

Understanding Reports On Financial Statements



CA Chartered Accountants
of Canada

www.cica.ca/CAS

Chartered Accountants are valued for their integrity and proven financial expertise. The CA's signature on an audit report means that the CA has conducted an examination of the organization's financial statements, has expressed an informed opinion on the fairness of the financial information, and can provide reasonable assurance on the presentation of the organization's financial position, performance and cash flows.

It is important to note that not all financial statements are audited. Many small organizations do not require an audit. Their reporting needs can be met in other ways – through reviews or compilations.

Whether the CA is required to perform an audit, a review or a compilation those who read financial statements and the accompanying communication can be confident that the engagement was conducted with the utmost integrity and professionalism.



www.cica.ca/CAS

Financial Statements

Most organizations are legally required to present annual financial statements to shareholders. The law requires certain entities to have their financial statements audited. However, most legislation allows private companies to waive the audit process.

It is management's responsibility to prepare financial statements for the shareholders. But in some cases, organizations without financial expertise may engage the services of Chartered Accountants to prepare financial statements on their behalf.

Fiscal year financial statements prepared for shareholders are usually prepared in accordance with an applicable financial reporting framework specified in law or regulation* and normally include:

- a balance sheet, which shows assets, liabilities and equity at year end;
- a statement of income, which shows the results of operations for the year;
- a statement of retained earnings, which summarizes changes in retained earnings during the year;
- a statement of cash flows, which shows operating, investing, and financing activities, and how these activities affect the cash position;
- notes to financial statements, which are an integral part of financial statements, and which provide additional explanations and details concerning financial statement items.

As well, there may be schedules attached which may provide more detailed information relating to items disclosed in the financial statements.

* *Most law or regulation indicates that the applicable financial reporting framework for financial statements is Canadian generally accepted accounting principles (GAAP), which are independent standards for use by Canadian organizations. These standards are set out in the Canadian Institute of Chartered Accountants (CICA) Handbook - Accounting, which indicates that Canadian GAAP applies to all types of profit-oriented enterprises and not-for-profit organizations. Governments and other entities in the public sector refer to the CICA Public Sector Accounting Handbook to determine the basis of accounting for purposes of their financial reporting.*

This publication reflects changes being made to accounting standards for financial statements for periods beginning January 1, 2011. Canadian GAAP includes several financial reporting frameworks — accounting standards for publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans. The financial reporting framework an organization uses depends on its type. The financial statements would describe the financial reporting framework that has been followed in their preparation. For example, a private enterprise might describe the accounting standards being followed as “Canadian accounting standards for private enterprises.” Publicly accountable entities, and other entities that choose to do so, follow International Financial Reporting Standards and describe the accounting standards in the financial statements as “International Financial Reporting Standards.”

Levels of Service Provided by Chartered Accountants With Respect to Financial Statements

Chartered Accountants provide three levels of service with respect to communications on financial statements – an audit, a review or a compilation. These services are conducted in accordance with relevant ethical requirements that are set out in Rules of Professional Conduct/Codes of Ethics applicable to the practice of public accounting issued by the various accounting bodies. These Rules/Codes apply to the services provided by public accountants and generally cover the following fundamental principles of professional ethics:

