exposes accounting firms to almost unquantifiable risk, disproportionate to their degree of responsibility.

"In Canada, the current model of joint and several liability is inherently unfair to the audit profession, particularly given the changes of the past few years and the increased expectations of auditors," says Chris Clark, PricewaterhouseCoopers' Canadian CEO and senior partner. "Auditors are prepared to accept responsibility for their actions, but they should not be held responsible for the mistakes of others."

The weight of disproportionate liability presents other disadvantages too, for example, hindering the ability of Canadian accounting firms to attract and keep talented professionals. "There is a shortage of experienced accountants around the world, and when people are in demand, they can move anywhere. They recognize that to be a partner in a CA firm in Canada puts all their assets at risk, while in many jurisdictions in the U.S., that isn't true," says Mr. Farlinger. "We've had partners retire early, basically saying the risk of being part of an accounting firm is just too high. We've had other partners come to us and say, 'I want to continue to work for the firm but I don't want to be a partner anymore.' We've had others tell us they no longer want to work on public company audits."

The result, he says, is that businesses are beginning to have a more difficult time finding financial advisors to provide vital services such as audit and assurance work. "Lots of people heard about Arthur Andersen, but they may not be aware that there are now only six international accounting firms in the world. We have fewer accounting firms, fewer experienced accountants and fewer accountants who do auditing."

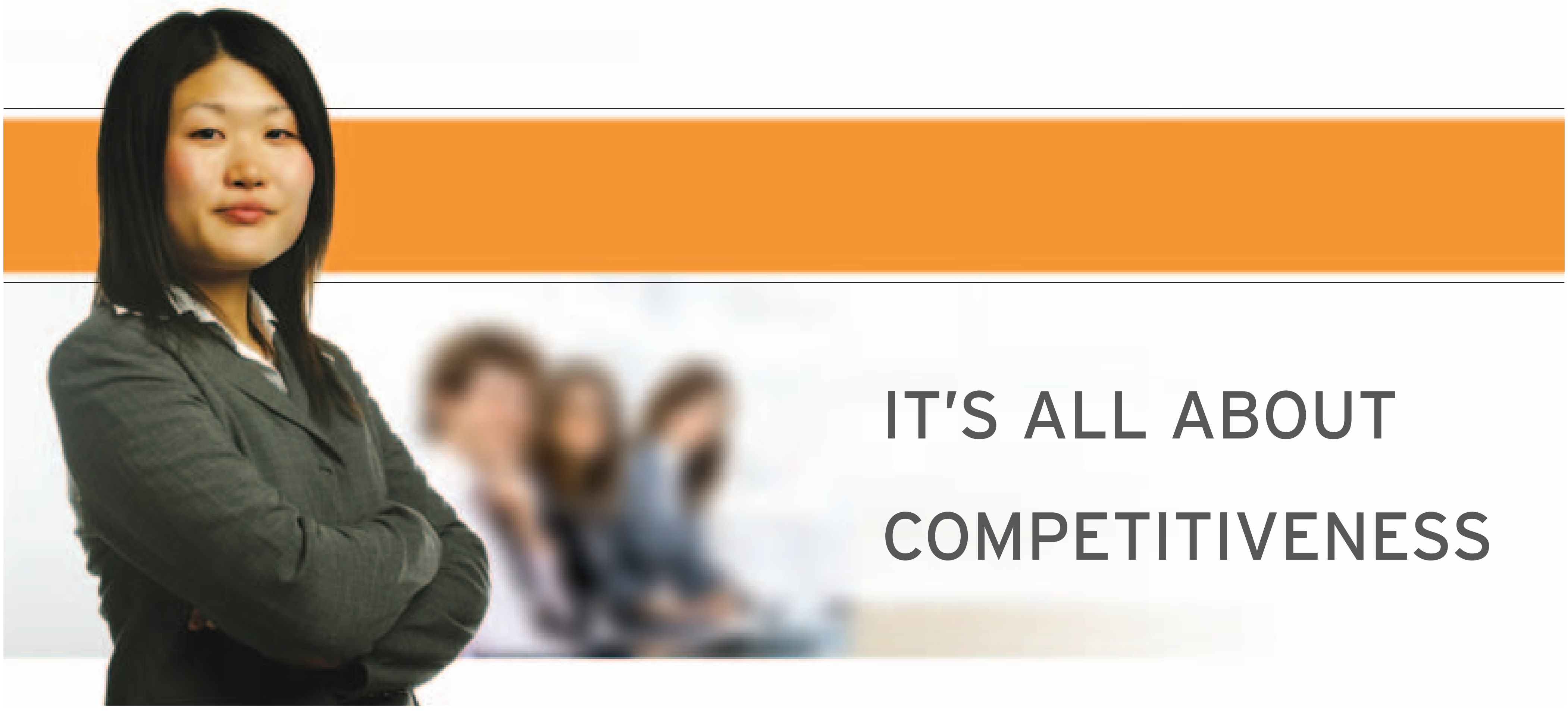
Canada's major trading partners are all moving toward new legal liability models, such as proportionate liability.

