



October 8, 2012

Mr. James Gunn  
Technical Director  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue – 14<sup>th</sup> Floor  
New York, NY 10017  
U.S.A.

Dear Mr. Gunn,

**Re: Invitation to Comment *Improving the Auditor's Report***

The Canadian Auditing and Assurance Standards Board (AASB) is pleased to provide its comments on the Invitation to Comment (ITC) *Improving the Auditor's Report*. In developing our response, we considered comments provided to us by our stakeholders who showed a strong interest in this topic. We held many face-to-face and conference call meetings with various user groups, including investors, analysts, management, audit committees, directors, regulators, auditors and others. Nearly 700 participants also provided input to polling questions presented during an interactive webinar.

**General Comments**

We support the efforts of the IAASB as it seeks to obtain a better understanding about views on the issues raised in this ITC as a pre-requisite to considering possible improvements in auditor reporting. We agree that it is appropriate to monitor and maintain the value and relevance of auditor reporting including, as appropriate, enhancing the auditor's report on the financial statements. We support the IAASB's desire to keep the objective and scope of the financial statement audit unchanged.

The auditor's report is the key output from the audit process. We support the development of an auditor reporting model including consistent use of auditor's reports that users around the world

can understand, that national standard setters would adopt and that auditors would apply. For these reasons, we support the IAASB continuing to work together with other bodies that are taking an interest in auditor reporting in their jurisdictions, such as the European Commission and the United States Public Company Accounting Oversight Board (PCAOB).

We congratulate the IAASB on developing an ITC that clearly sets out the IAASB's considerations, views and suggestions in a manner that our stakeholders found easy to navigate and understand.

## **Structure of Our Response**

In developing our response to the questions posed in the ITC, our approach has been to set out overall comments. For each significant section of the ITC, we present the Canadian viewpoints obtained during our consultations (see Appendix 1 for a summary of the consultations we have undertaken). Since we believe it is important to distinguish the perspectives of users of the auditor's report from the views of those responsible for preparation of the financial statements, the audit and oversight of the financial reporting process, we present these perspectives separately. The user perspective is based on discussions with financial statement users as well as the insights of auditors and others on this perspective. Our conclusions take into account the Canadian viewpoints. Our responses to questions in the ITC are set out in Appendix 2. Paragraph numbering has been provided for our detailed comments to facilitate cross-referencing of the material.

## **Overall Comments**

### Key elements of the Canadian environment

Our comments in this letter are provided in the context of the following key elements of the Canadian environment:

### **Whether there is the need for change to Canadian auditor reporting as a result of the global financial crisis**

Unlike many other countries, Canada weathered the financial crisis well and did not experience the banking and other financial system failures that are driving many of the proposed changes taking place to the financial statement audit process internationally. In this respect, we have not been receiving demands for more information about individual financial statement audits or the auditor's insights into the audited entity and its financial statements. The response to the ITC from the Canadian Securities Administrators also stated that "Canadian stakeholders whom we have consulted on a preliminary basis are not calling for an expanded auditor's report."

### **Recent adoption of International Standards on Auditing (ISAs) in Canada**

Canada adopted ISAs as Canadian Auditing Standards (CASs) with minimal amendments for the audits of financial statements and other historical financial information for periods ending on or

after December 14, 2010. When they were adopted, two significant changes were made to the audit reporting model that had previously existed in Canada. First, the wording of the standard Canadian auditor's report changed from a three-paragraph report to the format required by ISA (CAS) 700, *Forming an Opinion and Reporting on Financial Statements*. Second, the standards required auditors to include Emphasis of Matter (EOM) and Other Matter (OM) paragraphs in the auditor's report when applicable. The AASB devoted significant energy to informing stakeholders (auditors, management, regulators, investors, owners, and governing bodies) about these changes and to monitoring the implementation of the new audit reporting model in practice. We believe that Canadian stakeholders are well-informed about the audit reporting model and the ability of the auditor to add EOMs and OMs.

Based on the AASB's research, and through discussions with stakeholders since Canada's 2010 adoption, there has not been significant use of EOMs and OMs. In fact, stakeholders have generally expressed satisfaction with the standard auditor's report and the use of EOMs and OMs only when required by the standards. We believe that this finding confirms the view set out in paragraph 41 of the ITC, that a widespread use of EOMs and OMs will diminish the effectiveness of the auditor's communication of such matters.

### **Canadian marketplace**

A distinctive feature of the Canadian securities marketplace is the large proportion of small public companies. There are approximately 2,000 Canadian public issuers with market capitalization and total assets of under \$10 million. Many of these companies are involved in resource exploration. Canadian securities regulators have recognized the variance in size and nature of Canadian public issuers in setting requirements. Some of their requirements do not apply to certain public companies (for example those relating to corporate governance for entities listed on the TSX Venture Exchange).

There are approximately 350 Canadian companies that are registered and report with the US Securities and Exchange Commission (SEC). Many auditors of these entities conduct their audits in accordance with both Canadian generally accepted auditing standards and PCAOB auditing standards.

Many Canadian stakeholders expressed the view that there may be significantly different cost-benefit considerations for the suggested changes to auditor reporting for different categories of listed entities. They also saw a clear need for consistent auditor reporting across major jurisdictions.

Furthermore, Canada has a significant number of not-for-profit entities and government entities whose operations outside of Canada are minimal. Most of these prepare financial statements for audit but in many cases the primary user of the financial statements is a regulating body that does not require additional information in the auditor's report.