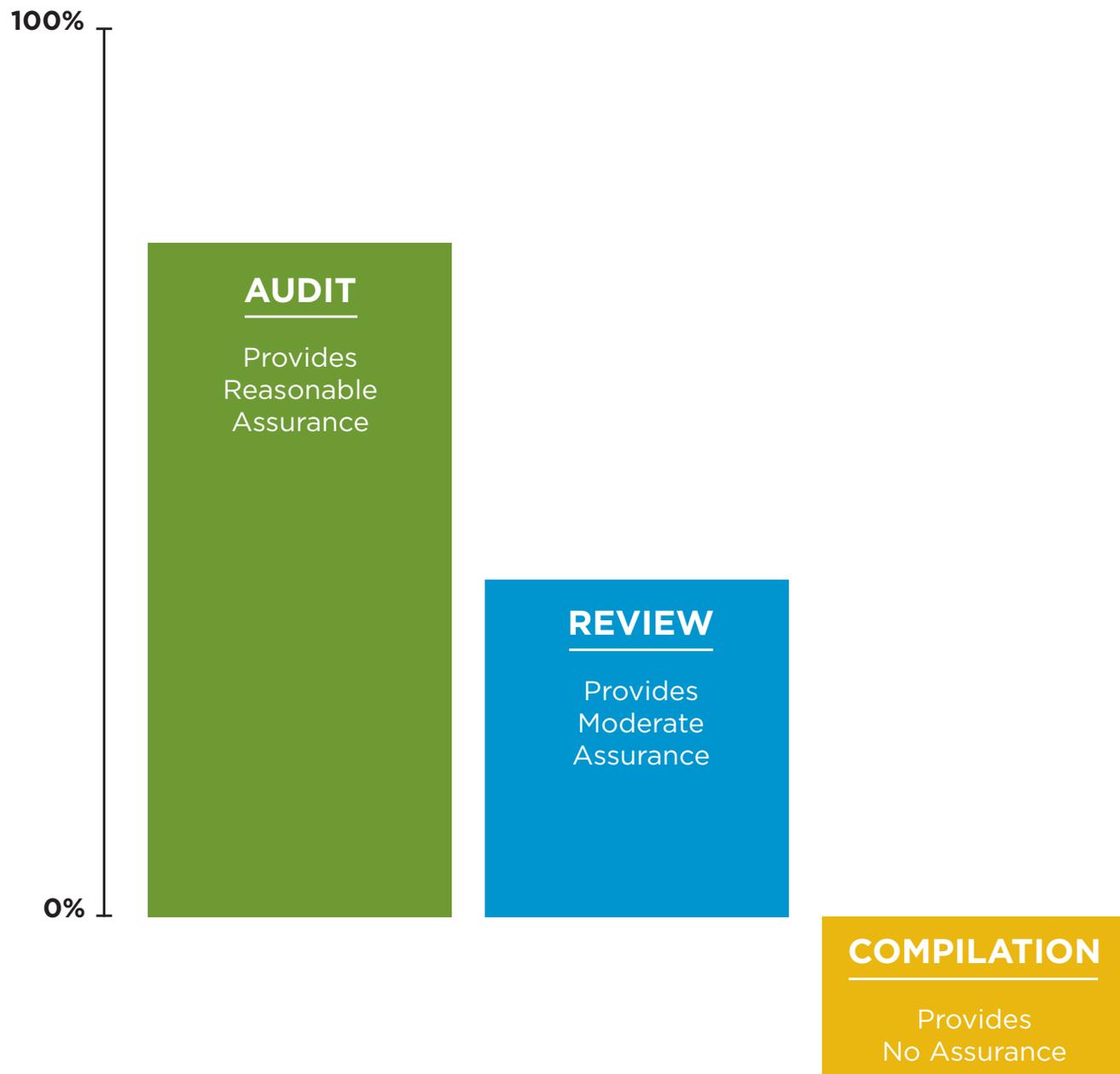
- (a) integrity,
- (b) objectivity,
- (c) professional competence and due care,
- (d) confidentiality, and
- (e) professional behavior.

The *CICA Handbook - Assurance* contains the audit, review and compilation standards that the CA must follow in conducting an audit, review or compilation engagement. This publication reflects audit, review and compilation standards relating to financial statements for periods ending on or after December 14, 2010.

Because of the differences in the nature and amount of work done, the cost to perform an audit, review or compilation varies accordingly. Each of the services lends a different level of assurance or credibility to the financial statements. For each service, the CA provides a different communication which sets out the extent of work performed and the degree of responsibility accepted by the CA.

