

## BASIS FOR CONCLUSIONS Section 7150, Auditor's Consent to the Use of a Report of the Auditor Included in an Offering Document

January 2013

This Basis for Conclusions has been prepared by staff of the Auditing and Assurance Standards Board (AASB). It relates to, but does not form part of, Section 7150, AUDITOR'S CONSENT TO THE USE OF A REPORT OF THE AUDITOR INCLUDED IN AN OFFERING DOCUMENT.

### Purpose of this Basis for Conclusions

This Basis for Conclusions provides a brief summary of the AASB's objectives in developing Section 7150, the public exposure and approval steps for this project and how the AASB dealt with significant matters arising from comments received in response to its Exposure Draft. This information is set out below.

### Background

The development of Section 7150 was undertaken as part of the AASB's project to revise the "7000 series of standards" that focus primarily on the auditor's role and responsibilities in the capital markets. Section 7150 replaces:

- (a) Section 7110, AUDITOR INVOLVEMENT WITH OFFERING DOCUMENTS OF PUBLIC AND PRIVATE ENTITIES;
- (b) Section 7115, AUDITOR INVOLVEMENT WITH OFFERING DOCUMENTS OF PUBLIC AND PRIVATE ENTITIES – CURRENT LEGISLATIVE AND REGULATORY REQUIREMENTS; and
- (c) ASSURANCE AND RELATED SERVICES GUIDELINE AuG-30, The Auditor's Consent and Comfort in Connection with Securities Offering Documents.

In August 2012, the AASB issued an Exposure Draft on Section 7150 (ED-7150). Two written responses to the ED-7150 were received. In addition to the two responses, consultation sessions with various stakeholders were held to seek input on the ED-7150.

The AASB approved Section 7150 at its meeting in October 2012. The Auditing and Assurance Standards Oversight Council confirmed that the AASB followed due process in developing Section 7150 and related consequential amendments prior to their issuance in the CICA Handbook – Assurance.

### AASB's Objectives in Developing Section 7150

The AASB's objectives in developing Section 7150 included the following:

- (a) to deal with concerns identified in the wording of the auditor's consent letter addressed to Canadian securities regulators; and
- (b) to clarify the auditor's responsibilities when an intervening period event is identified and the audited financial statements were prepared in accordance with a financial reporting framework that does not allow dual dating.

### *Wording of the Auditor's Consent Letter Addressed to Canadian Securities Regulators*

Section 7115 prescribed wording of the auditor's consent letter addressed to Canadian securities regulators ("regulatory consent letter"), which included a restriction on use of the letter and legal liability disclaimer regarding losses or damages for actions taken based on the letter. AuG-30 provided an example regulatory consent letter that reflected the relevant requirements in Section 7115. In response to concerns raised by the Canadian Securities Administrators, the auditor's consent letter under Section 7150 does not contain wording related to restrictions in use of the letter and disclaimers of legal liability.

In certain circumstance, Canadian securities regulations require the auditor's consent letter to state:

"I report that I have read the [specify type] prospectus and all information specifically incorporated by reference therein and have no reason to believe that there are any misrepresentations in the information contained therein that are derived from the financial statements upon which I have reported or that are within my knowledge as a result of my audit of such financial statements."

The words "have no reason to believe" are similar to those included in a review engagement report of a public accountant. This might lead readers to misunderstand the nature and extent of the auditor's involvement with information included in an offering document. Further, such misunderstanding might result in management, those charged with governance, underwriters, or other parties placing unwarranted reliance on the auditor's consent and, consequently, failing to fulfill their respective responsibilities in a securities offering. Section 7150 requires the consent letter to include wording in addition to that prescribed by regulation to clarify that the work done by the auditor providing consent does not constitute an audit or review of the offering document.

### *The Auditor's Responsibilities when Intervening Period Events Are Identified*

Offering documents may include audited financial statements that were amended to reflect intervening period events. Prior to the changeover to International Financial Reporting Standards (IFRSs), Canadian generally accepted accounting principles (GAAP) allowed the financial statement amendments to be made using a dual-dating approach. However, International Accounting Standards (IAS) 10 *Events after the Reporting Period* requires the entity to disclose the date when the financial statements were authorized for issue and who gave that authorization. This requirement has typically, but not universally, been interpreted as prohibiting dual dating.

Canadian Auditing Standard (CAS) 560, *Subsequent Events*, permits the auditor to take a dual-dating approach for the auditor's report only when dual dating is allowed by the applicable financial reporting framework, and the dual-dating approach has been followed by management in authorizing the amended financial statements. Section 7150 requires the auditor to follow relevant requirements in CAS 560 to deal with the circumstance when a material misstatement in the audited financial statements is identified, or when previously issued financial statements are otherwise amended to reflect intervening period events. In other circumstances, Section 7150 provides guidance on appropriate actions that can be taken by the auditor.