### AASB's overall conclusions on the IAASB's suggested changes

Based on the key matters discussed above and the input the AASB has received from Canadian stakeholders on the suggested changes, we support proposed changes to provide transparency about the audit, to clarify the respective responsibilities of the auditor, management and those charged with governance (TCWG) in an ISA audit, and to place the auditor's opinion more prominently in the auditor's report. However, we do not support a number of the changes suggested, particularly those related to auditor commentary and going concern. Although more detail is provided in the body of our response, we would like to emphasize two important reasons for our lack of support:

- The changes will result in additional cost for auditors, preparers and audit committees that do not appear to be justified relative to the value of the information to users. This is particularly true for smaller entities.
- There are significant risks of increasing the expectation gap rather than reducing it, particularly with respect to the potential for users to misinterpret the auditor as providing piecemeal opinions on matters included in the auditor's report, and consequential increases in costs for auditors to protect themselves against potential increased liability.

With respect to auditor commentary, in our view, it has not been clearly demonstrated that Canadian users would find the information of value nor that it would address the information and expectation gaps. Accordingly, we are not convinced that there is a need for auditor commentary. Because of identified significant impediments, we believe that if the IAASB moves forward with auditor commentary there is a high likelihood that the ultimate consequence will be a costly, significantly longer auditor's report containing extensive boilerplate information that does not adequately address user information needs.

With respect to going concern, we do not believe that the suggested statements in the auditor's report will address the expectation gap. Canadian users have indicated that the statements are of limited value and auditors and other Canadian stakeholders have indicated that there are significant potential risks in making such statements.

### Other alternatives

We believe that a primary reason that prevents auditor commentary from addressing information and expectation gaps is that the commentary would be provided in the auditor's report as part of the financial statement audit. A more suitable approach than requiring auditor commentary in the auditor's report, in our view, would be for the IAASB to explore a more holistic approach with policy makers, securities regulators, international bodies and others that would focus on better meeting user information needs through enhancements to Management Discussion & Analysis (MD&A) and public reporting by audit committees.

Acknowledging that providing information to users about the audit and the financial statements comes with additional costs, we are also suggesting that the IAASB explore whether auditor

commentary could be provided through another type of engagement already included in the IAASB standards, or by way of a new assurance engagement standard.

With respect to going concern, we support the IAASB undertaking a holistic approach that involves working with accounting standard setters and other policy makers to arrive at an appropriate solution. An effective auditor reporting regime for going concern is dependent on management providing appropriate going concern disclosures on a timely basis on which the auditor can provide assurance through the financial statement audit. In this respect, we believe it is important that a revised auditing standard recognize that management's going concern disclosures may be made in accordance with a wide range of possible financial reporting frameworks, not just International Financial Reporting Standards.

## **Auditor Commentary**

### **Canadian viewpoints on auditor commentary**

1. The auditor commentary concept reflects two significant assumptions about users:
  - (1) they require more information from the auditor, and
  - (2) they wish this information to be included in the auditor's report.
  
2. The AASB has not been receiving demands in Canada for more information about individual audits nor the auditor's insights into the audited entity and its financial statements. In addition, the AASB has not heard from Canadian users that there are issues with the current standard auditor's report. Given lack of Canadian user call for changes, the proposed changes in the ITC have been viewed by some Canadian users as self-serving (in that it results in increased audit fees with limited further value).

### **Information about the entity and the financial statements**

3. The following are Canadian user perspectives on including auditor commentary about the entity and the financial statements.
  
4. When discussing auditor commentary during our consultations, users of the financial statements and the auditor's report were generally supportive of the auditor providing more information about the entity and the financial statements but believe that, in practice, the information that the IAASB proposes be provided by auditors may not meet their information needs for the following reasons:
  - a) Information that would be most valuable to users would be subjective views on matters such as the quality of the entity's accounting practices and policies. However, users

recognize that providing such views in the auditor's report is problematic. Auditors may provide subjective views to the audit committee but do so in recognition that audit committees have a sound understanding of the entity and the auditor can engage the audit committee in discussions to provide further context and answer specific questions the audit committee may have. Further, providing this information in the auditor's report could blur, and undermine the importance of maintaining, the separate roles of management, the audit committee and the auditor as noted in paragraph 38 of the ITC.

- b) It is not practicable for an auditor to identify all matters that users believe are important. Users' needs vary widely and change over time. Users worry that auditors may adopt a "kitchen sink" approach that will result in long reports containing limited useful information.
- c) Auditors are perceived as being unlikely to provide meaningful relevant information on significant issues that would be useful for users' decision making because doing so could expose auditors to increased legal liability.
- d) Providing a roadmap to the financial statements will be of limited value to sophisticated users such as analysts because the processes they follow require them to use a broad range of information provided by the entity (beyond that contained in the financial statements). Their analytical approaches are primarily driven by inputting relevant, current and forward-looking information into their proprietary analytical models of which only one source is the financial statements.
- e) Many users indicated they like the standard auditor's report they currently receive because it is concise and clear. Further, with the current format, users are able to quickly detect if the auditor has qualified the opinion or added paragraphs to the auditor's report enabling them to quickly ascertain if the auditor has identified problems with the entity's financial statements. Users believe that these benefits will be lost with the addition of auditor commentary, and thereby potentially diminish the value of the auditor's report and of the audit.
- f) Some users indicated that the increased focus on providing additional information in the auditor's report on financial statement disclosures may lead to increased discussion by auditors, management and the audit committee about such disclosures. This may in turn lead to positive changes to financial statement disclosures and audit quality. Other users believe that such discussions will generally not be productive because it is not the auditor's role to determine the financial statement disclosures but rather to evaluate whether management's disclosures are fairly presented. They expect that the discussions could lead to time-consuming disagreements between auditors and management as to

what matters are most important to users and lead to only minor improvements in disclosures.

