

Auditor's Report on Financial Statements – Reporting on Supplementary Financial Statement Information

Introduction

1. This agenda paper discusses what guidance ISA 700 should provide on supplementary information included in the financial statements.

Action Required by the IAASB

Read the background, which discusses the history to this issue and the types of supplementary financial statement information found in practice. Consider Task Force's recommendations and why those positions are being proposed.

Consider the questions for discussion on page 5 and whether you agree with the Task Force's recommendations.

Background

2. In the project proposal, this issue was described as “the inclusion of more documents within the scope of the auditor's report than is currently mentioned” and it was noted that the issue was raised in the responses to exposure draft of the proposed revisions to ISA 700 to address the country of origin of the financial reporting framework.
3. The issue raised in the responses was that ISA 700 requires the auditor's report to “identify the financial statements of the entity that have been audited” but that the illustrative examples do not include reference to the statement of changes in equity, which is identified as being one of the basic financial statements in IAS 1. This issue will be addressed by the proposal that the illustrated auditor's report and guidance in ISA 700 be amended to include reference to the statement of changes in equity (see Agenda Item 2-G).
4. Entities may, however, include other information in their financial statements in addition to the basic financial statements and disclosures required by their financial reporting framework. ISA 720, “Other Information in Documents Containing Audited Financial Statements,” already sets out the auditor's responsibilities for other information in documents containing audited financial statements. But the financial statements may also include supplementary information that, although not required by the financial reporting framework, is presented as an integral part of the financial statements. Common types of additional disclosures that are found in practice include:
 - Reconciliations to other financial reporting frameworks
 - Pro forma financial information
 - “Convenience” translations into other currencies
 - Additional details or explanations of items in or related to the basic financial statements
 - Consolidating information (for discussion of the implications of including “parent only” financial statements together with the consolidated financial statements of the group, see Agenda Item 2-E).

Such information might be included in supplementary schedules, or as additional note disclosures.

Discussion

5. In researching this issue, the Task Force considered the principles already established in the ISAs and conducted a limited review of guidance in national standards.

GUIDANCE IN THE ISAS

6. IAASB's recent exposure draft on "Reporting on Compliance with IFRS" establishes, at least to a certain extent, a precedent. In the exposure draft, the view taken is that an assertion on the extent to which the financial statements comply with IFRS that is included in the notes to the financial statements, although a voluntary disclosure that is not required by the financial reporting framework, becomes an integral part of the set of financial statements and is covered by the auditor's procedures and opinion. Specifically, the exposure draft says:

"A note to the financial statements containing disclosure about compliance with IFRSs is treated no differently from any other note to the financial statements. All such notes contain management assertions and the auditor obtains sufficient appropriate audit evidence to support the assertions. If the notes contain a reference to compliance with IFRSs, the auditor considers whether the note contains misleading information such that the financial statements fail to comply with the entity's financial reporting framework because of inadequate or inaccurate disclosure in the financial statements. This is likely to be the case in circumstances where the reference to compliance with IFRSs:

- Contains untruthful or materially inaccurate information; or*
- Misleads readers of the financial statements because it implies compliance with IFRSs without providing sufficient information for readers to determine the extent to which the financial statements fail to comply with IFRSs (for example, quantification).*

If the financial statements fail to comply with the entity's financial reporting framework because the disclosures are misleading, the auditor's report expresses a qualified or an adverse opinion."

7. Relevant guidance in other ISAs includes paragraphs 7 and 10 of ISA 720, which state:

¶7 *"Some jurisdictions require the auditor to apply specific procedures to certain of the other information, for example, required supplementary data and interim financial statements. If such other information is omitted or contains deficiencies, the auditor may be required to refer to the matter in the auditor's report."*

¶10 *"The objective and scope of an audit of financial statements are formulated on the premise that the auditor's responsibility is restricted to information identified in the auditor's report. Accordingly, the auditor has no specific responsibility to determine that other information is properly stated."*

GUIDANCE IN NATIONAL STANDARDS

8. The Task Force did not conduct an extensive review of national standards in this area, but based on its limited review found that US Auditing Standards have the most comprehensive guidance on this topic. The US literature deals with two different situations: when reporting on information accompanying the basic financial statements in auditor-submitted documents (AU Section 551), and required supplementary information (AU Section 558).
9. Guidance is needed in the US on required supplementary information because such information is required, in certain circumstances, by US accounting standard setters (FASB, GASB or FASAB). Since that supplementary information is considered by the accounting standard setters to be information that is an essential part of the financial reporting of certain entities, and because authoritative guidance for the measurement and presentation of the information exists, the auditor is required under AU Section 558 to apply certain limited procedures to the information and to report deficiencies in, or the omission of, such information.

10. In other circumstances (addressed in AU Section 551), the auditor's responsibilities differ depending on whether the document involved is "auditor-submitted" or "client-submitted". If submitted by the client, the auditor's responsibilities are limited to those similar to ISA 720 unless the auditor has been specifically engaged by the entity to report on the supplementary information. If the information is included in an auditor-submitted document, however, the auditor is considered to have responsibility to report on all the information included in the document. In this case, the report on the information accompanying the basic financial statements is to describe clearly the character of the auditor's work and the degree of responsibility the audit is taking. This would include either reporting on the information in the auditor's report, or including a disclaimer in the auditor's report (i.e., stating that the auditor is expressing no opinion on the information) or clearly identifying the information as unaudited.
11. It is the Task Force view that, at least in ISA 700, it is unnecessary to provide guidance that is as extensive as the US guidance. To date, the IASB has not issued any standards requiring supplementary information and, therefore, it may be more appropriate to keep specific guidance to auditors at a national level in those jurisdictions where such financial reporting requirements exist.
12. However, the Task Force did believe that the guidance similar to that in AU Section 551 on what is considered to be covered by the auditor's standard report would establish a useful principle:

