

BASIS FOR CONCLUSIONS CANADIAN AUDITING STANDARD (CAS) 700, Forming an Opinion and Reporting on Financial Statements

September 2009

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, Canadian Auditing Standard 700, *Forming an Opinion and Reporting on Financial Statements*.

Background

In August 2007, the International Auditing and Assurance Standards Board (IAASB) issued its Exposure Draft of International Standard on Auditing (ISA) 700 (Redrafted), *The Independent Auditor's Report on General Purpose Financial Statements* (ED-ISA 700). The IAASB approved final ISA 700, including revising its title, in September 2008 subject to confirmation by the Public Interest Oversight Board (PIOB) that due process was followed. This confirmation was received in March 2009.

In September 2007, the AASB issued its Exposure Draft to adopt proposed ISA 700 as CAS 700 (ED-CAS 700) to replace Section 5400, THE AUDITOR'S STANDARD REPORT. Several Assurance and Related Services Guidelines are affected by new CAS 700 as follows:

- AuG-21, Canada-United States Reporting Differences — withdrawn;
- AuG-40, Auditor's Report on the Financial Statements of Federally Regulated Financial Institutions — the AASB is considering the future of this Guideline in discussions with the Office of the Superintendent of Financial Institutions Canada; and
- AuG-45, Legislative Auditor's Report on Financial Statements of a Federal, Provincial or Territorial Government — withdrawn.

There were 12 respondents to ED-CAS 700 (identified below).

The AASB approved CAS 700 in December 2008. The Auditing and Assurance Standards Oversight Council reviewed due process followed by the AASB in the development of this CAS prior to its issuance in the CICA Handbook – Assurance.

Purpose of this Basis for Conclusions

This Basis for Conclusions has been prepared to make Canadian stakeholders aware of the following.

- (a) A Basis for Conclusions prepared by IAASB staff for ISA 700 is available on the IAASB web site, and provides information on how the IAASB dealt with comments received on significant matters in response to the ED-ISA 700.
- (b) Information on how the AASB dealt with significant matters arising from comments received in response to its ED-CAS 700 is also available. This information is set out below.

Significant Matters

AASB's Consideration of Amendments to ISA Wording

1. CAS 700 contains no amendment to the ISA wording. However, as noted below, a change has been made in illustrative auditor's reports.
Use of the Phrases "present fairly" and "give a true and fair view"
When describing the wording of the auditor's opinion, ED-ISA 700 referenced two phrases — "present fairly, in all material respects" and "give a true and fair view." In Canada, governing legislation often requires use of, and it is generally accepted practice to use, the phrase "present fairly, in all material respects." The AASB wished to maintain consistency of reporting in Canada and believe it is appropriate for auditors to continue to use that phrase. Accordingly, ED-CAS 700 proposed to require that when expressing an opinion on financial statements prepared in accordance with a fair presentation framework, the auditor would use only the phrase "present fairly, in all material respects" (i.e., not use the phrase "give a true and fair view"). A similar amendment was proposed in ED-CAS 705, *Modifications to the Opinion in the Independent Auditor's Report*. Respondents were supportive of the AASB's proposal that auditors continue to use the phrase "present fairly, in all material respects."
2. Respondents to ED-CAS 210, "Agreeing the Terms of Audit Engagements," which contained a similar proposed amendment, were also generally supportive of the AASB's approach. However, some respondents to ED-CAS 210 pointed out that the proposed amendments may have unintended consequences. These respondents noted that it is possible that a Canadian auditor may be asked to conduct an engagement in jurisdictions other than Canada where use of the phrase "give a true and fair view" is appropriate in the auditor's report. Therefore, making it a requirement that the auditor use the phrase "present fairly, in all material respects" when reporting in accordance with the CASs would

cause difficulty for Canadian auditors in accepting such engagements. They took the position that it would be inappropriate for CAS 210 to create such difficulty, given that the ISAs indicate that the two phrases are regarded as equivalent.

