



CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

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October 12, 2012

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

Dear Sir:

Re: Invitation to Comment – Improving the Auditor’s Report

The Canadian Public Accountability Board (CPAB) is pleased to respond to the International Auditing and Assurance Standards Board’s (IAASB’s) Invitation to Comment on *Improving the Auditor’s Report* (the “ITC”). CPAB is Canada’s independent audit regulator responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing that contributes to public confidence in the integrity of reporting issuers’ financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

We recognize the need for change and improvement with respect to auditor reporting. Auditors need to provide greater value by sharing more information, related to the audit, directly with financial statement users (“Users”). Change needs to be responsive to the needs of Users, and should be implemented in a thoughtful, responsible way such that audit quality is enhanced and in no way diminished.

We commend the IAASB for giving the auditor reporting project such high priority in its current work program. However, it is important for bodies such as the IAASB, European Commission and United States Public Company Accounting Oversight Board to work together to devise one global solution to the perceived deficiencies in auditor reporting. Since many audit reports are read globally; a more coordinated approach will improve consistency and mitigate investor confusion. Greater divergence in auditor reporting is not in the public interest.

Auditor Commentary

We believe that the concept of an Auditor Commentary is an appropriate response to the call for auditors to provide more information to Users through the auditor's report. The increased transparency into the audit process will improve audit quality and ultimately lead to improved disclosures in publicly available financial information. It will also help contribute to the Users' appreciation of the relevance of the audit. To be effective the Auditor Commentary should be targeted at the key risk areas of most importance to the Users' understanding of the audit. While we recognize that the identification of those key risk areas requires professional judgment, the IAASB should develop a principles-based framework to identify the matters that, as a minimum, the auditor must address.

The framework the auditor uses to identify the matters to communicate in the Auditor Commentary should be consistent with that for identifying matters to communicate with those charged with governance and therefore will likely require concurring amendments to ISA 260, *Communication with Those Charged With Governance*. As a starting point for the framework we support the matters identified in paragraph 45 of the ITC which include: areas of significant management judgment; significant unusual transactions; and matters of audit significance, including areas of significant auditor judgment in conducting the audit. However, we are concerned that the illustrative example of Auditor Commentary in the ITC does not provide the informational or decision-making value that Users seek, although we acknowledge this is difficult to evaluate fully without knowing the content of the financial statement notes to which many of the matters are cross referenced. If the Auditor Commentary is to add value to the auditor's report it must provide more than a cross reference to a note in the financial statements.

We believe a discussion of why an auditor considered a matter important, an overview of the audit procedures performed, and the results of those procedures would provide relevant context to the matter. In addition to addressing the information gap, this may help Users better understand the audit, which might address Users' expectation gap.

Involvement of Other Auditors

We believe that disclosure of the involvement of other auditors in the audit would provide Users greater transparency with respect to who, other than the group auditor, was involved in the audit and the extent of that involvement. In its own inspections, CPAB has identified issues with both the extent the group auditor has used the work performed by component auditors and the extent of involvement of the group auditor in the work of the component auditor. This is particularly important when these other participants are not registered firms or when there are legal or other regulatory barriers to them being inspected by an audit regulator. Without impacting the group

auditor's sole responsibility for the audit, disclosure of the other participants would enable Users to determine the extent of use of component auditors by the group auditor and the degree of oversight the participants are subject to, including publicly available disciplinary history.

Going Concern

We are concerned that the proposed auditor statements regarding both the appropriateness of management's use of the going concern assumption and whether material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified will increase, rather than decrease, the Users' expectation gap. While we understand why the recent global financial crisis has resulted in greater focus on the assessment of going concern and related disclosures we do not believe statements by the auditor based on the work effort of ISA 570 will meet the needs of Users in that context.

The long standing issue with going concern is whether the disclosure of certain matters becomes a self-fulfilling prophecy - a risk that may be significantly higher for particular entities such as financial institutions. To address the lessons of the global financial crisis there may need to be different solutions for Systemically Important Financial Institutions ("SIFI") versus other commercial entities. Given the significance of SIFIs to the broader economy, CPAB would encourage consideration of alternative approaches, such as improved communication between auditors and prudential regulators, as a more effective method of achieving the desired objective.

We support the development of additional guidance for auditors, under ISA 570, with respect to the identification and response to material uncertainties as it is a complex and judgmental exercise and our inspections have evidenced that auditors are currently struggling to respond appropriately.

Format and Structure of the Standard Auditor's Report

We support the need to improve the format and structure of the existing standard audit report and to do so in a manner that enhances consistency of reporting at the global level. We, therefore, agree with the IAASB that there is merit in mandating the ordering of the elements within the auditors' reports across jurisdictions, unless otherwise required by law or regulation. We also believe that the changes to the format and structure proposed should be applied consistently across all listed entities as the reporting for smaller entities will generally be less complex.

