



CANADIAN PUBLIC ACCOUNTABILITY BOARD  
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

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December 18, 2013

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington D.C. 20006-2803  
USA

Dear Sir:

**PCAOB Rulemaking Docket Matter No. 34: The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain documents Containing Audited Financial Statements and the Related Auditor's Report**

The Canadian Public Accountability Board (CPAB) is pleased to comment on the Public Company Accounting Oversight Board (PCAOB) *Proposed Rule on The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* (the proposed standards). Investors and other financial statement users (Users) are calling for more transparency from the audit process and we commend the PCAOB for proposing amendments to their auditing standards that will require auditors to share more information, related to the audit, directly with Users.

CPAB is Canada's independent audit regulator and is responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing that contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

We believe the introduction of the critical audit matters section in the auditor's report will enhance the relevance and usefulness of auditor communications with Users. Augmenting the historic pass/fail model of the auditor's report to include a discussion of the most difficult, subjective or complex audit matters should help Users better understand the significant entity specific professional judgments the auditor made in performing the audit.

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Canada has adopted the International Standards on Auditing (ISAs) as Canadian Auditing Standards. We are encouraged by the similarity between the concept of critical audit matters and the International Auditing and Assurance Standards Board (IAASB) concept of “key audit matters”. While we appreciate that the PCAOB’s mandate is to develop auditing standards that are relevant to the U.S. public securities market we commend the Board for considering the IAASB project on auditor reporting in developing the proposed standards. Canada has the largest number of foreign public companies registered with the Securities and Exchange Commission (SEC). As Canadian securities regulators permit SEC registrants to have their audits conducted in accordance with PCAOB standards we strongly support the Board’s working together to minimize differences in global auditor reporting standards to mitigate investor confusion.

For your information, we have attached a copy of CPAB’s November 22, 2013 response to the IAASB on its Exposure Draft Reporting on Audited Financial Statements. This response provides our views on the IAASB’s auditor reporting proposals.

We appreciate the opportunity to respond to the proposed standards, and would be pleased to discuss our comments with you at your request.

Yours very truly,



Brian Hunt, FCPA, FCA  
Chief Executive Officer



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November 22, 2013

Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017  
USA

Dear Sir:

**Re: Exposure Draft – Reporting on Audited Financial Statements**

The Canadian Public Accountability Board (CPAB) is pleased to respond to the International Auditing and Assurance Standards Board's (IAASB's) Exposure Draft, *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)* (the "ED"). CPAB is Canada's independent audit regulator responsible for overseeing firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing that contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

We support the need for more transparency with respect to auditor reporting. Auditors need to provide greater value by sharing more information, related to the audit, directly with financial statement users ("Users"). The requirement to disclose key audit matters in the audit report will focus the attention of auditors, management and those charged with governance on the areas of most significant risk which should enhance audit quality and contribute to improving the quality of management's financial statement disclosures, however, we are concerned that disclosure of key audit matters will become boilerplate adding little value to Users. Key audit matters need to be informative, relevant and entity-specific to be useful to Users. We encourage the IAASB to appropriately field test the disclosure of key audit matters prior to finalizing the exposure draft to ensure that the requirements and related application guidance mitigate the risk of boilerplate disclosure.

We commend the IAASB for continuing to give the auditor reporting project such high priority in its work program. Consistent with our response to the IAASB's Invitation to Comment on *Improving the Auditor's Report* (the "ITC"), it is important for bodies such as the IAASB, European Commission and United States Public Company Accounting Oversight Board ("PCAOB") to work together to devise one global solution to the perceived deficiencies in auditor reporting. Since many audit reports are read globally; a more coordinated approach will improve consistency and mitigate investor confusion. Greater divergence in auditor reporting is not in the public interest. We are encouraged by the similarity between the IAASB concept of "key audit matters" and the PCAOB concept of "critical audit matters" in its auditor reporting exposure draft. We strongly support the Board's working together to minimize differences in global auditor reporting standards.