### **Significant Matters Arising from Comments in Response to ED 7150**

#### *Type of Standard*

1. A respondent suggested that Section 7150 be clearly positioned as a "procedure-based standard" as opposed to an "evidence-based standard". To explain the concept of a procedure-based standard versus an evidence-based standard, the respondent provided the following example:
  - (a) If Section 7150 is a procedure-based standard, the auditor would perform only the procedures specified in paragraph 13 to identify intervening period events.
  - (b) If Section 7150 is an evidence-based standard, the auditor would need to determine whether and, if so, what procedures beyond those listed in paragraph 13 are necessary to identify intervening period events.
2. Using Handbook terminology, a procedure-based engagement is an agreed-upon procedures engagement and an evidence-based engagement is an assurance engagement.
3. Section 7150 is not an agreed-upon procedures standard as contemplated in Section 9100, REPORTS ON THE RESULTS OF APPLYING SPECIFIED AUDITING PROCEDURES TO FINANCIAL INFORMATION OTHER THAN FINANCIAL STATEMENTS, and Section 9110, AGREED-UPON PROCEDURES REGARDING INTERNAL CONTROL OVER FINANCIAL REPORTING. Under Section 7150, the auditor is not precluded from exercising professional judgment in determining the nature and extent of procedures to be performed.
4. Consistent with extant Section 7110, Section 7115, and AuG-30, Section 7150 is also not an assurance engagement standard as defined in Section 5025, STANDARDS FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION. Paragraph 9 states, in part: "An engagement to provide consent is not an assurance engagement." As set out in Appendix 4 of the *Preface to the CICA Handbook – Assurance*, standards covering specialized areas, such as Section 7150, can be classified in a number of ways, including as related services standards. The AASB notes that there are some AASB projects underway that may result in reconsidering what constitutes "assurance".

#### *Effective Date*

5. ED-7150 proposed that Section 7150 be effective for an auditor's consent issued on, or after, approximately 90 days of issuance of Section 7150 in the Handbook, with early adoption allowed.
6. A participant in a consultation session indicated that it may be possible for an auditor to be involved with an entity's securities offering process that could extend beyond a 90-day period. This may occur if the entity's filings with securities regulatory authorities are repeatedly rejected due to incomplete information provided. The participant speculated that this situation may not be uncommon as many smaller entities may not have sufficient resources to properly prepare offering documents at the outset. The participant suggested that the effective date should take such situations into consideration and allow the auditor to complete an engagement under the extant standard if the engagement has already started.
7. The AASB reaffirmed the appropriateness of the proposed effective date. Securities legislation states that "an issuer must not file a final prospectus more than 90 days after the date of the receipt for the preliminary prospectus that relates to the final prospectus." Therefore, if the securities offering process extends beyond 90 days, a new preliminary prospectus is required to be filed. In this circumstance, the entity would need to make a request for the auditor to provide consent to the use of his or her report in a new prospectus. In the AASB's view, this would represent a new engagement and, accordingly, it would be appropriate for the auditor to update the terms of the engagement and his or her procedures as set out in Section 7150.
8. The AASB also received a suggestion that early adoption be disallowed because provincial securities regulatory bodies can better monitor and enforce compliance with one standard having a single effective date.
9. Given the relatively short time period between the inclusion of Section 7150 in the Handbook and the proposed effective date, the AASB agreed with the suggestion to disallow early adoption since it would have little impact in practice.

#### *Definition of "Misrepresentation"*

10. Paragraph A21 provides a discussion of the term "misrepresentation". A respondent suggested that the term be included in the definitions paragraphs of the standard. In developing Section 7150, the term misrepresentation was intentionally positioned in an application paragraph rather than in a definition. As used in Section 7150, this term is meant to be read in the context of the definition provided in the applicable legislative provision or contractual agreement.
11. In finalizing Section 7150, the AASB also reconsidered the appropriateness of the last sentence of paragraph A22 in ED-7150 (paragraph A21 of Section 7150), which provided guidance that, in the absence of legislative provisions and comparable rights, the auditor's concern would be limited to matters that appear to represent an untrue statement of a material fact. The AASB concluded that this sentence was inappropriate for the following reasons:
  - (a) This sentence seemed to provide a default definition of the term "misrepresentation", which is inconsistent with the intention that the term be read in the context of the definition provided in the applicable legislative provision or contractual agreement.
  - (b) Providing guidance stating that the auditor's concern is limited to untrue statements of material facts is inconsistent with the auditor's objective. The objective states that obtaining an appropriate basis to consent includes the resolution of matters that have come to the auditor's attention. Such matters include, for example, omissions that have come to the auditor's attention.

