MNP LLP

March 12, 2013

Technical Director
International Auditing and Assurance Standards Board (IAASB),
529 5th Avenue 6th Floor
New York, New York 10017
USA

Dear Sirs,

Re: Exposure Draft – The Auditor's Responsibility Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon (ED)

Thank you for the opportunity to comment on the ED. We have reviewed the ED and provided our responses to select questions, developed with the Canadian perspective in mind.

While our response will often refer to disclosures in Management's Discussion and Analysis (MD&A) our concerns are equally applicable to all other information issued by an entity that would be included in the scope of this ED.

Overall, we do not believe Canadian entities and their stakeholders will be best served by the proposed ED. A sizeable number of Canadian entities are small to mid-sized reporting issuers. In addition, the ED appears to scope in entities that are not publicly held, such as privately held enterprises, governments and not-for-profit enterprises. The ED will create additional costs to all of these entities that will result in limited benefits to the investors and other users of financial reporting documents.

We are very concerned about the confusion that will be created by including in the auditor's report on financial statements, references about disclosure that is not reported in the financial statements and that is not audited. Furthermore, given the limited time window between the completion of the financial statement audit and the required filing deadlines, it may be impractical for an auditor to review and report on MD&A.

Lastly, we not believe that the proposals address the practical limitations that the auditor's understanding of the business may be insufficient to facilitate effective or efficient review of information that may be forward-looking in nature or include technical disclosure for resource based issuers (i.e. involving engineering or geological expertise). In addition, the process to evaluate qualitative disclosure about management's view of the business involves a significant degree of judgement. In some cases, it may be extremely difficult to conclude whether the disclosure is materially inconsistent with the auditor's understanding of the business.

Our detailed responses to select questions are as follows:

Question 1: Do respondents agree that there is a need to strengthen the auditor's responsibilities with respect to other information? In particular do respondents believe that extending the auditor's responsibilities with respect to the other information reflects costs and benefits appropriately and is in the public interest?

We do not agree there is a need to strengthen the auditor's responsibilities with respect to other information without considering the nature of this "other information" to examine whether the auditor can effectively play that role. One result of the financial crisis is the automatic expectation placed on auditors to play "gatekeeper" and protect the public. We believe it is equally important to examine nature of the corporate disclosures that investors rely on to make their decisions and examine who should have responsibility over that disclosure.

As discussed in detail in our responses to follow, we do not believe that the auditor can effectively review or comment on much of the content in the Management Discussion and Analysis (MD&A) or similar disclosures that are filed concurrently with the financial statement filings. We agree that a need exists to bring more accountability to other entity disclosures not reported in the financial statements. However, we do not believe that the approach suggested in this ED is the appropriate approach. We believe the proposals in the ED are likely to be ineffective at reducing investor confusion. We believe that the costs of this proposal are likely to outweigh any benefits.

The current responsibilities for auditors in relation to MD&A and other information is to respond appropriately when there is disclosure that could undermine the credibility of the financial statements and the auditor's report. (Existing ISA 720) This responsibility includes reading the MD&A or other disclosure to identify material inconsistencies or misstatements of fact in relation to the audited financial statements. Issues are brought to management's attention for revision. Where management does not make the necessary revisions, the auditor would escalate the matter to those charged with governance. The auditor also considers their obligations with respect to legal, statutory or regulatory requirements. Existing ISA 720 can be applied by the auditor because the scope of auditor's responsibilities is limited to information that was examined by the auditor during the financial statement audit. The proposed changes in the ED significantly broaden the scope of auditor's responsibilities to areas that fall outside the scope of the financial statement audit and we believe it will be extremely difficult or impossible for the auditor to effectively discharge these additional responsibilities.