In structuring the format of the audit report the informational value of the content should be a significant consideration in determining the ordering with entity specific matters being presented first. Given the value of the "pass/fail" nature of the audit opinion we support increasing its prominence by moving it to the beginning of the report.

In concluding we again commend the IAASB for engaging with stakeholders on this important topic. In a continually changing global business environment, with increasingly complex financial reporting requirements, it is critical that auditor reporting evolves in a way that better meets the needs of financial statement Users and enhances the relevance and value of the audit.

In addition to our comments above, our responses to the questions posed in the ITC are included in the Appendix to this letter.

We would be pleased to discuss further any of the above comments.

Yours very truly,



Brian Hunt, FCA
Chief Executive Officer

cc. Mr. Mark Davies, CIA, CA
Chair, Auditing and Assurance Standards Board (Canada)

Mr. Greg Shields, CA
Director, Auditing and Assurance Standards
The Canadian Institute of Chartered Accountants

APPENDIX

Questions

Since CPAB's mandate relates to listed entities in Canada our comments apply solely to listed entities.

Overall Considerations

- 1. Overall, do you believe the IAASB's suggested improvements sufficiently enhance the relevance and informational value of the auditor's report, in view of possible impediments (including costs)? Why or why not?**

We commend the IAASB for giving the auditor reporting project such high priority in its current work program and support the overall direction of the suggested improvements. However, we believe that the auditor commentary should go further in terms of the informational value it provides on key risk areas. We also recommend the IAASB develop a principles-based framework to identify the matters that, as a minimum, the auditor must address.

- 2. Are there other alternatives to improve the auditor's report, or auditor reporting more broadly, that should be further considered by the IAASB, either alone or in coordination with others? Please explain your answer.**

Audit committees have a key oversight role to play in ensuring both audit quality and high quality financial reporting. In our view there is merit in considering having more transparent public reporting by audit committees on how they have discharged their responsibilities to oversee the audit. This could include reporting on how the audit committee has assessed the effectiveness of the external audit process in the current year and/or the results of the audit committee having performed a mandatory audit firm review. The mandatory audit firm review would be a formal evaluation by the audit committee, on a periodic basis, of the effectiveness of the auditor, with justification included in a public filing as to why the existing auditor has been reappointed or why the audit has been put out to tender or whether a new auditor has been appointed.

Auditor Commentary

3. Do you believe the concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information to users through the auditor's report? Why or why not" (See paragraphs 35-64.)

The concept of Auditor Commentary is an appropriate response to the call for auditors to provide more information through the audit report in key risk areas of most importance to the Users understanding of the audit as we believe the increased transparency into the audit process will improve audit quality and ultimately lead to improved disclosures in publicly available financial information.

Users clearly value the pass/fail nature of the current audit report, but the lack of transparency with respect to the nature and extent of professional judgment exercised by the auditor, particularly in auditing high risk areas, is a significant contributor to the current information gap between auditors and Users. As our financial systems become more global and grow in complexity Users are recognizing the importance of informed decision making. While Users may still place high value on the auditor's opinion as to the fairness of the presentation of the financial statements, they would have a better appreciation for that opinion if they were aware of the significant matters the auditor considered and how the auditor was satisfied that the matters had been appropriately addressed.

Audits are conducted using a risk based approach. Auditors spend considerable time and effort identifying the significant risks of material misstatement within the financial statements, however, without a discussion of these risks in the audit report Users cannot benefit from auditor insights to this significant work effort. In our inspection of audit files, we are often surprised at the inconsistency between the risk identified and the audit approach taken in high risk areas. We believe that if an auditor had to disclose the significant risks identified and the approach taken to address those risks it would reduce those inconsistencies and improve audit quality.

A significant concern with the concept of an Auditor Commentary is whether or not it will blur the lines of responsibility between the auditor, management and those charged with governance (TCWG). The specific concern is whether, in providing the Auditor Commentary, the auditor might provide entity specific information that should only be provided by management. While we recognize the validity of this concern, we believe that the development of the financial statements is an iterative process concurrent with the audit and so if certain entity specific information is critical to understand a matter in

the Auditor Commentary it is highly likely that the auditor is also discussing the need to include the information in the financial statements or other disclosure documents. We believe these discussions will ultimately lead to improved disclosures in publicly available financial information.

