



Reporting on Audited Financial Statements September 2013

**COMMENTS TO THE AASB MUST BE RECEIVED BY
NOVEMBER 1, 2013**

**COMMENTS TO THE IAASB MUST BE RECEIVED BY
NOVEMBER 22, 2013**

This Exposure Draft reflects proposals made by the International Auditing and Assurance Standards Board that the Auditing and Assurance Standards Board (AASB) intends to adopt as Canadian generally accepted auditing standards.

Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. All comments received by the AASB will be available on the website shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

**To be considered, comments must be received by
November 1, 2013, addressed to:**

**Greg Shields, CPA, CA
Director, Auditing and Assurance Standards
Auditing and Assurance Standards Board
277 Wellington Street West
Toronto, Ontario M5V 3H2**

A PDF [response form](#) has been posted with this document to assist you in submitting your comments. Alternatively, you may send comments by e-mail (in Word format), to: ed.assurancestds@cpacanada.ca

Introduction

The Auditing and Assurance Standards Board (AASB) proposes, subject to comments received following exposure, to adopt with appropriate amendments, if any:

- proposed new International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*;
 - proposed revised ISAs:
 - ISA 260 (Revised), *Communication with Those Charged with Governance*;
 - ISA 570 (Revised), *Going Concern*;
 - ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*;
 - ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*;
 - ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report*; and
 - conforming amendments to other ISAs,
- issued by the International Auditing and Assurance Standards Board (IAASB). The result would be new and revised respective Canadian Auditing Standards (CASs).

This Exposure Draft consists of:

- a link to the IAASB’s Exposure Draft, including its Explanatory Memorandum;
- a description of the AASB’s process for adopting ISAs;
- information about the IAASB’s 2011-2012 activities and the AASB’s response;
- significant changes to the auditor’s report in the IAASB 2013 Exposure Draft;
- the AASB’s discussion of the implications of adoption of the IAASB’s proposed new and revised ISAs; and
- a proposed effective date.

Please review “**Comments requested on this Exposure Draft**” on page viii for information on preparing your response to this Exposure Draft.

IAASB Exposure Draft

The IAASB’s Exposure Draft, “[Reporting on Audited Financial Statements](#),” is available on the IAASB website.

In addition to the text of proposed new and revised ISAs, the Exposure Draft includes an Explanatory Memorandum, which provides background to, and an explanation for, the proposed new and revised ISAs as well as an illustrative auditor’s report that is intended to show the result of the IAASB’s proposed changes to the auditor’s report. An analysis of the impacts anticipated by the IAASB to arise as a result of its proposed revisions is also presented.

Process for adopting ISAs

In 2009, the AASB commenced, and successfully completed, the adoption of all 36 ISAs and one International Standard on Quality Control (ISQC) for audits of financial statements and other historical financial information. The AASB embarked on that process because it believed that:

- the IAASB’s conceptual framework and standard-setting philosophy is closely aligned with the AASB’s;
- ISAs are increasingly being accepted as global auditing standards because of the rigour of the IAASB’s due process and the quality of the standards it produces; and
- ISAs reflect the needs of a broad range of stakeholders, including practitioners from smaller firms and the public sector.

To date, the AASB believes that adoption of ISAs is appropriate in Canada because:

- Canadian users of audit reports understand that Canadian auditors have conducted their audits in accordance with high-quality, globally accepted auditing standards;
- global standards are supported by non-authoritative guidance that assists practitioners in applying them consistently and cost effectively;
- global standards meet the needs of regulators by being demonstrably of high quality and applied consistently across all sizes and types of regulated entities; and
- Canada is able to provide strong technical input to the standard-setting process.

In embarking on its adoption process, the AASB issues as a Canadian exposure draft, every IAASB exposure draft of a proposed ISA. However, in doing so, the AASB recognizes that it has a vital role to play in monitoring changes made by the IAASB to ensure that standards remain in the public interest and that adoption of an ISA is not automatic. The AASB follows amendment criteria set out in the Appendix that allow the AASB to make amendments in specific circumstances. The criteria limit the additions and deletions that the AASB can make to an ISA. The criteria also permit the AASB to make amendments to an ISA when it believes that there are “circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada”. To date, very few amendments have been required in adopting ISAs as CASs. None relate to circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.

Other key attributes of the process for adopting ISAs as CASs are set out below:

- The deadline for responding to a CAS exposure draft provides the time needed for the AASB to consider the responses of Canadian stakeholders in developing its response to an IAASB exposure draft.

