



Exposure Draft

Proposed Canadian Auditing Standard

Communication of Key Audit Matters in the Auditor's Report

January 2019

**COMMENTS TO THE AASB MUST BE RECEIVED BY
May 15, 2019**

We value your input and look forward to your feedback on this Exposure Draft. Respondents are asked to email their comment letters (in a Word file) to: info@aaasbcanada.ca.

Please address your comments to:

**Eric Turner, CPA, CA
Director, Auditing and Assurance Standards
Auditing and Assurance Standards Board
277 Wellington Street West
Toronto ON M5V 3H2**

This Exposure Draft reflects proposals made by the Auditing and Assurance Standards Board (AASB) that it intends to include in the final standard, subject to deliberating comments received.

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 relate 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.

Highlights

The Auditing and Assurance Standards Board (AASB) proposes, subject to comments received on exposure, to revise Canadian Auditing Standard (CAS) 700, *Forming an Opinion and Reporting on Financial Statements*, relating to the communication of key audit matters (KAM) in the auditor's report, and make related conforming amendments.

Background

IAASB auditor reporting standards

The auditor's report is the key deliverable addressing the output of the audit process. Investors and other users of financial statements have called for the auditor's report to be more informative – in particular for auditors to provide more relevant information to users based on the audit that was performed. The International Auditing and Assurance Standards Board (IAASB) met this objective when it issued new and revised auditor reporting standards effective for audits of financial statement periods ending on or after December 15, 2016.

A key enhancement to the auditor's report the IAASB introduced is a new section to communicate KAM. KAM are those matters that, in the auditor's judgment, were of most significance in the audit of the current-period financial statements. The IAASB decided to require the communication of KAM for audits of complete sets of general purpose financial statements of listed entities, and when the auditor is otherwise required by law or regulation or decides to communicate KAM in the auditor's report.

In Canada, entities listed on the following exchanges meet the definition of listed entity for the new auditor reporting standards:

- Toronto Stock Exchange (TSX);
- TSX Venture Exchange (TSXV);
- Canadian Securities Exchange (CSE); and
- Aequis NEO Exchange (NEO).

AASB adoption of the new auditor reporting standards

The AASB conducted extensive consultation with stakeholders about the new auditor reporting standards, including the [Invitation to Comment, "Implementation Considerations for New Auditor Reporting Standards,"](#) which it issued in June 2015. Canadian stakeholders made it clear that changes to auditor reporting standards need to recognize that the Canadian and U.S. capital markets are closely integrated. The U.S. Public Company Accounting Oversight Board (PCAOB) proposed a rule dealing with auditor reporting in 2013, and a re-proposed rule in 2016.

There was general support from stakeholders for requirements to communicate KAM applying first to TSX-listed entities. However, there were concerns about the value and cost of communication of KAM for entities listed on exchanges other than the TSX, such as the TSXV, the NEO and the CSE, many of which are smaller entities and venture issuers (as defined in National Instrument (NI) 51-102, *Continuous Disclosure Obligations*). Some stakeholders recommended that the AASB delay deciding on whether venture issuers should be subject to communication of KAM until the Board can examine the costs and benefits of this reporting for such issuers. The Board's initial view was to research the topic with a view to making a decision within 18 months of the effective date of the requirement for auditors to communicate KAM for TSX-listed entities. The Board recognized that there was limited experience with the new report as it relates to smaller listed entities. Accordingly, the Board committed to wait until it could examine the experience of jurisdictions that have implemented the new auditor reporting standards to understand their experience, particularly with auditor communication of KAM for smaller listed entities. The Board believed

this approach would address stakeholders' concerns about communication of KAM for listed entities in that category.

In June 2017, the AASB adopted the International Standards on Auditing (ISAs) dealing with auditor reporting as CASs effective for periods ending on or after December 15, 2018, with earlier application permitted. In approving the standards, the Board determined that the auditor should be required to communicate KAM when the auditor is required by law or regulation or decides to communicate KAM. Based on input from stakeholders, and the PCAOB not having finalized its auditor reporting standards at that time, the Board decided that it was not appropriate at that time to require communication of KAM for audits of complete sets of general purpose financial statements of listed entities.