4. A respondent to ED-CAS 210 believed that the proposed amendment was not warranted because it did not meet the criteria for an amendment since, in the respondent's view, it did not relate to a matter that is "particular to the Canadian environment." This respondent believed that the phrase "present fairly, in all material respects" will likely continue to be used in Canada even if the amendment is not made.
5. One of the AASB's goals in adopting ISAs is to enable Canadian auditors to conduct audits on an equal footing with auditors in other jurisdictions. The proposed amendments were not intended to prevent auditors from accepting engagements in other jurisdictions where use of the term "give true and fair view" might be required. Also, the AASB believes that most auditors will continue to use the phrase "present fairly, in all material respects" in the auditor's opinion on the financial statement of Canadian entities even without various CASs containing a prohibition on the use of "true and fair view." Further, the two phrases are the same when translated into French. Accordingly, the AASB concluded that it should not include amendments to delete the phrase "give a true and fair view" from the requirements in the ISAs. However, it is important that illustrative reports provide appropriate guidance as to the wording most commonly used when reporting on the financial statements of Canadian entities in accordance with the CASs. Therefore, the AASB has amended the wording of the auditor's opinion in the illustrative reports so that in the CASs the opinions refer only to "present fairly, in all material respects." The *Preface to the CICA Handbook – Assurance* will provide an explanation of these amendments to the ISAs.

6. In summary, based on the above conclusions, the AASB decided not to make the amendment proposed in ED-CAS 700.

Form of Auditor's Report on General Purpose Financial Statements

7. As reflected in ED-CAS 700, the AASB held the view that the form of report on general purpose financial statements under the IAASB audit reporting model did not sufficiently differentiate financial statements prepared in accordance with an established financial reporting framework (such as generally accepted accounting principles (GAAP)) from those that are prepared in accordance with an acceptable financial reporting framework that is not an established framework. Canada has a sophisticated set of accounting standards, developed over many years, with respect to the preparation and presentation of general purpose financial statements for all types of entities. This has been reflected in most incorporating or other governing legislation of Canadian entities. The AASB believes that readers of audited financial statements have come to expect that such financial statements have been prepared in accordance with Canadian GAAP or, in certain circumstances, recognized financial reporting frameworks such as US GAAP and International Financial Reporting Standards (IFRSs). It also believes that readers expect to be alerted when such financial statements have not been prepared in accordance with an established GAAP.
8. Accordingly, the AASB stated its intention to add a requirement to the ED-CAS 210 that when the financial reporting framework to be used in preparation and presentation of general purpose financial statements is not the financial reporting standards established by an organization authorized or recognized to promulgate standards to be used by certain types of entities, the auditor shall advise management or, where appropriate, those charged with governance, in the terms of the audit engagement that the auditor's report on the entity's financial statements will incorporate an Other Matter paragraph, with a subheading titled "Financial Reporting Framework." This paragraph would be in accordance with CAS 706, *Emphasis of Matter Paragraphs or Other Matter Paragraphs in the Independent Auditor's Report*, and would:
 - (a) indicate that the financial statements are not, and are not intended to be, prepared and presented in accordance with Canadian generally accepted accounting principles, and
 - (b) describe, or draw users' attention to additional disclosures in the notes to the financial statements that describe:
 - (i) each difference between the basis on which the financial statements are prepared and Canadian generally accepted accounting principles that are applicable to its financial statements, or state that there are no such differences; and
 - (ii) how the reported financial position and performance of the entity would have differed if it had complied with Canadian generally accepted accounting principles.
- The AASB also stated that it intended to add an application material paragraph referring to the requirement in the ED-CAS 210. Appropriate conforming amendments would have been required in CAS 700.
9. While respondents to the ED-CAS 210 were supportive of the importance of Canadian GAAP to financial reporting in Canada, and virtually all supported the need to make amendments to proposed ISA 210, the views of respondents with respect to the nature and effectiveness of the proposed amendment were mixed. The following summarizes the significant points raised by respondents.
 - (a) Legislative auditors took the position that the requirements and guidance on determining the acceptability of a financial reporting framework in the ED-CAS 210 are open to different interpretations. In particular, they noted that paragraph A9 of the ED-CAS 210 could be interpreted as suggesting that a financial reporting framework prescribed by law or regulation by default is an acceptable framework. As a result, they concluded that the proposed amendment in ED-CAS 210 would make it more difficult for auditors to conclude that a legislated

