

Invitation to Comment

Auditing and Assurance Standards in Canada — Maintaining high standards in a global environment: A new standard-setting approach

prepared by:
Auditing and Assurance Standards Board

Comments are requested by March 14, 2006

AASB

Auditing and Assurance
Standards Board



Conseil des normes de
vérification et de certification

Request for comment

This Invitation to Comment is issued by the Auditing and Assurance Standards Board. Individuals and organizations are invited to send written comments to the Board. Comments are most helpful if they clearly explain the issues they raise and suggest a specific course of action supported by specific reasoning. All comments received will be available on a public file within one week of receipt.

To be considered, comments must be received by March 14, 2006, addressed to:

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For ease of handling, we prefer comments to be sent by e-mail (in Word format), to:

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Abbreviations

| | |
|-----------------|--|
| AASOC | Auditing and Assurance Standards Oversight Council |
| AcSB | Accounting Standards Board |
| AICPA | American Institute of Certified Public Accountants |
| AASB | Auditing and Assurance Standards Board |
| CAG | IAASB's Consultative Advisory Group |
| CICA | Canadian Institute of Chartered Accountants |
| CPAB | Canadian Public Accountability Board |
| CSA | Canadian Securities Administrators |
| EC | European Commission |
| EU | European Union |
| Handbook | CICA Handbook - Assurance |
| IAASB | International Auditing and Assurance Standards Board |
| IFAC | International Federation of Accountants |
| IOSCO | International Organization of Securities Commissions |
| ISA | International Standard on Auditing |
| OSFI | Office of the Superintendent of Financial Institutions |
| PICA | Provincial Institute of Chartered Accountants/Ordre |
| PCAOB | Public Company Accounting Oversight Board |
| PIOB | IFAC Public Interest Oversight Board |
| SEC | US Securities and Exchange Commission |

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Executive summary

This invitation to comment (ITC) sets out the proposed new standard-setting approach that the Auditing and Assurance Standards Board (AASB) would like to adopt for the future. The AASB developed the ITC under the oversight of the Auditing and Assurance Standards Oversight Council (AASOC). If the comments received on exposure agree with this approach, there will be a major change in how the AASB fulfils its standard-setting mandate.

Process to be followed

The AASB expects to obtain input on its proposals through comment letters and consultations with interested parties up to the comment deadline of March 14, 2006.

The AASB will modify its draft based on the comments received and will review it once more with the AASOC. The AASB expects to publish its finalized approach in the second half of 2006 and to begin implementing it immediately thereafter.

Matters covered in this ITC

This invitation to comment:

- provides background on Canada's standard-setting environment, an analysis of the AASB's current operating principles and the reasons why change is necessary;
- presents proposals for a new standard-setting approach that is expected to achieve the AASB's goals; and
- explains the consequences, benefits and risks of the proposed new approach.

Why the need for change?

Because of a number of highly publicized corporate financial scandals, the public lost faith in auditing standards in the US and elsewhere. This prompted the creation of the US Public Company Accounting Oversight Board (PCAOB), which is charged with setting auditing standards for reporting issuers. As a result, the US now has one standard setter setting auditing standards for public companies and another for private companies. Meanwhile, International Standards on Auditing (ISAs) set by the International Auditing and Assurance Standards Board (IAASB) have found greater acceptance worldwide. Unfortunately, there is little prospect of convergence between PCAOB standards and ISAs in the foreseeable future.

Practitioners in international accounting firms are now using ISAs on a daily basis, and most auditing standard setters, including the American Institute of Certified Public Accountants (AICPA), have moved away from promulgating a separate set of national standards, choosing to converge with ISAs instead. Canada's Accounting Standards Board (AcSB) is proposing to do the same, i.e., to focus on convergence with International Financial Reporting Standards (IFRSs) rather than continuing harmonization with US standards.

Currently, the AASB develops a separate set of Canadian standards based on both harmonizing with ISAs and eliminating significant differences between Canadian and PCAOB standards. The AASB believes that this approach creates an unjustifiable cost for stakeholders because:

- Canadian standards may not be appropriate for all stakeholders because they incorporate PCAOB standards used only by auditors of reporting issuers in the US;
- of duplication of effort and cost involved in maintaining a separate set of Canadian standards when ISAs are increasingly being recognized as global auditing standards, which could prevent the AASB from devoting sufficient resources to other important issues; and
- of increased concerns that the current approach contributes to standards overload rather than alleviating it.

The AASB wants to adopt a new approach that will ensure:

- that Canada continues to play a leading role in developing high-quality global auditing standards that meet the needs of Canadian stakeholders; and
- stakeholders continue to have confidence in the AASB's standard-setting process.

What the AASB proposes and why

The AASB believes that converging with ISAs is the best option for the future of standard setting in Canada, for the following reasons:

- The IAASB's Conceptual Framework and standard-setting philosophy is closely aligned with the AASB's.
- ISAs are increasingly being accepted as global auditing standards because of the rigour of the IAASB's due process and the quality of the standards it produces.
- The IAASB is embarking on a major project to clarify and restructure its standards, aimed at producing higher-quality audits.
- ISAs reflect the needs of a broad range of stakeholders, including practitioners from smaller firms and the public sector.
- It will give the AASB the opportunity to consider ways to enhance the interpretive guidance¹ materials it provides to practitioners.

The AASB plans to launch a program to converge Canadian auditing and assurance standards with ISAs beginning with the standards issued as part of the IAASB's restructuring project. This phase of the program will commence in 2006 and is expected to be completed by 2011. Under this program, the AASB will:

- amend adopted ISAs only when necessary to reflect Canadian circumstances — such amendments will be clearly differentiated in the standards;
- continue to develop Canadian standards for which there are no corresponding ISAs; and

¹ "Interpretive guidance" in this ITC refers to materials developed under the authority of the AASB and includes such things as Assurance and Related Services Guidelines and other publications defined as "interpretive publications" in Section 5021, *Authority of Assurance Standards and Other Guidance*, of the Handbook. Such guidance is in contrast with "implementation guidance", which is not developed under the authority of the AASB and includes such things as detailed work programs, practice aids, audit manuals, diagnostic tools and other training aids.

- refocus its resources on:
 - significantly influencing the IAASB in the development of a global set of auditing and assurance standards; and
 - developing appropriate interpretive guidance materials, and supporting the development of implementation guidance by others, for application of ISAs in a Canadian context.

The AASB will continuously monitor the environment to assess what might be affecting its standard-setting approach and will conduct a formal reassessment within twelve months of finalizing its approach. Further reassessments may take place at appropriate later dates.

The consequences of this approach for stakeholders

- The Handbook will ultimately take on the IAASB format.
- Canadian GAAS will eventually become equivalent to ISAs and will cease to be closely linked to, and may diverge significantly from, US auditing standards.
- Canadian GAAS will continue to consist of only one set of generally accepted auditing standards for the audits of all sizes and types of entities.
- The AASB will continue to develop its own standards for non-financial statement assurance engagements when warranted.
- Due process for developing auditing and related standards will change to strengthen Canadian stakeholder input to the IAASB.
- Canadian registrants with the US Securities and Exchange Commission (SEC) may decide that their audits should be performed in accordance with PCAOB standards, as permitted by legislation and regulation.

The benefits of the proposed approach

- It will promote confidence among Canadian users of assurance services about the quality of those services.
- There will be less confusion in the marketplace.
- By avoiding duplication of work, the AASB will be able to redirect resources to other important areas.
- It will demonstrate Canada's commitment to the development of global auditing and assurance standards.

The risks involved

- Virtually all Canadian standards will need to be revised to some extent over a relatively short period of time. Some practitioners may have difficulty absorbing these changes.
- The transition is being undertaken at a time when the IAASB is itself undergoing a massive standards restructuring project. The success of the AASB's approach will be affected by the outcome of the IAASB's project, in particular whether international regulators ultimately endorse ISAs.
- The AASB may not be able to influence the IAASB to take into account the views of Canadian stakeholders in developing its standards.

Questions for respondents

The AASB seeks comments and feedback on the following specific questions (where you do not agree, please explain why):

1. The AASB's current standard-setting approach

Do you agree that the AASB's current standard-setting approach needs to change? If not, how would the AASB address the challenges identified in continuing with the current approach?

