



International Federation of Accountants

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Agenda Item

5

Committee: IAASB

Meeting Location: London

Meeting Date: December 4-8, 2006

Reading Other Information in Documents Containing Audited Financial Statements

Objectives of Agenda Item

1. To approve as an Exposure Draft the proposed redrafted ISA 720, “Other Information in Documents Containing Audited Financial Statements.”

Task Force Members

2. The members of the Task Force are:

Will Rainey (Chair)	IAASB Member
Marcel Pheijffer	IAASB Member
Steven Leonard	Project Director, Auditing Practices Board

Activities Since Last IAASB Discussion

3. The IAASB discussed a previous draft at its meeting held in October 2006. Since that discussion the Task Force has prepared a revised draft taking account of:
 - Comments received from Board members during the October meeting.
 - Comments received from INTOSAI on the draft presented to the October meeting.
 - Comments received from the IFAC Small and Medium Practices (SMP) Committee on the draft presented to the October meeting.

Summary of disposition of matters raised by Task Force with IAASB at its October Meeting

4. In the covering note for the October IAASB meeting, the Task Force requested guidance from the IAASB on a number of matters. During the meeting, the IAASB provided the following input which is reflected in the redrafted version being submitted for approval.
5. The IAASB concurred with the proposal of the Task Force to retain a requirement to read the other information. In the extant ISA, this requirement is included in the overarching bold letter paragraph. Under the clarity conventions, the overarching bold letter paragraph usually forms the basis of the objective paragraph rather than becoming a requirement per se. This requirement is set out in paragraph 6 of the proposed redrafted ISA.
6. The IAASB concluded that the redrafted ISA should require the auditor to “read” rather than to “consider” the other information. The redrafted ISA has been drafted in this way

and the title of the ISA amended to be “Reading Other Information in Documents Containing Audited Financial Statements.” It is considered that the revised title makes clearer the purpose of the ISA.

7. The IAASB did not concur with the inclusion of bold letter paragraph 17 of the extant ISA as application material rather than as a requirement. In the proposed redrafted ISA, this bold letter paragraph is set out as a requirement in paragraph 12.
8. The Task Force had recommended that a number of present tense statements be elevated to requirements:

- (a) ***Reading Other Information before and after the date of the auditor’s report.*** The extant ISA is somewhat confusing in the language it uses with respect to when the auditor is required to read the other information. In paragraph 9 of the extant ISA, it is stated that “the auditor therefore needs to make appropriate arrangements with the entity to obtain such information prior to the date of the auditor’s report”. However, paragraphs 19 to 23 of the extant ISA address the circumstance when the information is not obtained prior to the date of the auditor’s report. In light of paragraph 9 it should not be logically possible for this latter circumstance to arise.

In order to clarify the requirements, the Task Force had proposed two discrete requirements. One of these applied to information included in a document containing audited financial statements and the other applied to information to be included. The IAASB did not support this attempt at clarification. It was considered both to go beyond the scope of the Clarity Project and to create another potential source of confusion. In the proposed redrafted ISA, therefore, the implicit requirement in the second sentence of paragraph 9 of the extant ISA has been elevated to a requirement in the first sentence of paragraph 7. The second sentence of paragraph 7 is a clarification of paragraph 19 of the extant ISA also elevated to be a requirement.

- (b) ***Revision of the audited financial statements after the date of the auditor’s report.*** Paragraph 21 of the extant ISA states as guidance that “when revision of the audited financial statements is appropriate, the guidance in ISA 560, “Subsequent Events” would be followed. The IAASB supported its elevation to a requirement. This requirement is set out in paragraph 15 of the proposed redrafted ISA.
- (c) ***Revision of other information when read after the date of the auditor’s report.*** The first sentence of paragraph 22 of the extant ISA reads “When revision of the other information is necessary and the entity agrees to make the revision the auditor would carry out the audit procedures necessary under the circumstances”. The IAASB supported its elevation to a requirement. This requirement is set out in paragraph 16 of the proposed redrafted ISA.

9. The IAASB did not support the inclusion of an internal control example of a “material misstatement of fact.”

10. In broad terms, the IAASB concurred with the approach of the Task Force toward the definitions proposed to be referred to in the ISA. In this regard the IAASB concluded that the ISA should apply to all misstatements of fact and not be restricted to material misstatements of fact. The IAASB further recommended with respect to material inconsistencies that the definition should be of an “inconsistency” rather than of a “material inconsistency”; and that application material should be provided with respect to materiality in the context of inconsistencies. In respect of the latter recommendation, the Task Force considered the redrafting and concluded that it did not improve clarity because there appeared to be two slightly different definitions which the Task Force considered may give rise to confusion. Further, as all of the applicable requirements are written in terms of material inconsistencies, it seems an unnecessary complication to define an “inconsistency” rather than a “material inconsistency”

Action Requested

Does the IAASB concur with the conclusion of the Task Force to retain the definition of “material inconsistency”?