### **Key Audit Matters**

We believe the introduction of the key audit matters section in the auditor's report will enhance the usefulness of the report to Users provided there is consistent identification of these matters in practice. The degree of usefulness will be impacted by how specific the auditor is in describing the matter and why the auditor considered the matter to be one of most significance in the audit.

We support a principles based approach for identifying key audit matters but anticipate implementation issues with the requirements as proposed in the ED. Through our inspections we have noted that auditors struggle with the identification of significant risks as we see inconsistencies in the nature and number of risks being identified. While we agree that significant risks should be considered for reporting as key audit matters, more consistent identification of significant risks would be necessary if this reporting is to be useful to Users. Conceptually we agree with the other two criteria for determining key audit matters: areas in which the auditor encountered significant difficulty during the audit; and circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control. However, more guidance is needed in evaluating what constitutes "significant", and therefore reportable, as auditors can expect push-back from management to what is effectively public criticism of them.

The illustrative examples of key audit matters in the ED are an improvement over the example auditor commentary included in the ITC, however, the examples need to be more entity-specific to provide value added insights to Users. We thought the "Goodwill" example would be particularly useful to Users although an auditor would likely encounter significant resistance from management to the auditor's level of detail if the disclosure by management was not at the same level of detail. Similarly, Users would probably appreciate the discussion of the risk of fraud from side agreements in the "Revenue Recognition Related to Long-Term Contracts"

matter but we are not sure that management and those charged with governance would agree it was a key audit matter that required disclosure if the auditor was ultimately unable to find evidence of the existence of side agreements as a result of the procedures performed. The IAASB should consider developing guidance for auditors, audit committees and management with respect to interactions on key audit matters to reduce the risk of unintended consequences for audit quality.

### **Going Concern**

We are concerned the proposed auditor statements regarding both the appropriateness of management's use of the going concern assumption and whether material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified will increase, rather than decrease, the Users' expectation gap. While we understand why the global financial crisis has resulted in greater focus on the assessment of going concern and related disclosures we do not believe statements by the auditor based on the work effort of ISA 570, *Going Concern* will meet the needs of Users in that context.

The long standing issue with going concern is whether the disclosure of certain matters becomes a self-fulfilling prophecy - a risk that may be significantly higher for particular entities such as financial institutions. To address the lessons of the global financial crisis there may need to be different solutions for Systemically Important Financial Institutions ("SIFI") versus other commercial entities. Given the significance of SIFIs to the broader economy, CPAB would again encourage consideration of alternative approaches, such as improved communication between auditors and prudential regulators, as a more effective method of achieving the desired objective.

In our response to the ITC we supported the development of additional guidance for auditors, under ISA 570, with respect to the identification and response to material uncertainties as it is a complex and judgmental exercise and our inspections have evidenced that auditors struggle to respond appropriately. In our view the International Accounting Standards Board needs to provide more guidance on management's responsibilities for evaluating and disclosing going concern uncertainties which the auditor would then evaluate and assess as part of the audit under ISA 570.

We believe that if auditors are required by Users to report on the appropriateness of the going concern assumption then there would need to be a commensurate increase in the work effort under ISA 570 to support that reporting. We understand there may be political pressure for the IAASB to incorporate additional going concern disclosures into the audit report, however, we encourage a more holistic approach to addressing this complex issue.

### **Format and Structure of the Standard Auditor's Report**

We support the need to improve the format and structure of the existing standard audit report and to do so in a manner that enhances consistency of reporting at the global level. In responding to the ITC we agreed with the IAASB that there is merit in mandating the ordering of the elements within the auditors' reports across jurisdictions, unless otherwise required by law or regulation. While it is not clear why country specific "cultural" preferences for the placement of certain elements within the audit opinion should prevail over the benefits of global consistency, we support the IAASB's position to require specific headings in the auditor's report to ensure the required reporting elements can be recognized even if they are presented in a different order.