2. Proposal to adopt ISAs in Canada

Do you agree that adoption of ISAs in Canada is in the public interest and will contribute to maintaining public confidence in the quality of audits undertaken here? What issues or concerns do you identify, if any, as a result of the AASB's proposal to abandon the objective of harmonizing with US auditing standards? As a user of audit services, do you have any concerns with the adoption of ISAs as regards market perception of the credibility of your financial reporting?

3. Application of ISAs in Canada

Do you agree that it will be necessary for the AASB to continue to set standards to address the Canadian environment, by interpreting ISAs in a Canadian context and by addressing areas not dealt with in ISAs, such as in the "Specialized areas" section of the Handbook?

4. Proposed approach

Do you agree that the AASB should increase its efforts in influencing the IAASB to take into account the views of Canadian stakeholders?

5. Process

Do you agree with the AASB's intended change in due process so that Canadian exposure drafts will in future contain a proposed ISA verbatim, together with a limited number of add-ons to take into account Canadian conditions?

6. Other issues

Do you have any other comments on the AASB's proposals or on other matters referred to in this ITC?

Background

In 2003, the AASB developed a Draft Strategic Plan meant to be in place for three years. Because the AASOC was just starting its operations and not yet able to provide the required oversight of the plan's development, it was never finalized. As an interim measure, from 2003 to 2005, the AASB operated under the principles described in Appendix 2. The goal of these operating principles was to ensure that the AASB continued to work toward achieving its mission of developing high-quality standards and guidance. They reflected the AASB's strategic objectives of both converging with ISAs and eliminating significant differences with US auditing standards.

The AASB reviewed the environment (see Appendix 1 for details) at its September 2004 meeting and concluded that it was time to reconsider its standard-setting approach. In particular, the AASB decided it needed to reconsider its activities with respect to ISAs, given that:

- the IAASB had developed a very strong due process for setting those standards;
- the AASB's experience in adopting ISAs over the preceding few years supported its view that ISAs are high-quality standards;
- starting in 2005, the IAASB came under the oversight of the International Federation of Accountants (IFAC) Public Interest Oversight Board (PIOB);
- the IAASB had increased the pace of standard setting beyond what was contemplated in the 2003 AASB plan; and
- a significant number of jurisdictions were working toward international harmonization or convergence in auditing standards. ISAs are currently used in national auditing engagement standards in more than 70 countries, including the United Kingdom, Australia and New Zealand. Because ISAs have to apply to all legal and regulatory environments, however, they tend to be more generic than national equivalents. For this reason, few jurisdictions have completely abandoned their standard-setting activities. There continues to be a need to interpret ISAs in the context of the local regulatory environment.

Meanwhile, the standard-setting environment in the US had changed radically since 2003 to include the following important elements:

- The public lost confidence in the US financial reporting and auditing system in the wake of several business scandals. The PCAOB was formed to develop standards for the audit of public companies in the US. The PCAOB has now issued several standards, and the AASB and its stakeholders have had a good opportunity to assess the PCAOB's impact on standard setting in the US. It seems unlikely that the PCAOB standards will be harmonized with ISAs in the foreseeable future.
- The AICPA, which is committed to harmonizing with ISAs (with a few exceptions), continues to set standards for the audit of non-public companies in the US.
- The Government Accounting Office (GAO) sets auditing standards for government entities.

Given these developments in the US, how useful is it for the AASB to continue to work toward eliminating significant differences between Canadian and PCAOB auditing standards?

Canada's Accounting Standards Board (AcSB), faced with similar issues, has proposed a significant change in its strategic direction to focus on convergence with International Financial Reporting Standards rather than on harmonization with US accounting standards. The AcSB issued an Exposure Draft of its new Strategic Plan in April 2005. The AASB needs to consider whether the AcSB's planned actions should influence its own direction. Both the AASB and the AcSB believe it is important to work in a co-ordinated manner on issues facing Canadian standard setters and their stakeholders, including the key question of harmonization/convergence with international and/or US standards. The AASB concluded that it should develop a draft plan for exposure as soon as possible after the AcSB released its plan.

Where is the AASB now?

After a detailed review of its environment (see Appendix 1), the AASB arrived at the following list of its strengths, weaknesses, opportunities and threats.

Strengths, weaknesses, opportunities and threats

Strengths

- The AASOC's independent oversight ensures the public interest is taken into account in all AASB activities.
- The AASB includes members from various stakeholder groups, including users of audit reports, practitioners from large and small practices, academics and auditors in the public sector. This, plus the input from stakeholders received during the AASB's due process, also ensures that the AASB sets auditing and assurance standards in the public interest.
- The AASB has a specific focus on addressing Canadian regulatory issues.
- The standards in the Handbook are recognized in incorporating and securities legislation as the primary source of Canadian generally accepted auditing standards.
- The AASB also has a due process for gathering input from Canadian stakeholders for developing responses to all IAASB exposure drafts.

Weaknesses

- Canadian standards contain a mixture of ISA and PCAOB requirements but are not fully aligned with either set of standards.
- Stakeholders are providing less input to AASB exposure drafts because they feel they cannot really influence what a final standard mandates. Yet, the AASB has been using that input as a primary source in developing standards. The question arises, then, whether Canadian standards fully reflect the needs of its stakeholders.
- Because the AASB works with both IAASB and PCAOB standards — whose strategic objectives, operating priorities and conceptual frameworks are not necessarily aligned — inefficiencies creep into the standard-setting process.
- The AASB may, as a result, not devote enough time to addressing small practice and public sector issues or to supporting the development of implementation guidance (such as audit procedures manuals, training courses and diagnostic tools) for practitioners.

Opportunities

- Canada has an enviable reputation as a producer of high-quality auditing and assurance standards that should help increase its influence in IAASB standard setting.
- Canada is well represented on international standard-setting bodies. The IAASB vice chair is Canadian, the PIOB has two Canadian members and some IAASB staff members and several technical advisors to the IAASB are from Canada. Although such representation enables Canada to have a lot of influence on IFAC, there is no AASB representative on the IAASB just now.

- The format and prescription of Canadian auditing and assurance standards are similar to those of IAASB standards. That makes it relatively easy to incorporate ISAs into Canadian standards. US standards, however, tend to be more prescriptive, which causes problems when US standards are incorporated into Canadian standards.

Threats

- In some jurisdictions, standard setting has been moved out of the hands of the profession as a response to concerns about the quality of audits.
- Because the AASB has not made a clear commitment to the adoption of ISAs, its ability to influence IAASB standards is diminished.
- Larger Canadian accounting firms tend to use international standards as a foundation for their audit approaches and may not see the benefit of a separate set of Canadian standards.
- Concerns about the number, complexity and length of standards and regulatory requirements appear to be fragmenting Canadian practitioners as they assess the costs and benefits of providing assurance versus non-assurance services.

Why the need for change now?

The AASB has significantly enhanced the quality of Canadian auditing standards in response to concerns arising from the US business scandals. For example, it recently issued fraud, quality control and audit risk standards. There is strong evidence, however, that there may be better means of developing high-quality standards in the future. For the following reasons, the AASB concluded that it needs to consider changes to its standard-setting approach:

1. The current approach does not meet the needs of all stakeholders

- Because Canadian standards contain differences from both ISAs and PCAOB standards, stakeholders have difficulty comparing the quality of Canadian standards with those standards and are increasingly questioning why Canadian standards need to be different.
- Many practitioners and their clients, particularly smaller entities, are questioning whether auditing standards incorporating PCAOB standards used only by auditors of reporting issuers in the US are really appropriate for meeting the public interest in Canada.
- The AASB is devoting resources to converting ISAs and PCAOB standards into Canadian format at the possible expense of addressing emerging Canadian issues and providing interpretive guidance to assist practitioners.
- Stakeholders are concerned that the current approach will contribute to standards overload — the burden of dealing with new requirements of regulators and standard setters — rather than help alleviate it.
- The AcSB issued a Draft Strategic Plan to obtain input on its proposed change in strategic direction for accounting standards. The AASB believes that it is important for the two Boards to be co-ordinated on the issues facing Canadian standard setters and their stakeholders, including the key question of harmonization/convergence with

international and/or US standards. The AASB's current approach is not consistent with the AcSB's proposals.