Finalization of the PCAOB auditor reporting standard

The PCAOB and the U.S. Securities and Exchange Commission (SEC) completed their processes to adopt a new auditor reporting standard in late 2017. The PCAOB auditor reporting standard includes a similar reporting concept to communication of KAM (called "critical audit matter reporting"). It will be effective for audits of financial statements of large accelerated filers for periods ending on or after June 15, 2019, and for all other U.S. issuers to which the requirements apply for periods ending on or after December 15, 2020. In setting these requirements, the PCAOB exempted certain entities, including investment companies under the U.S. Investment Company Act. The PCAOB explained its rationale for excluding investment companies in [Rulemaking Docket Matter No. 034](#) and included considerations such as:

- Investor decisions are based on an investment company's investment objectives, strategies, risks, costs and performance, and critical audit matters are not expected to provide information about these items and therefore would not be relevant.
- Investment companies are designed for the sole purpose of trading in and holding investments, and auditor judgment would arise primarily with respect to valuation of investments, which would tend to be repeated as a critical audit matter. The benefits of providing critical audit matters may be smaller for investment companies relative to other companies because of their purpose and structure.
- There may be additional costs of applying critical audit matter requirements to audits of investment companies as compared to audits of other types of companies. For example, in some cases, annual shareholder reports of affiliated investment companies might be filed with the SEC in one document containing a single auditor's report that covers multiple companies. In these situations, communicating critical audit matters specific to each investment company may require the auditor to prepare separate auditor's reports.

However, the PCAOB recognized that:

- The disclosures otherwise provided by investment companies may not fully substitute for the communication of critical audit matters, because these matters result in auditors providing investors with audit-specific information.
- Some academic research documented a difference in the perceived usefulness and reliability of information depending on the location of the disclosure and whether it was disclosed by management or by the independent auditor.

AASB actions in 2017 and 2018

Since the PCAOB finalized its auditor reporting standard in late 2017, the AASB has been assessing the nature and scope of requirements for auditors to communicate KAM in their auditor's reports. The Board's initial view was to require the communication of KAM for audits of complete sets of general purpose financial statements of TSX-listed entities for financial statement periods ending on or after December 15, 2020. This date is when the PCAOB critical audit matter reporting requirement will be

effective for all entities to which it applies. The Board believed this approach would address stakeholders' concerns about the consistency of auditor reporting in the North American capital market.

Entities listed on exchanges other than the TSX

The AASB monitored the experience of other jurisdictions as they implemented the ISAs to evaluate how auditor reporting has evolved since the IAASB issued its auditor reporting standards. The Board also examined research by Fred Pries and Sandra Scott from the University of Guelph in their September 2018 paper, *The Costs and Benefits of Key Audit Matter Reporting for Smaller Public Entities: The Australian Experience*. Given the positive experience of other jurisdictions and the evidence in the research paper, the Board reconsidered how it should move forward with auditor communication of KAM for entities listed on exchanges other than the TSX.

The AASB re-evaluated its timeline to decide on applicability of requirements to communicate KAM for entities listed on exchanges other than the TSX (which was initially intended to be within 18 months of the effective date of the requirement for auditors to communicate KAM for TSX-listed entities). The Board believes that adopting this view would mean that this form of reporting would likely not be in place until 2022 or later for entities listed on exchanges other than the TSX. This is an unnecessary delay contrary to the public interest. The Board wishes to provide certainty for stakeholders and avoid the potential for multiple future incremental changes. These will be disruptive to investors, auditors, audit committees and management while resulting in confusing and inconsistent auditor reporting.

Entities that are required to comply with NI 81-106

In discussing its initial view to require the communication of KAM for audits of complete sets of general purpose financial statements of TSX-listed entities with stakeholders, the AASB became aware of concerns. These concerns indicated that requiring communication of KAM for investment funds that are TSX-listed entities, while not requiring such communication for other listed and unlisted investment funds, will lead to inconsistent auditor reporting and may be confusing for users. The Board noted that closed-end funds, exchange traded funds and mutual funds must meet NI 81-106, *Investment Fund Continuous Disclosure*, but would be subject to different auditor reporting requirements because some are listed and others are unlisted.