5. Views obtained from Canadian auditor, preparer, and audit committee perspectives on auditor commentary were largely in accord with the views of users outlined above. These stakeholders also confirmed and reinforced the impediments and risks identified in paragraphs 62 and 63 of the ITC and identified the following further impediments:
  - a) Management saw little value in this information being provided by the auditor as it is duplicative of information in the financial statements.
  - b) As highlighted in paragraph 62 of the ITC, stakeholders believe that auditor commentary will result in additional cost to auditors, preparers and audit committees and may have implications for the timing of the release of the audited financial statements.
  - c) An effective two-way communication process between the auditor and the audit committee is essential to a high quality audit. Many stakeholders noted that providing auditor commentary may inform external parties about matters that the auditor has discussed with the audit committee. However, they indicated that transparency about such matters might inhibit discussions between the auditor and the audit committee and thereby reduce audit quality.
  - d) Auditors indicated that significant senior audit staff time would likely be required in developing auditor commentary. They believe that this time could be better spent in other areas to continue to improve the quality of the audit.
  - e) The nature and extent of auditor commentary about the entity and the financial statements in auditor's reports may drive unintended consequences, such as: inappropriate conclusions by users about the quality of the financial statements and the audit depending on the perceived implications of the information provided; and, users interpreting the auditor commentary as providing specific assurance on individual financial statement accounts and disclosures.
  - f) Stakeholders also noted that mandating auditor commentary for listed entities could be problematic in Canada because there are many smaller listed entities for which the value-impediment considerations are different than for larger listed entities that can more readily absorb the additional costs. Stakeholders of smaller listed entities noted that the financial and other resources of such entities are already being stretched and might be better devoted to matters other than auditor commentary. Also, it is unclear where public sector (government) entities fit given the huge variance in their size and complexity.
  - g) There is no unique definition of "user" that an auditor can employ in evaluating the nature and extent of auditor commentary. The wide range in the nature and size of Canadian companies preparing financial statements results in a wide range of users. Auditors will be

required to make judgments about what matters are most important to users and may be second-guessed after the event by users if they have not identified a matter that a user believes would have been important to that user's decision making. The potential to be second-guessed after the event raises liability concerns for auditors.

- h) Mandating auditor commentary for certain entities would create transition issues when an entity moves from being an entity for which auditor commentary is not mandatory to being an entity for which auditor commentary is mandatory. For example, if a private entity becomes listed, would the auditor's reports for comparative information need to be revised to include mandatory auditor commentary?
- i) Canadian stakeholders noted the specific challenges arising from agreeing a global definition of public interest entities (PIEs) identified in paragraph 54 of the ITC. In a Canadian context, stakeholders acknowledged that there would be definitional issues that are difficult to resolve at a national level, let alone at an international level. This issue may also be complicated by the fact that in Canada, and other jurisdictions, there are different financial reporting frameworks for different types of entities.

#### Information about the audit

- 6. The following are Canadian user perspectives on including information about the audit in auditor commentary:
  - a) Most users do not see informational value in obtaining information about the audit in the auditor's report. They recognized that such information could help them better understand how the auditor has addressed complex areas in the audit, which might reduce the expectation gap. However they acknowledged that the information provided is often highly technical in nature and the implications for decision making tenuous. Even sophisticated users that have extensive auditing knowledge agreed that information about audit procedures could be easily misinterpreted by users.
- 7. The following are Canadian auditor, preparer, and audit committee perspectives on including information about the audit in auditor commentary:
  - a) Some auditors believed that providing information about the audit may be useful to users because it is not available from the entity. However, they indicated that succinctly describing audit procedures is challenging and difficult for users to understand, and may be interpreted as providing additional assurance when none is intended.
  - b) Audit committee members indicated that such information is of little value to them because it is already provided to the audit committee by the auditor as part of the two-way communication process.



### **AASB conclusions on auditor commentary**

8. The AASB does not believe that 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, for the following reasons:
  - a) There does not appear to be a compelling demand from users for the information that the ITC suggests be included in auditor commentary in the auditor's report – see paragraphs 4(a)-(e), 5(a), 6(a) and 7(b).
  - b) There are significant impediments to providing auditor commentary in the auditor's report as identified in paragraphs 62 and 63 of the ITC. The following impediments were also frequently identified by Canadian stakeholders:
    - There are potential adverse implications for the financial reporting process – see paragraphs 4(f) and 5(b)-(d).
    - There may be unintended consequences such as inappropriate conclusions about the quality of the financial statements and the audit – see paragraph 5(e).
    - Additional costs would be incurred by auditors, management, the audit committee and ultimately the users of financial statements – paragraph 5(b) and (f).
    - Leaving matters to be addressed in auditor commentary to the judgment of the auditor is problematic as it will result in inconsistent reporting and potentially boilerplate – see paragraph 5(g).
    - Succinctly describing audit procedures is challenging and difficult for users to understand and may be interpreted as providing additional assurance when none is intended – see paragraphs 5(e) and 7(a).
9. In the AASB's view, there is a high likelihood that the ultimate consequence of the suggested changes would be significantly longer auditor's reports containing extensive boilerplate information that does not adequately address either the information or the expectation gaps.
10. Should auditor commentary be incorporated into the auditor's report, the AASB believes that it should not be mandated for any specific entities- see paragraph 5(f), (h) and (i). Rather, regulators or standard setters in particular jurisdictions should be given flexibility to determine for which audits, if any, auditor commentary should be required.
11. The AASB believes that the IAASB should explore a more holistic approach with policy makers, securities regulators, international bodies and others that would focus on better meeting user information needs through enhancements to MD&A and public reporting by audit committees. However, if the IAASB decides that the auditor commentary concept should be retained, we believe that it should be dealt with outside the financial statement auditor's

report. The AASB believes that auditor commentary could be provided through another type of engagement already included in the IAASB standards or by way of a new assurance engagement standard.