- Some accounting firms develop their audit methodologies using international rather than national auditing standards. For such firms, working with a separate set of Canadian standards may result in additional costs for few perceived benefits.
- An approach not fully aligned with either international or US standards may make it difficult to understand Canadian standards because they are trying to incorporate different conceptual bases. To understand and apply Canadian standards, accounting firms have to provide additional guidance and training to staff. The costs involved may ultimately be passed along to users of audit services, resulting in higher fees.

2. The current approach may not be sustainable in the long term

- Although the IAASB and the PCAOB are developing a working relationship, it is likely that there will be differences between their standards for some time to come. The AASB's current approach is sustainable over the longer term only if these two sets of standards become more closely aligned.
- In recent years, the AASB has noticed a significant decrease in the number of responses to its exposure drafts. There are also very few responses to requests for Canadian comment on IAASB exposure drafts. The AASB believes that these decreases may be due to the fact that respondents:
 - are overwhelmed generally with an ongoing increase in the number of requests for comment on proposed accounting, auditing and regulatory requirements;
 - prefer to respond directly to the IAASB through their international firms;
 - believe that the AASB is unlikely to make changes to ISA-based proposals; and
 - do not have the time to respond to both Canadian and international proposed standards.

To be effective, however, the AASB requires the input of its stakeholders. Although it has already begun more proactive efforts to obtain the views of stakeholders, the AASB believes that its current approach does not facilitate these efforts.

3. The current approach may not help the AASB influence the IAASB

- Devoting resources to monitoring both IAASB and PCAOB activities means the AASB has fewer resources for participating more rigorously in international standard setting.
- There may be a perception in international circles that Canada is not seriously committed to international convergence, which might hamper the AASB's efforts of influencing the IAASB in the development of ISAs.

Where does the AASB want to be?

In considering a new approach to standard setting, the AASB focused on the following two primary goals:

1. Canada wants to play a leading role in developing high-quality global auditing standards that meet the needs of Canadian stakeholders

- Global standards would meet the needs of Canadian users of audit reports by ensuring that readers understand that Canadian auditors have conducted their audits in accordance with high-quality, globally accepted auditing standards.
- Global standards would meet the needs of Canadian assurance providers by reflecting best practices for the audit of all sizes and types of Canadian entities and containing interpretive guidance to help ensure that assurance providers can apply them consistently and effectively.
- Global standards would meet the needs of Canadian regulators by being demonstrably of high quality and applied consistently across all sizes and types of regulated entities.
- Canada would suitably demonstrate its commitment to convergence with globally accepted auditing standards.
- Canada would provide strong technical input to the standard-setting process.

2. Canada wants to ensure continuing confidence in the AASB's standard-setting process

- The standard-setting process is subject to appropriate oversight so that standards are developed in the public interest.
- The standard-setting process is appropriately transparent and responsive to the input of Canadian stakeholders.
- The standard-setting process is conducted efficiently and effectively.
- The standard-setting process enables effective implementation of new auditing and assurance standards.

To achieve these two goals, the AASB developed the following key principles:

- Auditing and assurance standards must be based on clearly identifiable principles that allow for the appropriate use of professional judgment.
- AASB standards must be of value to all stakeholders:
 - both the public and private sectors;
 - international markets;
 - Canadian markets and in privately or publicly held entities; and
 - smaller, local and regional markets.
- The AASB must demonstrate that its standards are of the same high quality as globally accepted auditing standards. In this respect, the AASB's work plan will be synchronized to maintain pace with the development of global standards. Also, Canadian standards must allow stakeholders to easily identify any differences between Canadian and global standards.

- The AASB accepts that, by demonstrating consistency with global standards, it will no longer make final decisions on the technical content of individual standards being adopted. It does this on the basis that the due process for setting global auditing standards permits the involvement of Canadian stakeholders. The AASB must be able to participate vigorously in the global due process and take steps to increase the involvement of Canadian stakeholders in that process.
- The costs of standard setting must be reasonable in relation to the benefits to stakeholders.

How will the AASB get there?

The AASB's proposals

The following proposals best address how the AASB envisions its future.

1. The AASB will undertake a program to converge Canadian with IAASB standards, with the Handbook ultimately having the same structure and content as the ISAs.
2. The AASB will consider ways to help practitioners cope effectively with the changes in standards.
3. The transition process will be closely monitored and adjusted as necessary.

Program to converge with the ISAs

Chart A on page 15 provides an overview of the proposed evolution of Canadian auditing standards. The evolutionary process will be complex, particularly as certain factors are outside of the AASB's control. In addition, although the IAASB's Conceptual Framework and standard-setting philosophy are similar to Canada's, the IAASB sets standards in an international context, which may result in standards that are not always appropriate in Canada. How such differences will be resolved will depend on their specific circumstances and the views of Canadian stakeholders. Bearing this in mind, the following presents further details of how the AASB expects to operate under the new standard-setting approach.

Auditing standards

During the medium-term evolutionary period illustrated in Chart A:

- the Handbook will continue in its existing structure;
- the AASB will adopt new ISAs as Canadian standards as they are issued by the IAASB;
- the AASB may undertake other projects that are not on the IAASB agenda as necessary to meet the specific needs of the Canadian environment;
- the AASB may converge with ISAs that are not being restructured by the IAASB in the near term;
- the AASB will retain current Canadian standards having no corresponding ISAs, adapting them as necessary to ensure consistency of structure and terminology (for example, standards dealing with specialized areas in the Handbook, such as auditor assistance to underwriters and others);
- in adopting ISAs, the AASB will allow differences from them only in limited, specific circumstances; and
- the Handbook will clearly differentiate ISA material from Canadian add-ons* so that the AASB can demonstrate that Canadian standards are converged with ISAs.

* An "add-on" adapting a standard to Canadian circumstances would be embedded in the ISA at the appropriate place, rather than at the end of the ISA. Such additional material would, however, be easily identifiable so that readers of the Handbook will be able to see what is the ISA and what is not.

The AASB will focus its efforts on influencing the IAASB in the development of a global set of auditing and assurance standards appropriate to the needs of Canadian stakeholders. The AASB will also try to persuade the IAASB to add projects of specific interest to Canada to its agenda. The AASB may participate in such projects by, for example, conducting related research or supporting IAASB task forces. If the IAASB decides not to take on a project of importance to Canada, or doesn't do it quickly enough, the AASB will consider dealing with the project on its own or in partnership with other standard setters. Examples of areas where the AASB might undertake its own projects are capital markets or information technology developments.

Applying ISAs in a Canadian context may be an issue for practitioners. Identifying the need for, nature of and extent of such guidance, however, will be an evolving process. The AASB recognizes it has a role to play in developing interpretive guidance issued under its own authority and also in supporting others in the development of implementation guidance. For example, the Canadian Institute of Chartered Accountants (CICA), the provincial institutes of chartered accountants/ordre (PICAs) and others are working on approaches for providing timely implementation guidance to practitioners. The AASB expects that under the proposed approach, it will be able to devote additional resources to developing appropriate interpretive guidance materials and to working with the CICA and the PICAs as they develop implementation guidance for application of ISAs in a Canadian context.

The AASB will set a changeover date, when Canadian standards are converged with ISAs, at which time the AASB will restructure the numbering of the Handbook to be consistent with the numbering of the ISAs.

For audits of small entities, the AASB will work with the IAASB and other national standard setters to develop interpretive guidance for the use of ISAs in a small business environment.

Review and compilation standards

For review engagements, the AASB will shortly undertake a project to update current review standards with the objectives of converging with the International Standards on Review Engagements (ISREs) and developing Canadian interpretive guidance.

For compilation engagements, the AASB will undertake a project to update compilation standards with the objectives of converging with International Standard on Related Services (ISRS) 4410 and developing Canadian interpretive guidance.

Helping practitioners cope with change

The AASB will pay particular attention to the practical limitations on the ability of stakeholders to cope with change — the “standards overload” issue. When change is necessary, the AASB will consider an appropriate implementation period taking these limitations into account. However, in doing so, the AASB must also consider the implementation period that is applicable for ISAs that it is adopting and the need to stay on the same timetable as other jurisdictions. It will also offer help through direct

consultations and materials on the AASB website, including updates, articles, answers to frequently asked questions and web-based presentations.