### **Involvement of Other Auditors**

We are disappointed that the IAASB has chosen not to pursue a requirement to disclose the extent of involvement of other auditors in the audit. As stated in our response to the ITC, we believe such disclosure would provide greater transparency to Users with respect to who, other than the group auditor, was involved in the audit and the extent of that involvement. In its own inspections, CPAB continues to identify issues with both the extent the group auditor has used the work performed by component auditors and the extent of involvement of the group auditor in the work of the component auditor. This is particularly important when these other participants are not registered firms or when there are legal or other regulatory barriers to them being inspected by an audit regulator. Without impacting the group auditor's sole responsibility for the audit, disclosure of the other participants would enable Users to determine the extent of use of component auditors by the group auditor and the degree of oversight the participants are subject to, including publicly available disciplinary history.

In concluding we again commend the IAASB for engaging with stakeholders on this important topic. In a continually changing global business environment, with increasingly complex financial reporting requirements, it is critical that auditor reporting evolves in a way that better meets the needs of financial statement Users and enhances the relevance and value of the audit.

In addition to our comments above, our responses to the questions posed in the ED are included in the Appendix to this letter.

We would be pleased to discuss further any of the above comments.

Yours very truly,



Brian Hunt, FCPA, FCA  
Chief Executive Officer

cc. Mr. Mark Davies, CIA, FCPA, FCA  
Chair, Auditing and Assurance Standards Board (Canada)

Mr. Greg Shields, CPA, CA  
Director, Auditing and Assurance Standards  
Chartered Professional Accountants of Canada

## **APPENDIX**

### **Questions**

Since CPAB's mandate relates to listed entities in Canada our comments apply solely to listed entities.

#### **Key Audit Matters**

- 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?**

We believe the introduction of the key audit matters section in the auditor's report will enhance the usefulness of the report to Users provided there is consistent identification of these matters in practice. The degree of usefulness will be impacted by how specific the auditor is in describing the matter and why the auditor considered the matter to be one of most significance in the audit.

- 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 support a principles based approach for identifying key audit matters but anticipate implementation issues with the requirements as proposed in the ED. Through our inspections we have noted that auditors struggle with the identification of significant risks as we see inconsistencies in the nature and number of risks being identified. While we agree that significant risks should be considered for reporting as key audit matters, more consistent identification of significant risks would be necessary if this reporting is to be useful to Users. Conceptually we agree with the other two criteria for determining key audit matters: areas in which the auditor encountered significant difficulty during the audit; and circumstances that required significant modification of the auditor's planned approach to the audit, including as a result of the identification of a significant deficiency in internal control. However, more guidance is needed in evaluating what constitutes "significant", and therefore reportable, as auditors can expect push-back from management to what is effectively public criticism of them.

- 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?**

Key audit matters need to be informative, relevant and entity-specific to be useful to Users. We encourage the IAASB to appropriately field test the disclosure of key audit matters prior to finalizing the exposure draft to ensure that the requirements and related application guidance mitigate the risk of boilerplate disclosure. In performing the field testing, specific consideration should be given to whether there is sufficient guidance with respect to the circumstances where the auditor considers it necessary to indicate findings or a conclusion in relation to a matter as we do not believe that those circumstances are clear in the ED.

- 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.**

The illustrative examples of key audit matters in the ED are an improvement over the example auditor commentary included in the ITC, however, the examples need to be more entity-specific to provide value added insights to Users. We thought the “Goodwill” example would be particularly useful to Users although an auditor would likely encounter significant resistance from management to the auditor’s level of detail if the disclosure by management was not at the same level of detail. Similarly, Users would probably appreciate the discussion of the risk of fraud from side agreements in the “Revenue Recognition Related to Long-Term Contracts” matter but we are not sure that management and those charged with governance would agree it was a key audit matter that required disclosure if the auditor was ultimately unable to find evidence of the existence of side agreements as a result of the procedures performed. The IAASB should consider developing guidance for auditors, audit committees and management with respect to interactions on key audit matters to reduce the risk of unintended consequences for audit quality.

- 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?**

CPAB’s mandate relates to listed entities in Canada and so our comments are intended to apply solely to listed entities.

- 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?**

To avoid boilerplate reporting, 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. However, the statement that these circumstances are limited and expected to be rare should be incorporated into the requirements not the application guidance.

We agree that the proposed requirements to respond to the rare circumstance when no key audit matters have been identified are appropriate.

- 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 agree that 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 outlined in the ED.