- framework for general purpose financial statements is not acceptable and possibly lead to the increased use of inappropriate frameworks.
- (b) Legislative auditors are also prevented by their mandates from refusing to accept engagements to audit the financial statements of their respective governments and related bodies. Further, governments have the power to set their own accounting policies. Accordingly, legislative auditors noted that they may be put in the position of having to issue unmodified compliance reports with an Other Matter paragraph on general purpose financial statements prepared using a basis of accounting other than GAAP, when current practice would be to issue a qualified opinion on such financial statements.
 - (c) Some respondents took the position that the amendment did not go far enough because it did not mandate the use of Canadian GAAP in all cases. Other respondents accepted that Canadian GAAP might not be used for general purpose financial statements in all cases but expressed the view that the amendment should be strengthened by requiring quantification of the differences between the basis of accounting used and GAAP, similar to what would be required when the auditor issues a qualified opinion.
 - (d) Some respondents took the position that the amendment was not justified under the AASB's criteria for making amendments to the ISAs because, in their view, Canadian readers of audit reports are no less sophisticated than readers in other jurisdictions. Accordingly, there is no "particular circumstance in Canada" that warrants a different solution. As long as stakeholders carefully read the auditor's report and the notes to the financial statements, they should be able to determine the basis of accounting used in preparing the financial statements and respond accordingly.
 - (e) Some respondents expressed the following concerns.
 - (i) The required disclosures of the differences between the basis of accounting used and GAAP would likely not be identified by management and so auditors would have to take the responsibility for identifying these differences and including them in the auditor's report. Therefore, the proposed amendment would likely result in long and cumbersome audit reports.
 - (ii) There is an assumption that the comparison between the basis of accounting used and GAAP will be relevant to the readers of the financial statements, which may not be the case.
 - (iii) The comparison between the basis of accounting and GAAP may be of limited value in future because, under proposals of the Canadian Accounting Standards Board, there will be several different possible frameworks for preparation of general purpose financial statements and users may consider that the framework used for the comparison in the auditor's report is not appropriate for their purposes.
 - (f) Some respondents also stated that some audit engagements may be reconstituted as audits in accordance with the ISAs rather than the CASs in order to avoid the mandatory Other Matter paragraph in the auditor's report.
 - (g) Some respondents also noted that under the CASs an auditor may issue an Other Matter paragraph when the auditor believes that it is necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit. Therefore, an auditor may make the disclosures in the auditor's report even without the proposed amendment.
10. In reviewing the matters raised by respondents, the AASB agreed that the proposed amendment to the auditor's report contains some significant drawbacks. In addition, the AASB acknowledged that Canadian auditors may have difficulty applying the guidance in the ED-CAS 210 when determining the acceptability of a financial reporting framework in the Canadian context. It recognized that the proposed amendment was not intended to address the auditor's determination of the acceptability of the financial reporting framework. It was focused on the form of auditor's report on financial statements prepared using an acceptable financial reporting framework other than an established GAAP. The AASB recognized that if Canadian auditors have difficulty in determining the acceptability of a financial reporting framework, there is a risk that auditors may accept frameworks that are not, in fact, acceptable and this may lead to a decline in the quality of financial reporting in Canada.
11. In considering how best to address the comments made by respondents, the AASB noted that the final ISA 210 includes improvements over proposed ISA 210, on which ED-CAS 210 was based, that responded to concerns raised by the AASB and others concerning unacceptable financial reporting frameworks prescribed by law or regulation. Paragraphs 19-20 of final ISA 210 require that when a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the engagement only if:
- (a) management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and
 - (b) it is recognized in the terms of the audit engagement that:
 - (i) the auditor's report will incorporate an Emphasis of Matter paragraph; and
 - (ii) the auditor's opinion will not include the phrase "present fairly, in all material respects."
12. If these conditions are not present, and the auditor is required by law or regulation to undertake the engagement, the auditor shall evaluate the effect of the misleading nature of the financial statements on the auditor's report, and include appropriate reference to this matter in the terms of the audit engagement. The AASB believes that these requirements assist, for example, a legislative auditor who is required to report on financial statements prepared using an