- The AASB uses the same effective date for the CASs as the IAASB does for the ISAs.
- The AASB makes CASs available shortly after they are approved, so Canadian auditors can become familiar with them and prepare to implement them by the effective date.

IAASB 2011-2012 Activities and the AASB's response

Background

Discussions, public consultations and research studies on the topic of auditor reporting have generated a significant body of information about users' perceptions of the relevance and usefulness of auditor reporting, particularly in the context of listed entities. Building on this information, the IAASB issued a Consultation Paper, "Enhancing the Value of Auditor Reporting: Exploring Options for Change," in May 2011, to inform its views on whether it should embark on future standard-setting projects on auditor reporting.

IAASB Invitation to Comment

The IAASB issued an Invitation to Comment, "[Improving the Auditor's Report](#)," in June 2012, proposing a number of changes to auditor reporting that it believed, in principle, should be promulgated internationally:

- Additional information should be added to the auditor's report to highlight matters that are, in the auditor's judgment, likely to be most important to users' understanding of the audited financial statements or the audit, referred to as "auditor commentary." This information would be required for public interest entities – which include, at a minimum, listed entities – and could be provided at the discretion of the auditor for other entities.
- There should be an auditor conclusion on the appropriateness of management's use of the going concern assumption in preparing the financial statements and an explicit statement as to whether material uncertainties in relation to going concern have been identified.
- There should be an auditor statement as to whether any material inconsistencies between the audited financial statements and other information have been identified based on the auditor's reading of other information, and specific identification of the information read by the auditor.
- The auditor's opinion and other entity-specific information should be prominently placed in the auditor's report.
- There should be further transparency about the audit performed and the responsibilities of the auditor, management and those charged with governance in an ISA audit should be clarified.

AASB Response to the IAASB Invitation to Comment

The AASB provided its comments on the Invitation to Comment to the IAASB. In developing its response, the AASB held many face-to-face and conference call meetings with various user groups, including investors,

analysts, management, audit committees, directors, regulators, auditors and others. Input was also received in the form of a Discussion Paper issued in response to various global proposals to enhance auditor reporting by the Auditor Reporting Working Group of the Enhancing Audit Quality Initiative, a collaboration between the Canadian Institute of Chartered Accountants and the Canadian Public Accountability Board.

Based on the input the AASB received from Canadian stakeholders on the suggested changes, the AASB supported proposed changes to provide transparency about the audit, to clarify the respective responsibilities of the auditor, management and those charged with governance in an ISA audit, and to place the auditor's opinion more prominently in the auditor's report. However, the AASB did not support a number of the changes suggested, particularly those related to auditor commentary and going concern. The AASB emphasized two important reasons for its lack of support of the proposals in the Invitation to Comment:

- The changes might 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 would be particularly true for smaller entities.
- There would be 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.

IAASB 2013 Exposure Draft

Based on the input received on its Consultation Paper and Invitation to Comment, the IAASB is issuing its Exposure Draft. The IAASB significantly modified the positions taken in the Invitation to Comment as a result of comments received from global stakeholders, including those of the AASB. The following summarizes the significant changes in the proposed new and revised ISAs from existing auditor reporting standards:

Reporting of key audit matters

Proposed ISA 701 requires the auditor of the financial statements of a listed entity to determine, from the matters communicated with those charged with governance, those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

Reporting on going concern

Proposed ISA 570 (Revised) requires the auditor to include in the auditor's report a separate section under the heading "Going Concern" that includes a statement whether management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate, and a statement whether the auditor has identified a material uncertainty

that may cast significant doubt on the entity's ability to continue as a going concern.

Reporting on other information

Proposed ISA 700 (Revised) requires the auditor to report in accordance with ISA 720 (Revised). The IAASB has not completed its due process with respect to ISA 720 (Revised), so the form and content of the reporting requirements are still to be determined.

Emphasis of Matter and Other Matter paragraphs

No changes are being proposed to the underlying concepts in ISA 706, including the definition of Emphasis of Matter and Other Matter paragraphs. The IAASB is proposing that clarification be made within proposed ISA 706 (Revised) to ensure that auditors are not using Emphasis of Matter or Other Matter paragraphs for matters determined to be a key audit matters in accordance with proposed ISA 701 when applicable.

Disclosure of engagement partner name

Proposed ISA 700 (Revised) requires the engagement partner's name to be included in the auditor's report for audits of financial statements of listed entities. The engagement partner's name need not be disclosed in the auditor's report in those rare circumstances when such disclosure is reasonably expected to lead to a significant security threat to the individual.

Ordering of elements of auditor's report

Proposed ISA 700 (Revised) retains the level of flexibility for ordering of elements of the auditor's report that exists in extant ISA 700.

