



Canadian Securities  
Administrators

Autorités canadiennes  
en valeurs mobilières

August 31, 2012

International Auditing and Assurance Standards Board (IAASB)  
529 Fifth Avenue 6th Floor  
New York, New York 10017  
U.S.A.

Cc: Canadian Auditing and Assurance Standards Board

**Subject: Improving the Auditor's Report – Invitation to Comment**

Dear IAASB Members:

The Canadian Securities Administrators (CSA) is an organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets. The CSA Chief Accountants Committee is comprised of the Chief Accountants from the provinces of Ontario, Quebec, Alberta and British Columbia. We are submitting this letter to you in response to the invitation to comment from the International Audit and Assurance Standards Board (the IAASB) on Improving the Auditor's Report (ITC).

We appreciate the opportunity to comment on the Invitation to Comment (ITC), given the significant impact that these proposals may have on auditor reporting.

We have significant concerns that the proposed Auditor Commentary and proposed statements related to going concern:

- may be misinterpreted by users as "soft qualifications" of the auditor's opinion;
- will make auditor's reports longer and different among entities making comparisons more difficult;
- may detract from the clear "pass/fail" message in the current auditor's report;
- will increase the expectations gap for users; and
- blur the distinction between the roles and responsibilities of the auditor and those of management, which in turn may negatively impact auditor independence.

We are also concerned that the costs associated with the IAASB's proposals to expand the auditor's report, including Auditor Commentary and statements related to going concern, may exceed any potential benefits.

Finally, we encourage the IAASB to co-ordinate its efforts to improve the auditor's report with initiatives led by other bodies internationally. Users of auditor's reports are best served by consistent, or very similar, auditor reporting standards internationally.

We have provided a more detailed response to your questions in the attached Appendix.

If you have any questions about our letter, please do not hesitate to contact us.

Yours truly,

**The CSA Chief Accountants Committee**

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## Appendix

### Overall Considerations

**Question 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?

Canadian stakeholders whom we have consulted on a preliminary basis are not calling for an expanded auditor’s report. Canada transitioned to International Standards on Auditing (ISAs) for financial years ending on or after December 14, 2010. As a result, we believe it is premature to significantly change the auditor’s report. We need more time to assess the response of Canadian users to the current auditor’s report under ISAs, including their use of information in an Emphasis of Matter paragraph or Other Matters paragraph.

We have significant concerns that the proposed Auditor Commentary and proposed statements related to going concern may be misinterpreted by users as “soft qualifications” of the auditor’s opinion. There is also a risk that auditors could use these “soft qualifications” instead of qualifications to the auditor’s reports. In addition, we are concerned that the additional length of the auditor’s report and the lack of consistency between reports will make company comparisons more challenging and may detract from the clear “pass/fail” message of the current auditor’s report. Furthermore, we are concerned that the proposed changes will increase the expectation gap for users.

Auditor Commentary proposals include the auditor providing information about the entity by highlighting disclosures in the financial statements, and about the audit process by addressing the auditor’s procedures, key judgments, and conclusions. We have significant concerns about the auditor providing information about the entity. However, we suggest that enhanced disclosure from those charged with governance (e.g. audit committees) may provide an appropriate way to provide this information should users find this useful.

Securities legislation in Canada includes specific requirements for reporting issuers, for those charged with governance (including audit committees and boards of directors), and auditors. We strongly agree that changes to the auditor’s report should “not result in the auditor being the original provider of information about the entity.” (ITC paragraph 49). The auditor should not provide subjective insights about the entity in the auditor’s report. We are concerned about the possibility of “blurring” roles and responsibilities. The auditor reports to the audit committee, and the audit committee oversees the financial reporting process by management and the work of the external auditor. We believe these roles and responsibilities are appropriate. We are concerned that, in both perception and reality, the “blurring” of roles may impact auditor independence if the auditor were the originator of information.

**Question 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.

We are aware that there are several other proposals concerning auditor reporting under review internationally. These include proposals from the Public Company Accounting Oversight Board (PCAOB) and the European Commission, the U.K. House of Lords Report, and the Financial Reporting Council’s Sharman Inquiry. We encourage the IAASB to co-ordinate its efforts to

improve the auditor's report with initiatives led by other bodies internationally. Stakeholders in Canada are particularly concerned about convergence of ISAs and PCAOB standards given the connections between the capital markets in Canada and the U.S. including the existence of many cross-border issuers and cross-border industry peer groups. For example, approximately 340 Canadian reporting issuers are registrants of the U.S. Securities and Exchange Commission. We think that users of auditor's reports are best served by consistent, or very similar, auditor reporting standards internationally.

