CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

FAQ for Management and Audit Committees

NEW AUDITOR REPORTING STANDARDS

MAY 2017

What Management and Audit Committees Need to Know about the New Auditor Reporting Standards in Canada

This FAQ addresses key concepts and questions relevant to management and audit committees relating to the new and revised auditor reporting standards.

What are the New Auditor Reporting Standards?

The new auditor reporting standards are a collection of changes to various standards in the *CPA Canada Handbook –Assurance* that result in a new and enhanced auditor's report for audits of all entities. The implications of these new and revised standards are significant and will impact those involved in the financial reporting process (i.e., management, those charged with governance (TCWG), including audit committees) as well as external auditors and financial statement users. The new report provides reporting of going concern matters, as well as entity-specific reporting of other information and key audit matters for certain entities. The report also provides enhanced transparency by clarifying the scope of the auditor's work as well as the roles and responsibilities of the auditor, management and TCWG.

These changes aim to enhance communication by offering entity-specific information to make the auditor's report more informative and relevant to financial statement user decision making.

For audits of entities where the auditor decides or law or regulation requires the auditor to communicate key audit matters in the auditor's report please refer to **Appendix A** and CPA Canada's ***Audit & Assurance Alert — Key Audit Matters*** for further details.

When do the new standards come into effect?

The new auditor reporting standards will be effective for audits of financial statements for periods ending on or after December 15, 2018. Earlier application is permitted.

What are the significant changes?

Changes to the Auditor's Report and New Reporting Requirements	
For all audits	
Auditor's Opinion	auditor's opinion moved from the end of the auditor's report to the very beginning
Auditor's Independence and Ethics	an explicit statement of the auditor's independence in accordance with relevant ethical requirements and the auditor's fulfillment of other ethical responsibilities
Going Concern	a separate section under the heading "Material Uncertainty Related to Going Concern", when a material uncertainty exists related to an entity's ability to continue as a going concern and is adequately disclosed in the financial statements

Changes to the Auditor's Report and New Reporting Requirements	
For all audits *(continued)*	
Other Information (OI)	• a separate section under the heading "*Other Information*", when an entity prepares other information (e.g., an annual report) containing or accompanying the entity's financial statements and auditor's report thereon, to explain management's and the auditor's responsibilities for the other information and the auditor's conclusion from reading and considering the other information about 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 • For an audit of a non-listed entity this section will be added when, at the date of the audit report, the auditor has obtained some or all of the other information • For an audit of a listed entity this section will be added when, at the date of the audit report, the auditor has obtained, or expects to obtain, the other information **Note:** "Other Information" is financial or non-financial information (other than financial statements and the auditor's report) included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose Examples: Common examples of OI include: Management's Discussion and Analysis, Financial Statement Discussion and Analysis, Management Fund Report of Fund Performance and Glossy Annual Report • please refer to CPA Canada **Audit & Assurance Alert — CAS 720 —*Other Information*** for further details on the reporting requirements related to OI
Roles and Responsibilities	• an enhanced description of management's responsibilities for assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate • identification of TCWG (when applicable) and their responsibility for the oversight of the financial reporting process • an enhanced description of the auditor's responsibilities. In particular, new descriptions related to the auditor's responsibilities: — to conclude on the appropriateness of management's use of the going concern basis of accounting — in an audit of group financial statements — regarding communication with those charged with governance

Changes to the Auditor's Report and New Reporting Requirements	
	For audits of listed entities
Roles and Responsibilities	• a new description of the auditor's responsibilities to provide a statement to TCWG that the auditor has complied with relevant ethical requirements regarding independence
Engagement Partner	• a new disclosure of the name of the engagement partner

See **Appendix A** for FAQs on the new auditor reporting standards and FAQs on key audit matters.

See **Appendix B** for an illustrative example of the new auditor's report.

Other Resources

CPA Canada

1. **Audit & Assurance Alert New and Revised Auditor Reporting Standards**
2. **Audit & Assurance Alert Key Audit Matters**
3. Guide — Reporting Implications of the CASs

Auditing and Assurance Standards Board (AASB)

1. Basis for Conclusions: Reporting on Audited Financial Statements — New and Revised Auditor Reporting Standards and Related Conforming Amendments
2. **Auditing and Assurance Bulletin titled "Addressing Disclosures in the Audit of Financial Statements"**
3. **Message from the Chair — New Auditor Reporting and Other Standards Issued, May 2017**

Appendix A — Frequently Asked Questions

This FAQ section presents an amended version of the International Auditing and Assurance Standards Board (IAASB) Auditor Reporting Working Group Publication released in March 2016 — ***More Informative Auditor's Reports — What Audit Committees and Finance Executives Need to Know***.

The New Auditor Reporting Standards FAQs

The following is a summary of the most frequently asked questions regarding the new auditor reporting standards.