A sizable portion of Canadian public entities are small to medium sized enterprises when measured on an international scale. It will be difficult to convince Canadian public entities of the added benefit of the ED proposals considering they are not required by securities regulation in Canada. For example, there is no securities law requirement for the auditor to report on MD&A. We believe that the cost of imposing the ED requirements on small to medium sized Canadian reporting issuers will be prohibitive, particularly when many Canadian entities are currently having difficulties in raising funds in the capital markets.

Question 2: Do respondents agree that broadening the scope of the proposed ISA to include documents that accompany the audited financial statements and the auditor's report thereon is appropriate?

We are very concerned that the scope of the ED is too broad. The ED refers to "[information]...entities may distribute along with the audited financial statements" (ED page 7 and proposed ED paragraph A12 and A13). The ED implies that the scope can be extended to include a myriad of documents including website content, press releases and other promotional material that may be issued by the entity's public relations group. Many of these publications are not mandated by the securities regulatory authorities and therefore, the auditor may not be made aware of their existence. It would also require significant effort for the auditor to monitor the entity's publications after the completion of the audit engagement to ensure that any applicable disclosure issued by the entity is consistent with the proposed ED.

In addition, we are also concerned that the ED language is broad and potentially scopes in entities that are not publicly held enterprises (e.g. government institutions, private enterprises and non-profit enterprises) that publish MD&A and similar disclosure for their stakeholders, government and other purposes. We are concerned about the additional costs of imposing these requirements on entities that are not publicly held enterprises. The nature and purpose of reporting for non-public entities differs from that of public entities and the ED requirements do not appear to make this distinction.

Typically, the MD&A is prepared and finalized by the entity, late in the financial reporting process, generally AFTER the completion of the financial statements. We are also very concerned that there may not be sufficient time between the completion of the final version of the MD&A and the MD&A filing deadline to allow the auditor sufficient time to complete a high quality and thorough review, including resolving any issues with management. We believe reporting issuers' management will place undue time pressures on the auditor to ensure that the MD&A will be filed by the required deadlines.

We also believe that the current proposal, when read with Canadian regulatory filing requirements, leaves room for management manipulation of the timing of when the MD&A is finalized. We address this issue in our response to question three.

We do not believe it is appropriate to use the emphasis of matters section in the auditor's report to highlight potential issues in documents that are released separately from the audited financial statements. For example, we believe it is confusing to the reader if the "other matters" paragraph in the auditor's report refers to content in a corporate social responsibility report. The current ISA 706 "emphasis of matter" and "other matters" paragraphs relate exclusively to disclosures within the financial statements. To open up the use of the "other matters" section of the auditor's report to include other disclosure documents and information not in the audited financial statements will cause additional confusion. We discuss our concerns in further detail in question five.

Question 3: Do respondents find the concept of initial release clear and understandable? In particular, is it clear that initial release may be different from the date the financial statements are issued as defined in ISA 560?

Under the concept of "initial release" in the ED, we believe there would be options for manipulating the timing of the release of MD&A and other disclosures to avoid the proposed reporting requirements in the ED. We believe there would be comparability issues if entities are able to choose the date they finalize their MD&A because only MD&A dated on or before the date of auditor's report would be subject to the ED's reporting requirements.

Specifically, Canadian securities laws dictate the financial statement filing deadlines and require the MD&A be filed concurrently with the financial statements. IFRS and Canadian audit standards (CAS) drive the dating of the financial statements and auditor's report. Canadian securities requirements do not contain any explicit dating requirements for MD&A, other than the requirement that MD&A must be dated no later than the date that is it filed.

Therefore, under Canadian securities laws, Entity A is required to file its December 31, 2012 annual financial statements within 90 days of year end (i.e. March 31, 2013). Entity A's Board authorizes the financial statements for issuance on March 27, 2013 and the audit report is dated the same day. Under Canadian securities laws, there is no requirement for dating the MD&A except that the MD&A will be presumed to be dated the date it is filed (i.e. the MD&A can be dated as late as March 31, 2013). Therefore, management of Entity A may choose to finalize and date the MD&A <u>after</u> the date of the audit report to avoid any disclosure of the MD&A in the audit report's "other matters" paragraph.