### **Auditor Commentary**

**Question 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).

Paragraph 42 of the ITC explains that the objective of Auditor Commentary is to provide transparency about matters relating to both the entity's audited financial statements and the audit itself. Please see our response to Question 1 for our comments about additional information relating to the entity's financial statements. Regarding additional information about the audit itself, we suggest that enhanced disclosure from those charged with governance (e.g. audit committees) may provide an appropriate way to increase transparency about audit matters.

**Question 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.)

Notwithstanding our views on Auditor Commentary expressed in Question 1 and 3, if the IAASB proceeds to require an Auditor Commentary, we strongly recommend that the IAASB provide more extensive guidance including more specific criteria on the materiality and number of items to discuss, length of the commentary, and avoiding boilerplate. We understand that the IAASB does not intend to specify a "minimum number of matters to be addressed" or to "limit the number of matters", and that there is a "threshold of providing transparency into most important matters" (ITC paragraph 61). However, we believe that auditors will benefit from specific criteria and more extensive guidance as to the number and nature of these matters.

Canadian securities regulators have been working with Canadian reporting issuers to ensure compliance with IFRS disclosure requirements since Canada's transition to IFRS in 2011. Disclosure of significant judgments by management is an area where we have identified a lack of compliance with IFRS, and a lack of consistent interpretation of IFRS requirements. We are concerned that the proposal to require auditors to exercise considerable judgment in deciding what to include in Auditor Commentary will result in similar inconsistencies.

**Question 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.)

The illustrative examples provided do not fully address concerns we raised in our response to

Question 4.

**Question 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.)

Canadian reporting issuers are required to submit annual financial statements and accompanying auditor’s reports within 90 days for larger reporting issuers, and 120 days for smaller reporting issuers. We believe management and auditors may be increasingly challenged to complete the work required for the proposed Auditor Commentary within our deadlines.

See also response to Question 1 regarding roles of management and those charged with governance.

### **Going Concern**

**Question 8**—What are your views on the value and impediments of the suggested auditor statements related to going concern, which address 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 proposal to require an auditor’s report to include a conclusion about management’s use of the going concern assumption will not provide useful information that management is not already required to provide. ISA 570 requires an auditor to obtain sufficient appropriate audit evidence about the appropriateness of management’s use of the going concern assumption. If the going concern assumption is not appropriate, financial statements should be prepared on a liquidation basis of accounting. If the auditor does not agree with management’s going concern basis of presentation, an adverse opinion would be required in an auditor’s report which would sufficiently alert users to the concerns that the ITC proposals are attempting to address. We are also concerned that the proposed conclusion may provide inappropriate comfort to the users about the quality or appropriateness of the entity as a potential investment.

We question the proposal to require the auditor to make a statement about the absence of material uncertainties given that IFRS does not require this disclosure. IAS 1.25 requires management to “disclose material uncertainties related to events or conditions that may cast significant doubt upon the entity’s ability to continue as a going concern”. We are concerned that the proposed wording may confuse users about the auditor’s role regarding disclosure of uncertainties which should be disclosed by management. In addition, if an auditor’s report discloses material uncertainties that management has not disclosed and the auditor’s report contains an unmodified opinion, users may be confused about the implications of those disclosures.

Notwithstanding our views on the proposals for expanded disclosure relating to going concern, if the IAASB proceeds to implement new requirements in this area, we request that you address the following three issues.

Paragraph 27 of the ITC and the illustrative auditor’s report indicate that to minimize the

potential for users to misinterpret the proposed statements relating to going concern, that the auditor's report would include the following statement "Because not all future events or conditions can be predicted, this statement is not a guarantee that the Company will or will not be able to continue as a going concern." This statement implies that the auditor attempts to predict future events or conditions, but may not have predicted all of them. However, the "events and conditions" that an auditor refers to (as discussed in paragraph 25) appear to be existing events and conditions. While the auditor would consider the likely outcomes of existing events and conditions, it seems unreasonable to expect the auditor to predict future events and conditions. We recommend removing any suggestion that the auditor must predict future events or conditions.