	Audit	Review	Compilation
Nature of Involvement	Application of Canadian generally accepted auditing standards	Application of Canadian generally accepted standards for reviews	Application of Canadian compilation standards
Communication Provided	Independent Auditor's Report	Review Engagement Report	Notice to Reader
Level of Assurance	Highest level of assurance	Moderate level of assurance	No assurance
Basis of Presentation	Financial reporting framework in Canadian GAAP (e.g., IFRSs or Canadian accounting standards for private enterprises)	Financial reporting framework in Canadian GAAP (e.g., IFRSs or Canadian accounting standards for private enterprises)	Financial reporting framework selected by management

ASSURANCE PROVIDED BY ENGAGEMENT



The following pages explain these three types of service in more detail, provide an example and explain the components of each communication.

Audit



Nature of involvement: Application of Canadian generally accepted auditing standards

Communication provided: Independent Auditor's Report

Level of assurance: Highest level of assurance

The audit is the highest level of assurance that can be provided on financial statements. The audit provides reasonable assurance that the entity's financial statements present fairly its financial position, financial performance and its cash flows in accordance with the applicable financial reporting framework.

The key concept is "reasonable" assurance. The auditor does not provide absolute assurance, because this is not attainable due to factors like the need for judgment, the use of testing, the inherent limitations of internal control and the fact that audit evidence is generally persuasive rather than conclusive.

An audit of financial statements by an independent auditor may be required for various reasons. For example, a company's banker may require an audit to support an application for financing; an audit may be necessary when negotiating the purchase or sale of a business; or management or owners may find value in having an audit.

An auditor of a corporation is responsible to the shareholders. On behalf of the shareholders, an auditor examines the company's financial records and operations to determine whether the information reported in the financial statements is presented fairly. The CA communicates this assessment to shareholders through the expression of the audit opinion. It is important to remember that, in the end, management is responsible for the preparation and fair presentation of the financial statements.

If the CA discovers the financial statements depart materially from the applicable financial reporting framework, this fact is disclosed in the auditor's report.

Independent Auditor's Report*

(1) Independent Auditor's Report

(2) To the Shareholders of (COMPANY NAME)

(3) We have audited the accompanying financial statements of (COMPANY NAME), which comprise the balance sheet as at (DATE), and the statements of income, retained earnings and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

(4) Management is responsible for the preparation and (5) fair presentation of these financial statements in accordance with (6) Canadian accounting standards for private enterprises, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

(7) Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with (8) Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain (9) reasonable assurance about whether the financial statements are free from material misstatement.

(10) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

(11) We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

(12) In our opinion, the financial statements present fairly, in all material respects, the financial position of (COMPANY NAME) as at (DATE), and the results of its operations and its cash flows for the year then ended in accordance with Canadian accounting standards for private enterprises.

Anytown, Anyprovince

Date (13)

Signed
CHARTERED
ACCOUNTANT (14)

* See explanation of components on pages 8 and 9.

Explanation of the Independent Auditor's Report

- (1) INDEPENDENT AUDITOR'S REPORT — The auditor's report has a title that clearly indicates that it is the report of an independent auditor.
- (2) ADDRESSEE — The auditor's report is addressed to shareholders because that is the primary group to whom the auditor is responsible in corporate audits. The auditor's report for other organizations is addressed as appropriate (e.g., to the members or board of directors for non-profit organizations).
- (3) INTRODUCTORY PARAGRAPH — This paragraph identifies the entity whose financial statements have been audited, states that the financial statements have been audited, identifies the title of each financial statement that comprises the financial statements, refers to the summary of significant accounting policies and other explanatory information, and specifies the date or period covered by each financial statement.
- (4) MANAGEMENT'S RESPONSIBILITY PARAGRAPH — This paragraph describes management's responsibility for the financial statements. An audit is conducted on the premise that management has acknowledged certain responsibilities that are fundamental to the conduct of the audit. The audit does not relieve management of its responsibilities.
- (5) FAIR PRESENTATION FRAMEWORK — Where the financial statements are prepared in accordance with a fair presentation framework (such as the financial reporting frameworks in Canadian GAAP), the explanation of management's responsibility refers to "the preparation and fair presentation of these financial statements."
- (6) CANADIAN ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES — Incorporating or other governing legislation, or a contract, may require that an organization prepare its financial statements in accordance with Canadian generally accepted accounting principles. Canadian GAAP includes several financial reporting frameworks. Accordingly, making reference to Canadian GAAP in the financial statements and auditor's report does not adequately describe the financial reporting framework used in preparing the financial statements. The description of the financial reporting framework explains which specific accounting standards are being followed. Entities that follow International Financial Reporting Standards would describe the financial reporting framework as "International Financial Reporting Standards."
- (7) AUDITOR'S RESPONSIBILITY PARAGRAPH — This paragraph explains that the auditor's responsibility is to express an opinion on the financial statements based on the audit.

