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## GENERAL ASSURANCE AND AUDITING

### SECTION 5600

#### auditor's report on financial statements prepared using a basis of accounting other than generally accepted accounting principles

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**Effective date.** The Recommendations in this Section apply to auditors' reports dated on or after October 1, 2003.

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#### INTRODUCTION AND SCOPE

- .01 Reporting standard (iv) in GENERALLY ACCEPTED AUDITING STANDARDS, paragraph 5100.02, indicates "Where an opinion is expressed, it should indicate whether the financial statements present fairly ... in accordance with Canadian generally accepted accounting principles except when the financial statements are prepared as described in AUDITOR'S REPORT ON FINANCIAL STATEMENTS PREPARED USING A BASIS OF ACCOUNTING OTHER THAN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, paragraph 5600.09."
- .02 Generally accepted accounting principles is the basis of accounting used for general purpose financial statements, which are intended to meet the common information needs of external users. When engaged to report on general purpose financial statements, the auditor would refer to THE AUDITOR'S STANDARD REPORT, Section 5400.
- .03 There are circumstances when specific users may require financial statements prepared using a basis of accounting other than generally accepted accounting principles to meet their information needs. When the auditor performs an engagement to report on such financial statements, it is important for the auditor to have an understanding of the purpose of the financial statements, the basis of accounting used and the expressed interests of specified users. Before accepting the engagement, the auditor uses this information to determine what responsibility the auditor will be assuming. The auditor also uses this information in designing the nature, extent and timing of audit procedures for the engagement.
- .04 This Section provides guidance to an auditor engaged to express an opinion

on financial statements that are prepared using a basis of accounting other than generally accepted accounting principles. It applies only when such financial statements are prepared:

- (a) in accordance with regulatory or legislative requirements to meet the specific needs of a regulator or a legislator; or
- (b) in accordance with written contractual requirements such as may be set out in trust indentures or buy / sell agreements.

.05 The auditor cannot control an entity's distribution of financial statements upon which the auditor reports. For example, certain entities may be required by a regulator to place their financial statements on a public record. However, other entities may inappropriately provide financial statements prepared for specific users to a broader financial statement user group, such as its shareholders, who may use the financial statements for a variety of purposes. Broader distribution of financial statements prepared for specific users does not render them general purpose financial statements. However, because of the possible wide distribution and use of such financial statements, it is important that the auditor's report clearly communicates to readers the purpose of the financial statements and the specified users. The report should also indicate that the financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

#### **AGREEING THE TERMS OF THE ENGAGEMENT**

.06 When an entity's incorporating or other governing legislation requires general purpose financial statements to be prepared in accordance with generally accepted accounting principles, the auditor would not accept an engagement to report under this Section on general purpose financial statements prepared pursuant to that legislation. In this situation, if financial statements prepared in accordance with accounting principles other than generally accepted accounting principles are also required under other legislation, regulation or contractual requirements, the auditor would accept an engagement to report under this Section only when it is confirmed by the entity that the financial statements reported on under this Section are not general purpose financial statements, regardless of the distribution of such statements. In writing, preferably in an engagement letter, the auditor would advise the entity that:

- (a) the financial statements prepared using accounting principles other than generally accepted accounting principles do not comply with and will not satisfy the entity's incorporating or other governing legislation;
- (b) those charged with governance should consider the financial and other implications of such non-compliance and may wish to obtain legal advice; and
- (c) the auditor accepts no responsibility for any implications of potential non-compliance with the incorporating or other governing legislation.

.07 When an entity's incorporating or other governing legislation requires financial statements to be prepared in accordance with accounting principles other than generally accepted accounting principles, the auditor would not accept an engagement to report under this Section on general purpose financial statements prepared pursuant to that legislation. The auditor would advise those charged with governance of the entity that, if general purpose financial statements are prepared using accounting principles other than generally accepted accounting principles, the auditor would be required to issue a reservation in the auditor's report in accordance with RESERVATIONS IN THE AUDITOR'S REPORT, Section 5510.