## **Going Concern/Other Information**

### **Canadian viewpoints on going concern**

12. Paragraph 24 of the ITC alludes to the global financial crisis and refers to initiatives to place greater focus on going concern. Paragraph 24 states “These developments provide a significant impetus for the IAASB to seek to enhance auditor reporting in this area.” During discussions with Canadian stakeholders about the suggested changes relating to going concern, a frequent question was “Would these suggested changes have made any difference during the financial crisis?” Canadian stakeholders are not convinced that the suggested changes in this area would have any impact on concerns arising out of the financial crisis.
13. The following are Canadian user perspectives on including statements in the auditor’s report related to management’s use of the going concern assumption and whether material uncertainties have been identified:
  - a) The statements would serve only to confirm what users already assume is the case. They would expect an auditor to modify the auditor’s opinion if the entity is not a going concern.
  - b) The statements would be boilerplate and would be included in virtually every auditor’s report. As such, they are of little value.
  - c) They might serve to mask the red flag provided by the existing requirement for the auditor to include an EOM in the auditor’s report when there are material uncertainties relating to going concern disclosed in the financial statements.
  - d) The positioning of the going concern statements near the beginning of the auditor’s report would give them undue emphasis.
14. Overall, users see little value in the statements.
15. The following are Canadian auditor, preparer and audit committee perspectives on including statements in the auditor’s report related to management’s use of the going concern assumption and whether material uncertainties have been identified:
  - a) Preparers of public sector entity financial statements questioned whether mandated statements about going concern in the auditor’s report would provide relevant information for users of financial statements of many public sector entities.
  - b) Some auditors would be prepared to make the suggested statements because they reflect the work they have performed. Other auditors are concerned that users would misinterpret the statements as providing additional assurance as to the future viability of

the entity. These auditors believe that one reason for this is that users do not understand terms such as “going concern” and “material uncertainties”.

- c) Preparers, auditors and audit committees noted that Canada has a large number of small public companies whose operations are at the exploratory stage. These entities often make disclosures about the nature of their business that are important to users of the financial statements – explaining, for example, that continued operations depend on the entity’s ability to obtain continued financial support – but do not meet the threshold of material going concern uncertainties. The preparers and auditors noted that users likely would be confused to see the statement in the auditor’s report indicating an absence of material going concern uncertainties and (potentially) seeing a reference to nature of business disclosures in auditor commentary.
- d) Some auditors indicated that a requirement to make such explicit statements would change the work they do relating to going concern. This is because they believe that any statements they make in the auditor’s report would necessitate additional involvement of senior audit staff and quality control reviewers. It is not clear that such additional work effort would improve audit quality; it might simply add audit cost that would be difficult to pass on to users.
- e) Auditors noted that management is not required under all financial reporting frameworks to make an explicit statement that it has prepared the financial statements on a going concern basis. Nor is management required to make an explicit statement under all financial reporting frameworks about the absence of material uncertainties. These auditors therefore believe that the suggested statements might confuse users as to the respective roles of auditors and management related to going concern.
- f) Auditors also raised the following concerns about the suggestion in paragraphs 30-31 of the ITC that auditors provide additional information as to audit procedures they performed in reaching a conclusion that no material uncertainty exists:
  - They believe that this would inevitably result in auditors providing information about the entity that is not already provided by management.
  - It might also be contradictory for an auditor to say on the one hand that the auditor has not identified material uncertainties that need to be disclosed and then on the other hand make reference to uncertainties that do not require disclosure.
  - Users might interpret this information as implying that auditors have proactively searched for any material uncertainties, which would not be the case.
  - Some might see the additional information as a form of qualification of the “no material uncertainties” statement. Preparers and audit committees also shared these concerns.
  - As there is no clear definition of “material uncertainty” considerable judgment would be required on the part of auditors to determine what matters to include in the auditor’s report.

### **AASB conclusions on going concern**

16. The AASB recognizes that going concern is an area where the expectation gap is significant. However, we do not believe that the suggested statements would provide useful information that addresses the expectation gap, and might increase the expectation gap – see paragraphs 13 and 15(a).
17. We have also concluded that they are not appropriate because they might:
- a) be open to misinterpretation –see paragraph 15(b) and (c)
  - b) result in additional cost – see paragraph 15(d), and
  - c) extend the auditor’s responsibilities beyond those of management – see paragraph 15(e).

The AASB therefore does not support the suggested statements.

18. We believe that meaningful change in this area can be achieved by considering whether the work effort in ISA 570, *Going Concern*, needs revision. We also support the IAASB’s efforts to work with the International Accounting Standards Board to clarify the language in International Accounting Standards (IAS) 1, *Presentation of Financial Statements*, paragraph 25.
19. We believe that 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 is problematic – see paragraph 15(f).

### **Canadian viewpoints on “other information”**

20. Canadian stakeholders were generally supportive of the IAASB’s objective of improving overall transparency about the auditor’s work related to “other information.” The proposals would address an expectation gap about the auditor’s involvement with such information. For all listed entities in Canada, the MD&A does not contain, or incorporate by reference, the audited financial statements even though securities legislation in many Canadian jurisdictions requires the MD&A to be filed concurrently with the financial statements. The AASB understands that this situation is not addressed in extant ISA 720, *The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*. However, the AASB understands that revisions to ISA 720 may address the Canadian circumstance.
21. The following are Canadian user perspectives on including statements related to “other information” in the auditor’s report:

- a) Users believe that including a statement in the auditor’s report about the auditor’s involvement with other information is helpful in explaining the responsibilities of the auditor of the financial statements for that other information. Most users recognized that auditors do some work with respect to other information. Users’ expect auditors to identify inconsistencies between other information and the audited financial statements.
- b) They supported the proposal to identify in the auditor’s report the specific documents that the auditor has read and include a statement whether the auditor has identified material inconsistencies with the financial statements.
- c) Several users noted, however, that the IAASB’s suggested change does not address the issue of the auditor’s association with the other information and appropriately communicating that association in the other information. Until this issue is addressed, there will continue to be an expectation gap with respect to the auditor’s involvement with the other information.