For the reasons stated above, the sentence is not included in Section 7150. As a consequential amendment, the same sentence was also deleted from AUDITOR'S CONSENT TO THE USE OF THE AUDITOR'S REPORT IN CONNECTION WITH DESIGNATED DOCUMENTS, paragraph 7500.A26.

*Intervening Period Events*

12. Paragraph 13(b) of ED-7150 required the auditor to make inquiries of management and, when appropriate, those charged with governance. This wording is consistent with that in CAS 560, *Subsequent Events*, for inquiries regarding subsequent events. In finalizing Section 7150, the AASB deleted the reference to those charged with governance from paragraph 13(b) because the process for identifying intervening period events is not an audit of subsequent events as set out in CAS 560. Initial inquiries regarding intervening period events would normally be made only of management. This change does not mean that the auditor ignores matters involving those charged with governance. For example, paragraph 13(c) requires the auditor to read minutes, if any, of the meetings of the entity's owners, management and those charged with governance that have been held in the intervening period and inquiring about matters discussed at any such meetings for which minutes are not yet available. Also, if matters come to the auditor's attention that require further inquiries, paragraph 18 requires the auditor to make inquiries of "management and, when appropriate, those charged with governance, or the entity's legal counsel ..." to resolve those matters.
13. Paragraph 13(d) of ED-7150 required the auditor to:
  - (a) consider intervening period events when performing review procedures on the interim financial statements included in an offering document; or
  - (b) read the entity's latest interim financial statements not included in the offering document.

In finalizing Section 7150, the AASB concluded that this wording could be misinterpreted to mean that an auditor who is performing review procedures on interim financial statements included in the offering document could ignore intervening period events, if the auditor reads the entity's latest interim financial statements not included in the offering document. Therefore, the AASB replaced the word "or" with "and" to clarify what is required.

*Written Representations*

14. Paragraph 13(f) of ED-7150 required the auditor to obtain representations from management and, where appropriate, those charged with governance regarding intervening period events. In finalizing Section 7150, the AASB reconsidered this requirement and is of the view that written representations should not be limited to intervening period events. The AASB noted that the requirement in extant paragraph 7110.67(f) was for the auditor to obtain "appropriate written representations from management." The auditor should request those written representations that the auditor deems appropriate in the circumstances. Therefore, the AASB replaced paragraph 13(f) in ED-7150 with a requirement for the auditor to obtain appropriate written representations from management and, where appropriate, those charged with governance in paragraph 19.

*Wording of the Auditor's Consent Addressed to a Canadian Securities Regulator*

15. A respondent expressed general agreement with the proposed wording of the auditor's consent addressed to a Canadian securities regulator but suggested that some specific wording be changed. The consent wording in ED-7150 was developed after careful consideration of concerns raised by staff of the Canadian Securities Administrators. As no fatal flaw was identified by the respondent and all other respondents expressed agreement with the wording, the AASB concluded that no change to the consent wording was necessary.
16. Paragraph A9 of Section 7150 notes that only because of a regulatory requirement to do so, the auditor makes the statement in the auditor's consent that he or she has "read the offering document ... and has no reason to believe that there are any misrepresentations ..." A respondent suggested deleting this assertion from paragraph A9. The reason given by the respondent was that there is an implication that the assertion would not be appropriate but for the fact that it is prescribed by securities legislation. In the view of the respondent, this implication is not accurate given that the AASB concluded that it is appropriate for the auditor to make this assertion in the auditor's consent.

17. The AASB concluded that no change should be made to paragraph A9. The auditor's statement relating to reading the offering document and having no reason to believe that there are any misrepresentations is required by Canadian securities legislation. As explained in paragraph A9, this statement could be misinterpreted as implying that the auditor is providing a moderate level of assurance that the offering document does not contain misrepresentations. In the AASB's view, the guidance in paragraph A9 is essential in providing the basis for the requirements for the auditor to clarify his or her responsibilities in the terms of the engagement and in communications with underwriters.