- (8) CANADIAN GENERALLY ACCEPTED AUDITING STANDARDS — These standards require that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audits. The audit is planned and performed using professional judgment and professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.
- (9) REASONABLE ASSURANCE — Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.
- (10) AUDIT PROCESS — The auditor follows a well defined process for performing an audit.
- (11) SUFFICIENT APPROPRIATE AUDIT EVIDENCE — The auditor needs sufficient appropriate audit evidence before he or she can conclude on the fair presentation of the financial statements. If the auditor is unable to obtain all such evidence, the auditor may not be able to reach a conclusion on the financial statements.
- (12) OPINION PARAGRAPH — The auditor's opinion does not represent a statement of facts. It does not assure the future viability of the organization nor the efficiency or effectiveness with which management has conducted the affairs of the organization. The opinion reflects the fact that the auditor has obtained a reasonable but not absolute level of assurance.
- (13) DATE — The date indicates the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.
- (14) CHARTERED ACCOUNTANT — Auditors in Canada are regulated through various licensing regimes. If appropriately licensed to perform audits, Chartered Accountants may perform audits in any province because of the CA's high standards of training and performance. Licensing requirements may prescribe how the auditor is described in the auditor's report.

Review



Nature of involvement: Application of Canadian generally accepted standards for reviews

Communication provided: Review Engagement Report

Level of assurance: Moderate level of assurance

In a review engagement, the responsibilities and the report that explains the CA's involvement with the financial statements differ significantly from those of an audit. The objectives are different and accordingly, so are the procedures.

The CA's objective in an audit is to express an opinion on the financial statements; whereas in a review engagement, the objective is to determine whether the financial statements are plausible in the circumstances. "Plausible" is used in the sense of being worthy of belief, which is a moderate level of assurance.

A review consists primarily of enquiry, analytical procedures and discussion. This type of engagement is useful when a company does not need audited financial statements, but management or third parties (e.g., banks, granting agencies, etc.) want some assurance that the financial statements are plausible. A CA reviews financial statements in accordance with established professional standards.

If the CA discovers the financial statements depart materially from the applicable financial reporting framework, this fact is disclosed in the review engagement report.

Review Engagement Report*

(1) To (person engaging the Chartered Accountant)

(2) I have reviewed the balance sheet of (COMPANY NAME) as at (DATE), and the statements of income, retained earnings and cash flows for the year then ended. (3) My review was made in accordance with Canadian generally accepted standards for review engagements and, accordingly, consisted primarily of enquiry, analytical procedures and discussion related to information (4) supplied to me by the company.

(5) A review does not constitute an audit and consequently I do not express an audit opinion on these financial statements.

(6) Based on my review, nothing has come to my attention that causes me to believe that these financial statements are not, in all material respects, in accordance with Canadian accounting standards for private enterprises.

Anytown, Anyprovince

Date (7)

Signed

CHARTERED
ACCOUNTANT (8)

* See explanation of components on page 12.

