

Ms. Jan Munro  
Deputy Director  
International Standards Ethics Board for Accountants (IESBA)  
6th Floor, 529 5<sup>th</sup> Avenue  
New York, NY 10017  
U.S.A.

Email: [janmunro@ethicsboard.org](mailto:janmunro@ethicsboard.org)

December 13, 2012

Dear Madam,

**Re: Invitation to comment, Exposure Draft: Responding to a Suspected Illegal Act.**

Thank you for the opportunity to comment on the Exposure Draft (ED). We reviewed the ED and provide our comments below.

**Question 17**

The concept of suspected illegal acts in the ED is described as “[any] acts of omission...intentional or unintentional...which are contrary to the prevailing laws and regulations”.

Placing an expectation for the auditor to report on any type of suspected illegal act is very broad in scope and does not appear to be consistent with the underlying principles that exist in current requirements. Specifically, in International Audit Standards (ISA) 240 and 250, the auditor’s responsibilities are limited to reporting fraud and non-compliance or suspected non-compliance of laws and regulations related to the audit of financial statements.

Furthermore, ISA 250.5 identifies a number of practical limitations on the auditor’s ability to detect non-compliance of laws and regulations. There are many laws and regulations that relate principally to the operating aspects of the entity that typically do not affect financial statements and are not captured by the entity’s financial reporting systems. In addition, non-compliance may involve conduct to deliberately conceal information from the auditor (i.e. collusion, forgery, failure to record information and other acts of intentional misrepresentations). Most importantly, ISA 250.5 concludes that the further removed the act of non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor will become aware of it or will be able recognize the non-compliance.

We believe the concept of “suspected illegal acts” is a significant departure from existing requirements set out in the ISAs and we are very concerned about the ability of the auditor to identify and address such a wide spectrum of potential of suspected illegal activities. The ED does not acknowledge the practical limitations discussed in ISA 250.5 for the auditor to identify suspected illegal acts that are unrelated to the financial reporting process. In addition, the ED is silent on how the broader expectation for the auditor to address all forms of suspected illegal activities reconciles with the existing requirements in ISA 240 and

ISA 250 that address only fraud or acts of non-compliance identified during the audit of financial statements.

We are also concerned with the lack of clarity on the concept of “suspected illegal acts that are the subject matters which fall within the expertise of the professional accountant” in proposed paragraph 225.13. The ED’s explanatory memorandum provides an example of non-compliance with securities legislation to illustrate the concept described in 225.13. We have significant concerns implied by this illustrative example. Securities legislation is a very specialized area requiring the expertise of legal counsel with an active securities practice. A professional accountant serving in the role of auditor would possess only basic knowledge about limited aspects of securities law.

For example, an auditor may obtain some working knowledge of securities legislation in order to assess whether the client is in compliance with its financial statement filing requirements. However, there are other requirements in securities legislation that are not related to financial reporting and would be outside of the expertise of the professional accountant. One example of this in Canada is the requirement for companies with mineral projects to file a report in accordance with National Instrument 43-101, Standards of Disclosure for Mineral Projects (43-101 Report). The determination of when a company is required to file a 43-101 Report includes an assessment of technical aspects of the mining project operations by the company’s chief geologist and legal counsel to determine if a reportable event was triggered. Reportable events that trigger a 43-101 Report are not normally recorded in the financial statements or captured by systems related to financial reporting. There are many other aspects of securities legislation such as insider trading and reporting and rules around raising capital in an exempt market that would not be captured by financial reporting systems and would fall outside the expertise of a professional accountant.

In order to meet the expectations implied by 225.13, the auditor may have to broaden the scope of audit procedures to examine processes and systems not related to financial reporting. In the example above, this may include comprehensive reviews of the client’s compliance with securities legislation in areas that are outside of financial reporting. However, there may not be a practical way for an auditor to test compliance. For example, the auditor may not be able to access the necessary third party stock brokerage records to test for insider trading.

Furthermore, the higher cost of an expanded audit scope may be burdensome for small to mid-sized organizations. Small-cap entities listed on junior markets and venture exchanges often struggle to raise the funds required to sustain operations. Recent uncertainties in the financial markets attributed to the U.S. fiscal cliff and the debt concerns in the European Union have made it increasingly difficult to raise funds in Canada for small-cap entities.

The ED’s explanatory memorandum focuses on examples and application issues related to audit clients that are for-profit, publicly traded entities. We are concerned about the application of the ED to audit clients that are not publicly traded, including governmental and not-for-profit organizations (Non-Commercial Entities).

In Canada, Non-Commercial Entities report under different accounting frameworks<sup>1</sup> recognizing that there is no “one size fits all” solution. Even the application of the “public interest” test may require a different approach. The nature and operations of Non-Commercial Entities can differ significantly from for-profit publicly traded entities. For example, the nature, breadth and scope of regulations applicable to government operations may be more complex and more regulated compared to a for-profit publicly traded entity. In the case of a municipality, many aspects of municipal operations (e.g. bylaws, waste management, water management, taxation policy, policing etc...) would not be captured by the financial reporting processes and it would be impractical for an auditor to obtain sufficient expertise in all areas of regulation related to municipal affairs.

One of the consequences implied by the ED is that the auditor may have to expand the scope of their audit. Generally, Non-Commercial Entities are subject to funding constraints and may be unable to secure additional funds outside of their budget to cover the costs of an expanded audit. Securing additional funding for an expanded audit scope would require approvals from government agencies in an era where governments are pushing for fiscal restraint and budget cut-backs. The scope of the financial statement audit may be strictly defined by regulation. In order to change the scope of the audit, the auditor may require additional regulatory approval.

In conclusion, we have concerns that the requirements discussed above are too broad, unclear and may not be workable in practice. In addition, a large number of reporting issuers in Canada are listed on venture and junior capital markets. The costs of the proposed requirements appear to outweigh the benefits for these smaller entities. We have similar concerns about the practical application and financial burden of the ED for Non-Commercial Entities. We believe the IESBA should engage in further research and discussion of the kinds of issues we’ve identified, above.

We are pleased to offer our assistance to the IESBA in further exploring issues raised in our response.

MNP LLP (MNP) is one of Canada’s largest chartered accountancy and business advisory firms. Our clients include small to mid-size owner-managed businesses in agriculture, agribusiness, retail and manufacturing as well as credit unions, co-operatives, First Nations, medical and legal professionals, not-for-profit organizations and municipalities. In addition, our client base includes a sizable contingent of publicly traded companies.

Yours truly,

**MNP LLP**

*Jody MacKenzie*

Jody MacKenzie, CA

Vice President, Assurance Professional Standards

---

<sup>1</sup> In Canada, there are three accounting frameworks applicable to Non-Commercial Entities:

- Accounting Standards for Private Enterprises
- Accounting Standards for Not-For Profit Organizations
- Public Sector Accounting Standards