*Clarifying that the Auditor's Consent Addressed to a Canadian Securities Regulator Is Normally Filed on SEDAR and Not Included in the Offering Document*

18. Two consent letters have been provided by auditors in connection with certain offering documents filed with a Canadian securities regulator. For such offering documents, one auditor's consent has been included in the offering document and a different consent has been addressed to the Canadian securities regulator. The consent addressed to the Canadian securities regulator was not included in an offering document but was posted on the System for Electronic Document Analysis and Retrieval (SEDAR).
19. ED-7150 proposed requiring only one auditor's consent letter relating to these offering documents. However, ED-7150 was unclear as to whether the auditor's consent addressed to the Canadian securities regulator would also be reproduced in the offering document. Therefore, paragraph A25 of Section 7150 now clarifies that the auditor's consent addressed to a Canadian securities regulator is normally posted on SEDAR and not included in the offering document.
20. In finalizing Section 7150, the AASB also included additional guidance in paragraph A24 to clarify that an auditor's consent that arises through an agreement between the auditor and the entity is provided only to the entity.

*Advice Letter to Securities Regulatory Authorities*

21. Paragraph 24(a) of ED-7150 required the auditor to perform the procedures in paragraph 13 up to a date as close as is reasonable and practicable to the date of the preliminary prospectus. Paragraph 13 deals with intervening period events. The intention of paragraph 24(a) of ED-7150 (paragraph 25(a) of Section 7150) is for the auditor to update all the procedures necessary to obtain an appropriate basis to provide comfort on the financial statements included in the preliminary prospectus when the auditor's report on the financial statements is unsigned. To better reflect this intention, in finalizing Section 7150, the AASB replaced the reference to "performing the procedures in paragraph 13" with "performing the procedures in this Section."
22. Paragraph A28 provides guidance related to the advice letter issued by the auditor to securities regulatory authorities providing comfort on financial statements in a preliminary prospectus. Appendix 5 provides an illustrative advice letter. In ED-7150, the illustrative advice letter states that the auditor is withholding his or her signature from the draft report in the preliminary prospectus pending the auditor's:
- review of events between the dates of the preliminary and final prospectuses;
  - review of comments, which may be issued by the Commission(s); and
  - reading of the final prospectus.
23. Since the financial statements are not yet complete at the preliminary prospectus stage, those charged with governance would not have authorized the financial statements and the financial statements cannot be audited. Therefore, in finalizing Section 7150, the AASB:
- deleted references to "audited" when referring to the incomplete financial statements; and
  - added guidance to clarify that:
    - at the preliminary prospectus stage, those charged with governance have not authorized the financial statements; and
    - the authorization of the financial statements by those charged with governance is required for the audit to be completed.

24. Further, the AASB reproduced the pending matters covered in the illustrative example letter in paragraph A28 to provide context to the auditor as to when it is appropriate to issue an advice letter.

*Additional Guidance in the Illustrative Engagement Letter*

25. Appendix 2 of ED-7150 presented an illustrative engagement letter. A respondent suggested the following additional guidance be included in the example engagement letter:
- a reference to the expected form and content of the auditor's consent; and
  - a statement relating to the auditor's responsibility to resolve matters that have come to the auditor's attention.
26. The AASB agreed with the respondent's suggestion regarding inclusion of a reference to the expected form and content of the auditor's consent since this is required in paragraph 8(d) of Section 7150. Accordingly, the AASB included a reminder in the illustrative engagement letter for the auditor to insert appropriate reference to the expected form and content of the auditor's consent.
27. With respect to the statement relating to the auditor's responsibility to resolve matters, the AASB concluded that the inclusion of such a statement in the illustrative engagement letter is not necessary. This is because paragraph 8 does not require the auditor to include a statement relating to the auditor's responsibility to resolve matters.

*Consequential Amendments to Section 7200*

28. ED-7150 proposed guidance regarding an auditor's response to a question posed by an underwriter in Example N of Section 7200, AUDITOR'S ASSISTANCE TO UNDERWRITERS AND OTHERS. This guidance is meant to clarify that the statement in the auditor's consent: "... I report that I have read the [short form] prospectus ... and have no reason to believe that there are any misrepresentations in the information contained therein ..." does not mean that the auditor has audited or reviewed the offering document. A respondent to ED-7150 suggested that the auditor's response also include a statement that the auditor may wish to state that he or she expects to be in a position to issue a consent to the use of his or her report at the time the offering is completed in final form. The AASB did not make a change to the standard in response to this comment because of concerns that the suggested statement might dilute the key message that the auditor did not perform an audit or review on the offering document.
29. Another respondent suggested that the AASB modify paragraph 7200.48 to make reference to the Ordre des comptables professionnels agréés du Québec, which was formed in May 2012 pursuant to the unification of the accounting profession in Quebec. Section 7200 will be revised in the near term and this matter will be considered then.

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