22. The following are Canadian auditor, preparer and audit committee perspectives on including statements in the auditor’s report related to other information:

- a) Most auditors, preparers and audit committees did not object to including a statement in the auditor’s report about the auditor’s involvement with other information as part of an audit of financial statements. Several believe, however, that such a statement is of limited value to users and would be better placed in the Auditor Responsibility section.
- b) Many auditors expressed concern about providing a statement that the auditor has identified no material inconsistencies with the financial statements because users may misinterpret the statement as providing assurance on the “other information” - the words “we have not identified material inconsistencies” imply a review level of work effort.

**AASB conclusions on “other information”**

23. The AASB believes that there is value in including in the auditor’s report an indication of the auditor’s responsibility with respect to other information when performing an audit of financial statements as this would address part of the expectation gap – see paragraph 21 (a) and (b).

24. We believe that, providing transparency about the auditor’s responsibility would best be placed in the Auditor’s Responsibility section of the auditor’s report rather than in a separate paragraph after auditor commentary – see paragraph 22(a). We believe that a separate paragraph would result in excessive prominence being given to this responsibility as compared to other responsibilities as part of the audit.

25. The AASB believes that the phrase “Based upon reading it, we have not identified material inconsistencies” can be misinterpreted as providing a review level of assurance on the other information – see paragraph 22(b). Further, this possible misinterpretation is not addressed in the sentence that follows it because that sentence only states that the auditor has not audited the information, and not that the auditor has not reviewed the information (although we understand that this concern may be addressed in the upcoming exposure draft of revised ISA 720).

26. The AASB therefore recommends that the IAASB take a different approach for dealing with other information as follows:

a) An additional bullet should be added to the Auditor Responsibility section of the report as follows:

As part of our audit, we are required to read [clearly identify the specific other information] contained in [specify the document containing the other information], for the purpose of identifying whether there are material inconsistencies with the audited financial statements. If we become aware of any apparent material inconsistencies we are required to consider the implications for our report.

b) The auditor should be required to make a statement by exception if the auditor has identified information that is materially inconsistent with the audited financial statements and has not been able to resolve the issue with management and those charged with governance.

c) There should not be a requirement for the auditor to report when there are no exceptions identified.

d) We believe that this approach would be somewhat consistent with the UK Financial Reporting Council proposals in its Consultation Paper “Proposed revisions to International Standards on Auditing (UK and Ireland) to give effect to the FRC Effective Company Stewardship proposals” dated April 2012.

27. The AASB agrees that users who read other information may not be aware of the auditor’s involvement with that other information if the other information does not explain this involvement (even though the involvement is explained in the auditor’s report on the financial statements) – see paragraph 21(c). The AASB recognizes that resolving this aspect of the expectation gap may require the IAASB to take a holistic approach and work with regulatory bodies and others to develop an appropriate solution to this association issue.

## Clarifications and Transparency

### Canadian viewpoints on clarifications and transparency

28. The following are Canadian user perspectives on clarifications and transparency:
- a) Users did not express strong views with respect to clarifications and transparency. They did not support long descriptions of management's, the auditor's and TCWG's responsibilities.
  - b) Some users supported disclosure of the engagement partner's name in the auditor's report because they believe it would increase the partner's sense of accountability.
  - c) Most users did not see value in the disclosure relating to the Involvement of Other Auditors. This is because they were not sure how the information would affect their investment decisions. Other users who had a better understanding of the audit indicated that information about the involvement of other auditors might be important to them in assessing investment risks. They acknowledged that under auditing standards the group auditor is responsible for the work of other auditors. At the same time, these users believe that audit quality may not be uniform throughout the world and that it would therefore be useful information for them to understand the extent of work done by non-affiliated firms. They were also of the view that this information should be relatively easy to provide because it is factual.
29. Users were ambivalent about 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. The following are Canadian auditor, preparer and audit committee perspectives on clarifications and transparency:
- a) Auditors generally supported the IAASB's efforts to improve clarification of the various responsibilities of those involved in the financial reporting process and transparency about the audit. They believe that it is not the task of the auditor's report to educate users about what an audit is and so were supportive of efforts to focus only on matters that would help reduce the expectation gap.
  - b) Sole practitioners and auditors in smaller firms had no objections to disclosing the engagement partner name in the auditor's report. In many cases they already do this. However, auditors of larger firms expressed different views, including the following:
    - There are personal security concerns about making the partner name publicly available particularly for larger entities with a large number of stakeholders.
    - On larger audits there are other participants in the audit who play significant roles, such as the engagement quality control reviewer, engagement partners on significant components, and the tax partner.

- Requiring auditors to disclose their names in auditor’s reports would not have any impact on their sense of accountability. Internal processes in their firms are already rigorous enough to instill a strong sense of accountability.
  - Disclosing to users only the engagement partner’s name may lead them to reach inappropriate conclusions as to the performance and capabilities of the engagement partner because the role and responsibilities of engagement partners on large audits can vary considerably.
- c) Auditors of larger and smaller firms were generally of the view that disclosing the engagement partner name would have little or no effect on their behavior on audits. They consider that they already have professional obligations to behave appropriately.
- d) Auditors of Canadian entities that are registered with the US Securities and Exchange Commission indicated that disclosure of the name of the engagement partner may increase the personal liability of engagement partners in the US when they are named in documents filed with the SEC.
- e) Many auditors believe that permitting or requiring disclosures regarding the role of other auditors appears contrary to the “sole responsibility” principle. They are concerned that the suggested disclosure regarding the involvement of other auditors will be misinterpreted by users as implying a weakness in the quality of the audit which may not be warranted.