- 4. Do you agree that the matters to be addressed in Auditor Commentary should be left to the judgment of the auditor, with guidance in the standards to inform the auditor's judgment? Why or why not? If not, what do you believe should be done to further facilitate the auditor's decision-making process in selecting the matters to include in Auditor Commentary? (See paragraphs 43-50.)**

To be effective the Auditor Commentary should be targeted at the key risk areas of most importance to the Users' understanding of the audit. While we recognize that the identification of those key risk areas requires the use of professional judgment, the IAASB should develop a principles-based framework to identify the matters that, as a minimum, the auditor must address.

The framework the auditor must use to identify the matters to communicate in the Auditor Commentary should be consistent with the framework for identifying matters to communicate with TCWG and therefore will likely require concurring amendments to ISA 260. As a starting point for the framework we support the matters identified in paragraph 45 of the ITC which include: areas of significant management judgment; significant unusual transactions; and matters of audit significance including areas of significant auditor judgment in conducting the audit.

- 5. Do the illustrative examples of Auditor Commentary have the informational or decision-making value users seek? Why or why not? If not, what aspects are not valuable, or what is missing? Specifically what are your views about including a description of audit procedures and related results in Auditor Commentary? (See paragraphs 58-61.)**

We believe that the illustrative example of Auditor Commentary in the ITC does not provide the informational and decision-making value that Users seek, although this is difficult to evaluate fully without knowing the content of the financial statement notes to which many of the matters are cross referenced. If the Auditor Commentary is to add value to the auditor's report it must provide more than a cross reference to a note in the financial statements.

We believe a discussion of why an auditor considered a matter important, an overview of the audit procedures performed, and the results of those procedures would provide relevant context to the matter. In addition to addressing the information gap, this may help Users better understand the audit, which might address Users' expectation gap.

6. What are the implications for the financial reporting process of including Auditor Commentary in the auditor's report, including implications for the roles of management and those charged with governance (TCWG), the timing of financial statements, and costs? (See paragraphs 38 and 62-64.)

We recognize that any additional disclosure on the part of the auditor will result in more time and therefore costs for the auditor, management and TCWG due to the need to develop, consider and discuss the content of the Auditor Commentary as well as the need to subject it to quality control procedures. However, given the informational value of the disclosure and the fact that it should be reflective of work already performed by the auditor, we do not see these costs as prohibitive and believe the related benefits to Users of a meaningful Auditor Commentary outweigh or exceed the related costs.

7. Do you agree that providing Auditor Commentary for certain audits (e.g. audits of public interest entities (PIEs)), and leaving its inclusion to the discretion of the auditor for other audits? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided? (See paragraphs 51-56.)

CPAB's mandate relates to listed entities in Canada and so our comments are intended to apply solely to listed entities.

Going Concern / Other Information

8. What are your views on the value and impediments of the suggested auditor statements relating to going concern, which addresses the appropriateness of management's use of the going concern assumption and whether material uncertainties have been identified? Do you believe these statements provide useful information and are appropriate? Why or why not? (See paragraphs 24-34.)

We are concerned that the proposed auditor statements regarding both the appropriateness of management's use of the going concern assumption and whether material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified will increase, rather than decrease, the

Users' expectation gap. While we understand why the recent global financial crisis has resulted in greater focus on the assessment of going concern and related disclosures we do not believe statements by the auditor based on the work effort of ISA 570 will meet the needs of Users in that context.

The long standing issue with going concern is whether the disclosure of certain matters becomes a self-fulfilling prophecy - a risk that may be significantly higher for particular entities such as financial institutions. To address the lessons of the global financial crisis there may need to be different solutions for Systemically Important Financial Institutions ("SIFI") versus other commercial entities. Given the significance of SIFIs to the broader economy, CPAB would encourage consideration of alternative approaches, such as improved communication between auditors and prudential regulators, as a more effective method of achieving the desired objective.

9. What are your views on the value and impediments of including additional information in the auditor's report about the auditor's judgments and processes to support the auditor's statement that no material uncertainties have been identified?

As noted in our response to question 8 above, we have concerns with the proposed auditor statements regarding going concern which would extend to the inclusion of additional information about the auditor's judgments and processes.

10. What are your views on the value and impediments of the suggested auditor statement in relation to other information? (see paragraphs 65-71.)

While we support the identification of the specific other information the auditor has read and the statement as to whether any material inconsistencies between this information and the audited financial statements have been identified, we share the concern that an explicit statement may potentially lead to the misinterpretation by Users that the other information has been audited. The inclusion of the disclaimer that the auditor has not audited the other information may reduce the risk of a misunderstanding or it may simply create confusion with respect to the auditor's work effort relative to the other information. Further research into the perceptions of Users would be helpful.

