

Background and Purpose

The former CICA Handbook was premised on the use of only one reporting framework—Canadian GAAP—whereas the reporting model within the Canadian Auditing Standards allows for circumstances where the auditor may be requested to report on different frameworks in a global context.

The audit reporting model contained within Canadian Auditing Standards (CASs) is new, complex, and somewhat ambiguous, which poses challenges to auditors in interpreting the requirements. While supplemental guidance prepared by the CICA provides some relief to the challenges, there still remains a fair amount of room for different interpretations.

The purpose of this discussion paper is to consider the various reporting alternatives within the CASs reporting model and to develop tentative Office positions for the financial statement audits conducted within the B.C. public sector.

Executive Summary

The tentative OAG views expressed in this paper can be summarized as follows:

1. Auditors should encourage government entities to prepare their publicly accountable external financial statements in accordance with a general purpose reporting framework;
2. If there is no material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity's financial statements, the auditor can provide a fair presentation opinion;
3. If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity's financial statements, the auditor can provide a compliance opinion when the requirements of paragraph 19 of CAS 210 have been met;
4. If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity's financial statements and the requirements of paragraph 19 of CAS 210 have not been met, the auditor is required to evaluate the misleading nature of the financial statements on the auditor's report—in most cases this will result in a modified report;
5. If there is no material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government organization's financial statements, the financial reporting framework can be described as "Canadian Public Sector Accounting Standards" or as "Canadian Public Sector Accounting Standards and the requirements of Section 23.1 of the Budget Transparency and Accountability Act";
6. A fair presentation opinion will be provided on the government's summary financial statements as required under the Auditor General Act. If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410, a modified report will be issued; and

7. To ensure compliance with the Auditor General Act, the financial reporting framework for the government's summary financial statements will be described in the auditor's report as "Canadian Public Sector Accounting Standards, which is one of the financial reporting frameworks included in Canadian generally accepted accounting principles".

References

Together, these CASs interact to create the new audit reporting model:

- CAS 200, "*Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Canadian Auditing Standards*";
- CAS 210, "*Agreeing the Terms of Audit Engagements*";
- CAS 700, "*The Independent Auditor's Report on General Purpose Financial Statements*";
- CAS 705, "*Modifications to the Opinion in the Independent Auditor's Report*";
- CAS 706, "*Emphasis of Matter Paragraphs and Other Paragraphs in the Independent Auditor's Report*"; and
- CAS 800, "*Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*".

Canadian-specific guidance referred to:

- "*Reporting Implications of New Auditing and Accounting Standards*"—Issue No. 7—January 2012 (CICA-AASB);
- *Explanatory Memorandum—“Reporting on Financial Statements under Canadian Auditing Standards”*—March 2011 (CICA-AASB);
- *Basis of Conclusions—CAS 200, CAS 210, CAS 700* (CICA-AASB); and
- April 23, 2012 Comment Letter to OAG from Ken Krauss, Chair AASB Auditor Reporting Implications of the New Canadian Auditing Standards Task Force (ARIC).

Identifying the purpose of the financial statements

Financial statements can be prepared in accordance with either a general purpose or a specific purpose financial reporting framework under the new audit reporting model.

- CAS 200, paragraph A4, describes "general purpose financial statements" as financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users.
- CAS 200, paragraph A4, also describes "special purpose financial statements" as financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specific users.

Financial reporting frameworks developed by the Accounting Standards Board (AcSB) or the Public Sector Accounting Standards Board (PSAB) are developed to meet the information needs of a wide range of users for financial statements such that they are general purpose frameworks (AcSB or PSAB frameworks).