Auditors expressed diverse views about whether the description of their responsibilities should be permitted to be relocated to a website or an appendix. On balance, they preferred that this information be included with the auditor’s report, possibly in an appendix, rather than on a website. Auditors indicated that users are less likely to read material that is located outside the auditor’s report rather than within the report itself.

**AASB conclusions on clarifications and transparency**

30. The AASB believes that the descriptions of the responsibilities of management, TCWG, and the auditor would be helpful to users’ understanding of the nature and scope of the audit and will contribute to narrowing the expectation gap – see paragraphs 28(a) and 29(a).
31. We are not convinced that disclosing the engagement partner name would have positive behavioral implications for auditors – see paragraphs 28(b), 29(b) and (c). We are concerned that users might reach inappropriate conclusions with respect to the performance and capabilities of engagement partners on larger audits – see paragraph 29(b). We are also concerned about creating standards that would cause undue potential liability implications for certain auditors – see paragraph 29(d).



We therefore do not support requiring disclosure of the engagement partner name in auditors' reports.

32. The AASB agrees with those who believe that permitting or requiring disclosures regarding the role of other auditors appears contrary to the "sole responsibility" principle – see paragraph 29(e). We believe that the group auditor is best placed to decide when users should be informed about such involvement and the nature and extent of information that should be provided to best explain this involvement – see paragraph 28(c). Accordingly, we do not support mandating the suggested disclosure nor that it be required in all circumstances. We believe that auditors could consider including information on the involvement of other auditors in auditor commentary (if such concept is retained) or, preferably, as part of the Auditor Responsibility section of the auditor's report.
33. The AASB is of the view that standardized material describing the auditor's responsibilities should not be relocated outside the auditor's report – see paragraphs 28(d) and 29(f). We therefore support placing the material in the body of the auditor's report or in an appendix to it.

## **Form and Structure**

### **Canadian viewpoints on form and structure**

34. There were no significantly different views as between Canadian users and Canadian auditors, preparers and audit committees. Accordingly, the views are presented as one group in this section of our response:
- a) Stakeholders were supportive of the suggested structure of the illustrative report and the mandatory ordering of items.
  - b) Canadians noted that Canada is one of the few jurisdictions that adopted the requirements in paragraphs 20-42 of ISA 700 (rather than the accommodation provided in paragraph 43 of ISA 700). All stakeholder groups remain strongly in favour of consistency in auditor's reports.
  - c) Stakeholders noted that many other jurisdictions already take advantage of the flexibility in reporting provided in paragraph 43 of ISA 700. They also agreed that improving the relevance of the auditor's report is a laudable goal and recognize that the addition of entity-specific information to the auditor's report will inevitably adversely affect consistency. They believe that it may also have serious consequences for the notion that "an audit is an audit."
  - d) Stakeholders strongly believe that there needs to be global consistency in auditors' reports, for the following reasons:

- The existing standard auditor’s report promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards.
- The standard auditor’s report also is used consistently in Canada irrespective of the nature of the reporting entity. This provides assurance to stakeholders that Canadian auditors of all types and sizes of entities are applying consistent, global standards.
- Users are able to readily identify when the auditor’s report makes reference to unusual circumstances.
- Consistency in auditor reporting facilitates comparability of reports by users.

35. Stakeholders believe the IAASB’s suggested changes are focused primarily on addressing requests from institutional investors and analysts of primarily other countries and that such changes are not necessarily appropriate for users of all types and sizes of entities. They believe that if the IAASB moves forward with its suggested changes, there would have to be different reporting requirements depending on the type and size of entity. They confirmed the views of respondents to the IAASB’s May 2011 consultation, as set out in paragraph 92 of the ITC, that the impediments to additional reporting requirements for SMEs, including increased cost, would likely exceed the value of the auditor including additional information in the auditor’s report. Many stakeholders believe that this would also be the case for many smaller listed entities.

**AASB conclusions on form and structure**

36. The AASB supports the IAASB’s suggested structure of the illustrative report – see paragraph 34(a).

37. The AASB strongly believes that there needs to be global consistency in auditors’ reports – see paragraph 34(b)–(d).

We do not believe that the IAASB would achieve its objective, set out in paragraph 90 of the ITC, to balance the need for “a report issued for an ISA audit can be easily recognized by investors and more readily compared to reports of other ISA audits” with the need for “reports that are relevant in the context of additional law or regulation in the particular jurisdiction.” We are concerned that the IAASB’s suggested changes would essentially eliminate consistency of auditor reporting. We believe that the many benefits of the existing standard auditor’s report would be lost as a result of the IAASB’s suggested changes.

38. The AASB supports the proposed mandated ordering of items in a manner similar to that shown in the illustrative report. The AASB notes that the exception granted in the case of law or regulation that requires different ordering of items would inevitably lead to unwarranted inconsistency of reporting and confusion for users.

39. In our view, the IAASB's suggested changes would not be appropriate for entities of all sizes and in both the public and private sectors – see paragraph 35. We believe that the IAASB should work towards a solution that retains the benefits of consistent reporting across all entities while permitting auditors to provide relevant information for users.

We hope that these comments will be useful to the IAASB in developing its proposed changes to auditor reporting standards. If you have any questions or require additional information, please contact Greg Shields, Director, Auditing and Assurance Standards at (416) 204-3287.

Yours very truly

A handwritten signature in black ink, appearing to read 'Mark Davies', written in a cursive style.

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

c.c. Canadian Auditing and Assurance Standards Board members  
Bruce Winter, FCA

## **APPENDIX 1: SUMMARY OF AASB CONSULTATIONS ON THE IAASB'S ITC**

The following is a summary of the consultations undertaken by the AASB in developing its response to the IAASB's ITC.

