



International Federation of Accountants

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Agenda Item

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Committee: IAASB

Meeting Location: New York

Meeting Date: October 25-27, 2006

ISA 720 (Redrafted), “Other Information in Documents Containing Audited Financial Statements”

Objective of Agenda Item

1. To approve as an Exposure Draft the proposed ISA 720 (Redrafted), “Other Information in Documents Containing Audited Financial Statements,” based on the clarity drafting conventions adopted by the IAASB.

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

Matters for IAASB Consideration

GENERAL

3. This Task Force was formed following the July 2006 IAASB meeting with the purpose of redrafting ISA 720 using the clarity conventions adopted by the IAASB.
4. The Task Force has met once by conference call and corresponded by e-mail. An earlier version of the redrafted ISA has been reviewed by three members of the Clarity Task Force and the staff member responsible for that project.

OVERARCHING STANDARD

5. When redrafting an ISA under the clarity drafting conventions, the overarching bold letter paragraph will often form the basis of the new objective paragraph. In redrafting ISA 720, however, the Task Force took the view that an element of the overarching paragraph 2 of the extant ISA represented a separate requirement that should be carried forward as a requirement in the redrafted ISA (see paragraph 5 of the redrafted ISA). Although the requirement to read the other information is implicit in the other bold letter paragraphs, the Task Force took the view that this should be an explicit requirement.

Action Requested

Does the IAASB concur with the position taken by the Task Force in retaining a requirement to read the other information in paragraph 5 of the requirements?

READ VS. CONSIDER

6. Related to the preceding point, the Task Force has identified as an issue whether the requirement for the auditor should be to “read” or to “consider” other information. Extant ISA 720 uses these words somewhat interchangeably. In the overarching standard (paragraph 2 of extant ISA 720), the auditor is required to “read” the other information. On the other hand, for example, in paragraph 1 the word “consideration” is used, and in paragraph 9 the expression “an auditor can consider” is used.
7. The Task Force believes that these words may convey different meanings to different users of the ISAs and, as a consequence, be a potential source of confusion rather than clarity. The Task Force understands that in some countries “read” is a well understood term in the context of “other information” in annual reports. The requirement is described in “read” terms because the requirement is unambiguous and can readily be contrasted with audit and review requirements. For purposes of the redraft, the Task Force has adopted “read” as the requirement. The Task Force further recommends that consideration be given to amending the title of the ISA to begin with the word “reading.”
8. An alternative view is that a “read” requirement is much less rigorous than a requirement to “consider,” and that the term “consider” therefore may be the more desirable in the context of this ISA.
9. A further alternative may be to use the two terms in conjunction with each other making clear that “reading” is the procedural requirement and that the consideration is based on the reading and the auditor’s knowledge and nothing else.

Action Requested

The IAASB is asked to advise the Task Force as to whether the fundamental requirement should be, “read,” “consider,” or a combination of the two terms?

BOLD PARAGRAPH IN EXTANT ISA 720 NOW INCLUDED AS APPLICATION MATERIAL

10. In preparing the redraft the Task Force has included paragraph 17 of extant ISA 720 as application material (see paragraph A10). There are two reasons for this:
 - a. Paragraph 17 of extant ISA 720 is a description of an iterative process between the auditor and management and is not necessary as a requirement in its own right. The preceding paragraph 16 requires the auditor to discuss the matter with management and the following paragraph 18 addresses how to deal with a refusal by management to correct a material misstatement of fact. Paragraph 17 is in essence application guidance concerning how the matter may be discussed with management.
 - b. The Task Force questions whether the ISA should be so specific as to require “the auditor to request management to consult with a qualified third party.” It seems as though the auditor is being encouraged to manage the business rather than conduct an audit. Paragraph A10, therefore, has been rephrased to recommend management to consult with an appropriate expert (the entity’s legal counsel may be in-house and, therefore, not be a third party).

Action Requested

Does the IAASB concurs with the inclusion of paragraph 17 of extant ISA 720 as application material (see paragraph A10) in the manner suggested by the Task Force?

PRESENT TENSE STATEMENTS ELEVATED TO REQUIREMENTS*Reading other information before and after the date of the auditor's report*

11. There is a distinction made in extant ISA 720 between requirements and guidance for other information obtained “prior to” and “subsequent to” the date of the auditor’s report. There is, however, no bold lettered requirement that other information, which is included with the financial statements, should be read before the auditor’s report is signed.
12. The second sentence of paragraph 9 of extant ISA 720, in stating 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” is apparently expressing such a requirement, though without using the word “should.” However the next sentence, together with paragraph 19, concede that the information may not be available prior to the date of the auditor’s report and, therefore, the implicit requirement may not always be capable of being met.
13. The implicit requirement in paragraph 19 has been restated as requirements in paragraphs 5 and 6 of the redrafted ISA. In paragraph 5 the auditor is required to read other information that is included in a document containing audited financial statements before finalizing the auditor’s report. Paragraph 6 further requires that, where other information is to be included in such a document, the auditor shall read such other information at the earliest possible opportunity thereafter.
14. Paragraph A7 of the application material explains the advantage of obtaining the other information prior to the date of the auditor’ report and a new sentence has been added, stating that “An agreement with the entity as to when the other information will be available may be helpful.”