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In accordance with guidance from ARIC, when a financial reporting framework is not one of the AcSB or PSAB frameworks, determining whether the framework is a general or special purpose framework may be complex. For example, such a framework may be designed because:

- The prescriber of the financial reporting framework does not agree with an accounting requirement of the AcSB or PSAB frameworks but the financial reporting framework is still intended to meet the information needs of a wide range of users. In such a case, the financial reporting framework may still be a general purpose framework (even though the auditor may not consider the financial reporting framework acceptable).
- The prescriber of the financial reporting framework may prescribe an accounting requirement that differs from an AcSB or PSAB frameworks to meet specific information needs. For example, a ministry may require that a school board prepare financial statements for the ministry in a particular form but also make the financial statements available to the school board's stakeholders. In such a case, even though the financial statements are distributed to the school board's stakeholders, the financial reporting framework may be a special purpose framework.
- In rare circumstances, the AcSB or PSAB framework may not address the circumstances of a particular type of entity (for example, a rate-regulated entity) or the particular financial information being reported on (an acquisition statement for an oil and gas property). In such a case, the financial reporting framework may still be a general purpose framework even though the framework is not an AcSB or PSAB framework.

Under the new reporting model, the auditor needs to determine whether the financial reporting framework is a general or specific purpose framework as it may not always be the case that all financial reporting frameworks for government organizations are general purpose frameworks. However, it is the OAG's view that the BC general public is not well served if government organizations begin publishing special purpose financial statements which also serve as the primary accountability statements to legislators and the general public. While we acknowledge that paragraph A4 of CAS 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* suggests that financial statements with broad distribution can still be considered special purpose financial statements, we do not believe it is in the public interest to issue these types of external statements in the BC public sector. Accordingly, we will encourage government and government organizations to prepare their publicly accountable external financial statements in accordance with a general purpose reporting framework.

OAG Position—Auditors should encourage government entities to prepare their publicly accountable external financial statements in accordance with a general purpose reporting framework.

Acceptability of a General Purpose Financial Reporting Framework

A key decision the auditor must make in determining whether to accept the engagement is whether the financial reporting framework is acceptable (paragraph 6(a) of CAS 210). At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders (paragraph A8 of CAS 210). In Canada, the AcSB and PSAB are authorized or recognized to promulgate standards to be used by certain types of entities for general purpose financial statements. Paragraph CA8a of CAS 210 states that AcSB and PSAB standards “are relevant” in determining the acceptability of the applicable financial reporting framework in Canada. This paragraph intends that a starting point in determining the acceptability of a general purpose financial reporting framework will always be whether the financial reporting framework is one of the frameworks in AcSB or PSAB standards. The auditor must use professional judgment in deciding whether a financial reporting framework that departs from those standards is an acceptable general purpose framework.

Paragraph A9 of CAS 210 states that, in some jurisdictions, law or regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements for certain types of entities. In the absence of **indications to the contrary**, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared by such entities.

Although there may be circumstances where law or regulation prescribes a financial reporting framework other than the AcSB or PSAB frameworks, the auditor will often determine that such financial reporting framework is not acceptable once the auditor considers relevant indicators. For example, where the accounting standard setter has already considered a particular issue and reached a conclusion on the appropriate measurement and disclosures, a modification which conflicts with this conclusion is likely to be an indicator that the financial reporting framework is unacceptable.

However, there may be limited circumstances where a financial reporting framework prescribed by law or regulation that is other than the AcSB or PSAB frameworks developed by the AcSB or PSAB may be acceptable. An example would be where the AcSB or PSAB framework does not address the specific circumstances of a particular type of entity (for example, a rate-regulated entity) or does not address the financial information being reported on (an acquisition statement for oil and gas).

Accordingly, even where modifications to AcSB or PSAB frameworks are made that may be appropriate in these limited circumstances, the auditor will still need to consider whether the modifications result in an acceptable general purpose financial reporting framework by considering whether indicators to the contrary exist. In accordance with ARIC guidance provided to the OAG, factors that may be considered in determining whether indicators to the contrary exist include:

- The transparency of the process followed to develop the modification to the framework;
- The opportunity for input from stakeholders;
- The stated reasons for the modification; and
- Whether the resulting financial statements will be misleading.

At the end of this assessment process, the auditor will have reached a conclusion that the financial reporting framework:

- (a) Is one of the frameworks developed by either the AcSB or PSAB;
- (b) Contains additional legislative requirements that do not conflict with one of the frameworks in (a) (for example when the requirements narrow the range of acceptable choices under the framework in (a));
- (c) Is not one of the frameworks in (a) or is a framework containing requirements that conflict with (a) but the conflicts are acceptable in the circumstance; or
- (d) Is not one of the frameworks in (a) or is a framework containing requirements that conflict with (a) but the conflicts are not acceptable in the circumstances – CAS 210 has specific requirements under this scenario.