1. Roundtable discussions in Toronto, Montreal, Vancouver and Calgary (2), and conference call roundtable in Halifax. Attendees were primarily auditors, directors, preparers, securities regulators and government funders.
2. Roundtable discussion with institutional analysts in Toronto.
3. Roundtable discussion with small public company advisory group in Toronto comprising auditors, preparers and securities regulators.
4. Telephone interviews with several individual chief financial officers of large, medium and small listed entities across Canada.
5. Roundtable discussion in Toronto with a performance reporting advisory board comprising senior financial management, audit committee chairs, investors, auditors, and financial academics.
6. Webinar open to the public but primarily attended by members of the chartered accountancy profession. Over 1,000 attended the webinar and over 700 responded to polling questions dealing with the IAASB's suggested changes.

## APPENDIX 2: RESPONSES TO QUESTIONS IN IAASB'S ITC

### 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?**

No, not in all areas. See Overall Comments.

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

Yes. See Overall Comments.

### 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?**

No. See AASB conclusions in paragraphs 8, 9 and 11.

Should the IAASB decide on the basis of comments received to continue with the auditor commentary concept in the auditor's report, then the AASB would recommend the following:

- Auditor commentary should not be mandatory for audits of any specific entities (see our response to Question 7 below);
- There should be flexibility for national standard setters to require that auditor commentary be provided outside the auditor's report;
- National standard setters should be given the flexibility to decide on the matters to be included in auditor commentary and the form and content of those matters.

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?**

We do not support auditor commentary. See discussion in paragraph 5(g) and AASB conclusion in paragraph 8(b). Leaving matters to be addressed in auditor commentary to the judgment of the auditor is problematic as it will result in inconsistent reporting and potentially boilerplate commentary.

If the IAASB retains the auditor commentary concept, the AASB recommends that:

- Clarity be provided as to what “original provider of entity-specific information” means;
- There be detailed guidance to assist auditors in determining the matters to include in auditor commentary and the amount of detail to provide; and
- Linkage be provided between matters communicated with those charged with governance and those that should be included in auditor commentary.

**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 the audit procedures and related results in Auditor Commentary?**

Overall, Canadian users did not find the information provided in the illustrative examples particularly helpful to their decision making. Detailed discussion we had with users about the examples, particularly those that included discussion of the auditor’s procedures, highlighted that users might easily misinterpret the information.

Canadian users provided the following views on the illustrative examples in the ITC:

- Users found the second sentence of the introductory wording - “Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures” – appeared to contradict illustrative examples where the auditor identified audit procedures that were designed to specifically address financial statement amounts or disclosures.
- Users found that the Outstanding Litigation example was somewhat helpful because it pointed to a specific disclosure in the financial statements. However, users were concerned that, because auditors would not necessarily know what matters were important to their specific needs, auditors would not identify all important matters. Alternatively, auditors would potentially identify a long list of items that will result in long reports containing limited useful information.
- Users commenting on the Goodwill example were concerned that the auditor may omit important information when summarizing the entity’s disclosures. The reference to

Management Commentary implied to some users that the auditor had done more work on Management Commentary than was explained in the Other Information paragraph of the auditor's report. They did not necessarily make a link between the two paragraphs in the auditor's report. The wording presented, for example, the phrases "marginally exceeded", and "material negative effect", raised more questions than they answered for some users. It was also not clear to users that the information provided all came from the entity and not the auditor, i.e., that the auditor might be the original provider of information. Some analysts noted that the commentary on Goodwill would have no effect on their decision making because they assign their own values to goodwill based on other factors.

- The Valuation of Financial Instruments example was considered not to be helpful because it gave no indication of how conservative or aggressive the entity's accounting practices are. The fact that management's recorded amount fell within the auditor's range was not considered useful information because users believed that if the amount had fallen outside the range then the auditor would have qualified the opinion on the financial statements. That the amount fell within the range merely confirmed what users already believed. The example makes reference to a model but provides no information about the adequacy of the model, only that it worked in this instance. The fact that the auditor identified that the valuation of financial instruments gives rise to a high risk of material misstatement was not found to be informative. Users know that the valuation of financial instruments can be complex and therefore prone to risk. Some users were more interested in what management had done to arrive at the valuation than what the auditor's procedures were. Users expressed different reactions to the fact that the auditor had used specialists to develop an independent range for evaluating the financial instruments. Some felt that this was normal and therefore not worth including in the auditor's report. Others indicated that this information could have been informative as to the quality of the audit but only if the user had been aware of the practice of auditors on audits of other entities in the same industry.
- Sophisticated users found that the example dealing with audit strategy relating to the recording of revenues did not provide enough information to enable them to reach an appropriate conclusion about the auditor's work – they could not assess what the implications were for specific accounts and assertions. Less sophisticated users were not aware how this information might affect their decision making. All users presumed that because the example contained no conclusions and did not highlight misstatements, if any, the auditor had no concerns with the new system, which may not be the case.
- Most users did not see much value in the example dealing with the Involvement of Other Auditors. This is because they were not sure how the information would affect their

investment decisions. Other users who had a better understanding of the audit indicated that information about the involvement of other auditors might be important to them in assessing investment risks. They acknowledge that under auditing standards the group auditor is responsible for the work of other auditors. At the same time, these users believe that audit quality is not uniform throughout the world and that it is therefore useful information to them to understand the extent of work done by non-affiliated firms.

**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, the timing of financial statements and costs?**

These are set out in paragraphs 4(f) and 5(b)-(d).