¶2 "The auditor's standard report covers the basic financial statements: balance sheet, statement of income, statement of retained earnings or changes in stockholders' equity, and statement of cash flows. The following presentations are considered part of the basic financial statements: descriptions of accounting policies, notes to financial statements, and schedules and explanatory material that are identified as being part of the basic financial statements."
13. This definition establishes boundaries to the information considered to be covered by the auditor's opinion based on the components of the financial statements defined by the financial reporting framework, but also allows flexibility by allowing the auditor and entity to agree on whether any voluntary supplementary information included in schedules and explanatory material will be considered part of the financial statements and covered by the audit opinion. Thus, in the situation envisaged by the proposed IAPS on "Reporting on Compliance with IFRS," the voluntary disclosure would be one which had been agreed between the entity and the auditor as being part of the basic financial statements.
14. This principle could be supported by including guidance similar to that in Section 5400.11 of Canadian Auditing Standards, which says:

"Notes to the financial statements, and supporting schedules and other information to which the financial statements are cross-referenced, are an integral part of such statements and, accordingly, need not be specifically referred to in the auditor's report. It is important that unaudited information which could be construed to be part of the audited financial statements be clearly differentiated."
15. Such guidance would also allow the flexibility of the auditor and entity being able to agree on whether supplementary information would be subject to audit (i.e., it is consistent with the model in paragraph 12). But it also clearly establishes the principle that if other supplementary information that the auditor and entity have agreed will not be subject to audit is included in the financial statements, it should be clearly identified as unaudited. Together, these two principles would provide a simple framework regarding supplementary information.

Proposed recommendations: ISA 700 should include the following guidance on supplementary financial information:

- (i) ISA 700 should require the auditor's report to identify the primary financial statements, which comprise the financial statements on which the auditor is expressing an opinion. While the guidance should be framework-neutral, the illustrative examples should refer to the components of the financial statements defined in IAS 1. (See further discussion in Agenda Item 2-G.)
- (ii) ISA 700 should include guidance that explains that the auditor's opinion on the financial statements covers the basic statements defined by the financial reporting framework, which would ordinarily include: balance sheet, income statement, statement of changes in equity and cash flow statements. The guidance should also clarify that the following would also ordinarily be considered part of the basic financial statements: descriptions of accounting policies and explanatory notes to the financial statements required under the financial reporting framework. In addition, the auditor's opinion would also cover any additional schedules or explanatory material that are presented as being part of the basic financial statements, as agreed between the auditor and the entity.
- (iii) ISA 700 should also clarify that supporting schedules and other information to which the financial statements are cross-referenced or are presented as an integral part of the financial statements need not be specifically referred to in the auditor's report, but would be considered to be covered by the auditor's opinion unless clearly identified as being unaudited. The guidance should also state that it is important that unaudited information, which could be construed to be part of the audited financial statements, be clearly differentiated.

16. The Task Force also discussed whether ISA 700 should provide an illustration of how an auditor could report on supplementary information included with the basic financial statements but not considered to be part of them (and, therefore, not considered to be covered by the auditor's opinion on the financial statements). An example of wording that might be used in these circumstances, from the US literature, is shown in paragraph 17.

17. AU§551 provides the following as an example of an opinion that the auditor might include on the supplementary information:

"Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify accompanying information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole."

18. If IAASB decides that it would be useful to include a similar example, the wording of the opinion will need to be considered in light of the IAASB's conclusions regarding the wording of the opinion in different circumstances, as discussed in Agenda Paper 2-D.

19. The example of a disclaimer regarding the supplementary information provided in AU§551 is:

"Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify accompanying information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it."

20. After considering the issue, the Task Force concluded that, while this sort of guidance may be useful, it would be best to address it in future when the topic could be addressed in a more complete ISA or IAPS. There are a number of permutations in the type and nature of supplementary information and it would be preferable to address the reporting implications of those various permutations in more detail rather than to illustrate possible report wording that may prove not to be appropriate in all circumstances. The Task Force believes that the ISA 700 revision should keep the guidance on supplementary information brief and limited to the three principles outlined in proposed recommendations on page 4. This would set out principles that would help to promote consistency in practice, while keeping open the option for IAASB to provide more detailed guidance on supplementary information in the future.

Questions for Discussion

Do you believe that the ISA 700 revision should:

- Limit the guidance on this topic to simply clarifying that the identification of financial statements in the auditor's report should include the statements and disclosures that are required under the financial reporting framework (i.e., the guidance discussed in recommendation (i) above and proposed Agenda Item 2-G)?
- Provide guidance on the reporting implications of supplementary financial information or note disclosures that are not required under the financial reporting framework and may be voluntary disclosures?

If so, do you agree with the Task Force recommendation that this guidance should be limited to identifying any supplementary information that is not considered to be covered by the auditor's opinion on the financial statements as unaudited (i.e., proposed recommendations (ii) and (iii) above)?

Alternatively, do you believe that the ISA 700 revision should also:

- Provide an illustration of how the auditor might report on the supplementary financial information that is not covered by the auditor's opinion on the financial statements but for which the auditor has agreed to perform procedures and issue an opinion on it as part of the auditor's report on the financial statements (i.e., similar to the opinion in paragraph 17 of this agenda paper)?
- Also include an illustration of a disclaimer regarding supplementary information for which the auditor has assumed no responsibility (i.e., similar to the wording in paragraph 19 of this agenda paper)?

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