Monitoring the transition to the new standard-setting approach

The AASB will continuously monitor the environment to assess what might be affecting its standard-setting approach and will conduct a formal reassessment within twelve months of finalizing its approach. Such monitoring might include the following:

- Canada’s progress in converging with revised ISAs;
- the relationship between PCAOB and IAASB standards and any significant differences between the two; and
- any teething problems identified in adopting ISAs in the European Union.

Further reassessments may take place at appropriate later dates.

EVOLUTION OF STANDARDS UNDER THE AASB'S PROPOSALS

CURRENT SITUATION

CICA HANDBOOK – ASSURANCE

Amalgamation of:

- Unique Canadian standards and guidance
- Some (not all) ISA standards and guidance
- Some (not all) US PCAOB standards and guidance

Legislation/regulation

- Corporations Acts refer to Canadian GAAP and GAAS set out in CICA Handbook.
- Securities regulations allow Canadian SEC registrants to use Canadian or US GAAP and GAAS.

MEDIUM-TERM EVOLUTION

CICA HANDBOOK – ASSURANCE

ISAs plus:

- Canadian add-ons that are clearly identifiable. Add-ons must meet AASB's criteria (see page 17)
- Canadian standards where there are no ISAs

**PCAOB STANDARDS
(for audits of Canadian
SEC registrants filing US
GAAP financial statements)**

Legislation/regulation

- Canada Corporations Acts refer to Canadian GAAP and GAAS set out in the CICA Handbook or US GAAP and PCAOB standards for Canadian SEC registrants (starting in 2005). Provincial changes in process.
- Securities regulations allow Canadian SEC registrants to use Canadian or US GAAP and GAAS.

LONG-TERM VISION

**CICA HANDBOOK –
ASSURANCE**

International Standards on
Auditing

**PCAOB STANDARDS
(for audits of Canadian
SEC registrants filing US
GAAP financial statements)**

Legislation/regulation

- Canadian GAAP and GAAS the same as IFRSs and ISAs respectively.
- Securities regulations allow Canadian SEC registrants to use Canadian or US GAAP and GAAS.

Consequences of the proposals

The AASB's proposed new standard-setting approach would result in:

- Canadian GAAS eventually becoming equivalent to ISAs;
- abandoning the objective of harmonizing with US auditing standards;
- significant changes to the format of the Handbook;
- significant changes in the due process for developing auditing and related standards;
- continuing to have only one set of generally accepted auditing standards for the audits of all sizes and types of entities;
- developing unique Canadian standards for non-financial statement assurance engagements when warranted;
- a sustained period of change for practitioners; and
- possible changes in how AASOC provides oversight.

Canadian GAAS equivalent to ISAs

Practitioners performing audit engagements will still have to follow and report using Canadian GAAS in accordance with Canadian incorporating and securities legislation. Therefore, the AASB's overriding goal will continue to be to set high-quality auditing and assurance standards in the Canadian public interest. Once the convergence process is complete, however, auditors will also be able to report in compliance with ISAs.

The AASB recognizes that certain existing Canadian auditing standards may have no ISA equivalent. Such standards will be retained and updated as necessary until the AASB considers that their guidance is no longer required, for example, because a new ISA addresses the specific topic or because of changes in the Canadian environment.

Abandoning the objective of harmonizing with US auditing standards

This is perhaps the most significant consequence of the AASB's proposals. As set out in its 2003-2005 operating principles (see Appendix 2), the AASB seeks to eliminate significant differences between Canadian and US standards and to avoid creating new ones. The AASB does not propose to continue this approach in the future.

The AASB notes that many Canadian SEC registrants require their auditors to report using PCAOB standards rather than Canadian GAAS for their US filings. In addition, the CSA permits filings with Canadian securities regulators to be audited in accordance with PCAOB standards in certain circumstances. It is possible that, as a result of the AASB's proposals, the CSA and other regulators may allow or require entities that are not SEC registrants to be audited using PCAOB standards. Accordingly, more entities may require their auditors to audit and report under PCAOB standards in future, and more auditors may need to be able to practice using such standards.

Significant changes to format of the Handbook

The Handbook will eventually contain ISAs together with separately identifiable Canadian add-ons. The AASB estimates that the Handbook already contains approximately 60 percent of the ISAs that are part of the IAASB's Clarity Project. By

2011, the Handbook will contain 100 percent of these ISAs. The AASB notes that Canadian standards already are converged with ISAs in most key areas, such as the audit risk model and the auditor's responsibility to consider fraud. Once the convergence process is complete, the numbering of the Handbook will be restructured to be consistent with the numbering of the ISAs.

Significant changes in due process for developing auditing and related standards

The adoption of ISAs significantly changes the process for developing Canadian auditing standards. The AASB will no longer develop unique Canadian auditing standards except where gaps in IAASB standards need to be addressed in a Canadian context. Instead, its role will be to perform "due diligence" on the ISAs considered for adoption in Canada.

The AASB will do this by:

- seeking comment from Canadian stakeholders on IAASB exposure drafts;
- contributing standard-setting expertise and effort toward influencing the development of international auditing standards; and
- refocusing resources to achieve an increased level of participation in international standard setting.

The IAASB follows a transparent standard-setting process. For example:

- IAASB meetings are open to the public; and
- the IAASB website contains:
 - lists of current projects and project histories;
 - outstanding exposure drafts;
 - IAASB meeting agenda materials;
 - minutes and audio recordings of IAASB deliberations;
 - copies of its annual report and action plan; and
 - responses to IAASB exposure drafts.

The AASB believes, therefore, that Canadian stakeholders will have ample opportunities to take part in the international standard-setting process and also in the development of Canadian standards based on ISAs. The AASB believes that the resulting due process for the convergence with ISAs will be transparent.

Until now, when IAASB exposure drafts have been issued, the AASB has sought comments from Canadian stakeholders to be passed to the IAASB. This has been separate and distinct from the AASB's due process for developing Canadian auditing standards. In the future, however, the AASB will issue IAASB exposure drafts as proposed Canadian standards. Such Canadian exposure drafts will contain the proposed ISA verbatim, together with a limited number of Canadian add-ons. Add-ons may be necessary, for example, to reflect the Canadian legal or regulatory environment, or for consistency with Canadian accounting standards. Based on the feedback from this exposure process, the AASB will provide input to, and try to influence, the IAASB.

Only one set of GAAS

The Handbook will contain one set of standards for audits regardless of the size of the entity being audited or the practice performing the audit. The AASB believes that an

audit is an audit, in the sense that the objectives and principles are the same for all entities, but that approaches, methodology and procedures may differ. It believes that the IAASB's due process takes into account the views of small and medium-sized practices auditing small entities. In addition, one of the objectives of the IAASB's Clarity Project is to address issues of length and complexity of standards for small and medium practices. The AASB believes that its proposals for adopting ISAs restructured under the Clarity Project will aid in addressing the concerns of small and medium practitioners.

Standards for non-financial assurance engagements

The IAASB's current focus is on developing standards for audits of financial statements, although it ultimately also intends to set standards for other assurance engagements. Under the IAASB Conceptual Framework, ISAs are developed primarily in the context of audits of historical financial statements. The IAASB has stated that ISAs are applicable to all such audits (for example, private sector, public sector, not for profit entities and small, medium-sized and large entities). The Handbook applies to all types of assurance engagements, however, not just audits of financial statements. Accordingly, the AASB will continue to set standards for other assurance engagements as it considers necessary.

Sustained period of change for practitioners

The AASB's proposals call for a sustained period of change to standards from 2006 to 2011. This would have several consequences, including the following:

- Stakeholders will be asked to respond to a large number of exposure drafts.
- A considerable amount of professional development effort will be required of post-secondary educators, provincial institute trainers, practice inspectors, regulators and firms.
- Many changes will be required to accounting firm audit manuals without there necessarily being significant changes to specific audit procedures.

Possible changes in how AASOC provides oversight

The AASB recognizes that the adoption of its new standard-setting approach may have implications for AASOC's oversight role, particularly as the IFAC's PIOB plays a similar role in overseeing the activities of the IAASB. Precisely how the implementation of the AASB's proposals would affect the AASOC's mandate, however, is yet to be determined.

Benefits of the proposals

The AASB's proposals respond to a significant number of the strengths, weaknesses, opportunities and threats identified earlier in this ITC.

They respond to the needs of Canadian stakeholders as follows:

- By promoting confidence among users of assurance services about the quality of those services, because now there will be common requirements to perform such services to the same high standards no matter where they are performed.