- <sup>1</sup> The auditor would, however, be able to accept an engagement to report under this Section on financial statements prepared pursuant to that legislation, but only when it is confirmed by the entity that the financial statements reported on under this Section are not general purpose statements, regardless of the distribution of such statements.
- .08 Before accepting an engagement to report under this Section, the auditor would obtain, through means including discussion with management, an understanding of the specified user(s) of the financial statements and the purpose(s) for which they will use them, and the basis of accounting used. The auditor would confirm this understanding in writing, preferably in an engagement letter. The auditor would also assess whether the basis of accounting used in the financial statements is suitable for the engagement. Guidance on suitable criteria for assurance engagements is provided in STANDARDS FOR ASSURANCE ENGAGEMENTS, Section 5025.
- .09 ♦ *The auditor should accept an engagement to report under this Section only when the financial statements have been prepared:*
- (a) *in accordance with regulatory or legislative requirements to meet the specific needs of a regulator or a legislator; <sup>2</sup> or*
- (b) *in accordance with written contractual requirements such as may be set out in trust indentures or buy / sell agreements. [OCT. 1, 2003 <sup>\*</sup>]*
- .10 The auditor would not accept an engagement to report under this Section on financial statements that have been prepared for the purpose of meeting a precondition to entering into a contract that does not exist. When an existing contract is subject to change or renewal, the engagement would be performed based on the terms of the contract in force at the period-end date of the financial statements.
- .11 The auditor would inform the entity that because the financial statements have been prepared as described in this Section they are not intended for distribution to anyone other than the specified users. However, an auditor is not responsible for controlling the entity's distribution of its financial statements. Accordingly, the auditor's report will include a paragraph after the opinion paragraph indicating that the financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose. The auditor may also wish to include commentary in the engagement letter indicating that should the entity distribute the financial statements to anyone other than the specified users the auditor accepts no responsibility for any loss or damage suffered by the addressee or any other reader as a result of using the financial statements for any other purpose.
- .12 ♦ *The auditor should confirm in writing the understanding reached with the entity as to the intended purpose(s) and specified user(s) of the financial statements and the basis of accounting used. [OCT. 1, 2003 <sup>\*</sup>]*

#### **DISCLOSURE IN THE FINANCIAL STATEMENTS**

- .13 When forming an opinion on financial statements, the auditor considers whether the disclosure of information on significant accounting policies is consistent with the Recommendations of DISCLOSURE OF ACCOUNTING POLICIES, CICA HANDBOOK – ACCOUNTING Section 1505. The auditor also considers whether the financial statements include informative disclosures that are in accordance with the basis of accounting used.
- .14 The auditor needs to consider whether any significant interpretations of the regulatory, legislative or contractual requirements have been made by management in preparing the financial statements. An interpretation is

significant when adoption of another reasonable interpretation would have produced a material difference in the financial statements. Such interpretations may affect the nature, extent and timing of audit procedures.

- .15 ♦ *When expressing an opinion on financial statements prepared using a basis of accounting other than generally accepted accounting principles as described in paragraph 5600.09, the auditor should consider whether the presentation and disclosures in the financial statements are in accordance with the basis of accounting used and the notes to the financial statements appropriately describe the:*
- (a) *purpose(s) of such financial statements;*
  - (b) *basis of accounting used in preparing the financial statements including:*
    - (i) *the significant accounting policies;*
    - (ii) *management's significant interpretations, if any, of regulatory, legislative or contractual requirements; and*
    - (iii) *other informative disclosures; and*
  - (c) *material differences between the basis of accounting and generally accepted accounting principles, which need not be quantified. [OCT. 1, 2003 \* ]*

#### **THE AUDITOR'S REPORT**

- .16 ♦ *The auditor's report on financial statements prepared using a basis of accounting other than generally accepted accounting principles as described in paragraph 5600.09 should include "Auditor's Report" in the title of the report and be presented as described in paragraph 5600.17. [OCT. 1, 2003 \* ]*
- .17 ♦ *When engaged to express an opinion on financial statements prepared using a basis of accounting other than generally accepted accounting principles, the auditor should:*
- (a) *in the introductory paragraph, state that:*
    - (i) *the financial statements identified in the report have been audited;*
    - (ii) *the financial statements have been prepared for [the purpose (s)] [if the purpose(s) are described in the notes to the financial statements, it is sufficient for the auditor's report to refer to that description];*
    - (iii) *the financial statements are the responsibility of the entity's management; and*
    - (iv) *it is the auditor's responsibility to express an opinion on the financial statements based on the audit;*
  - (b) *in the scope paragraph, state that:*
    - (i) *the audit was conducted in accordance with Canadian generally accepted auditing standards;*
    - (ii) *those standards require that an audit be planned and performed to obtain reasonable assurance whether the financial statements are free of material misstatement; and*
    - (iii) *an audit includes:*
      - *examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;*
      - *assessing the accounting principles used and significant*