unacceptable financial reporting framework to report appropriately when the financial statements are misleading. Therefore, the AASB believes that paragraphs 19-20 in ISA 210 address the concern expressed by legislative auditors that some general purpose financial statements, prepared using a compliance financial reporting framework, could be misleading but that the legislative auditor would nevertheless have to issue an unmodified auditor's report on such statements.

13. The AASB reconsidered whether the form of the auditor's report needed to be amended in ED-CAS 210. The fundamental question is whether readers of audit reports will be misled by the new form of auditor's report in the CASs. The AASB concluded that it should not make the proposed amendment in ED-CAS 210 for the reasons set out below.
 - (a) Respondents' concerns about the drawbacks of the proposed amendment in ED-CAS 210 are compelling to the extent the proposed amendment would not have achieved the objective of improving readers' understanding of the auditor's report.
 - (b) Auditors are permitted under the CASs to add Other Matter paragraphs to their audit reports when they consider it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in their judgment, is relevant to users' understanding of the audit.
 - (c) The AASB proposed to supplement the material in paragraph A8 of ISA 210 so that auditors will be less likely to find acceptable a financial reporting framework that is not one of the frameworks referred to in the proposed new paragraphs. The proposed supplement did not require a conforming amendment to CAS 700.

Summary of Significant Accounting Policies

14. The AASB believes that existing Canadian GAAP does not require financial statements to contain a summary of significant accounting policies. Accordingly, the AASB proposed an amendment to paragraph 20(d) of ED-ISA 700 to read as follows:
 - (d) Refer to the summary of significant accounting policies, where applicable, and other explanatory notes;
15. The majority of respondents who commented on this proposal were of the view that the amendment should not be made because the respondents believed that Canadian GAAP does require such a summary and because the proposed amendment might be interpreted as providing an option. Accordingly, the AASB concluded that the amendment proposed in ED-CAS 700 should not be made.

Withdrawal of AuG-45

16. A respondent believed that AuG-45 should not be withdrawn as proposed by the AASB. However, the respondent believed that AuG-45 needs to be revised to address the situation when a legislative auditor is required to report on financial statements prepared in accordance with a government's stated accounting policies, which departs from GAAP. The AASB noted that the situation identified by the respondent and the other situations dealt with in AuG-45 are addressed in paragraph A31 of CAS 700 and related paragraphs and confirmed its decision to withdraw AuG-45.

Concept of "Compliance Framework"

17. A respondent expressed the view that the term "compliance framework" is obscure and that it is not clear which of the two frameworks currently applies in Canada. The respondent also expressed the view that all material relating to compliance frameworks should be removed from CAS 700. The AASB agreed that the compliance framework concept is new in Canada. The existing Handbook is premised on the use of only one reporting framework — Canadian GAAP — whereas the audit reporting model in the CASs recognizes that auditors may be requested to report on different frameworks in different circumstances, in a global context. The AASB believes that it is a fundamental principle of adopting the ISAs that Canadian auditors be able to report on a global basis. Accordingly, the AASB did not make any change to CAS 700. However, the AASB agrees that further communication is required regarding the new audit reporting model and its implications. As part of the overall communication strategy applicable to the adoption of the CASs, a decision will be made regarding the appropriate format, content and delivery method for further communications and guidance in this respect.

Other Matters

None.

List of Respondents to ED-CAS 700

Assistant Comptroller General Canada

Auditor General Alberta

Auditor General of Canada

BDO Dunwoody LLP

Canadian Public Accountability Board Deloitte & Touche LLP

KPMG LLP

Meyers Norris Penny LLP

Ordre des comptables agréés du Québec

Provincial Auditor Saskatchewan

Provincial Comptroller's Division — Ministry of Finance, Saskatchewan Vérificateur général du Québec

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