- By reducing confusion in the Canadian marketplace because there will be only two sets of standards — ISAs and PCAOB standards — rather than the three in the current environment (ISAs, PCAOB standards and Canadian GAAS).
- By creating a relationship between accounting and auditing standards that the marketplace will understand because the majority of entities will follow international GAAP and be audited in accordance with international GAAS.
- By reinforcing that the AASB’s standards are set in the public interest because the IAASB itself expresses its objectives in standard setting in the context of serving the public interest (see Appendix 4 for information about the IAASB).
- While the IAASB processes for recognizing special considerations in the audits of small and public sector entities are still evolving, the AASB will be able to increase its focus on these key audit areas.
- Standards in the Handbook will evolve so that users can readily identify Canadian add-ons that distinguish the standards used in Canada from ISAs. This will help those developing audit approaches for their firms based on ISAs to easily identify where they need to tailor their firm’s manual for use in Canada.
- The AASB anticipates that the need for Canadian add-ons will eventually disappear (for example, if securities regulations affecting auditors become largely consistent on a global basis) so that ISAs will be applied globally (except in the US, where adoption of ISAs seems unlikely).
- The AASB and staff will spend less time eliminating inconsistencies in the Handbook arising from converting ISAs and PCAOB standards into Canadian format and terminology, concentrating instead on more productive activities.

The AASB’s standard-setting process will become more sustainable by:

- refocusing time and effort on monitoring the agenda of only one other standard setter, rather than two with different approaches;
- taking advantage to the fullest extent of the views of world experts in developing standards and avoiding the duplication of effort required to “translate” them for Canadian purposes; and
- simplifying the due process for responding to exposure drafts.

The AASB will receive greater recognition internationally by:

- being a leader in converging with ISAs; and
- having more time to influence the international standard-setting process because it will be adopting ISAs on a more proactive basis and, therefore, be more able to contribute to the international debate on new standards.

Risks of the proposals

The ability of the AASB to influence the IAASB

There is no certainty that the proposed actions will actually increase AASB influence at the IAASB. The IAASB has an appropriate due process, however, that ensures it considers the views of all stakeholders. The AASB is satisfied that this due process will

permit it to present its views. By aligning its agenda with the IAASB's, the AASB will have more opportunity to participate in IAASB projects. In addition, the AASB is a member of the IAASB National Standard Setters group that meets annually and focuses on promoting international convergence (see Appendix 1 for further discussion about this group). This membership ensures the AASB has an ongoing liaison with the IAASB about its standard-setting program and activities.

Canadian standards may not adequately respond to unique Canadian circumstances

If the AASB were to rigidly adopt ISAs without giving due consideration to unique aspects of the Canadian environment, the resulting standards might not be fully operational in a Canadian context. The proposed new exposure draft process would, however, focus on obtaining input on unique Canadian circumstances. Also, experience has shown that each country has fewer unique circumstances over time — auditors and their stakeholders are facing similar issues in many countries.

Being tied to the IAASB Clarity Project timetable

The AASB's proposals are closely linked with the IAASB's Clarity Project. If the IAASB's project deviates from its expected timetable, this could significantly affect the ability of the AASB to achieve a smooth transition to ISAs.

The ability of stakeholders to absorb changes during transition period

As discussed on page 18, the AASB's approach calls for a sustained period of change to standards from 2006 to 2011. There is a risk that stakeholders will have difficulty implementing the changes during this period.

The AASB intends to develop an implementation plan during the transition period that will respond to the above risks.

Appendix 1: AASB's environment

International Standard Setting

The quality of the ISAs has continued to improve, partly because of a strong, transparent due process. With the formation of the PIOB in the spring of 2005, the IAASB² is now under public oversight. The IAASB has devoted substantial effort to building and strengthening relationships with its stakeholders, including global regulators, international and regional organizations, IFAC member bodies and national standard setters. As a result, it seems more appropriate than ever before for the AASB to actively pursue convergence with ISAs.

When the AASB developed its last strategic plan, the IAASB had just begun implementing a program designed to strengthen its processes and broaden its membership with a view to meeting the needs of regulators and other external observers for efficiency, transparency and credibility. Since then, the IAASB has undertaken significant initiatives to respond to the "Proposals for Reform" that the IFAC approved in November 2003 and that are supported by regulators worldwide. The aim of these reforms was to increase public confidence in IFAC's public interest activities, including the IAASB's standard setting. The reforms are discussed in more detail in the IAASB's 2004 Annual Report (www.ifac.org/IAASB/Downloads/current_IAASB_Annual.pdf) and include the following:

- Appointment of an independent Consultative Advisory Group (CAG) to strengthen the IAASB's due process and to further the public interest in the IAASB's standard-setting activities.
- Appointment of a full-time Chair on October 1, 2004.
- All members of the IAASB have for the first time signed a declaration, to be repeated annually, that they will act with integrity and in the public interest in the discharge of their responsibilities. The aim of this declaration is to strengthen the acknowledgment by IAASB members to act in the best interests of the public.
- To enhance the avenues for direct input into the IAASB's standard-setting process, invitations for observer seats to the IAASB were sent to and accepted by the PCAOB and the Japanese Financial Services Agency. A response on a third invitation, sent to the European Commission, is pending. In addition, the chairman of the IAASB CAG has accepted a fourth observer seat. These observer seats carry speaking, but not voting, rights.
- In July 2004, the IAASB issued an exposure draft proposing enhancements to its due process; comments are now being considered. The proposals respond to the IFAC reforms that called for consideration of public hearings on standard-setting projects, enhanced responsiveness to comments received on exposure drafts and a report on compliance with due process in the IAASB's annual report. The exposure draft also

² The IAASB's due process is set out in the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services, and is summarized in Appendix 4.

proposes other changes to strengthen the IAASB's deliberative process, and to expand the present description of the IAASB's due process and working procedures to reflect more fully the practices that are being followed.

- The IFAC reforms also called for the development and formalization of the present liaison arrangements between the IAASB and national standard setters.

While implementing the reforms, the IAASB has also focused on its primary objective — the development of robust and high-quality auditing standards. One project with significant and far-reaching consequences is the Clarity Project (see Appendix 3 for the project timetable). In 2003, the IAASB decided to review the drafting conventions used in its standards with the objective of identifying ways to improve the clarity and, thereby, the consistency of application, of its standards. In September 2004, the IAASB issued the Exposure Draft, "Clarifying Professional Requirements in International Standards Issued by the IAASB." The Exposure Draft and accompanying consultation paper deal with the IAASB's drafting conventions and some suggestions for resolving issues surrounding the structure, length and perceived complexity of IAASB standards. The IAASB believes that acceptable solutions are needed to contribute toward global convergence of standards.

Another major IAASB focus has been on achieving global convergence to its standards. The challenges of convergence to international standards were clearly highlighted in the report commissioned by the IFAC and issued in September 2004, "Challenges and Successes in Implementing International Standards: Achieving Convergence to IFRSs and ISAs" (see www.ifac.org/convergencereport), written by former IFAC board member Peter Wong.

Recognizing the importance of small and medium-sized practices (SMPs), the IAASB solicited the input and support of the IFAC SMP Permanent Task Force at all key stages of each of its projects, beginning with the project proposal. This reflects the need for the IAASB to give appropriate consideration to SMP issues and to understand the views of SMPs so that the IAASB's pronouncements are relevant and applicable to them.

To facilitate the IAASB's partnership with SMPs, the IAASB has appointed its Deputy Chair to act as liaison with the SMP Permanent Task Force.

Regulators:

European Commission

The EC recently proposed that statutory financial statement audits in the EU should be conducted in accordance with ISAs, as developed by the IAASB and to the extent endorsed by the EC.

International Organization of Securities Commissions

IAASB representatives attend meetings of IOSCO's Standing Committee No. 1 and the Auditing Subcommittee. IOSCO has commented regularly on the IAASB's exposure drafts, and IOSCO representatives have attended most of the public meetings of the IAASB. IOSCO participates in the IAASB CAG and is involved in the development of the IFAC reforms.

The IAASB continues to explore with IOSCO the ways in which IOSCO might eventually endorse IAASB standards for use in all capital markets regulated by IOSCO members.