Question 4: Do respondents agree that the limited circumstances in which a securities offering document would be in scope (e.g., initial release of the audited financial statements in an initial public offering) are appropriate or should securities offering documents simply be scoped out? If other information in a securities offering document is scoped into the requirements of the proposed ISA in these circumstances, would this be duplicating or conflicting with procedures the auditor may otherwise be required to perform pursuant to national requirements?

There are existing requirements in Canadian securities requirements and CAS that address auditor's involvement in securities offering documents. We understand that the Canadian standard setters plan to amend the applicable sections in proposed ED 720 to address any duplication or inconsistencies.

Question 5: Do respondents consider that the objectives of the proposed ISA are appropriate and clear? In particular:

a) ***Do respondents believe that the phrase "in light of the auditor's understanding of the entity and its environment acquired during the audit" is understandable for the auditor? In particular, do the requirements and guidance in the proposed ISA help the auditor understand what it means to read and consider in light of the auditor's understanding of the entity and its environment acquired during the course of the audit?***

MD&A and other information released in conjunction with the financial statements allows management to promote the affairs of the entity to current and potential investors by discussing historical results and current and future prospects of the business. The language used in MD&A and similar disclosure includes technical, qualitative and future oriented discussions for which no audit assurance can be provided.

In existing ISA 720, the standard of "consistency with the financial statements" is objective. Consistency with the audited financial statements is a clear standard because there is little room for interpretation when the benchmark is whether the disclosure is consistent with the information reported in the audited financial statements.

The ED eliminates the "consistency with the financial statements" concept, replacing it with the concept of consistency with the "auditor's understanding of the entity" (the New Standard). Consistency with the "auditor's understanding of the entity" creates a significant grey area and leaves a lot of room for interpretation. In many situations, it may be difficult to identify and conclude definitively whether the disclosure is <u>not</u> consistent with the New Standard. It will also be difficult in practice to consistently apply the New Standard due to the varying degrees of professional judgement involved.

There is also an independence threat associated with maintaining a positive business relationship with audit clients given the significant room for interpretation in applying the New Standard. Also, audit clients may "opinion shop" to identify audit firms that are willing undertake a review of MD&A and other corporate disclosures in the most expedient manner, keeping issues raised to a minimum.

We also believe that the ED may result in an unintended consequence for entities to limit their MD&A and similar disclosures to basic information to avoid attracting auditor's review of information that could be identified as inconsistent with the New Standard. In addition, management may try to limit the auditor's understanding of the business by restricting information provided to the auditor in order to minimize the number of opportunities for the auditor to question MD&A disclosures under the New Standard.

Lastly, we do not believe that the phrase "in light of the auditor's understanding of the entity and its environment acquired during the audit" is understandable or workable in practice for the following reasons:

- The Canadian MD&A form enables reporting issuers to disclose forward-looking information. It is not possible to perform any type of assurance work on forward-looking information. There are no ISA's covering assurance procedures for forward-looking information. Given the nature of forward-looking information, audit firms will take on substantial and unnecessary liability associated with reporting on forward-looking financial information particularly when securities regulators provide safe harbour provisions to entities that disclose forward-looking statements

- The Canadian MD&A form allows resource issuers to report on resources, reserves, assay findings, well flow tests and other similar technical information that is outside the scope of the auditor's expertise. Typically, the entity's chief geologist or engineer takes responsibility for this information. The auditor must rely on an independent mining or oil and gas expert to evaluate technical disclosure in the MD&A.

  The additional cost involved in engaging an independent technical expert to evaluate technical disclosure in MD&A is prohibitive for many small resource entities that are not yet at a revenue earning stage. Presently, there is no requirement for independent verification of mining or oil and gas disclosures in MD&A in Canadian securities law. As a result, we believe that entities will be reluctant to incur the additional costs if it is not required by law.

