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Edmonton, Alberta Canada

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International Auditing and Assurance Standards Board
New York, New York

Dear Sir or Madam,

We are pleased to respond to "Reporting on Auditing Financial Statements: Proposed New and Revised International Standards on Auditing."

The proposals increase transparency of the audit, in particular by describing key audit matters. As such, they are part of the profession's overall response to the global financial crisis. However, we are concerned that it is unclear how these changes in audit transparency will either reduce the likelihood of future financial crises, or result in better information so that future financial crises can be better managed. Reducing the likelihood of future crises, in particular by examining the role fair value accounting may have had in exasperating the crisis, or improving accounting standards so that better information is available before and during financial crises, are accounting matters, not auditing matters.

In this light, the proposals may be characterized as an auditing response to what are accounting issues. The proposals may do little to prevent future financial crises, may not improve audit quality, and risk widening the expectation gap.

Our responses to the specific questions are below.

Question 1

Do users of the audited financial statements believe that the introduction of a new section in the auditor's report describing the matters the auditor determined to be of most significance in the audit will enhance the usefulness of the auditor's report? If not, why?

The new section may provide information that is useful to some users. However, there is a concern that the information may be used incorrectly, or lead to piecemeal opinions.

There is also a concern that the auditor will be in a difficult position to describe the key audit matters, yet not provide additional information about the matters disclosed in the financial statements. Setting aside circumstances where the auditor's report is qualified, while the auditor's report improves the credibility of the overall financial statements, the auditor's report should not disclose additional information about the entity or its operations or financial condition. It is the responsibility of the entity to disclose this information. In other words, users of financial statements (e.g. capital market participants) should not be able to obtain new information from what is disclosed in the auditor's report, including key audit matters. This calls into question the relevance of the key audit matters.

Knowing *whether* a number is correct or not is important to users of financial statements, such as capital market participants. Knowing *how* the auditor determined whether that number is correct or not is of questionable relevance, unless it is suggested that users of financial statements will evaluate the sufficiency and appropriateness of the procedures described by the auditor in the key audit matters. One may suggest capital market participants will evaluate some audit procedures as more reliable than others, and therefore discount or place more value on that financial statement information. Or one may suggest that capital market participants will assume that an audit procedure that is not mentioned must not have been done, and further discount the reliability of the information. Or further, capital market participants may inappropriately discount information in the financial statements that is not mentioned in key audit areas. If these occur, it could lead to boilerplate descriptions for audit areas, or very long descriptions of all procedures performed. For example, an audit report that does not mention that the auditor confirmed cash balances seems to omit a very important audit step, although usually confirming cash balances is not considered a key audit matter.

Various approaches to auditing particular areas are valid under the auditing standards. However, users may be confused when different auditors use different approaches for the same financial disclosure, either across different years or across entities with the same financial disclosure.

Before adopting the proposals, we suggest that the IAASB more extensively research and explain how auditor discussion of key audit areas, and user knowledge of auditing procedures performed, is incorporated into decision models of users of the financial statements. Such research could also demonstrate that the expected benefits as noted in paragraph 8 are not offset by unintended consequences.

Question 2

Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide an appropriate framework to guide the auditor's judgment in determining the key audit matters? If not, why? Do respondents believe the application of proposed ISA 701 will result in reasonably consistent auditor judgments about what matters are determined to be the key audit matters? If not, why?

We do not believe it provides an appropriate framework, for reasons discussed above. The framework already present in the standards with respect to forming an opinion, as well as emphasis of matter paragraphs, is sufficient. The existing framework in "communicating with those charged with governance" is more relevant, in particular the information that the auditor communicates regarding an overview of the audit, as well as finding from the audit. It may be that what the public would be interested in is the same information as those charged with governance.

Question 3 Do respondents believe the proposed requirements and related application material in proposed ISA 701 provide sufficient direction to enable the auditor to appropriately consider what should be included in the descriptions of individual key audit matters to be communicated in the auditor's report? If not, why?

We believe the direction may be inappropriate, as discussed above. However, with respect to its sufficiency, the proposed requirements are unclear on what is probably the most relevant aspect of the auditor's work – the findings or results of the procedures. Therefore, additional guidance on how the auditor should describe, quantify, and report on audit differences that arise from the procedures should be included. It is difficult to see how this could result in anything other than the auditor disclosing, directly or indirectly, the auditor's materiality, errors found in other (perhaps non-key) areas of the audit, as well as areas of disagreement with management and where financial statements were adjusted by management, based on a request by the auditors, to avoid material misstatement in the financial statements. And if the overall audit opinion is unqualified, this may lead to piecemeal opinions. Of course, if the auditor's report is unqualified i.e. if the procedures led to findings that the financial statements were not materially misstated, then this leads back to our point above – that *how* the auditor determined something was fairly stated adds little information of relevance to users of the financial statements.

Question 4 Which of the illustrative examples of key audit matters, or features of them, did respondents find most useful or informative, and why? Which examples, or features of them, were seen as less useful or lacking in informational value, and why? Respondents are invited to provide any additional feedback on the usefulness of the individual examples of key audit matters, including areas for improvement.

Examples of key audit matters where the auditor disagreed with management by a material amount, and the financial statements were subsequently changed to avoid qualification, should be added.

Question 5

Do respondents agree with the approach the IAASB has taken in relation to key audit matters for entities for which the auditor is not required to provide such communication – that is, key audit matters may be communicated on a voluntary basis but, if so, proposed ISA 701 must be followed and the auditor must signal this intent in the audit engagement letter? If not, why? Are there other practical considerations that may affect the auditor's ability to decide to communicate key audit matters when not otherwise required to do so that should be acknowledged by the IAASB in the proposed standards?