US Public Company Accounting Oversight Board

Recognizing the PCAOB's unique role in setting auditing standards for the US capital markets, the IAASB established working relationships with the PCAOB to foster better understanding of each other's activities and further the goal of global convergence of standards.

In 2004, the PCAOB was granted observer status at IAASB meetings. Through this channel, the PCAOB professional standards staff has contributed to the IAASB's deliberations on significant projects. In the observer role to the IAASB, PCAOB staff also attends meetings of the IAASB CAG.

Conversely, the IAASB has accepted an invitation to participate as an observer at meetings of the PCAOB's Standing Advisory Group (SAG). The IAASB Chair attends meetings of the SAG and participates in the discussions addressing PCAOB projects.

Standard Setters:

National Standard Setters

Standard setters from 10 countries, including Canada and the US (both the PCAOB and the AICPA's Auditing Standards Board), attend an annual meeting of national standard setters. These meetings include discussions on how to improve coordination of work agendas between the IAASB and national standard setters, issues of international convergence, how the clarity of IAASB standards might be improved, the translation of ISAs and the development of implementation guidance.

During 2004, the IAASB worked with national standard setters on three projects. In addition, in a project initiated by the major international audit firms, staff of the firms,

national standard setters and professional accountancy bodies collaborated with IAASB staff to develop questions and answers regarding the first-time adoption of International Financial Reporting Standards.

International Organization of Supreme Audit Institutions

The INTOSAI's goal is to develop Guidelines for Financial Audit that will provide its members with practical guidance on the application of INTOSAI auditing standards to financial audits of public sector entities. INTOSAI has resolved that these Guidelines should, as far as possible, draw upon ISAs.

The IAASB has approved a final Memorandum of Understanding (MoU) with INTOSAI that formalizes a project structure and cooperation process enabling INTOSAI to use ISAs as a basis for its proposed Guidelines for Financial Audit. The MoU also provides for INTOSAI to designate experts in the field of public sector auditing to work with the IAASB to facilitate the incorporation of public sector perspectives into the body of ISAs. INTOSAI nominees have been appointed to several IAASB task forces.

These co-operative efforts represent an important contribution to the development of standards that will be applicable in both the private and public sectors.

International Accounting Standards Board

The IAASB considers it important to maintain close liaison with the IASB given the range of common issues both face. The IASB already represents an important element in the IAASB's due process through its participation on the IAASB's CAG. In addition, closer liaison between the IAASB and the IASB was initiated in 2004 through meetings between the chairs of the respective Boards to discuss common issues and projects of mutual relevance.

The state of international convergence

A significant number of jurisdictions have been engaged in a process of international harmonization or convergence in auditing standards. ISAs are currently used as the basis for national auditing engagement standards in more than 70 countries, such as European countries including the United Kingdom and Germany, Australia, New Zealand and South Africa.

As previously stated, the EC is considering a process and timetable for endorsement of ISAs for use throughout the EU in the future.

The Statements of Membership Obligations issued by the IFAC Board provide clear benchmarks for IFAC member organizations. These Statements also spell out members' obligations, including their efforts at international convergence.

US standard-setting developments

The US standard-setting scene has changed dramatically since 2003, with the division of standard-setting responsibilities among different bodies being one of the most significant developments.

Public Company Accounting Oversight Board

The PCAOB was formed in July 2002 to oversee the auditors of public companies in the US. The PCAOB has powers to establish standards for auditing, attestation, quality control, ethics and independence for registered accounting firms. The PCAOB relies on the advice of a Standing Advisory Group to assist it in performing its standard-setting responsibilities.

On April 16, 2003, the PCAOB adopted certain existing standards as its interim auditing standards. Most of these standards were promulgated by the AICPA and pre-date the PCAOB's formation. These interim standards are incorporated into the PCAOB's rules. Registered public accounting firms have to comply with both interim standards while they are in effect and the permanent standards adopted by the PCAOB.

In May 2004, the SEC approved the PCAOB's proposed standard requiring registered public accounting firms to include in their reports on the financial statements of public companies a statement that the engagement was conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)." The standard supersedes previous standards that required references to "generally accepted auditing standards."

In June 2004, the SEC approved the PCAOB's proposed standard for auditors' attestation to management's assessment of internal control over financial reporting.

In August 2004, the SEC approved the PCAOB's proposed standard for audit documentation. The PCAOB considers this standard to be one of the fundamental building blocks on which both the integrity of audits and the PCAOB's oversight will rest.

In 2003, the PCAOB accepted an invitation to observe, with speaking rights, IAASB meetings. Similarly, the PCAOB invited the IAASB to participate as observers in the Standing Advisory Group. Although not an explicit objective, the PCAOB supports the development of high-quality international professional standards.

Further details about the PCAOB may be found at www.pcaobus.org.

American Institute of Certified Public Accountants

Prior to the formation of the PCAOB, AICPA members who performed audits were required to comply with Statements on Auditing Standards promulgated by the AICPA's Auditing Standards Board (ASB). These standards constitute what is known as generally accepted auditing standards in the US and, in the past, applied to all audits. Now, however, the auditing and related professional practice standards established by the PCAOB are to be used in the performance of, and reporting on, audits of public

companies. Accordingly, AICPA members must now comply with PCAOB standards when auditing public issuers and with ASB standards when auditing non-public companies.

With the formation of the PCAOB, the ASB changed its focus to:

- developing auditing, attestation and quality control standards for nonpublic engagements;
- contributing to the development of high-quality national and international auditing and assurance standards;
- meeting the needs of financial statement users;
- fostering public trust in the profession; and
- developing timely practical guidance on implementing the standards

The ASB has also indicated its intention to adopt wording conventions for future Statements on Auditing Standards that are consistent with those used by the PCAOB. Under these conventions, a requirement is indicated by the words “must” or “is required”. Presumptive requirements, with which the auditor must comply in all cases where the requirement applies, are indicated by the word “should.” The IAASB has chosen not to use these wording conventions in its standards.

Canadian environment

The Canadian environment has also seen significant changes since 2003, with the creation of the Canadian Public Accountability Board, the Accounting Standards Board’s (AcSB) proposed change of strategic direction and the Canadian Securities Administrators permission for certain issuers to use US accounting and auditing standards, and standards overload issues. As a result, the AASB also needs to consider its standard-setting approach.

Canadian Public Accountability Board

In 2003, the provincial securities commissions, the Federal Superintendent of Financial Institutions and the CICA created the CPAB to provide independent public oversight for auditors of issuers reporting to the securities commissions. The Canadian Securities Administrators (CSA) National Instrument 52-108 requires that financial statements of reporting issuers be audited by public accounting firms registered with the CPAB oversight program. The CPAB has contractual agreements with participating audit firms to take any actions necessary to carry out its role. The CPAB’s actions to promote high-quality external audits of reporting issuers include:

- establishing and maintaining requirements for participation in the CPAB’s oversight program, and publishing on its website a register of participating audit firms;
- conducting inspections of participating audit firms directly or in co-operation with professional regulatory authorities to assess the compliance of each firm with the CPAB Rules, professional standards and the firms’ own quality control policies, and requiring firms to take remedial action to address inspection findings when necessary or appropriate;

- conducting investigations of, and imposing requirements, restrictions and sanctions on, participating audit firms when necessary or appropriate;
- providing comments and recommendations on accounting and assurance standards to relevant standard-setting and professional oversight bodies; and
- reporting to the public at least annually on the results of its activities.

The CPAB developed a co-operative working relationship with the PCAOB, leading in early 2005 to a documented understanding of how the two organizations will work together to ensure the oversight of firms auditing public companies in both countries without duplicate effort. Nearly 500 Canadian companies are registered with the SEC in the US. Also, about 200 foreign firms registered in Canada are audited by US and other foreign accounting firms.

Unlike the PCAOB, the CPAB does not set auditing standards in Canada. The CPAB is, however, represented on AASOC and the Accounting Standards Oversight Council, the independent body established to oversee the AcSB. The CPAB has a particular interest in ensuring that Canada has world-class standards for auditing and for auditor independence. Both Canadian and international auditing standards are undergoing major revision, in part as a response to the audit failures of recent years. Audits are becoming more rigorous and more sophisticated.