- estimates made by management; and*
- *evaluating the overall financial statement presentation;*
- (c) *in the opinion paragraph, express the auditor's opinion whether the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the entity in accordance with the basis of accounting described in the notes to the financial statements;*
- (d) *in a paragraph following the opinion paragraph, state that these financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of (the addressee) and:*
- (i) *(the regulator or legislator), and/or*
  - (ii) *(the parties to the contract),*
- for (the purpose(s)), and are not intended to be and should not be used by anyone other than the specified users, or for any other purpose; and*
- (e) *disclose the addressee, which in most cases will be the person engaging the auditor, the name of the auditor (or firm), the date of the report, and the place of issue. [OCT. 1, 2003 \*]*

#### **RESERVATION OF OPINION**

- .18 The auditor's responsibilities in expressing a reservation in his or her report are established in reporting standards (iii) and (iv) in GENERALLY ACCEPTED AUDITING STANDARDS, paragraph 5100.02. In determining whether a reservation is necessary, the auditor will consider the materiality of the matter (see MATERIALITY AND AUDIT RISK IN CONDUCTING AN AUDIT, Section 5130).
- .19 ♦ *The auditor should express a reservation in his or her report in the following circumstances:*
- (a) *there is a departure from the disclosed basis of accounting;*
  - (b) *there is a failure to appropriately disclose the information specified in paragraph 5600.15 in the notes to the financial statements or to present information in an appropriate manner; or*
  - (c) *there is a limitation in the scope of the examination and as a result the auditor is unable to determine whether there is a departure from the disclosed basis of accounting. [OCT. 1, 2003 \*]*
- .20 The auditor is referred to RESERVATIONS IN THE AUDITOR'S REPORT, Section 5510, for guidance on reporting when expressing a reservation in the auditor's report.

#### **CHANGES IN BASIS OF ACCOUNTING OR SIGNIFICANT INTERPRETATIONS**

- .21 When there has been a change in the basis of accounting, the method of application of an accounting principle or any significant interpretation of the regulatory, legislative or contractual requirements, the auditor would refer to the guidance in THE AUDITOR'S STANDARD REPORT, paragraphs 5400.17-.21.

#### **APPENDIX**

#### **EXAMPLES OF AUDITOR'S REPORTS ON FINANCIAL STATEMENTS PURPOSE OF THE EXAMPLES**

The following examples are provided for illustrative purposes only. They

have been designed to illustrate the form and possible content of the auditor's report and note to the financial statements describing the basis of accounting for financial statements prepared using a basis of accounting other than generally accepted accounting principles as described in this Section. The auditor must exercise professional judgment when drafting the auditor's report to ensure that the wording meets the requirements of this Section and adequately informs the reader of the purposes of the financial statements.

### **SUMMARY OF EXAMPLES**

- Example A** — Auditor's report on pension fund financial statements filed with a regulator
- Example B** — Auditor's report on financial statements prepared in accordance with the terms of a purchase or sale agreement
- Example C** — Auditor's report on non-consolidated financial statements prepared both for income tax purposes and in accordance with the lending agreement with DEF Bank for the purpose of monitoring its existing loan
- Example D** — Auditor's report on financial statements of a co-operative housing association filed with Canada Mortgage and Housing Corporation

### **EXAMPLE A**

#### **Auditor's report on pension fund financial statements filed with a regulator**

##### **Situation**

- The financial statements have been prepared in accordance with a legislative requirement to meet the expressed needs of the regulator.
- The regulator makes the financial statements available as a matter of public record.
- The financial statements are not in accordance with generally accepted accounting principles because they exclude pension obligations calculated in accordance with PENSION PLANS, CICA HANDBOOK – ACCOUNTING Section 4100.