Revisions to auditor reporting standards in December 2018

In considering the issues relating to communication of KAM for investment funds and entities listed on exchanges other than the TSX, the AASB sought to balance two public interest considerations as the December 15, 2018 effective date of the new auditor reporting standards was approaching. First, the Board believed it needs to hear from stakeholders more broadly before finalizing the requirements to communicate KAM for audits of investment funds and entities listed on exchanges other than the TSX. Second, the Board believed that it is important for auditors of TSX-listed entities other than listed investment funds, and their stakeholders, to have sufficient time to prepare to implement the new requirements for auditors to communicate KAM in 2020. Accordingly, in October 2018 the Board approved revisions to the CASs to require communication of KAM for audits of TSX-listed entities, other than those required to comply with NI 81-106, for financial statement periods ending on or after December 15, 2020. An update to the CPA Canada Handbook – Assurance was issued in December 2018.

Main features of the Exposure Draft

The AASB proposes to expand the requirements for auditors to communicate KAM for audits of complete sets of general purpose financial statements so that they apply to:

- all entities listed on the TSX, TSXV, NEO and CSE; and
- all entities required to comply with NI 81-106.

The AASB also proposes a staged implementation of these reporting requirements as follows:

Type of Entity	Effective for Audits of Financial Statements for Financial Statement Periods Ending on or After
As Required by CAS Revisions in December 2018	
TSX-listed entities other than those required to comply with NI 81-106	December 15, 2020
As Proposed in this Exposure Draft	
Entities required to comply with NI 81-106 (both listed and unlisted investment funds)	December 15, 2021
Entities listed on exchanges other than the TSX (NEO, CSE and TSXV)	

These reporting requirements will be achieved by revising paragraphs C5, C30 and C40C(c) of CAS 700, as shown in Appendix 1, and related conforming amendments.

Public interest considerations in making these revisions

In making the changes proposed in this Exposure Draft, the AASB has taken account of the following public interest considerations:

Enhancing the quality and value of auditor reporting

The increased transparency and enhanced informational value of the auditor's report are intended to have significant public interest benefits. The AASB believes that communicating KAM in the auditor's report will:

- increase transparency about the audit that was performed;
- focus investors and other users on areas in the financial statements that are subject to significant management judgment and auditor attention;
- provide users with a basis to engage further with management and audit committees;
- enhance communications between the auditor and the audit committee about the most significant matters in the audit and potentially result in increased attention to disclosures about those matters in the financial statements by management and the audit committee; and
- renew 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.

Alignment with IAASB auditor reporting standards

The AASB continues to receive strong support from regulators, auditors and other stakeholders for the continued adoption of ISAs as CASs. The Board believes that alignment with the ISAs is in the public interest in preserving the quality of auditing standards in Canada.

Consistency of auditor reporting for audits of entities subject to NI 81-106

The AASB recognizes that users of the auditor's report of entities required to comply with NI 81-106 may be confused if KAM are communicated for certain entities and not others depending on whether the entity is listed or unlisted. It is in the public interest for the Board to seek solutions to the communication of KAM reporting that will minimize such inconsistencies.

Matters the AASB considered in addressing the public interest considerations and its conclusions

The AASB considered several matters in addressing the above public interest considerations, including:

Certainty with respect to the PCAOB auditing standard

The PCAOB finalized its auditor reporting standard in 2017. The changes the AASB made in December 2018 to the requirements to communicate KAM address concerns of stakeholders about the need for the Board to recognize that the Canadian and U.S. markets are closely integrated.

Experience of other jurisdictions in applying the standards

The AASB reviewed the experience reported by jurisdictions that have implemented the IAASB's auditor reporting standards. These jurisdictions included Australia, Brazil, Hong Kong, Malaysia, New Zealand, Singapore and the United Kingdom, as well as some global studies.¹ The studies included Brazil, Cyprus, Kenya, Nigeria, Oman, Romania, South Africa, the United Arab Emirates and Zimbabwe. The marketplace in Australia is very similar to Canada's in many respects; for example, both have many smaller listed entities in the resource sector.

The studies considered the outcome in the first or second year of the implementation of the new auditor report. They indicated positive feedback from investors, audit committees and management about the benefits from communicating KAM. These benefits are not just related to the specific value of communicating KAM to assist stakeholders understanding of the audit. They include improved governance activities, better audit quality and enhanced corporate reporting.