The CPAB comments on each auditing exposure draft issued by the AASB, highlighting situations where it believes, based on the results of its inspections, current Canadian standards need to be improved. For example, the CPAB noted the need for improvement in standards for audit documentation and standards where an auditor of financial statements relies on another auditor to do part of the required work – for example, work on the client’s operations in a foreign country. The AASB has now approved a new audit documentation standard and has approved a project to address group audits.

Further details about the CPAB may be found at www.cpab-ccrc.ca.

Accounting Standards Board

The AcSB has embarked on a strategic planning process of its own. It issued a Discussion Paper in June 2004, "Accounting Standards in Canada: Future Directions," outlining various matters that should be considered in formulating the AcSB’s strategic direction and policies. Responses to this Discussion Paper were taken into account in the Draft Strategic Plan the AcSB issued in May 2005. This draft outlines a significant change in direction for the AcSB. These documents can be found at <http://www.acsbcanada.org>.

The AcSB plans to pursue separate strategies for the major categories of reporting entities (public companies, private businesses and not-for-profit organizations). The AcSB recognizes that “one size does not necessarily fit all,” and that each category deserves a strategy that specifically addresses the particular needs of the users of its financial statements.

For public companies:

The best way to achieve the objective of a single set of globally accepted, high-quality accounting standards is to converge Canadian GAAP with International Financial Reporting Standards (IFRSs) over a transitional period, expected to be five years. At the end of that period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies. To achieve convergence, the AcSB will:

- amend or replace individual Canadian standards to conform to corresponding IFRSs, and adopt newly developed IFRSs;
- work with both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to ensure that the Canadian perspective is taken into account in the deliberations of those bodies; and
- work to promote the further convergence of IASB and FASB standards.

In taking on a role in the development of global standards, the AcSB will cease to make final decisions on most matters affecting the technical content and timing of implementation of standards applied in Canada.

Full convergence with IFRSs will be achieved by the changeover date at the end of the transitional period. The AcSB believes that, by providing ample lead time and a clear transition plan, the costs and disruption to affected stakeholders will be less than the alternative of a gradual, extended phase-in approach with multiple successive accounting changes. The AcSB may consider giving companies the ability to adopt individual converged standards during the transitional period as they are introduced into the CICA Handbook – Accounting to replace current standards.

The AcSB will review progress in implementing its strategy after the first 24-30 months. The AcSB will assess whether there have been significant changes in any of the environmental factors that have influenced the development of the strategy, without necessarily undertaking further public consultations. The plan will be assessed in particular against progress in the development of IFRSs and their acceptance globally. Assuming that the AcSB's review confirms the suitability of IFRSs as a basis for public company financial reporting in Canada, the AcSB will set the definitive changeover date when Canadian GAAP for public companies will be fully converged with IFRSs.

The AcSB acknowledges that US GAAP has been determined by competent authorities to be an appropriate alternative basis of financial reporting for certain public companies. Public companies would continue to be permitted to adopt US GAAP, in place of IFRSs, on the basis decided by lawmakers and regulators.

For private businesses:

The AcSB will undertake a comprehensive examination of who the users of these businesses' financial statements are, along with their needs, and then determine the most appropriate financial reporting model to meet those needs. The AcSB has no preconceived idea of the outcome of this process, but it could result in either similar or substantially different standards from those currently in use.

The proposed research may be conditional on obtaining additional resources and will take some time to complete, during which the current differential reporting model will remain in place. Any additional alternatives will be developed through the current process with the advice of the AcSB's Differential Reporting Advisory Committee.

The AcSB will clarify that GAAP requirements are intended to apply only to entities that have significant external users of financial information and require the application of a common basis of financial reporting. The AcSB plans to limit the scope of its standards to such entities, exempting a number of smaller private businesses that do not need GAAP financial statements.

For not-for-profit organizations:

Not-for-profit organizations (NFPOs) will continue to apply GAAP for profit-oriented enterprises applicable also to NFPOs. The AcSB will consult with the not-for-profit sector to determine whether all NFPOs should base their accounting on the standards for public companies, or whether some might base their accounting on the standards for Canadian private businesses or be exempted from the scope of accounting standards altogether. The AcSB will continue its current practice of developing standards that deal with the special circumstances of NFPOs, and will focus more of its attention on addressing those circumstances.

Canada will continue to maintain its own standard-setting capability to carry out the strategies outlined above, although the roles, structures, processes and resources will evolve to match those strategies.

In carrying out these strategies, the AcSB proposes to pay particular attention to the practical limitations on the ability of the Canadian financial reporting system to cope with change. In other words, the AcSB will be particularly sensitive to the "standards overload" issue. Where change is determined to be necessary, the AcSB will assist affected parties in dealing with change through, for example, participating in the development of implementation aids and training programs.

The AcSB will take into account any of the AASB's findings and proposals that are relevant to its own strategic directions. The AcSB will also work with the AASB and the Public Sector Accounting Board in resolving financial reporting issues it has in common with those boards.

Public Sector Accounting Board

During 2003 and 2004, the Public Sector Accounting Board (PSAB) developed new strategic directions for public sector reporting in Canada. Some of the key outcomes sought are as follows:

- the CICA Public Sector Accounting (PSA) Handbook becomes a comprehensive body of high-quality, generally accepted accounting and financial reporting standards for the Canadian public sector.
- the public sector in Canada prepares its financial statements in accordance with the CICA PSA Handbook.

- Auditors report whether public sector financial statements are prepared in accordance with the CICA PSA Handbook.

Canadian Securities Administrators

In 2004, the Canadian Securities Administrators issued National Instrument 52-107, which sets out accounting principles and auditing standards for preparing and auditing financial statements in documents filed with Canadian securities regulators. The National Instrument can be found at www.osc.gov.on.ca. The following table summarizes the auditing standards permitted for the audit of financial statements:

| | Canadian issuer | SEC issuer | Foreign issuers | | |
|--|-----------------|------------|--------------------|---------------------------|----------------------|
| | | | SEC foreign issuer | Designated foreign issuer | Other foreign issuer |
| Canadian GAAS | X | X | X | X | X |
| US GAAS | | X | X | X | X |
| International Standards on Auditing | | | X | X | X |
| Auditing standards accepted in the designated foreign jurisdiction | | | | X | |

Please refer to National Instrument 52-107 for definitions of terms used in the above table.

Standards overload issues

The AcSB's Discussion Paper refers to the increase in the pace of change in accounting standard setting in recent years, including the increase in the length and complexity of standards issued not only by accounting bodies but also by securities regulators, governments and others. The same is true of auditing standards. This trend is commonly described as "standards overload".

The AASB cannot resolve standard overload issues by itself. Much like the AcSB, the AASB is attempting to communicate better with stakeholders about its new standards and to assist others in developing implementation guidance for practitioners affected. Recent examples of this are:

- its involvement in the development of the CICA's *Quality Assurance Manual* in cooperation with practitioners from smaller firms and staff from provincial institutes;
- support for the development of an updated *Professional Engagement Manual* dealing with new audit risk standards; and
- sponsoring a revised Audit Technique Study on the audit of a small business that includes, among other things, new guidance on dealing with the audit risk model as it applies to such audits.

Although the AASB's role includes providing interpretive guidance to assist practitioners in applying its standards, it does not get involved in educational efforts designed to train auditors. While education is beyond the AASB's mandate and resources, it recognizes that it must work with others who are responsible for educating practitioners.

Appendix 2: AASB's operating principles — 2003 to 2005

The AASB's overriding goal is to set high-quality auditing standards that enable the profession to serve the public interest. In meeting this goal:

1. The AASB works with the AASOC to identify and address issues affecting Canada's auditing standard setting.
2. The AASB works toward international harmonization as follows:
 - When the IAASB develops new international standards, the AASB adopts them if they are of at least as high a quality as existing Canadian standards. For example, the AASB recently adopted the IAASB's standards on audit risk.
 - When the PCAOB develops new standards for reporting issuers in the US, the AASB considers adopting such standards when it believes that they improve the quality of Canadian auditing standards and are appropriate for a broad range of stakeholders. For example, the AASB has approved a standard on audit documentation that includes certain of the PCAOB's requirements.
 - The AASB seeks to eliminate significant differences between Canadian and US standards and to avoid creating new ones.
 - The AASB undertakes projects to continually improve the quality of the Handbook. Such projects may be to remove a gap in the Handbook or to update an existing standard, for example, resulting from suggestions made by regulators and others, such as the CPAB. In undertaking such projects, the AASB looks to existing IAASB and US guidance as a starting point. The AASB may develop new Canadian standards that go beyond existing IAASB and US standards where it considers it necessary to do so to reflect current practice. For example, the AASB recently issued standards on management representations and terms of engagement.
 - The AASB develops its own standards where the Canadian environment is different from other jurisdictions or where there are no existing IAASB or US standards. For example, the AASB is developing a standard on the auditor's report on public sector general-purpose financial statements.
3. The AASB contributes to the IAASB standard-setting process by providing technical input on IAASB Exposure Drafts.
4. The AASB explores means of improving processes to ensure that they are as efficient and effective as possible while remaining appropriately transparent.
5. The AASB researches issues surrounding the scope, content, structure and terminology used in the Handbook.
6. The AASB participates in discussions involving the CICA and the provincial institutes/ordre to address standards overload issues and develop a comprehensive

implementation guidance program to address the need for implementation guidance for standards.