#### **AUDITOR'S REPORT**

To the Trustees of ABC Pension Plan

I have audited the statement of net assets available for benefits of the fund of ABC Pension Plan as at ....., 20... and the statement of changes in net assets available for benefits for the year then ended. These financial statements have been prepared to comply with Section xx of the ..... Act. These financial statements are the responsibility of the pension plan's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the net assets available for benefits as at ....., 20... and the changes in net assets available for benefits for the year then ended in

accordance with the basis of accounting described in Note X to the financial statements.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Trustees of the ABC Pension Plan and (name of regulatory authority) for complying with Section xx of the ..... Act. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

City (signed).....

Date CHARTERED ACCOUNTANT

**Note X to the financial statements:**

**BASIS OF ACCOUNTING**

The financial statements have been prepared in accordance with the significant accounting policies set out below to comply with the accounting requirements prescribed by (name of regulatory authority) for financial statements under Section xx of the ..... Act. The basis of accounting used in these financial statements materially differs from Canadian generally accepted accounting principles because it excludes the actuarial liabilities of the plan. Consequently, these financial statements do not purport to show the adequacy of the plan's assets to meet its pension obligations.

**EXAMPLE B**

**Auditor's report on financial statements prepared in accordance with the terms of a purchase or sale agreement**

**Situation**

- The financial statements have been prepared using a basis of accounting specified in the terms of an agreement between the parties to the transaction.
- The financial statements are not in accordance with generally accepted accounting principles because property has been recorded at appraised values in accordance with the terms of the agreement between the parties to the transaction. Amortization and future income taxes have been adjusted accordingly.
- ABC Limited has engaged the auditor to report on the financial statements prepared pursuant to the purchase and sale agreement.

**AUDITOR'S REPORT**

To the Directors of ABC Limited

I have audited the balance sheet of ABC Limited as at ....., 20... and the statements of income, retained earnings and cash flows for the year then ended. These financial statements have been prepared to comply with Section A of the purchase and sale agreement dated ....., 20... between ABC Limited and DEF Limited. These financial statements are the responsibility of the company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the

overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the company as at ....., 20... and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note X to the financial statements.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of ABC Limited and DEF Limited for complying with Section A of the purchase and sale agreement dated ....., 20... between ABC Limited and DEF Limited. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

City (signed).....

Date CHARTERED ACCOUNTANT

**Note X to the financial statements:**

**BASIS OF ACCOUNTING**

The financial statements have been prepared in accordance with the significant accounting policies set out below to comply with Section A of the purchase and sale agreement dated ....., 20... between ABC Limited and DEF Limited. The basis of accounting used in these financial statements materially differs from Canadian generally accepted accounting principles because property has been recorded at appraised values. The difference between the appraised values of property and its net book value has been reflected as an appraisal increase credit in shareholders' equity.

Amortization of property and future income taxes have been based on the appraised values of property.

**EXAMPLE C**

**Auditor's report on non-consolidated financial statements prepared both for income tax purposes and in accordance with the lending agreement with DEF Bank for the purpose of monitoring its existing loan**

**Situation**

- The entity has a subsidiary and the entity's directors require audited non-consolidated financial statements for the following purposes:
  - income tax purposes; and
  - in accordance with the lending agreement with a bank for the purpose of monitoring its existing loan.
- The financial statements are not intended as the general purpose financial statements.
- The financial statements are not in accordance with generally accepted accounting principles because they have been prepared on a non-consolidated basis.
- The auditor has accepted the engagement to report on the entity's non-consolidated financial statements both for income tax purposes and in accordance with the lending agreement with DEF Bank for the monitoring of its existing loan.

**AUDITOR'S REPORT**

To the Directors of ABC Limited

I have audited the balance sheet of ABC Limited as at ....., 20... and the statements of income, retained earnings and cash flows for the year then

ended. These financial statements have been prepared on a non-consolidated basis both for income tax purposes and in accordance with the lending agreement with DEF Bank for the purpose of monitoring its existing loan. The financial statements are the responsibility of the company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the company as at ....., 20... and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note X to the financial statements.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of ABC Limited, the federal and provincial income tax authorities, for income tax purposes, and DEF Bank, for the purpose of monitoring its existing loan under the loan agreement dated ....., 20..., as updated on ....., 20.... The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

City (signed).....