Some entities provide disclosure in the notes to financial statements about circumstances that relate to the going concern assumption but do not meet the IAS 1 threshold for disclosure. For example, an entity may disclose that its operations have been funded primarily by the issuance of share capital and through advances by related parties, and that continued operations depend on the company's ability to generate profitable operations in the future, or obtain continued financial support from related parties or equity. Such disclosures are sometimes referred to as "soft going concern" disclosures. In such cases, there is no Emphasis of Matter paragraph in the auditor's report (under existing ISAs). We question how users will interpret the statements proposed in paragraph 25 of the ITC in relation to "soft going concern" disclosure in the notes to financial statements. Presumably, despite the "soft going concern" disclosure in the notes to the financial statements, the auditor's report would include the statement "we have not identified material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern that we believe would need to be disclosed in the accordance with IFRSs". We question whether a user will appreciate that the matters described in the notes do not meet the threshold of "material uncertainties related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern."

The ITC proposes to require the auditor to make an explicit statement regarding "whether, based on the audit work performed, 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" (paragraph 25(ii)). Use of the word "may" is consistent with wording currently in IAS 1 and ISA 570. However, we suggest that the IAASB reconsider use of conditional language because it does not clearly communicate whether or not the auditor or management think that the uncertainties cast significant doubt.

In addition, if the IAASB believes that clarification is needed with respect to going concern, we recommend that the communication of the auditor's responsibilities to make an assessment of management's use of the going concern assumption be included as part of the Auditor's Responsibility section of the auditor's report.

**Question 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? (See paragraphs 30–31.)

Paragraph 29 of the ITC explains that if the auditor identifies a material uncertainty, the auditor must draw users' attention to disclosure in the financial statements, based on the current requirement in ISA 570. Paragraph 30 says "There are also situations where the auditor may have determined that no material uncertainty exists, but certain events or conditions nevertheless have been identified that may cast significant doubt on the entity's ability to continue as a going concern. In such circumstances, there may be merit in the auditor describing in the auditor's report significant judgments the auditor may have made, and audit procedures the auditor may have performed, in reaching a conclusion that no material uncertainty exists."

We think paragraph 30 is confusing because if existing events or conditions "may cast significant doubt about the entity's ability to continue as a going concern" how could there not be "material uncertainty"? Further, what is the rationale for making it optional to comment about such events or conditions, as suggested by the phrase "may be merit" in paragraph 30?

As noted in our response to Question 1, we are concerned that the proposed disclosures may be misinterpreted by users as "soft qualifications". In addition, auditors may argue that proposed disclosures reduce their exposure to liability for their opinion on the financial statements, as the disclosure was made public in the auditor's report. Alternatively, the auditor's liability may be increased through users misunderstanding the proposed disclosures.

### **Other Information**

**Question 10**—What are your views on the value and impediments of the suggested auditor statement in relation to other information? (See paragraphs 65–71.)

We agree with the objective of enhancing transparency about the auditor's responsibilities in relation to Management Discussion and Analysis (MD&A). We understand that some investors in Canada are currently confused about this area. The ITC proposal for an auditor statement about any material inconsistencies between annual financial statements and other information (including MD&A) appears to be limited to situations where MD&A is included in a document that includes the financial statements. This proposal will not address the situation in Canada where securities legislation requires an issuer to file MD&A separate from the annual financial statements. We think that investors would benefit from clarification of auditor responsibilities in relation to MD&A, whether or not the MD&A is included in a document that includes the annual financial statements.

We believe that extensive outreach with regulators, auditors, and preparers would be necessary before proceeding to require disclosure of an auditor's involvement with other information. In Canada, we have been recently working with the Canadian Auditing and Assurance Standards Board to revise the wording of the auditor's consent required for inclusion of an auditor's report in offering documents. This has been a lengthy and complex process, resulting in proposed changes to the Canadian standards on involvement of the auditor with offering documents.

### **Involvement of other auditors**

**Question 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 are concerned that the proposed disclosure for the involvement of other auditors in a group audit engagement may confuse users about the responsibility of the group auditor. Users may perceive the disclosure as shifting responsibility for the audit from the group auditor to the component auditors, and this misunderstanding may outweigh the advantages of providing more transparency about the audit. We currently have concerns about ISA 600 which we hope to see addressed in future changes to the standard. If these changes are not made, we would consider recommending including additional information about the component audits of a group audit in the auditor's report.

### **Form and Structure**

**Question 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 proposal to place the auditor's opinion towards the beginning of the report.

**Question 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.)

We support the proposal.

**Question 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.)

We support the proposal to mandate the ordering of items.

### **Size of entity**

**Question 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- and 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.)

Given the large number of small Canadian reporting issuers, we are concerned that the costs associated with the IAASB's proposals to expand the auditor's report, including Auditor Commentary and statements related to going concern, may exceed any potential benefits.