The AASB also reviewed specific jurisdictions that require auditors to communicate KAM to understand the scope of their requirements. These findings confirm that other jurisdictions require auditors to communicate KAM for all listed entities and, in some cases, to other entities. The U.K., Australia and New Zealand have requirements to communicate KAM that apply to audits of listed entities. In the U.K., the requirements include public interest entities (reflecting European Union legislation) and other entities that are required to report on how they have applied the U.K. Corporate Governance Code. In New Zealand, the requirements also apply to audits of complete sets of general purpose financial statements of FMC-reporting entities (entities that are required to comply with the Financial Markets Conduct Act 2013) considered to have a higher level of public accountability.

¹ Reports reviewed included: The U.K.: Financial Reporting Council (FRC), "[Extended Auditor's Reports: A Further Review of Experience](#)," (January 2016); FRC, "[Extended Auditor's Reports: A Review of Experience in the First Year](#)" (March 2015). Brazil: Thais Carrana, "[Auditor Points Out Uncertainty in the Future of Companies](#)," IBRACON website. Malaysia: AOB, MIA and ACCA, "[Enhanced Auditors' Report: A Review of First-year Implementation Experience in Malaysia](#)," (January 2018); ACCA global: Association of Chartered Certified Accountants, "[Key Audit Matters: Unlocking the Secrets of the Audit](#)," (March 2018). New Zealand: External Reporting Board and Financial Markets Authority, "[Key Audit Matters: A Stock Take of the First Year in New Zealand](#)," (November 2017). Hong Kong: Hong Kong Institute of Certified Public Accountants, "[Standard Setting: Revised Auditor's Reports: First Year Review of Experience](#)," (October 2017). Singapore: Institute of Singapore Chartered Accountants, "[Embracing Transparency, Enhancing Value – A First Year Review of the Enhanced Auditor's Report in Singapore](#)," (October 2017).

Costs of communicating KAM

Determining the costs of implementing the requirements to communicate KAM, and any impact on audit fees, are difficult to quantify because they are affected by many different factors. The costs may relate to additional time to prepare and review auditor's reports, including discussions with management and the audit committee. For auditors, there may be one-time and recurring costs. One-time costs could result from firms revising audit methodologies and quality control procedures, and developing and conducting training on the new reporting. Although communication of KAM is based on work the auditor has already performed, there may be recurring costs to determine and communicate KAM in auditor's reports. Such costs may decrease over time as auditors become more experienced in applying the requirements.

The PCAOB's research into the auditor's reports of certain U.K. companies² did not find a statistically significant increase in audit fees (on average 4.6%). As mentioned above, Pries and Scott's research supports this finding. Researchers examined 362 Australian listed entities with year-ends between December 15, 2016, and December 15, 2017, and with market capitalization of less than AUD\$10 million. They found that audit fees dropped 2.9% in the year of that communication of KAM in the auditor's report was introduced. However, the report notes that the Australian audit market was quite competitive at that time, which may have impacted audit fees.

The AASB believes that the auditor reporting standards provide a principles-based framework for communicating KAM and allow for using professional judgment when determining and communicating KAM. The costs of communicating KAM will primarily depend on the audit's nature and complexity. This in turn will depend on the complexity of the entity's operations and its corporate governance. For example, where the entity is not operating, or operations are limited; or its sole purpose is trading in and holding investments, such as for some investment funds, there may be very few matters that require significant auditor attention. For such entities, the costs of communication of KAM are likely to be relatively lower than for other entities. Further, there are now a significant number of examples of the new auditor's report available on public databases in other jurisdictions, such as the U.K., Australia and New Zealand, that can provide a basis for designing communications. The reporting standards recognize that, in certain limited circumstances (e.g., for a listed entity that has very limited operations), the auditor may determine that there are no KAM because there are no matters that require significant auditor attention.

Whether to require communication of KAM for investment funds

The AASB considered whether it should require auditors to communicate KAM for any, some or all investment funds, taking into account the PCAOB's decision. In doing so, the Board considered the arguments put forward by the PCAOB and noted that jurisdictions other than the United States have not excluded such entities. Entities required to comply with NI 81-106 are the primary investment vehicle for a large portion of the public and therefore the increased transparency about the audit that was performed is in the public interest.

AASB conclusions

The AASB concluded that it should require communication of KAM for all entities required to comply with NI 81-106 and entities listed on exchanges other than the TSX for the following reasons:

- Maintains the alignment with the ISAs, which Canadian stakeholders strongly support.
- Maintains the consistency of Canada's auditor reporting regime with other jurisdictions that adopt the ISAs.
- Maintains the alignment of both accounting and auditing standards with international standards, which is an important feature of the Canadian regulatory regime.