Revision of the audited financial statements after the date of the auditor's report

15. Paragraph 21 of extant ISA 720 states as guidance that, when revision of the audited financial statements is appropriate, the guidance in ISA 560, “Subsequent events” would be followed. The Task Force believes that this is a present tense statement that should be elevated to a requirement.
16. This requirement is applicable both when the entity makes a correction and when it does not. Hence the requirement is included in both paragraphs 9 and 10 of the redrafted ISA. (Also see paragraph 18 of this paper below).

Revision of other information when read after the date of the auditor's report

17. The first sentence of paragraph 22 of extant ISA 720 is a present tense statement that the Task Force recommends be elevated to a requirement. The sentence 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.”

18. This requirement is now included in paragraph 9(b) of the redrafted ISA. The requirement in paragraph 9(a), which deals with the entity agreeing to make changes to the financial statements, is not dealt with in extant ISA 720 and is included in the redrafted ISA for completeness. (Also see paragraph 16 of this paper above).

Action Requested

The IAASB is asked to consider whether it concurs with the proposal of the Task Force to elevate these present tense statements to requirements?

EXAMPLE OF MATERIAL MISSTATEMENT OF FACT – INTERNAL CONTROL

19. Paragraph A9 of the redrafted ISA is guidance that the IAASB in July 2006 asked the Task Force to include in the redrafted ISA to illustrate that inaccurate internal control statements are material misstatements of fact. The detailed wording was provided by the Material Weaknesses in Internal Control Task Force. The IAASB should note that this application material is new to the ISA and does not arise from the clarity process.
20. Members of the Task Force are concerned that the inclusion of this paragraph may unbalance the ISA by inclusion of a specific example of a material misstatement but not including examples of material inconsistencies or other examples of material misstatements. On the other hand, members of the Task Force are also concerned that what constitutes effective internal control is extremely judgmental and that the auditor's knowledge of material weaknesses may not be sufficient, in and of itself, to determine whether or not internal control has operated effectively.

Action Requested

Does the IAASB support the inclusion of the internal control example of a "material misstatement of fact?" The IAASB is further asked to consider whether examples of material inconsistencies and additional examples of material misstatements should also be included in the redrafted ISA?

DEFINITIONS

21. A number of defined terms are used in the redrafted ISA. A separate definitions sections has been included. It includes the following three definitions in paragraph 4 of the redrafted ISA:
 - a. Material inconsistency;
 - b. Material misstatement of fact; and
 - c. Other information.
22. The criteria for including these terms are that each of them are used in the requirements paragraphs and are terms that are appropriately introduced by ISA 720 rather than any other ISA.
23. Some members of the Clarity Task Force have expressed concern that the definitions of "material inconsistency" and "material misstatements of fact" are not written as

definitions but as explanations of the terms. It has been suggested that these definitions either be relegated to the application material or be rewritten more tightly as definitions. The Task Force believes that the explanation of these terms is central to an understanding of ISA 720 and would resist relegating them to the application material. The Task Force has undertaken some redrafting of the definitions to seek to alleviate the concerns expressed.

24. The following terms are used in the ISA but not included in the definitions section for the reasons given:
- a. “Annual Report.” Although this term is defined in the present glossary of terms, it is more in the nature of a description than a definition and is not used in a requirement paragraph.
 - b. “Emphasis of matter paragraph.” Although used in a requirement paragraph, this term is more appropriately introduced by ISA 706.
 - c. “Material weakness.” This term appears in the Application and Other Explanatory Material, but not in the Requirements section.
 - d. “Qualified and adverse opinion.” Although used in a requirement paragraph, this term is more appropriately introduced by ISA 705.

Action requested

Does the IAASB concur with the treatment of definitions described above?

Material Presented (Note: Agenda Items 3-A and 3-B will be used for purposes of the discussion at the meeting.)

Agenda Item 3-A Proposed ISA 720 (Redrafted) - For Approval

(Pages 2453 – 2458)

Agenda Item 3-B Proposed Disposition of the Present Tense and Other Statements in
Proposed ISA 720 (Redrafted)

(Pages 2459 – 2460)

Agenda Item 3-C Mapping Document – Proposed ISA 720 (Redrafted)

(Pages 2461 – 2466)

Action Requested

25. The IAASB is asked to approve proposed ISA 720 (Redrafted) in Agenda Item 3-A, for issuance as an Exposure Draft, subject to the Task Force making such changes as may be required to reflect guidance from the IAASB, particularly in response to the questions raised above.

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