**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 is appropriate? Why or why not? If not, what other criteria might be used for determining the audits for which Auditor Commentary should be provided?**

We do not support auditor commentary. Should auditor commentary be incorporated into the auditor’s report, the AASB believes that it should not be mandated for any specific entities - see paragraph 5(f), (h) and (i). Rather, regulators or standard setters in particular jurisdictions should be given flexibility to determine for which audits, if any, auditor commentary should be required.

## **Going Concern/Other Information**

**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?**

We do not support the suggested statements. See AASB conclusions in paragraphs 16-18.

Should the IAASB, based on comments received, decide to move forward with the suggested statements, we have the following recommendations:

- The wording of the statement relating to going concern should be amended to avoid possible misinterpretation that the auditor is providing a specific conclusion on going concern in that the objective of an audit is to form an opinion on the financial statements as a whole. For example, the wording could be revised as follows:



As part of our audit of the financial statements, we ~~have concluded that~~ obtained sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements ~~is appropriate~~.

- An additional bullet should be added to the Auditor's Responsibility section of the report to be consistent with the inclusion of going concern in the Management Responsibility section of the report, along the following lines:
  - Obtain sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern assumption in the preparation of the financial statements and determine whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.
- To reflect the addition of the bullet in the Auditor's Responsibility section of the report as set out in the previous bullet above, the following sentence in the Going Concern Section of the auditor's report would need to be revised:

The responsibilities of management and ourselves with respect to going concern are described in a separate section of our report.

**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?**

We believe that 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 is problematic. See discussion in paragraph 15(f).

**10. What are your views on the value and impediments of the suggested auditor statement in relation to other information?**

While we believe that there is value in including in the auditor's report an indication of the auditor's responsibility with respect to other information when performing an audit of financial statements, we do have some concerns. We have provided a proposed alternative approach. See discussion in paragraphs 23-27.

In the event that based on comments received the IAASB retains the suggested changes in the ITC, we suggest the following wording changes to the Other Information section of the report:

As part of our audit, we have read [*clearly identify the specific other information read, e.g., the Chairman's Statement, the Business Review, etc.*] contained in [*specify the document containing the other information, e.g., the annual report*], **prepared by management, and** ~~for the purpose of identifying whether there are material inconsistencies with the audited financial statements. Based upon reading it, we have not identified material~~ inconsistencies between this information and the audited financial statements. However, we have not audited **or reviewed** this information and accordingly do not express ~~an~~ **any assurance** on it.”

## Clarifications and Transparency

11. **Do you believe the enhanced description of the responsibilities of management, those charged with governance, and the auditor in the illustrative auditor's report is helpful to users' 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?**

Yes. We believe that the descriptions of the responsibilities of management, TCWG, and the auditor would be helpful to users' understanding of the nature and scope of the audit and will contribute to narrowing the expectation gap. See discussion in paragraphs 28(a) and 29(a).

The following are suggestions for improving the descriptions:

- The Auditor's Responsibility section of the report should be expanded to include reference to going concern and other information as suggested in our responses to questions 8 and 10 respectively.
- The last sentence of the overall description of the risk-based model in the paragraph before the bullets should be amended because (a) the first sentence already states that misstatements can arise from fraud or error, and (b) to make clear that misstatements include omissions as indicated in paragraph 2 of ISA 320, *Materiality*, as follows:

Misstatements, ~~including omissions, can arise from fraud or error and~~ are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

- The second bullet should be amended to make it clear that the auditor’s consideration of internal control is made in the context of the auditor’s responsibility to assess risk of material misstatements.
- The fifth bullet should address the auditor’s evaluation when the financial statements are prepared in accordance with a compliance reporting framework.

**12. What are your views on the value and impediments of disclosing the name of the engagement partner?**

We do not support requiring disclosure of the engagement partner name in auditors’ reports. See discussion in paragraphs 28(b) and 29(b)-(d) and AASB conclusion in paragraph 31.

In the event that based on comments received the IAASB retains the suggested change in the ITC, we suggest that either (a) the IAASB directly, or (b) the IAASB provide flexibility to national standard setters to, exempt disclosure of the engagement partner name in auditor’s reports on documents filed in jurisdictions where there is undue personal liability as a result of disclosure of the engagement partner name, or when identifying the engagement partner publicly may give rise to a significant threat to an individual’s personal security. Consideration should also be given to the appropriate means of implementing the IAASB’s suggested change in the context of auditors of public sector entities where the nature of their mandates may not be the same as for auditors of private sector entities.

**13. What your views on the value and impediments of the suggested disclosure regarding the involvement of other auditors? Do you believe that such disclosure should be included in all relevant circumstances, or left to the auditor’s judgment as part of Auditor Commentary?**

We do not support mandating the suggested disclosure regarding the involvement of other auditors. If the IAASB does mandate the suggested disclosure, there should be flexibility for this not to be required in all circumstances. See AASB conclusion in paragraph 32.

**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?**

The AASB is of the view that standardized material describing the auditor’s responsibilities should not be relocated outside the auditor’s report. See discussion in paragraphs 28(d) and 29(f) and AASB conclusion in paragraph 33.

**Form and Structure**

- 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?**

The AASB supports the IAASB’s suggested structure of the illustrative report. See discussion in paragraph 34(a).

- 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?**

The AASB strongly believes that there needs to be global consistency in auditors’ reports. See discussion in paragraph 34(b)–(d) and AASB conclusion in paragraph 37.

- 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?**

The AASB supports the proposed mandated ordering of items in a manner similar to that shown in the illustrative report. The AASB notes that the exception granted in the case of law or regulation that requires different ordering of items would inevitably lead to unwarranted inconsistency of reporting and confusion for users.

- 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?**

In our view, the IAASB’s suggested changes would not be appropriate for entities of all sizes and in both the public and private sectors. See discussion in paragraph 35 and AASB conclusion in paragraph 39.