Lastly, for publicly traded entities, given the limited window between the time the MD&A is finalized and the MD&A filing deadline, it may not be practical to engage an independent technical expert to complete a detailed review of the MD&A disclosures.

- An auditor may obtain a broad but basic understanding of the business sufficient to complete the financial statement audit. However, this understanding is significantly less than the depth of knowledge possessed by management that is required to run the business. For example, if management discusses the business in detail in MD&A, the auditor may not have sufficient in-depth knowledge of the business to evaluate the disclosures effectively or efficiently.

- The Canadian MD&A form enables management promote the affairs of the entity. This information is typically qualitative in nature, high in judgement and not verifiable or quantifiable. We believe it would be challenging for an auditor to evaluate this type of information. Please refer to our response to question six for further details.

Question 6: Do respondents agree that the definitions of terms of "inconsistency" including the concept of omissions and "a material inconsistency" in the other information are appropriate?

We believe it will be challenging to establish consistent application of the "material inconsistency" concept for qualitative information that is typically disclosed in MD&A. Financial information is quantifiable and can be reconciled directly to information in audited financial statements. However, materiality for qualitative disclosure is subjective, requires professional judgement, varies by individual (based on personal biases or perceptions), and there may be a range of what is considered acceptable. As a result, it will be challenging to apply the material inconsistency concept consistently across audit firms.

In evaluating qualitative disclosures, a wide range of subjective interpretations may exist based on examining the reporting issuer's choice of words and it will be difficult for the auditor to conclude on what is considered outside the realm of acceptability in all but the most extreme cases. We provide the example below to illustrate our concerns.

Entity X has developed a new product (product A) and tested it with 50 potential customers, 30 of the customers had positive feedback and 5 had neutral feedback and the remaining customers did not provide any feedback. Management did not follow up to find out why the remaining customers did not respond. Entity X is a development stage corporation and all of its products are in various stages of testing. Compared to the entity's other products, A is in the most advanced stage of testing. Entity X does not yet generate revenue.

Management considers making the following statements in MD&A: "After preliminary testing phase, management is excited about product A and its future potential" and "preliminary market tests indicate that customer feedback is positive for product A".

Management does not wish to disclose the number of customers tested or the detailed test results due to proprietary concerns and there is no industry standard to suggest whether a test sample of 50 customers is an appropriate sized sample. A is a new product and there are no comparable products that exist in the marketplace. The auditor performed very limited reviews of the product A customer market tests because the customer test results do not directly affect any amounts reported in the annual financial statements (i.e. all costs are expensed, there are no capitalized development assets and associated impairment testing).   In this example, it would be very difficult for the auditor to evaluate if the either of the two statements in MD&A are materially inconsistent with their understanding of the Entity X and therefore, not acceptable under the New Standard.

Question 7: Do respondents believe that users of auditors' reports will understand that an inconsistency relates to an inaccuracy in the other information as described in (a) and (b) of the definition, based on reading and considering the other information in light of the auditor's understanding of the entity and its environment acquired during the course of the audit?

We do not support the reporting requirement proposed in the ED.

Presently, there is already a significant expectations gap in the public's understanding of the role of auditor in relation to the audit of financial statements. We believe the proposals in the ED will only perpetuate this expectations gap. Investors already have a misconception about the ownership and responsibility for the financial statements and what an audit will detect, even though the auditor's report specifically states that the ownership of the financial statements belongs to management and that an audit will not necessarily detect fraud.

This difference in expectations will be made worse by attributing more disclosure documents to the auditor. Reporting the auditor's review of MD&A and other information in the auditor's report under "other matters" will simply cause investors to attribute ownership of these additional disclosure documents to the auditor and imply that this additional disclosure was somehow "audited" because of its reference in the auditor's report. It is confusing to readers to include references to additional disclosure documents reviewed by the auditor in the <u>auditor's report on financial statements</u> when no audit assurance was provided for this additional disclosure and the documents in question are filed separately from the financial statements.