Explanation of the Review Engagement Report

- (1) ADDRESSEE — The review engagement report is usually addressed to the person who has engaged the accountant.
- (2) IDENTIFY STATEMENTS — The entity whose financial statements have been reviewed, the title of each financial statement that comprises the financial statements, and the date or period covered by the financial statements, are identified.
- (3) NATURE OF REVIEW — The scope of the CA's review is described. It explains that the review was conducted in accordance with Canadian generally accepted standards for reviews.
- (4) IDENTIFY SOURCE OF INFORMATION — The source of information used in preparing the financial statements, and on which the financial statements are based, is identified.
- (5) STATE NO AUDIT PERFORMED/DISCLAIM OPINION — The CA clearly states that no audit was conducted and audit evidence was not obtained on each financial statement item. Therefore, no audit opinion is expressed.
- (6) NEGATIVE ASSURANCE — Although sufficient evidence was not obtained to allow the CA to express an audit opinion, nothing has come to the CA's attention causing a belief that the information being reported on is not, in all material respects, in accordance with the applicable financial reporting framework. Incorporating or other governing legislation, or a contract, may require that an entity prepare its financial statements in accordance with Canadian generally accepted accounting principles. Canadian GAAP includes several financial reporting frameworks. Accordingly, making reference to Canadian GAAP in the financial statements and review engagement report does not adequately describe the financial reporting framework used in preparing the financial statements. The description of the financial reporting framework explains which specific accounting standards are being followed. Entities that follow International Financial Reporting Standards would describe the financial reporting framework as "International Financial Reporting Standards."
- (7) DATE — The date indicates the date up to which the review engagement CA has performed sufficient procedures to support the negative assurance being expressed.
- (8) CHARTERED ACCOUNTANT — Reviewers in Canada are regulated through various licensing regimes. If appropriately licensed to perform reviews, Chartered Accountants may perform reviews in any province because of the CA's high standards of training and performance. Licensing requirements may prescribe the form of the reviewer's description in the reviewer's report.

Compilation



Nature of involvement: Application of Canadian compilation standards

Communication provided: Notice to Reader

Level of assurance: No assurance

The lowest level of involvement the CA can have with financial statements, leading to a communication, is the compilation engagement. This type of engagement can be used in those limited circumstances where the owners, management and other users do not need financial statements containing all of the disclosures that are normally required for general-purpose use nor do they need the assurance provided by an audit or a review. In a compilation engagement, the financial statements need not necessarily be in accordance with a financial reporting framework in Canadian GAAP (for example, the statements may lack disclosure required by the financial reporting framework or be prepared on a cash basis). Nevertheless, such statements may be appropriate for users such as management who are aware of the possible limitations of the statements.

The Rules of Professional Conduct/Code of Ethics for CAs require that the CA disclose in the Notice to Reader the nature of any activity, or relationship, and the nature and extent of any interest, in respect of the compilation engagement which would be seen by a reasonable observer to impair the CA's independence.

No expression of assurance is provided in a compilation engagement.

Notice to Reader*

(1) On the basis of information provided by management (or the proprietor), I have compiled the balance sheet of (COMPANY NAME) as at (DATE), and the statements of income, retained earnings, and cash flows for the (PERIOD) then ended from information provided by management.

(2) I have not performed an audit or a review engagement in respect of these financial statements and, accordingly, I express no assurance thereon.

(3) Readers are cautioned that these statements may not be appropriate for their purposes.

Anytown, Anyprovince

Date

Signed

CHARTERED
ACCOUNTANT (4)

* See explanation of components below.

Explanation of the Notice to Reader

- (1) NATURE OF ASSIGNMENT — Explicit reference is made as to what work the Chartered Accountant did (i.e., compiled statements from information supplied by management or the proprietor — the CA did not audit or review the statements).
- (2) SCOPE LIMITATIONS — It is clearly stated that the CA's work is limited and did not include an audit or review. There is no form of assurance implied by the CA, or expressed on the financial statements.
- (3) CAUTION TO READERS — Since management or the proprietor (not the Chartered Accountant) determines the distribution of the statements, it is necessary to convey a caution to readers. The statements may not be appropriate for the users' purposes.
- (4) CHARTERED ACCOUNTANT — Compilation services are not regulated in all provinces. Before engaging a person to perform a compilation engagement, it is prudent to check whether such engagements are regulated in the particular province and, if so, whether the person to be engaged is appropriately licensed.



Compliments of:



www.cica.ca/CAS