"The U.S. has had proportionate liability for several years, Australia has recently introduced liability reform legislation, and New Zealand is expected to announce liability reform in the coming months," says Mr. Clark. "Germany, Belgium, Austria, Greece and Slovenia have solved the problem with a liability cap and Britain is introducing the concept of proportionate liability. Canada needs to keep pace with liability reforms underway elsewhere."

Under the current system, financial advisors and firms find the costs of insurance either rapidly rising or simply unavailable. Either way, costs are passed on to clients and, in situations where firms can't obtain insurance, they are forced to take on the role of insuring our capital markets. For public companies, the current legislative environment threatens the ability of shareholders to access verifiable information. It also hinders the ability to raise equity or other financing in the capital markets.

Proportionate liability, which limits accountability for damages to match responsibility, is in the public interest for many reasons, says Mr. Clark, "including fairness, consistent legislation, retention of quality auditors, broader audit firm market, reduction of risk of audit firm failure, reduction of audit cost, broader access to insurance, access to auditing services, and remaining competitive with our international peers."

"This clearly affects the business community at large," says Mr. Farlinger. ☐



IT'S ALL ABOUT COMPETITIVENESS

MAIN STREET VIEW

BUSINESSES OF EVERY SIZE FEEL LIABILITY'S PINCH

An outdated regulatory regime is making it more difficult for Ontario's small and medium-sized businesses to compete in a global marketplace.

"Businesses need credit," says Joel Cohen, a senior partner at RSM Richter, a firm that has been serving entrepreneurs since 1926. "Few businesses have enough cash flow to finance growth quickly enough. Growing businesses have to go to sources of capital, which include banks and other lenders. Those lenders require audited financial statements to give them assurance that financial statements are fairly presented. Lenders want to know that they're investing in businesses that are financially sound and that there are assets on which to secure loans.

"If audit and other financial services aren't available, it restricts the rates of growth of these businesses, and it restricts the rate of economic growth in the country. Access to capital is a key determinant of growth."

Doug McLarty, managing director of McLarty & Co., says, "We have a fairly good high-tech presence in Ottawa. We're very fortunate to have good universities, a great physical plant and good lifestyle balance. A lot of the local high-tech companies are small firms looking to raise capital."

One of the other primary needs for business growth is access to capital, and that means cost-effective audit services. "Investors need assurance that the numbers make sense, and that's where the audit services come in. It's critically important," says Mr. McLarty.

The cost and availability of audits are not the same in Ontario, unfortunately, as for similar businesses in most U.S. states. "Many of the jurisdictions that we compete with directly have made some changes to their legal liability environment, a lot of them to proportionate liability. That means that the costs audit firms incur are lower," he says.

For example, says Mr. McLarty, insurance costs may be lower, and it may be easier for them to attract professionals to those environments. "Auditors are very well-educated, and they can choose to work in any environment that they want. In Ontario, we are at a competitive disadvantage because the cost structures may be higher. A lot of the firms work as partnerships; a young person may choose to go to an environment where liability is limited."

The costs and risks associated with the current legal environment also make it tremendously difficult for any but the largest accounting firms to provide audit services, limiting the options of small and medium-size businesses. "It is a more natural fit for some of these small high-tech firms to be using services of a similar sized firm, and in the mid-tier, what we're seeing is that many of our peers are choosing to leave the market for assurance services and do other types of work," says Mr. McLarty.

This impact isn't restricted to small and medium-size business owners and their employees. "For each dollar of economic growth, there is what we call a multiplier effect," says Mr. Cohen. "If I spend a dollar, that dollar gets circulated many times throughout the economy. (In uncompetitive environments) it's not just my dollar of growth that's lost – it is the recirculation of that dollar through the economy many times. We have a much bigger economy if it is more efficient, and liability reform is one of the ways to make it more efficient." ☐