7. The AASB considers means of improving two-way communications with stakeholders with a view to informing stakeholders of the AASB's project activities and seeking stakeholder input on project priorities, the quality of auditing standards and satisfaction with the AASB's processes.

Appendix 3: The IAASB Clarity Project timetable — 2006-2011

The following indicates the approximate timing of the IAASB's Clarity Project.

| | 2006-2007 | 2008-2011 |
|---|-----------|-----------|
| Objective and General Principles Governing an Audit of Financial Statements (ISA 200) Quality Control for Audits of Historical Financial Information (ISA 220) Documentation (ISA 230) Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements (ISA 240) Communication of Audit Matters with Those Charged With Governance (ISA 260) Planning an Audit of Financial Statements (ISA 300) Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (ISA 315) Audit Materiality (ISA 320) The Auditor's Procedures in Response to Assessed Risks (ISA 330) Audit Evidence (ISA 500) Audit of Accounting Estimates (ISA 540) Related Parties (ISA 550) Management Representations (ISA 580) The Audit of Group Financial Statements (ISA 600) Using the Work on an Expert (ISA 620) The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements (ISA 700) Modifications to the Opinion in the Independent Auditor's Report (ISA 705) Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (ISA 706) The Independent Auditor's Report on Other Historical Financial Information (ISA 701) The Independent Auditor's Report on Summary Audited Financial Statements (ISA 800) | X | |
| Terms of Audit Engagements (ISA 210) Consideration of Laws and Regulations in an Audit of Financial Statements (ISA 250) Audit Considerations Relating to Entities Using Service Organizations (ISA 402) Audit Evidence — Additional Considerations for Specific Items (ISA 501) External Confirmations (ISA 505) Initial Engagements — Opening Balances (ISA 510) Analytical Procedures (ISA 520) Audit Sampling and Other Means of Testing (ISA 530) Auditing Fair Value Measurements and Disclosures (ISA 545) ³ Subsequent Events (ISA 560) Going Concern (ISA 570) Considering the Work of Internal Auditing (ISA 610) Comparatives (ISA 710) Other Information in Documents Containing Audited Financial Statements (ISA 720) | | X |

³ Consideration will be given to whether the redrafted ISA 540 (following the clarity proposal) should subsume some or all aspects of ISA 545, as part of the effort to reduce duplicate guidance.

Appendix 4: The International Auditing and Assurance Standards Board

The IAASB is a standard-setting body designated by, and operating independently under, the auspices of the IFAC.⁴ Its goal is to serve the public interest by setting high-quality auditing, assurance, quality control and related services standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

Due Process

IAASB pronouncements are developed following a due process that includes input from the general public, IFAC member bodies and their members, and the IAASB Consultative Advisory Group (CAG) representing regulators, preparers and users of financial statements.

The process outlined below applies to the development of all IAASB standards.

Research and consultation

A task force is ordinarily established with the responsibility to develop a draft standard or practice statement. The task force develops its positions based on appropriate research and consultation.

Transparent debate

A proposed standard is presented for discussion and debate at an IAASB meeting, which is open to the public.

Exposure for public comment

Exposure drafts are placed on the IAASB's website and are widely distributed for public comment. The exposure period is ordinarily no shorter than 120 days. The public has access to comment letters.

Consideration of comments received on exposure

The comments and suggestions received as a result of exposure are considered at an IAASB meeting, which is open to the public, and the exposure draft is revised as appropriate. If the IAASB believes the changes made after exposure are substantive and require re-exposure, the revised document will be reissued for further comment.

Affirmative approval

Approval of exposure drafts, re-exposure drafts, international standards and practice statements is made by the affirmative vote of at least two-thirds of the members.

⁴ The International Federation of Accountants (IFAC) is the worldwide organization of the accountancy profession. It is dedicated to serving the public interest, strengthening the worldwide accountancy profession and contributing to the development of strong international economies. Its current membership consists of 163 professional accountancy bodies in 119 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce.

Role of the Public Interest Oversight Board

An international Public Interest Oversight Board (PIOB) oversees IFAC's public interest activities. The objective of the PIOB is to increase confidence of investors and others that such activities, including the setting of IAASB standards, are properly responsive to the public interest. PIOB members are nominated by international institutions and regulatory bodies. David Brown, former chair of the Ontario Securities Commission, and Michael Hafeman, former assistant superintendent of financial institutions at the Office of the Superintendent of Financial Institutions (OSFI), are Canadian members at the PIOB.

Role of the IAASB CAG

The CAG comprises representatives of regulators, business and international organizations, as well as users and preparers of financial statements, who are interested in the development of high-quality international standards on auditing, assurance, quality control and related services. Through active consultation, the IAASB receives valuable public interest input from the CAG on its agenda, project timetable, priorities and technical issues.

Further information about the IAASB, its pronouncements and the processes it observes in developing its international standards is available at www.ifac.org/IAASB.

Appendix 5: Comparison between Canadian standards and ISAs

(A more detailed comparison of individual Canadian standards and ISAs is available at www.cica.ca/aasb.)

Legal and regulatory environment

Because ISAs have to apply to any legal and regulatory environment, they tend to be more generic than national equivalents. For this reason, few jurisdictions have completely abandoned their standard-setting activities. There continues to be a need to interpret ISAs in the context of the local regulatory environment.

A number of Canadian standards deal specifically with the Canadian environment, for example:

- sections dealing with specialized areas such as auditor involvement with offering documents of public and private entities;
- communications with law firms;
- communications with actuaries; and
- auditor's report on financial statements of federally regulated financial institutions.

Objective and fundamental principles of auditing

Canadian standards and ISAs are founded on similar general objective and fundamental principles of auditing, such as the following:

- The objective of an audit is to enable an auditor to express an opinion on whether the financial statements taken as a whole are free from material misstatement.
- An auditor acts with due care and with an objective state of mind.
- An auditor applies professional scepticism to achieve a critical assessment of evidence obtained.
- An auditor is not associated with misleading information.
- An auditor obtains sufficient appropriate audit evidence to afford a reasonable basis to support the content of the report.
- An auditor provides a clear report of the results and conclusions of the work performed.

Layout and format standards

| Canadian Handbook | IAASB Handbook |
|--|--|
| Contains Handbook Sections and Assurance and Related Services Guidelines | Contains ISAs and International Auditing Practice Statements (IAPs) |
| The professional standards — Recommendations — are contained in italicized type. Explanatory material is contained in unitalicized type. | Basic principles and essential procedures are contained in bold type. Explanatory material is contained in grey lettering. |

| | |
|--|---|
| <p>Contains standards for:</p> <ul style="list-style-type: none"> • Assurance engagements • Review engagements • Related services | <p>Contains standards for:</p> <ul style="list-style-type: none"> • Assurance engagements • Review engagements • Related services |
| <p>Material includes specific guidance, where necessary, with respect to:</p> <ul style="list-style-type: none"> • Audits of small entities • Public sector audits <p>Such material is integrated into the guidance and generally not separately identified.</p> | <p>Material includes specific guidance, where necessary, with respect to:</p> <ul style="list-style-type: none"> • Audits of small entities • Public sector audits <p>Such material is generally separately identified in the guidance.</p> |

Other differences

Certain matters are not addressed in the auditing standards because they are the responsibility of the provincial institutes and are addressed in the rules of professional conduct, for example communications between predecessor and successor auditors and confidentiality.