We note that currently the IAASB has a project to revise ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*. It is our understanding that the project is proposing an expansion of the work effort required by the auditor on the other information but not to the extent that the auditor would be providing assurance. Input received from that project, including the

proposed reporting requirements, should be considered before a final decision is made regarding whether or not to include a statement in the auditor's report regarding other information.

Clarifications and Transparency

- 11. Do you believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor in the illustrative auditor's report are helpful to user's understanding of the nature and scope of an audit? Why or why not? Do you have suggestions for other improvements to the description of the auditor's responsibilities? (See paragraphs 81-86.)**

We believe the enhanced descriptions of the responsibilities of management, TCWG, and the auditor are helpful.

- 12. What are your views on the value and impediments of disclosing the name of the engagement partner? (See paragraphs 72-73.)**

We understand the basis for the proposals to require disclosure of the name of the engagement partner in the audit report. However, we would encourage a more holistic approach to better understand the root causes of lapses in audit quality in developing solutions to improve accountability for the audit. Greater focus needs to be given to the organizational structure of audit firms and how this can be improved to build greater quality into the execution of the audit. Consideration needs to be given to how accountability can be strengthened for audit firms at the engagement level, office level and national level. A more holistic approach should also consider the role of the audit committee and explore ways in which audit committees can more effectively oversee and evaluate the quality of the audit.

- 13. What are your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such a disclosure should be included in all relevant circumstances, or left to the auditor's judgment as part of Auditor Commentary? (See paragraphs 77-80.)**

We believe that disclosure of the involvement of other auditors in the audit would provide Users greater transparency with respect to who, other than the group auditor, was involved in the audit and the extent of that involvement. In its own inspections, CPAB has identified issues with both the extent the group auditor has used the work performed by component auditors and the extent of involvement of the group auditor in the work of

the component auditor. This is particularly important when these other participants are not registered firms or when there are legal or other regulatory barriers to them being inspected by an audit regulator. Without impacting the group auditor's sole responsibility for the audit, disclosure of the other participants would enable Users to determine the extent of use of component auditors by the group auditor and the degree of oversight the participants are subject to, including publicly available disciplinary history.

14. What are your views on explicitly allowing the standardized material describing the auditor's responsibilities to be relocated to a website of the appropriate authority, or to an appendix to the auditor's report? (See paragraphs 83-84.)

We believe that the standardized material describing the auditor's responsibilities should be retained within the auditor's report to ensure completeness and accessibility regardless of the technology available to the user. However to improve the readability of the audit report and to emphasize entity specific information it would be acceptable to move this standardized material to an appendix to the auditor's report.

15. What are your views on whether the IAASB's suggested structure of the illustrative report, including placement of the auditor's opinion and the Auditor Commentary section towards the beginning of the report, gives appropriate emphasis to matters of most importance to users? (See paragraphs 17-20.)

We support the need to improve the format and structure of the existing standard audit report and to do so in a manner that enhances consistency of reporting at the global level. We, therefore, agree with the IAASB that there is merit in mandating the ordering of the elements within the auditors' reports across jurisdictions, unless otherwise required by law or regulation. We also believe that the changes to the format and structure proposed should be applied consistently across all listed entities as the reporting for smaller entities will generally be less complex.

In structuring the format of the audit report the informational value of the content should be a significant consideration in determining the ordering with entity specific matters being presented first. Given the value of the "pass/fail" nature of the audit opinion we support increasing its prominence by moving it to the beginning of the report.

16. What are your views regarding the need for global consistency in auditors' reports when ISAs, or national auditing standards that incorporate or are otherwise based on ISAs, are used? (See paragraphs 21-23 and 87-90.)

It is important for bodies such as the IAASB, European Commission and the United States Public Company Accounting Oversight Board to work together to devise one global solution to the perceived deficiencies in auditor reporting. Since many audit reports are read globally; a more coordinated approach will improve consistency and mitigate investor confusion. Greater divergence in auditor reporting is not in the public interest. See also response to Question 15.

17. What are your views as to whether the IAASB should mandate the ordering of items in a manner similar to that shown in the illustrative report, unless law or regulation require otherwise? Would this provide sufficient flexibility to accommodate national reporting requirements or practices? (See paragraph 17 and Appendix 4.)

See response to Question 15.

18. In your view, are the IAASB's suggested improvements appropriate for entities of all sizes and in both the public and private sectors? What considerations specific to audits of small- medium –sized entities (SMEs) and public sector entities should the IAASB further take into account in approaching its standard-setting proposals? (See paragraphs 91-95.)

Changes to the reporting model should be applied consistently across all listed entities. For SMEs the issues, and therefore the reporting, should generally be less complex. However, the challenges and costs will vary given differences in corporate governance structure and types of Users for SMEs.