Restricted Contributions Regulation

It is noted that under Section 23.1(2) of the Budget Transparency and Accountability Act (BTAA), the Treasury Board has the power to modify the accounting standards that would normally be used for financial statements in the BC public sector. When the Treasury Board uses its powers, the auditor needs to determine whether such modifications are acceptable or whether there are “indications to the contrary”. An auditor would make this determination using professional judgment in considering the matters referred to in the previous section.

To date, Treasury Board has issued two regulations under the BTAA. One regulation relates solely to BC Hydro and addresses an accounting issue that is not currently addressed by the framework used by BC Hydro (IFRS). This ‘modification’ appears not to conflict with the applicable framework and therefore appears to fall under framework (b) in the previous section. This regulation will not be discussed further in this paper.

The other regulation issued by Treasury Board—the *Restricted Contributions Regulation*—which applies to all “taxpayer-supported” government organizations, could conflict with the applicable reporting framework used by these types of organizations (i.e., PSA standards). Whether this regulation actually conflicts with PSAB standards for a particular organization depends on the nature and extent of government transfer-related transactions of the organization. For some organizations, this will represent a significant conflict, while for others it will have no impact. So while it may be concluded that the regulation in substance conflicts with the PSA standards, it does not necessarily follow that the conflicts will have a material impact on all organizations.

Implications for the BC Public Sector

In the event that the auditor considers the framework to be unacceptable, paragraph 8 of CAS 210 requires the auditor to not accept the engagement except as provided in paragraph 19. The OAG believes this will arise for organizations in the BC public sector where there is a material conflict between the requirements of the Restricted Contributions Regulation and Section PS 3410 of the PSA Handbook.

Paragraph 19 of CAS 210 deals with the situation where the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation. In turn, Paragraph 20 of CAS 210 deals with the situation when the conditions in paragraph 19 are not present but the auditor is required to accept the engagement.

The key features of paragraph 19 are:

- Management is required to make additional disclosures to avoid the financial statements from being misleading. Assuming management agrees to make such disclosures, it is a matter of professional judgment whether the auditor believes that management's disclosures could be sufficient to achieve this goal.
- In considering the additional disclosures, the auditor would use caution, particularly when the body prescribing the financial reporting framework is not independent of the entity that would apply such a framework. If the auditor believes that the disclosures do not avoid the financial statements from being misleading, or management does not agree to provide required additional disclosures, then the auditor is required to evaluate the misleading nature of the financial statements on the auditor's report – in most cases, this will mean a modified opinion.
- The auditor adds an emphasis of matter paragraph to the auditor's report that refers to the additional disclosures.
- The auditor's report must not include phrases that imply the framework is a fair presentation framework, unless required by law or regulation.

Consequently, the OAG believes that paragraphs 19 and 20 of CAS 210 will be relevant in the circumstances when the requirements of the Restricted Contribution Regulation results in a material conflict with Section PS 3410. To assist auditors in this determination, the OAG has developed the guideline "Accounting for Government Transfers under New Section PS 3410".

OAG Position—If there is no material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity's financial statements, the auditor can provide a fair presentation opinion.

OAG Position—If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity’s financial statements, the auditor can provide a compliance opinion when the requirements of paragraph 19 of CAS 210 have been met.

OAG Position—If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government entity’s financial statements and the requirements of paragraph 19 of CAS 210 have not been met, the auditor is required to evaluate the misleading nature of the financial statements on the auditor’s report—in most cases this will result in a modified report.

Description of the Financial Reporting Framework

Paragraph 15 of CAS 700 requires the auditor to determine whether the financial statements adequately describe the financial reporting framework. The auditor usually describes the financial reporting framework in the auditor’s report using the same wording that is used in the financial statements.

When the financial reporting framework includes Public Sector Accounting Standards and requirements of the Treasury Board that do not conflict, the financial reporting framework may be described as “Canadian Public Sector Accounting Standards”.