Other Matters Raised by IAASB at the October Meeting

11. In addition to the matters noted above that were raised by the Task Force, the IAASB raised a number of additional matter concerning the clarification of ISA 720.

OBJECTIVE OF THE ISA

12. The extant ISA 720 in the overarching requirement at paragraph 2 states that the purpose of reading the other information is to identify material inconsistencies with the financial statements. At paragraph 14 in a guidance paragraph, the extant ISA notes that when reading the other information for the purpose of identifying material inconsistencies the auditor may become aware of an apparent material misstatement of fact. The identification of misstatements is therefore viewed as a potential by-product of the reading of the document rather than an objective of the reading.
13. In the draft presented to the October meeting of IAASB, the Task Force gave equal prominence, within the ISA, to material inconsistencies and material misstatements of fact. The IAASB rejected the approach followed by the Task Force. It considered that the approach went beyond clarification and, as such, was changing the scope of the ISA. In the proposed redrafted ISA, therefore, the distinction made in the extant ISA has been preserved.

THE AUDITOR’S OBLIGATION TO REPORT

14. Paragraph 1 of the extant ISA describes the other information in terms of information “on which the auditor has no obligation to report”. In clarifying the ISA, the Task Force concluded that this clause is confusing and, therefore, deleted it. The confusion arises from the fact that the extant ISA at paragraphs 12, 13, 18 and 23 establishes reporting obligations with respect to the “Other Information”.

15. The IAASB considered that the proposed revised ISA should make clear that the scope of the auditor's opinion does not encompass the other information. Paragraph A1 in the proposed redrafted ISA addresses this point.

SCOPE OF THE ISA

16. The IAASB discussed the clarity with which the scope of the ISA was described. As a result of this discussion the following changes have been made to the proposed redrafted ISA in order to improve the clarity of its description of its scope:
- (a) The first sentence of paragraph 2 is new drafting and states that the ISA has been drafted "in terms of documents containing audited financial statements that are provided to owners on the same terms, and at the same time as the financial statements". This wording is derived from that used by the IASB in paragraph B6 of IFRS 7 which addresses information that forms part of the financial statements but which is included in a statement such as a management commentary.
 - (b) The second sentence of paragraph 2 states that the ISA may also be applicable, adapted as necessary in the circumstances, to other documents such as those used in securities offerings. This wording is derived from paragraph 2 of the clarified version of ISA 260.
 - (c) Paragraph A4 is new drafting of explanatory material with respect to the definition of other information. It sets out a number of examples of information that do not fall within the definition of other information.

Action Requested

Does the IAASB concur with the following wording used in the first sentence of paragraph 2?

- (a) The phrase "on the same terms". This phrase is used by IASB in IFRS 7. One member of IAASB considered the phrase to be unnecessary.
- (b) The use of the word "owner". IAASB does not have a generic term that it uses to describe shareholders or their equivalent. "Owner" was suggested by a member of IAASB at the October meeting. Another possible alternative might be "Shareholders or their equivalent".

17. At the October meeting a Board member suggested that it may be helpful to provide guidance in ISA 720 equivalent to the guidance in the penultimate sentence in paragraph 23 of ISA 700 (Revised). This equivalent guidance is provided in paragraph A2 of the proposed redrafted ISA.

Action Requested

Does the IAASB consider that paragraph A2 in the proposed revised draft is necessary?

DEFINITION OF OTHER INFORMATION

18. One member of IAASB suggested that the definition of "Other Information" should specifically exclude from its scope "other information subject to audit". The Task Force has not adopted this recommendation because it believes it to be conceptually flawed. To adopt the recommendation would mean that information in, for example, an audited

directors' remuneration report would not need to be read, by the auditor, in order to identify material inconsistencies with the financial statements.

19. As there are no requirements in ISAs for inconsistencies between the financial statements and other audited information to be identified, the Task Force is of the view that the definition of Other Information should include everything in the document other than the financial statements and the auditor's report thereon.

Action Requested

Does the IAASB concur with the view of the Task Force that the definition of "Other Information" should include everything in the document other than the financial statements and the auditor's report thereon?

Material Presented (Note: Agenda Items 5-A and 5-B will be used for purposes of the discussion at the meeting.)

Agenda Item 5-A (Pages 2939 – 2944)	Proposed ISA 720 (Redrafted)
Agenda Item 5-B (Pages 2945 – 2946)	Proposed Disposition of the Present Tense and Other Statements in the Proposed Redrafted ISA 720
Agenda Item 5-C (Pages 2947 – 2952)	Mapping Document
Agenda Item 5-D (Pages 2953 – 2958)	Redrafting changes made to the extant ISA 720

Action Requested

The IAASB is asked to approve the proposed redrafted ISA 720 in Agenda Item 5-A, for issuance as an Exposure Draft, subject to the Task Force making such changes as may be required to reflect further guidance from the IAASB.

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