Responsibilities of management, auditor and those charged with governance

Proposed ISA 700 (Revised) requires:

- an enhanced description of the auditor's responsibilities and permits relocating this material to an Appendix or referring to a website of appropriate authority; and
- a reference to whom in the entity is responsible for overseeing the entity's financial reporting process.

Source of relevant ethical requirements

Proposed ISA 700 (Revised) requires the auditor to specify the relevant ethical requirements to which the auditor is subject. Further, if the independence and other ethical responsibilities of the auditor are established by different sources, the auditor is required to specify the source of the other relevant ethical requirements.

The IAASB believes the following benefits, among others, could be realized as a result of the proposed new and revised ISAs:

- enhanced communicative value of the auditor's report, providing more transparency about the audit that was performed;

- enhanced communications between the auditor and those charged with governance;
- increased attention by management and those charged with governance to matters disclosed in the financial statements to which reference is made in the auditor’s report (for example, key audit matters, going concern, etc.), which may result in improvements to the quality of financial reporting; and
- renewed focus of the auditor on matters to be reported, which could indirectly result in an increase in professional skepticism, among other contributors to audit quality.

Implications of adoption of the IAASB’s proposed new and revised ISAs

As explained in the section “Process for adopting ISAs” above, the AASB issues as a Canadian exposure draft, every IAASB exposure draft of a proposed ISA. This is part of the AASB’s vital role in monitoring changes made by the IAASB to ensure that standards remain in the public interest. In this context, the AASB’s objective in considering the IAASB’s auditor reporting proposals is to determine whether they are appropriate for use in Canada and whether amendments may be required. In order to make this determination, the AASB is seeking input from stakeholders on the proposed new and revised ISAs. In obtaining this input, the AASB believes that Canadian stakeholders need to consider:

- proposals by standard setters in other jurisdictions (and potential consequences of their adoption); and
- potential consequences of adopting or not adopting the proposed new and revised ISAs.

Proposals by standard setters in other jurisdictions

Standard setters in the United Kingdom, the United States and the European Union either have auditor reporting projects in progress, have implemented new auditor reporting standards or are considering legislation to specify auditor reporting requirements.

The U.K. Financial Reporting Council has already issued revised auditor reporting standards that expand the information that the auditor is required to include in the auditor’s report. Further, the U.S. Public Company Accounting Oversight Board (PCAOB) has been monitoring the IAASB project. In August 2013, the PCAOB issued auditor reporting proposals some of which are similar to the proposed new and revised ISAs, for example proposing to require the auditor to include in the auditor’s report information about “critical audit matters”.

The European Commission is discussing draft legislation that would require auditors of public interest entities in the European Union to include more information in the auditor’s report.

Therefore, there is the prospect that auditor reporting in the U.S., the U.K, other parts of Europe and elsewhere may be moving in a similar direction as the IAASB and, thus, be significantly different from existing Canadian auditor reporting standards.

Potential consequences of adopting or not adopting the proposed new and revised ISAs in Canada

The proposed new and revised ISAs will have a significant impact on auditor reporting in Canada. As such, in evaluating the proposals, it is important to understand the implications of both adopting and not adopting them.

If the proposed new and revised ISAs are adopted in Canada, there are a number of potential consequences, for example:

- There may be additional cost for auditors, preparers and audit committees arising from additional quality control processes at the audit firm, additional discussions between the auditor, management and those charged with governance, and the resulting iterative process to finalize the auditor's report.
- The expected benefits of the new auditor reporting may not be realized, particularly for smaller listed entities.
- There is a danger that auditors may adopt a "kitchen sink" or boilerplate approach, in particular to the application of the key audit matters requirements, that will result in longer reports.
- The working relationship between the auditor, management and the audit committee may be affected if there are increased disagreements arising from proposed disclosures in the auditor's report.
- The going concern statements may:
 - mask the red flag provided by the existing requirement for the auditor to include an Emphasis of Matter paragraph in the auditor's report to highlight the existence of a material uncertainty relating to going concern disclosed in the financial statements; or
 - be misinterpreted by readers.

If the proposed new and revised ISAs are not adopted in Canada, Canadian auditors performing an audit in accordance with the CASs would not be able to also represent compliance with the ISAs. There are a number of potential additional consequences, for example:

- It would be evident to the marketplace that Canadian audits are not being performed in accordance with globally accepted auditing standards because a Canadian auditor's report would generally contain significantly less information than an auditor's report under the revised ISAs.
- If regulators consider that an auditor's report under the ISAs is more informative than one under the CASs, they may require that audits be performed in accordance with the ISAs rather than the CASs.
- Auditors whose audit manuals are based on the ISAs may choose to follow the ISAs rather than the CASs when reporting on Canadian entities to maintain global consistency of their firm's auditor reporting.