The framework might also be described as “Canadian Public Sector Accounting Standards and the requirements of the Budget Transparency and Accountability Act”. In reviewing this latter form of description, ARIC offered the following comments:

- This description will generally not be appropriate when the requirements of the Treasury Board conflict with Public Sector Accounting Standards because it would imply that the financial statements have been prepared in accordance with Public Sector Accounting Standards when this is not the case.
- The words “the requirements of the Budget Transparency and Accountability Act” may not be precise enough to explain what the accounting requirements are. This is especially true if such act contains numerous sections that address matters other than financial reporting. Consideration should be given to referring to the specific accounting requirements in that Act.

The OAG believes that for circumstances where there is no material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410, it is appropriate to describe the reporting framework as either “Canadian Public Sector Accounting Standards” or “Canadian Public Sector Accounting Standards and the requirements of Section 23.1 of the Budget Transparency and Accountability Act”.

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The OAG further believes that for circumstances where there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410, it is appropriate to describe the reporting framework as “Section 23.1 of the Budget Transparency and Accountability Act”.

A question arises as to the auditor’s responsibility in circumstances where the auditor does not believe the financial statements provide an adequate description of the financial reporting framework (i.e., is not consistent with the above paragraphs). Unfortunately, the CASs do not provide guidance in circumstances where the reporting framework is described differently in the financial statements than what is considered acceptable in the auditor’s report (i.e., in circumstances where the financial statements do not provide an adequate description of the framework). Is an appropriate response by the auditor to include an additional explanatory paragraph in his/her auditor’s report? This would appear to us to be the most practical approach in this circumstance.

OAG Position—If there is no material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410 in a government organization’s financial statements, the financial reporting framework can be described as “Canadian Public Sector Accounting Standards” or as “Canadian Public Sector Accounting Standards and the requirements of Section 23.1 of the Budget Transparency and Accountability Act”.

Summary Financial Statements—Requirement to Report under GAAP

Section 11(2) of the Auditor General Act requires that the Auditor General must state whether the financial statements of the government reporting entity are presented fairly in accordance with generally accepted accounting principles. The requirements of this section imply that a fair presentation opinion is required on the government’s summary financial statements (i.e., a compliance opinion is not an option). Therefore, if adopting the Restricted Contributions Regulation results in a material conflict with the Public Sector Accounting Standards, the OAG will need to issue a modified report based on failure to comply with the Public Sector Accounting Standards.

In considering the implications of the requirements of the Auditor General Act on the ability to report appropriately, we are guided by paragraph 21 of CAS 210 which requires, in cases where law prescribes the wording/form of the auditor’s report, the auditor to evaluate whether users might misunderstand the assurance obtained from the audit of the financial statements and whether additional explanation in the auditor’s report can mitigate possible misunderstanding. If the auditor concludes that additional explanation in the auditor’s report cannot mitigate possible misunderstanding, the auditor shall not include any reference within the auditor’s report to the audit having been conducted in accordance with Canadian generally accepted auditing standards. However, this latter requirement is not an option for the Auditor General as he is required under Section 11(1) of the Auditor General Act to report in

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accordance with generally accepted auditing and assurance standards, which in our view is equivalent to “Canadian generally accepted auditing standards”.

Further, under the new CASs auditors must specify the exact financial reporting framework for which they are reporting on, that is, they can no longer use the generic reference to “in accordance with GAAP”. Consequently, the OAG is guided by CICA guidance (Reporting Implications of New Auditing and Accounting Standards—November 2011, Q&A 1(g)) which suggests the adoption of the following wording: “Canadian Public Sector Accounting Standards, which is one of the financial reporting frameworks included in Canadian generally accepted accounting principles”.

OAG Position—A fair presentation opinion will be provided on the government’s summary financial statements. If there is a material conflict between the accounting results under the Restricted Contributions Regulation and Section PS 3410, a modified report will be issued.

OAG Position—The financial reporting framework for the government’s summary financial statements will be described in the auditor’s report as “Canadian Public Sector Accounting Standards, which is one of the financial reporting frameworks included in Canadian generally accepted accounting principles”.

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