**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 with the retention of the concepts of Emphasis of Matter and Other Matter paragraphs. However, in the context of Canadian listed entities, if the proposed changes to going concern disclosure in the audit report are made, we expect the use of an Emphasis of Matter paragraph to be rare and the use of Other Matter paragraphs to be limited to those situations where the prior period financial statements have been audited by a predecessor auditor.

**Going Concern**

**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.**

We are concerned that the proposed auditor statements regarding both the appropriateness of management's use of the going concern assumption and whether material uncertainties related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern have been identified will increase, rather than decrease, the Users' expectation gap. While we understand why the global financial crisis has resulted in greater focus on the assessment of going concern and related disclosures we do not believe statements by the auditor based on the work effort of ISA 570, Going Concern will meet the needs of Users in that context.

The long standing issue with going concern is whether the disclosure of certain matters becomes a self-fulfilling prophecy - a risk that may be significantly higher for particular entities such as financial institutions. To address the lessons of the global financial crisis there may need to be different solutions for Systemically Important Financial Institutions ("SIFI") versus other commercial entities. Given the significance of SIFIs to the broader economy, CPAB would again encourage consideration of alternative approaches, such as improved communication between auditors and prudential regulators, as a more effective method of achieving the desired objective.

In our response to the ITC we supported the development of additional guidance for auditors, under ISA 570, with respect to the identification and response to material uncertainties as it is a complex and judgmental exercise and our inspections have evidenced that auditors struggle to respond appropriately. In our view the International Accounting Standards Board needs to provide more guidance on management's responsibilities for evaluating and disclosing going concern uncertainties which the auditor would then evaluate and assess as part of the audit under ISA 570.

We believe that if auditors are required by Users to report on the appropriateness of the going concern assumption then there would need to be a commensurate increase in the work effort under ISA 570 to support that reporting. We understand there may be political pressure for the IAASB to incorporate additional going concern disclosures into the audit report, however, we encourage a more holistic approach to addressing this complex issue.

**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?**

As noted in the response to question 9, we are concerned that the proposed statements with respect to going concern will increase rather than decrease, the Users' expectation gap. It is unlikely that an explicit statement that neither management nor the auditor can guarantee the entity's ability to continue as a going concern will mitigate this risk.

**Compliance with Independence and Other Relevant Ethical Requirements**

**11. What are respondents' 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 there would be limited value to Users in disclosing the source of independence and other relevant ethical requirements and could create confusion if that disclosure involved multiple sources.

**Disclosure of the Name of the Engagement Partner**

**12. What are respondents' 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 understand the basis for the proposals to require disclosure of the name of the engagement partner in the audit report. However, we would encourage a more holistic approach to better understand the root causes of lapses in audit quality in developing solutions to improve accountability for the audit. Greater focus needs to be given to the organizational structure of audit firms and how this can be improved to build greater

quality into the execution of the audit. Consideration needs to be given to how accountability can be strengthened for audit firms at the engagement level, office level and national level. A more holistic approach should also consider the role of the audit committee and explore ways in which audit committees can more effectively oversee and evaluate the quality of the audit.

#### **Other Improvements to Proposed ISA 700 (Revised)**

**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 are generally supportive of the proposed changes to ISA 700 described in paragraph 102 of the ED. However with respect to the description of the auditor's responsibilities, this should be retained within the auditor's report to ensure completeness and accessibility regardless of the technology available to the user. Therefore, we do not support the proposed option to allow a cross reference to a website but to improve the readability of the audit report and to emphasize entity specific information it would be acceptable for this standardized material to be in an appendix to the auditor's report.

**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 support the need to improve the format and structure of the existing standard audit report and to do so in a manner that enhances consistency of reporting at the global level. In responding to the ITC we agreed with the IAASB that there is merit in mandating the ordering of the elements within the auditors' reports across jurisdictions, unless otherwise required by law or regulation. While it is not clear why country specific "cultural" preferences for the placement of certain elements within the audit opinion should prevail over the benefits of global consistency, we support the IAASB's position to require specific headings in the auditor's report to ensure the required reporting elements can be recognized even if they are presented in a different order.