Adoption of new auditor’s reports
AASB and PCAOB approve new standards
July 2017

What you need to know

- The Auditing and Assurance Standards Board (AASB) approved a package of standards, effective in 2018, dealing with auditor reporting, and reporting and responsibilities relating to other information.
- The new audit report is required for December 2018 year-ends, with earlier adoption permitted.
- Key audit matter (KAM) reporting is optional unless required by law or regulation.
- The AASB is currently considering the PCAOB final auditor reporting standard and monitoring SEC approval status. An announcement following SEC approval is expected.
- Work is currently progressing to draft a single auditor’s report that will aim to comply with both Canadian and PCAOB auditing standards.

Overview

In April 2017, the AASB adopted International Auditing Standards (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) as Canadian Auditing Standards (CAS) dealing with:

- Auditor reporting
- Changes to performance standards with respect to going concern
- Changes to address the audit of financial statement disclosures
- Reporting and other responsibilities relating to other information included in an entity’s annual report

Adopted by more than 110 countries, the new auditor’s report represents a step change in the information content of the report. It better describes what an audit is and what an auditor does, including an ability to provide transparency in the reporting of key audit matters (KAM).

The new auditor’s report will be effective for all audits for periods ending on or after 15 December 2018, with earlier adoption permitted. The IAASB’s effective date for these standards was for periods ending on or after 15 December 2016. Accordingly, auditors conducting audits of financial statements in accordance with the CAS for periods ending on or after 15 December 2016 should not represent compliance with the ISA unless they have complied with the respective ISA issued by the IAASB.

In June 2017, the U.S. Public Company Accounting Oversight Board (PCAOB) also announced the adoption of a final auditing standard to significantly change the auditor’s report. Key differences between the new AASB audit reporting standard and the PCAOB standard are highlighted on page 3.
Enhancements to the auditor’s report under the Canadian standard

All entities
Enhancements made to the new auditor’s report, which are applicable for all entities:

- The format of the report has changed, with the opinion presented at the beginning of the report, followed by the basis for opinion.
- The new auditor’s report contains an affirmative statement of independence and fulfillment of relevant ethical responsibilities.
- A description of management’s and auditor’s responsibilities relating to going concern is required, and a separate dedicated section related to material uncertainty is required when a material uncertainty exists.
- The new auditor’s report discloses identification of those charged with governance (TCWG) within the management’s responsibilities section.
- There is an expanded description of auditor’s responsibilities, including key features of an audit.
- For all entities with “other information,” such as an annual report, disclosure of other information that the auditor is required to read but which the auditor has not yet received at the date of the auditor’s report is required.

Listed entities
Beyond those enhancements noted for all entities, the following are enhancements applicable to listed entities:

- Disclosure of the name of the engagement partner is required.
- There is a new section in the auditor reporting standard addressing KAM, which are those matters that were considered to be of most significance in the audit of the current period. Disclosure of KAM will be optional under the Canadian standard unless required by law or regulation.

Key audit matters [Optional]
A significant change that introduces a new level of transparency into the audit process in the new standards is the introduction of KAM. The final reporting standards, as adopted, do not contain a KAM reporting requirement at this time. However, they do allow for law or regulation to require reporting of KAM and for the auditor to decide to do so.

KAM are defined as: “Those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. KAM are selected from matters communicated with those charged with governance.”

Always consider:
- Higher assessed risks and significant risks
- Areas of significant management judgment and estimation uncertainty
- Significant transactions or events

Description of each KAM in the auditor’s report is required to include:
- Why the matter was considered to be one of most significance in the audit
- How the matter was addressed in the audit
- Reference to the related disclosure(s)
Key differences between auditing standards adopted by the AASB and the PCAOB

On 1 June 2017, the PCAOB adopted a new auditor reporting standard: The Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion. This new auditing standard is subject to approval by the U.S. Securities and Exchange Commission (SEC).

The standard requires auditors to add information about auditor tenure, clarify the language about the auditor’s responsibilities, and change the organization and format of the auditor’s report. Those requirements are effective for annual periods ending on or after 15 December 2017. In 2015, the PCAOB approved a standard that requires the disclosure of the audit engagement partner and certain other participants in the audit in a new form (Form AP). The disclosure of the engagement partner is required for reports issued on or after 31 January 2017, while the disclosure of other participants is required in reports issued on or after 30 June 2017.

The standard also requires auditors to include in the auditor’s report information about matters that they communicated or were required to communicate to the audit committee that relate to material accounts or disclosures and involved especially challenging, subjective or complex auditor judgment. These are known as critical audit matters (CAM). The framework for determining CAM is substantially similar to the framework for determining KAM and starts with those matters communicated or required to be communicated to the audit committee.

CAM reporting requirements are effective for annual periods ending on or after 30 June 2019 for large accelerated filers and on or after 15 December 2020 for all other filers (with certain exceptions, such as securities brokers and dealers that are not issuers, certain investment companies, employee stock purchase, savings and similar plans, and emerging growth companies).