² PCAOB, "[White Paper on the Auditor's Reports of Certain UK Companies that Comply with International Auditing Standard \(UK and Ireland\) 700](#)" (Revised June 2013).

- Evidence shows that communication of KAM enhances audit quality and potentially also financial reporting.
- Requiring auditors to communicate KAM will allow users to benefit from such reporting.

This Exposure Draft provides an opportunity for all stakeholders, such as regulatory bodies, stock exchanges, preparers, directors, auditors and users of the auditor's report, to provide further input to the AASB in finalizing the requirements to communicate KAM.

Effective date

There are approximately 800 TSX-listed entities other than those required to comply with NI 81-106. Auditors of these entities will be required to communicate KAM in their auditor's reports for financial statement periods ending on or after December 15, 2020. Under this Exposure Draft, the number of entities affected by the proposed requirements to communicate KAM will expand as follows:

Type of entities	Approximate number of entities
Exchange traded and closed-end funds listed on the TSX	650
Entities required to comply with NI 81-106 that are unlisted	3,400
Entities listed on the TSXV	1,650
Entities listed on the NEO	50
Entities listed on the CSE	350
Approximate total entities affected	6,100

The AASB has taken the above information into account when deciding on the proposed effective date for the requirements.

The AASB expects to finalize the revisions to CAS 700 and related conforming amendments in late 2019 and to issue the changes in the CPA Canada Handbook – Assurance as soon as possible thereafter. Subject to input it receives from stakeholders, the Board proposes that the requirements to communicate KAM will be effective for audits of financial statements of the affected entities for periods ending on or after December 15, 2021. Early application will be permitted.

This effective date will give time for:

- stakeholders to implement the new requirements;
- auditors, audit committees and management to become familiar with the implications in the circumstances of their entities and perform “dry-run” activities, if needed;
- appropriate communication;
- development of processes, methodologies and supporting guidance to drive a high-quality implementation based on meaningful auditor's reports specific to the audited entity's circumstances; and
- entities and their auditors to learn from experiences gained from communication of KAM in other jurisdictions as well as audits of TSX-listed entities other than those required to comply with NI 81-106.

Comments requested

The AASB requests comments on any aspect of the proposed revisions. Any comments that express disagreement with the proposals should clearly explain the problem and include a suggested alternative, supported by specific reasoning.

The AASB seeks views on the following questions:

1. Do you agree with the proposed scope of the revisions to the requirements to communicate KAM in the auditor's report? If not, why not?
2. Is there a need for guidance to assist stakeholders with implementing the new requirements? If so, please explain.
3. Does the effective date provide enough time to implement the new requirements?

The deadline for providing your comments to the AASB is May 15, 2019.

Proposed revised paragraphs C5, C30 and C40C(c) of CAS 700

Effective Date

- C5. This CAS is effective for audits of financial statements for periods ending on or after December 15, 2018. Paragraphs C30(a) and C40C(c) are effective for audits of financial statements for periods ending on or after December 15, 2020. Paragraph C30(b) is effective for audits of financial statements for periods ending on or after December 15, 2021. [In ISA 700, the effective date is for audits of financial statements for periods ending on or after December 15, 2016.]

Key Audit Matters

- C30. For audits of complete sets of general purpose financial statements of ~~entities listed on the Toronto Stock Exchange, other than entities required to comply with National Instrument 81-106, Investment Fund Continuous Disclosure~~ the following entities, the auditor shall communicate key audit matters in the auditor's report in accordance with CAS 701:

- (a) Entities listed on the Toronto Stock Exchange, other than entities required to comply with National Instrument 81-106, Investment Fund Continuous Disclosure; and
- (b) Other listed entities, and all entities required to comply with National Instrument 81-106.

[In ISA 700, this paragraph states: For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with ISA 701.]

- C40. The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall: (Ref: Para. A50)

...

C(c) For audits of financial statements of ~~entities listed on the Toronto Stock Exchange, other than entities required to comply with National Instrument 81-106, Investment Fund Continuous Disclosure~~ for which communication of key audit matters is required by paragraph C30, and any other entities for which key audit matters are communicated in accordance with CAS 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. ...

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