- If the CASs conflict with the ISAs and/or PCAOB standards, this may create reporting issues for auditors of entities that currently report in accordance with both the CASs and either ISAs or PCAOB standards.
- Because auditor reporting affects a number of ISAs/CASs, tracking the differences and making amendments when ISAs with auditor reporting elements are revised and updated would be complicated.

Canadian stakeholders providing input to the AASB will need to balance their views on the importance of the AASB continuing its commitment to adoption of ISAs as CASs with their views on the potential consequences of adoption of the proposed new and revised ISAs.

Proposed effective date

Assuming the proposed new and revised ISAs are issued as final standards in the fourth quarter of 2014, the effective date would be for periods beginning on or after December 15, 2015, although the IAASB is seeking input on whether an earlier effective date would be feasible. If adopted as new and revised CASs, the standards would have the same effective date as the ISAs.

Comments requested

Stakeholders are asked to provide comments on the IAASB Exposure Draft directly to the IAASB, and provide the AASB with a copy of the response. The AASB will take these comments into account in drafting its own response to the IAASB Exposure Draft. Respondents are asked not to include comments on matters particular to the Canadian environment in their responses to the IAASB. Such comments should be included only in responses sent to the AASB.

Please refer to the “Guide for Respondents” contained in the IAASB’s Exposure Draft and respond to the specific questions therein.

Stakeholders are asked to provide comments directly to the AASB on any other matters the AASB should consider in deciding on whether to adopt the proposed new and revised ISAs.

The AASB would appreciate receiving stakeholder input on the following additional questions:

1. What are your views on whether the AASB should adopt the proposed new and revised ISAs within Canada?
2. What are your views on the importance of the AASB maintaining its commitment to adopt ISAs as CASs for audits of financial statements and other information in Canada, recognizing that if the AASB does not adopt the proposed new and revised ISAs, Canadian auditors performing an audit in accordance with the CASs would not be able to also represent compliance with the ISAs?

3. Are there other options that you believe the AASB should consider that may enable the AASB to maintain its commitment to adopt ISAs as CAs for audits of financial statements and other information in Canada while minimizing adverse consequences of the proposed new and revised ISAs? If so, please provide details.

The deadline for providing your comments to the AASB on the above is November 1, 2013.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. When a respondent agrees with proposals in the Exposure Draft, it will be helpful for the AASB to be made aware of this view.

For your convenience, a PDF [response form](#) has been posted with this document. You can save the form both during and after its completion for future reference. Alternatively, written comments may be submitted by email (Word format preferred) to: ed.assurancestds@cpacanada.ca

Criteria for amending ISAs when adopting them as Canadian Auditing Standards

With respect to the adoption of ISAs, the AASB's overriding goal is to adopt ISAs into the Assurance Handbook without amendment. However, there may be circumstances where amendments are required. The following sets out the limited circumstances when the AASB makes amendments to ISAs:

1. The AASB limits additions to an ISA to those required to comply with Canadian legal and regulatory requirements.¹
2. The AASB limits deletions from, or other amendments to, an ISA to the following:
 - (a) The elimination of options (alternatives) provided for in the ISA.
 - (b) Requirements or guidance, the application of which Canadian law or regulation¹ does not permit, or which require amendments to be consistent with law or regulation.
 - (c) Requirements or guidance, where the ISA recognizes that different practices may apply in different jurisdictions and Canada is such a jurisdiction.
3. The AASB may make amendments to an ISA with respect to requirements or guidance that do not fall within 1 or 2 above when it believes that there are circumstances particular to the Canadian environment where such amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.
4. To the extent possible, amendments that are:
 - (a) additions to an ISA will not be inconsistent with the current requirements or guidance in the ISA; and
 - (b) deletions from, or other amendments to, an ISA will be replaced by an appropriate alternative that achieves the objective of the deleted requirement.

Proposed amendments to an ISA are highlighted in exposure drafts of proposed Canadian standards. The AASB indicates the reasoning for the amendments and respondents are invited to comment on them, including when the amendment will not result in convergence with the ISA in accordance with the International Auditing and Assurance Standards Board's guide for national standard setters. Amendments to ISAs are separately

¹ Canadian incorporating and other governing legislation often requires entities to prepare financial statements in accordance with Canadian GAAP. Accordingly, if Canadian GAAP necessitates a different audit response in Canada, these differences fall within the definition of a legal or regulatory requirement.