Date CHARTERED ACCOUNTANT

#### **Note X to the financial statements:**

##### **BASIS OF ACCOUNTING**

These financial statements have been prepared in accordance with the significant accounting policies set out below. These financial statements materially differ from Canadian generally accepted accounting principles because they are non-consolidated. The company's investment in its wholly-owned subsidiary GHI Limited has been recorded at cost. Earnings from the investment are recognized only to the extent dividends are received or receivable.

##### **EXAMPLE D**

#### **Auditor's report on financial statements of a co-operative housing association filed with Canada Mortgage and Housing Corporation.**

##### **Situation**

- The housing association is incorporated under provincial co-operative corporations legislation that requires financial statements prepared in accordance with Canadian generally accepted accounting principles.
- Under the terms of the mortgage agreement with Canada Mortgage and Housing Corporation (CMHC), financial statements must be filed using prescribed accounting requirements. These accounting requirements differ materially from Canadian generally accepted accounting principles.
- Financial statements have been prepared in accordance with CMHC's prescribed accounting requirements. The auditor cannot accept an engagement to report on these financial statements under this

Section if the purpose of the engagement is to assist the housing association meet its reporting requirements under its incorporating legislation. However, the auditor would be able to report under this Section for the purpose of meeting CMHC's filing requirements.

#### AUDITOR'S REPORT

To the Directors of ABC Housing Co-operative

I have audited the balance sheet of ABC Housing Co-operative as at ....., 20... and the statements of changes in net assets, operations and cash flows for the year then ended. These financial statements have been prepared to comply with Section xx of the mortgage agreement dated ....., 20... with Canada Mortgage and Housing Corporation (CMHC). The financial statements are the responsibility of the co-operative's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the co-operative as at ....., 20... and the results of its operations and its cash flows for the year then ended in accordance with the basis of accounting described in Note X to the financial statements.

These financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Directors of ABC Housing Co-operative and CMHC to comply with Section xx of the mortgage agreement dated ....., 20... with CMHC. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

City (signed).....  
Date CHARTERED ACCOUNTANT

#### **Note X to the financial statements:**

##### **BASIS OF ACCOUNTING**

These financial statements have been prepared in accordance with the significant accounting policies set out below to comply with Section xx of the mortgage agreement dated ....., 20... with Canada Mortgage and Housing Corporation (CMHC). The basis of accounting used in these financial statements materially differs from Canadian generally accepted accounting principles because:

- (a) amortization is not provided on building and furniture and equipment purchased from loans recognized by CMHC over the estimated useful lives of these assets but rather at a rate equal to the annual principal reduction of the mortgage;
- (b) capital assets:
  - (i) purchased from accumulated surplus are charged to operations in the year the expenditure is incurred, and
  - (ii) purchased from the replacement reserve are charged against

- the replacement reserve account,  
rather than being capitalized on the balance sheet and amortized  
over their estimated useful lives; and
- (c) a reserve for future capital replacement is appropriated annually from  
operations.
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## Endnotes

1. When reporting on financial statements of federal, provincial, territorial or local governments, the auditor would refer to AUDIT OF GOVERNMENT FINANCIAL STATEMENTS, Section [PS 5200](#), for guidance.
  2. Such financial statements are considered to meet the specific needs of a regulator or a legislator notwithstanding that the financial statements may be required to be placed on the public record. For the purposes of this Section, non-consolidated financial statements prepared for income tax purposes are considered to be financial statements prepared in accordance with regulatory or legislative requirements.
- [1] \* See explanation of [effective date](#) at the beginning of this Section.
- [2] \* See explanation of [effective date](#) at the beginning of this Section.
- [3] \* See explanation of [effective date](#) at the beginning of this Section.
- [4] \* See explanation of [effective date](#) at the beginning of this Section.
- [5] \* See explanation of [effective date](#) at the beginning of this Section.
- [6] \* See explanation of [effective date](#) at the beginning of this Section.