We do not agree. "An audit is an audit is an audit" is the goal of having a global set of standards for audits of historical cost financial statements. There are few, if any, good reasons why users of financial statements of a listed entity should be provided an audit that is a different quality than users of the financial statements of a non-listed entity.

Question 6

Do respondents believe it is appropriate for proposed ISA 701 to allow for the possibility that the auditor may determine that there are no key audit matters to communicate?

a) If so, do respondents agree with the proposed requirements addressing such circumstances?
b) If not, do respondents believe that auditors would be required to always communicate at least one key audit matter, or are there other actions that could be taken to ensure users of the financial statements are aware of the auditor's responsibilities under proposed ISA 701 and the determination, in the auditor's professional judgment, that there are no key audit matters to communicate?

We agree. There may be no key audit matters.

Question 7

Do respondents agree that, when comparative financial information is presented, the auditor's communication of key audit matters should be limited to the audit of the most recent financial period in light of the practical challenges explained in paragraph 65? If not, how do respondents suggest these issues could be effectively addressed?

We do not agree. We note the specific use of the term "comparative" rather than "corresponding" information, and that comparative requires the audit report to refer to both the current and prior period. The only approach theoretically consistent with ISA710 "Comparative information – corresponding figures and comparative financial statements" is for key audit matters to refer to both periods. Otherwise, the auditor's report on the comparative financial statements is incomplete. The practical challenges noted in paragraph 65 are neither onerous nor substantially different from existing practical challenges with comparative audit reports.

Q**uestion 8**

Do respondents agree with the IAASB's decision to retain the concepts of Emphasis of Matter paragraphs and Other Matter paragraphs, even when the auditor is required to communicate key audit matters, and how such concepts have been differentiated in the Proposed ISAs? If not, why?

We agree they should be retained. But we believe they should be retained because an approach that includes modifications to ISA260 and 265, and ISA706, would be a better approach than the proposals. Perhaps all that is needed is to make some changes to ISA260 and 265, to require the auditor to evaluate whether any information required to be reported to those charged with governance should also be included in "emphasis of matter paragraphs" or "other matter paragraphs," and to replace the word "fundamental" in ISA706.6 with "of key relevance."

Question 9

Do respondents agree with the statements included in the illustrative auditor's reports relating to:

(a) The appropriateness of management's use of the going concern basis of accounting in the preparation of the entity's financial statements?
(b) Whether the auditor has identified a material uncertainty that may cast significant doubt on the entity's ability to concern, including when such an uncertainty has been identified (see the Appendix of proposed ISA 570 (Revised))?

In this regard, the IAASB is particularly interested in views as to whether such reporting, and the potential implications thereof, will be misunderstood or misinterpreted by users of the financial statements.

As the proposals indicate, going concern is an accounting matter, and issues relating to how accounting frameworks should more adequately disclose going concern matters should be dealt with outside changes to the audit standards. ISA570 is adequate and changes to ISA570 should be deferred pending further developments in accounting standards.

Question 10

What are respondents' views as to whether an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern should be required in the auditor's report whether or not a material uncertainty has been identified?

This statement is unnecessary and may widen the expectation gap. Informed users of the financial statements should already be aware that the auditor cannot guarantee the entity's ability to continue as a going concern. An unintended consequence of specifically mentioning that there is no guarantee of going concern is that users expect that the auditor may be guaranteeing other things, such as profitability, growth in dividends, correctness of the financial statements, etc. To illustrate, a more complete statement would state that "the auditor does not guarantee either the accuracy of the information in the financial statements nor anything about the entity, including its present or future operations, financial position, ability to discharge its debts, profitability, growth or continued existence."

Question 11

What are respondent's views as to the benefits and practical implications of the proposed requirement to disclose the source(s) of independence and other relevant ethical requirements in the auditor's report?

We believe this is unnecessary. The source of ethical behaviour of auditors should not only be from a set of requirements.

Question 12

What are respondent's views as to the proposal to require disclosure of the name of the engagement partner for audits of financial statements of listed entities and include a "harm's way exemption"? What difficulties, if any, may arise at the national level as a result of this requirement?

We do not disagree. However, we note in some legal or legislative contexts, the auditor's report may be signed by someone other than the engagement leader. The standard should explicitly provide an exemption that, where legal or convention establishes that the auditor's report is signed by someone other than the engagement leader, it is sufficient to disclose the name of the person signing the auditor's report.

Question 13

What are respondents' views as to the appropriateness of the changes to ISA 700 described in paragraph 102 and how the proposed requirements have been articulated?

We agree.

Question 14

What are respondents' views on the proposal not to mandate the ordering of sections of the auditor's report in any way, even when law, regulation or national auditing standards do not require a specific order? Do respondents believe the level of prescription within proposed ISA 700 (Revised) (both within the requirements in paragraphs 20-45 and the circumstances addressed in paragraphs 46-48 of the proposed ISA) reflects an appropriate balance between consistency in auditor reporting globally when reference is made to the ISAs in the auditor's report, and the need for flexibility to accommodate national reporting circumstances?

We have no concerns with the level of prescription.

We believe that global audit standards are important. Therefore, in our view, if the proposals are adopted, the Canadian audit standards setter, the Auditing and Assurance Standard Board, should adopt the new and revised standards within Canada.

We appreciate the opportunity to respond to these proposals. The views contained herein do not necessarily reflect the views of the Office of the Auditor General of Alberta.

Sincerely,

Wayne Morgan

cc Auditing and Assurance Standards Board, Canada