CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

150 York Street, Suite 200, Box 90, Toronto, Ontario M5H 3S5
Tel 416.913.8260 Fax 416.850.9235 www.cpab–ccrc.ca

June 1, 2011

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

Dear Sir:

Re: Discussion Paper on The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications

The Canadian Public Accountability Board (CPAB) is pleased to comment on the International Auditing and Assurance Standards Board's (IAASB's) discussion paper on issues relevant to auditing disclosures in a financial statement audit.

CPAB is Canada's independent audit regulator responsible for overseeing audit 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.

The continuing evolution and increased complexity of financial reporting has created significant challenges for auditors in applying the International Standards on Auditing (ISAs) to obtain sufficient, appropriate audit evidence about financial statement disclosures to support their opinion on the financial statements as a whole. As a result of these challenges, CPAB believes this is an important area for the IAASB to address to improve audit quality.

Exploration of Alternatives for Improving Auditing Standards

While CPAB applauds the initiative the IAASB has taken in issuing this discussion paper, we believe more suggestions and alternatives could have been explored in the paper for how auditing standards can be improved in the area of financial statement disclosures. For example, what constitutes sufficient, appropriate audit evidence for forward-looking qualitative information may be different to disclosure for a significant risk area with high estimation uncertainty. Greater consideration could also have been given to the views of financial statement users in exploring improvements to auditing standards. Going forward we encourage the IAASB to perform greater outreach with stakeholders, including preparers, audit committee members, regulators, investors and other financial statement users, to gain their perspectives on the importance and relevance of disclosures.

Increased Coordination between IAASB and IASB

The use of the disclosures required by International Financial Reporting Standards (IFRS) as a frame of reference for the issues raised in the paper is highly relevant in Canada where publicly accountable enterprises were required to adopt IFRS for years beginning on or after January 1, 2011. In transitioning to IFRS Canadian entities are adopting disclosures that are generally more objective based and many of the more judgemental or higher risk disclosures are often not directly associated with account balances or classes of transactions. Many accounting frameworks, including IFRS, require preparers and auditors to consider the need to go beyond the requirements of the framework to achieve fair presentation.

The trend towards increasingly complex financial statement disclosures highlights the importance of any future developments in accounting frameworks including consideration of whether the standards contain suitable criteria against which the disclosures can be evaluated. This consideration should include whether the audited financial statements are the most appropriate document for the disclosures being proposed or whether other continuous disclosure documents, like Management's Discussion and Analysis, would be more consistent with the nature and purpose of the disclosure, and perhaps auditors should have greater involvement with the MD&A. While CPAB is encouraged by the fact that the IAASB meets with representatives of the International Accounting Standards Board (IASB) on a regular basis to discuss recent financial reporting and auditing developments, we believe there should be more formal co-ordination between the IASB and the IAASB so that appropriate consideration can be given to the issue of auditability earlier in the development of financial reporting standards and related disclosure requirements.

Boilerplate Disclosures

The paper suggests that reporting issuers and auditors are reluctant to remove financial statement disclosures that are immaterial. This has not been our experience. The more significant issue we have observed is boiler plate disclosures being provided in financial statements which do not address the intent and spirit of the disclosure requirements, and fail to convey meaningful entity specific information. Auditors have an important role to play in ensuring management provides transparent, meaningful disclosures with respect to risks, uncertainties and sensitivities.

In our inspection activities we have seen many instances of poor or non-existent disclosures, especially in higher risk areas. For example, debt covenant violations not being disclosed, significant related party transactions not being disclosed, inadequate disclosures related to level 3 securities valuations and weak disclosures with respect to off-balance sheet exposures. In most of these instances the lack of disclosure was not identified by the auditor or if it was identified it was not communicated to the audit committee as a significant disclosure deficiency.

Auditor's Responsibilities Related to Financial Statement Disclosures

The ISAs currently address disclosures consistent with account balances and classes of transactions. In this context the auditor generally applies the same quantitative and qualitative concepts of materiality and audit evidence to disclosures as those applied to the audit of the recorded amounts. As the concepts of materiality and audit evidence and the objectives of the audit procedures performed are very different for disclosures not directly linked to account balances and classes of transactions, the audit of these disclosures should be specifically and separately addressed in the auditing standards. This separate guidance would help auditors apply the audit risk model to those disclosures as well as the determination of materiality. We believe the paper should have gone further in exploring alternatives to improving auditing standards in this area.

We do not agree that a higher materiality should be used to assess disclosure deficiencies versus misstatements impacting the face of the financial statements. This sends the wrong message with respect to audit quality. Financial statement users should be able to rely on note disclosures to the same extent as items on the face of the financial statements.

Further guidance should also be provided on what constitutes a material misstatement with respect to disclosure deficiencies. This will assist auditors and preparers in applying appropriate judgement to what is important to a financial statement user. This is also an area with potential for increased coordination between the IAASB and IASB.

Application of Professional Scepticism

With increasing complexity in financial reporting and greater areas of judgement, estimation and material uncertainties in the financial statements, financial statement disclosures are taking on greater prominence for financial statement users. The audit needs to be responsive to these developments and greater qualitative guidance needs to be provided by the IAASB on the factors an auditor should take into account to evaluate disclosure deficiencies and the work effort required by the auditor to obtain sufficient appropriate audit evidence in this area. The IAASB needs to strengthen the requirements with respect to auditing disclosures to promote greater application of professional scepticism and a thinking, risk-based approach to auditing disclosures which will improve the quality of disclosures provided to financial statement users. This is particularly critical in areas of the financial statements with high estimation uncertainty and management judgement.

CPAB believes that the Engagement Quality Control Reviewer (EQCR) can play a significant role in improving the quality of the audit of financial statement disclosures by providing an alternative perspective on whether or not the disclosures provide fair presentation. While **ISA 220, *Quality control for an audit of financial statements*** currently requires the EQCR to review the financial statements, the objectives of this review particularly with respect to disclosures could be made more explicit.

Communication with Audit Committees

The requirements with respect to communications with those charged with governance need to be strengthened to include requirements in both **ISA 260**, ***Communication with those charged with governance*** and **ISA 450**, ***Evaluation of misstatements identified during the audit*** to require significant disclosure deficiencies to be reported by auditors to audit committees as is currently required for uncorrected misstatements.

The discussion paper contains a number of consultation questions tailored for specific stakeholder groups. The stakeholder group most relevant to CPAB would be regulators, as this includes audit oversight bodies of which we are one. While we have attempted to address the topics included in the paper, we found it difficult to answer many of the questions as the evaluation of the fair presentation of disclosures is very fact and circumstance specific. We would encourage the IAASB to explore other forums for gaining input, such as round table discussions in the next phase of this project.

CPAB appreciates the opportunity to provide input to the IAASB in its efforts to gain an understanding of the issues relevant to auditing disclosures in a financial statement audit.

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

Yours very truly,

Brian Hunt, FCA

Chief Executive Officer

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