Question 9: Do respondents believe that the examples of qualitative and quantitative information included in the Appendix in the proposed ISA are helpful?

We are concerned that the examples and guidance in the ED (A43) suggests assurance procedures would be applied to the information disclosed in the MD&A even though the audit report will state that no assurance is provided. Specifically, the ED includes an example of the proposed work to be performed in testing the currency effect on projected revenue growth to support the applicable discussion in the MD&A.

Based on the examples in the Appendix, we are also concerned that that the work effort required to review the MD&A and other disclosures extends beyond the scope of work completed for the financial statement audit. This will substantially increase the cost of compliance for entities that file MD&A or other information.

Going back to our example discussed in question 6, should the auditor perform detailed verification of the market tests on the 50 potential customers in order to conclude whether the MD&A disclosure met the New Standard? In reviewing the entity's ability to continue as a going concern, the auditor would have considered the results of the market tests but the extent of audit work on the market tests may be limited to audit procedures with an objective to corroborating the applicable going concern assumptions. Because the market tests do not directly affect any amounts reported on the financial statements, it is unlikely that the financial statement audit file will contain any extensive work audit to verify the 50 market tests completed by the entity. If the work performed during the year-end audit engagement is not sufficient for the purposes of corroborating the MD&A discussion about management outlook on product A, based on our reading of ED A43, it is unclear whether the auditor would need to go back and conduct more work in order to verify that the MD&A discussion met the New Standard.

Question 11: With respect to reporting:

a) ***Do respondents believe that the terminology (in particular, "read and consider," "in light of our understanding of the entity and its environment acquired during our audit," and "material inconsistencies") used in the statement to be included in the auditor's report under the proposed ISA is clear and understandable for users of the auditor's report?***

b) Do respondents believe it is clear that the conclusion that states "no audit opinion or review conclusion" properly conveys that there is no assurance being expressed with respect to the other information?"

We do not support the reporting requirement proposed in the ED.

We do not believe the terminology including "read and consider," "in light of our understanding of the entity and its environment acquired during our audit," and "material inconsistencies" is clear or understandable for readers. As discussed in our response to question seven, we believe that there is an expectations gap between the actual work performed by the auditor in an audit of financial statements and the expectations of investors and the public. The proposals in the ED will further contribute to this expectations gap.

We believe that the investors and the public will not understand the proposed terminology to "read and consider". We do not believe the proposed terminology will direct readers to the fact that MD&A and other additional information listed in the "other matters" section of the auditor's report is <u>not audited</u> particularly when the auditor's report draws attention to these disclosure documents in the first place. The public will have difficulty differentiating between the concepts of "read and considered" as opposed to "audited." Lastly, we do not believe the proposed reporting requirements provide users with an understanding of what work was actually done by the auditor.

Closing comments

In conclusion, we do not support the proposed revisions to ISA 720 as the costs to Canadian entities will outweigh any benefits for investors and other users of MD&A and similar filings. While we support efforts to improve the ISAs, we do not believe measures that involve review of information that is outside the scope of the auditor's expertise and that <u>do not</u> constitute added assurance are beneficial to investors and other users of financial reporting.

We believe regulators and standard setters should identify the nature of information that investors rely on to make decisions. We do not believe that investors make investing decisions solely based on the historical components of financial reporting. The auditor and the traditional financial statement audit focuses on historical disclosures. The auditor is unable to provide assurance on forward-looking information and therefore, we question the effectiveness of measures that attempt to increase auditor's responsibilities in areas that are outside of financial statements. While we support an environment of accountability for information disseminated to investors and other users of financial reporting, we do not believe the proposals in the ED are the appropriate starting point.

We are pleased to offer our assistance to the IAASB in further exploring issues raised in our response or in finding alternative solutions to meet the needs of financial statement users.

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Yours truly,

MNP LLP

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Vice President, Assurance Professional Standards

cc: AASB, Canada