1. **How do the new going concern disclosures impact management and audit committees?**
   While the responsibilities of management and audit committees regarding going concern have not changed, the auditor's report will now include enhanced disclosures highlighting these responsibilities. If there have been close calls in the recent history of the entity, or if new conditions exist in the current year that cause management and audit committees to think there is a possibility of a material uncertainty or a close call, then it is advised that they discuss the matter with their auditor as soon as is practicable to enable the matter to be addressed in the early stages of the audit.

2. **Will the new and more informative auditor's report add significantly more time to the audit and the financial reporting process?**
   The new auditor's report represents one of the biggest changes in auditor reporting and communications in decades. It is difficult to argue that there will not be some additional work effort, particularly in the first year of implementation. There are new performance standards and responsibilities that auditors are required to adhere to with respect to going concern, key audit matters (KAM), other information and financial statement disclosures. These changes will require more time and involvement from experienced members of the audit team such as managers and partners.

   Management and audit committees may consider engaging their auditor in a discussion on the any additional time and costs that may be incurred relating to the new auditor's report.

3. **What is Other Information and how do the new disclosures impact management and audit committees?**
   Other Information is financial or non-financial information (other than financial statements and the auditor's report) included in an entity's annual report. The auditor's opinion on the financial statements does not cover Other Information. The auditor is, however, required to read and consider the Other Information and determine whether it is materially consistent with the financial statements and the auditor's knowledge obtained during the audit. The new auditor reporting standards require the auditor to add

a section to the auditor's report explaining the auditors work related to the Other Information and also whether a material misstatement was noted in the Other Information. For audits of listed entities, the auditor will also need to disclose any Other Information expected to be obtained after the date of the auditor's report.

To promote audit efficiency, management and the audit committees should consider meeting with their auditors at the planning stage of the audit to identify any documents that might be considered as Other Information. Ideally these documents will be provided to the auditor prior to the report date of the audit of the financial statements.

Key Audit Matters FAQs (only applicable when KAM are applied)

The following is a summary of the of the most frequently asked questions regarding key audit matters

1. **Are Key Audit Matters Required in Canada?**
   Canadian Auditing Standard (CAS) 701, *Communicating Key Audit Matters in the Independent Auditor's Report* was approved by the AASB in April 2017 and is effective for audits of financial statements for periods ending on or after December 15, 2018. The standard applies to audits of complete sets of general purpose financial statements when:
   - the auditor decides to communicate key audit matters in the auditor's report
   - the auditor is required by law or regulation to communicate key audit matters in the auditor's report.

   The following is an excerpt taken from the May 2017 AASB Message from the Chair. **Click here** to see the complete message:

   A significant component of the auditor reporting ISAs is a requirement that auditors of listed entities communicate key audit matters — those matters that, in the auditor's judgment, were of most significance in the audit.

   Canadian stakeholders made it clear in a variety of interactions that changes to auditor reporting standards need to recognize that the Canadian and U.S. capital markets are closely integrated. They emphasized that if key audit matter reporting requirements and the entities to which they would apply, are significantly different between Canada and the U.S. this could create confusion in the marketplace and potentially affect comparability of information across the North American capital markets.

The U.S. Public Company Accounting Oversight Board has not finalized its auditor reporting standards, including with respect to a key audit matter reporting concept. As a result, the AASB believes that it is not appropriate at this time to mandate key audit matter reporting for listed entities in Canada.

The final CASs, as adopted, do not contain a key audit matter reporting requirement at this time. They do allow for law or regulation to require reporting of key audit matters and for the auditor to decide to do so.

While there are other differences between the CASs and U.S. reporting standards, the AASB understands, based upon discussions with stakeholders, such differences do not create the same sensitivities as key audit matter reporting.

2. **Is the auditor taking on a management role when communicating KAM?**
KAM are not a replacement of, or supplement to, management's perspective embodied in the financial statements. The intent is not to "fill the gaps" for disclosures viewed as incomplete or missing — the auditor's consideration of the adequacy and appropriateness of disclosures is part of forming an opinion on the financial statements.

   There will often be a link between KAM and areas of complexity or significant judgment in the financial statements. Such is the nature of auditing — a risk-based approach that focuses auditor attention on matters of greatest risk of material misstatement. The intent of KAM is to provide transparency for users as to HOW this affected the auditor's approach to the audit. It's intended to highlight for users the matters that required the most auditor attention so that users can then focus greater attention on how such matters were dealt with.

3. **Will the communication of these matters publicly have an impact on the relationship, and the candid dialogue, between the auditor and the audit committee?**
A commonly expressed concern is that the communication of KAM may have a negative effect on the auditor's relationship with the audit committee, possibly leading to less candid or robust discussions on auditing and financial reporting matters. However, experience in the UK and elsewhere has shown that requiring auditors to communicate KAM enhances communications about those matters between the auditor and the audit committee, and increases attention by management and the audit committee to the disclosures referred to in the auditor's report.

Audit committees may consider requesting to see a draft of the auditor's report (at least the KAM section) as early as possible to get an understanding for what the auditor may intend to say about the matters and to start a dialogue to discuss the matters.