The key differences between the AASB reporting standards and the PCAOB standards are:

- The PCAOB standard will require all entities that conduct their audits under PCAOB standards to report CAM in their auditor’s report, whereas KAM are optional under the final AASB standard unless required by law or regulation.
- Except for the CAM reporting requirement, the PCAOB standard is effective for entities for periods ending on or after 15 December 2017 and the AASB reporting standard is effective on or after 15 December 2018.
- The PCAOB standard requires the auditor’s report to disclose the tenure of the audit firm, which is not a requirement under the AASB reporting standard.
- The AASB standard requires the auditor’s report to disclose the name of the audit engagement partner for audits of listed entities, whereas the PCAOB requires audit firms to file a Form AP with the PCAOB that names the audit engagement partner (i.e., the partner with primary responsibility for the audit) and discloses information about certain accounting firms that participated in the audit. The form is available to the public on the PCAOB website.

What’s next?

Significant efforts will be required to implement the enhanced auditor’s reporting standards. Management, TCWG, and the auditors should align their goal of improving communications so as to ensure smooth implementation in 2018 calendar-year audits. For those entities that are subject to the PCAOB standard or ISA, the auditors, management, and TCWG should consider the unique requirements that are in effect for their upcoming audits.

The AASB is considering the final PCAOB standard and monitoring SEC approval status. Given the AASB objective of adopting the ISA, we expect that the AASB will take some action following SEC approval of the PCAOB standard, expected in fall 2017. We expect that this will entail the auditors of some population of larger Canadian listed entities being required to apply KAM reporting on a similar timeline as the CAM reporting requirement under the PCAOB standards.

The AASB has indicated that it will continue to study the issue of the applicability and timing of KAM reporting applying to the smallest listed entities. The AASB has communicated that it will take additional time to further assess this.

At the same time, there is a task force working on how the current and future Canadian auditor’s report can be harmonized with the new US auditor’s report to allow companies to continue to issue a single auditor’s report meeting Canadian and US standards.

While this process has not been concluded, companies that have issued a report under Canadian and US standards in the past should plan to continue to do so as the working group works to bring this process to conclusion.

The AASB is working directly with the Australian standard setter to study their experience in implementing the new auditor reporting standards, particularly with respect to smaller listed entities. They will review experience gained in Canada by those who apply KAM reporting in accordance with law or regulation, as well as those who apply this reporting voluntarily. The IAASB is also scheduled to conduct a post-implementation review on auditor reporting.

Insights gained from these activities will guide the AASB in future deliberations on this additional level of transparency in the auditor’s report.
Independent auditor’s report

To the Shareholders of
ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20x1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects the consolidated financial position of the Group as at December 31, 20x1, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

(For listed entities) Key Audit Matters (OPTIONAL)

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter is in accordance with CAS 701, Communicating Key Audit Matters in the Independent Auditor’s Report]

Other Information [or another title if appropriate, such as “Information Other than the Consolidated Financial Statements and Auditor’s Report Thereon”]

Management is responsible for the other information. The other information comprises the [information included in the “Annual Report” (as defined in CAS 720), but does not include the financial statements and our auditor’s report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. [We have nothing to report in this regard [or a statement that describes any material misstatement of the other information].

Enhancements to the Auditor’s Report

Opinion first. The auditor’s opinion – the “pass/fail” statement that users have said they continue to value – is required to be positioned at the beginning of the report, followed by the Basis for Opinion.

Basis for Opinion section is required. Currently only required when the auditor’s report was modified.

New affirmative statement about the auditor’s fulfilment of independence and other relevant ethical responsibilities and requirements.

The new KAM section is currently optional unless required by law or regulation.

A separate section relating to other information is required under revised CAS 720, The Auditor’s Responsibilities Relating to Other Information.
Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

(Because of the increased length of this section, CAS 700 includes a provision that certain components of the following description of the auditor's responsibilities section may be presented in an appendix to the auditor's report or, where law, regulation, or national auditing standards expressly permit, by reference to a website of an appropriate authority.)

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
• Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

• Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

(For listed entities) We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

(For listed entities) (OPTIONAL UNLESS REQUIRED BY LAW OR REGULATION)
From the matters communicated with those charged with governance, we determine 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. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements
(The form and content of this section of the auditor’s report would vary depending on the nature of the auditor’s other reporting responsibilities prescribed by local law, regulation, or national auditing standards. The matters addressed by other law, regulation, or national auditing standards (referred to as “other reporting responsibilities”) shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the CAS as part of the Report on the Audit of the Consolidated Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the CAS may be combined (i.e., included in the Report on the Audit of the Consolidated Financial Statements section under the appropriate subheadings) provided that the wording in the auditor’s report clearly differentiates the other reporting responsibilities from the reporting that is required by the CAS where such a difference exists.)

The engagement partner on the audit resulting in this independent auditor’s report is [name].

[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[Auditor address]

[Date]