4. **Will investors and other users view KAM as a "scorecard" on management's performance?**

   Existing auditing standards require the auditor to communicate with audit committees about certain matters. This includes the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. The intent of this communication is a candid discussion with the audit committee about any observations (including any concerns) the auditor may have about the entity's accounting practices or management's judgments or assumptions underlying critical accounting estimates.

   Auditors are required to say something in the auditor's report about how KAM were addressed. However, the specifics of the description are left to the judgment of the auditor. The auditing standards do not require either a lengthy description of the auditor's procedures, nor do they require an indication of the outcome of the procedures or a conclusion on the matter.

   Users generally welcome additional transparency and insight from auditors. Others believe that outcomes or conclusions on individual matters can be misconstrued as separate opinions and detract from the auditor's opinion on the financial statements as a whole.

5. **How will the auditor deal with significant matters that may not have been publicly disclosed by the entity?**

   The auditor reporting standards set a very high bar for communicating matters that meet the definition of KAM, as the overall aim of communicating KAM are to provide greater transparency to users of the auditor's report. Such matters must be included in the auditor's report unless law or regulation precludes public disclosure about the matter or, in extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

   The auditor's decision not to communicate a "sensitive matter" would be informed by a full consideration of the facts and circumstances, along with discussions with management and the audit committee about the possibility of public disclosure by the entity about the matter.

Appendix B — Illustration of the New Auditor's Report

Although the example below assumes the financial statements are prepared in accordance with International Financial Reporting Standards (IFRSs) and that a comparative financial statement reporting approach is being used (i.e., opinion on two years), the changes highlighted apply equally in other circumstances.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the consolidated financial statements of ABC Company (the Entity), which comprise the consolidated statement of financial position as at December 31, 20X1 and December 31, 20X0, and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

auditor's opinion moved from the end of the auditor's report to the very beginning

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 20X1 and December 31, 20X0, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

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 Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other 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.

explicit statement about the auditor's independence in accordance with relevant ethical requirements and the auditor's fulfilment of other ethical responsibilities

Material Uncertainty Related to Going Concern

We draw attention to Note X in the consolidated financial statements, which indicates that the Entity incurred a net loss of $X during the year ended December 31, 20X1 and, as of that date, the Entity's current liabilities exceeded its total assets by $X. As stated in Note X, these events or conditions, along with other matters as set forth in Note X, indicate that a material uncertainty exists that may cast significant doubt on the Entity's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

separate section when a material uncertainty exists related to an entity's ability to continue as a going concern, and is adequately disclosed in the financial statements

Other Information

[Reporting in accordance with CAS 720, The Auditor's Responsibilities Relating to Other Information — Refer to CPA Canada's Audit & Assurance Alert — Other Information for further details on the reporting requirements related to OI, including illustrative examples.]

separate section when an entity prepares other information, such as an annual report, containing or accompanying the entity's financial statements and auditor's report thereon, to explain management's and the auditor's responsibilities for the other information and the auditor's conclusion from reading and considering the 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 financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

enhanced description of management's responsibilities for assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate

In preparing the financial statements, management is responsible for assessing the Entity'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 Entity or to cease operations, or has no realistic alternative but to do so.

identification of those charged with governance, when applicable, and their responsibility for the oversight of the financial reporting process

Those charged with governance are responsible for overseeing the Entity'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 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 financial statements. 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 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 Entity'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 Entity'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 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 Entity to cease to continue as a going concern.

new description of the auditor's responsibilities to conclude on the appropriateness of management's use of the going concern basis of accounting

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the 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 financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

new description of the auditor's responsibilities in an audit of group financial statements

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.

new description of the auditor's responsibilities regarding communications with TCWG

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.

new description of the auditor's responsibilities to provide a statement to TCWG that the auditor has complied with relevant ethical requirements regarding independence for listed entities

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 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*]

new disclosure of the name of the engagement partner for listed entities

This text is an extract from *More Informative Auditor's Reports — What Audit Committees and Finance Executives Need to Know* published by the International Federation of Accountants (IFAC) in March 2016 and is used with permission of IFAC. Contact **permissions@ifac.org** for permission to reproduce, store or transmit, or to make other similar uses of this document.

Comments

Comments on this FAQ for Management and Audit Committee, or suggestions for future Publications should be sent to:

Mike Wynen, CPA, CA
Principal, Research, Guidance and Support
Audit & Assurance
Chartered Professional Accountants of Canada
277 Wellington Street West
Toronto ON M5V 3H2
Email: **mwynen@cpacanada.ca**

DISCLAIMER

This publication was prepared by the Chartered Professional Accountants of Canada (CPA Canada) as non-authoritative guidance.

CPA Canada and the authors do not accept any responsibility or liability that might occur directly or indirectly as a consequence of the use, application or reliance on this material. This Audit & Assurance Alert has not been issued under the authority of the Auditing and Assurance Standards Board.