

Other Information—Issues and IAASB Task Force Proposals

Background

1. The IAASB has reached the following key decisions in this project to date:
 - *Scope of proposed ISA 720 (Revised)*
 - The IAASB agreed that the scope of the proposed ISA should extend only to such *accompanying* documents that have a primary purpose of providing commentary to enhance the intended users' understanding of the *audited financial statements and the financial reporting process*. Documents *containing* the audited financial statements and the auditor's report thereon will continue to be in scope if prepared and issued in connection with such initial release.
 - Preliminary announcements are out of scope given the fact that the Board has already identified a separate project addressing preliminary announcements in its strategy and work program for 2012-2014.
 - *The auditor's work effort regarding other information (OI)*
 - The IAASB agreed that the auditor's work effort should be one of "reading and considering" the OI in light of the auditor's understanding of the entity and its environment acquired during the course of the audit.
 - *The auditor's objectives*
 - The focus of extant ISA 720 is clearly on reading the OI for material inconsistencies with the audited financial statements, with a spirit for the auditor of avoiding being associated with materially false or misleading information. The IAASB agreed to broaden the objective to require the auditor to respond to matters in the OI that are inconsistent with *the auditor's understanding of the entity and its environment acquired during the course of the audit*, thereby promoting a different mindset that would add more value to the auditor's reading of the OI.

Structure of this Issues Paper

2. This Issues Paper sets out the Task Force's (TF) recommendations on the following significant matters, including those raised by the IAASB at its December 2011 meeting:
 - (a) Scope
 - (b) Objective
 - (c) Materiality
 - (d) Nature and extent of work effort when reading and considering OI
 - (e) Reporting
 - (f) Other Matters
 - (g) Consideration by IAASB of significant matters identified by the TF

Significant Issues and Task Force Recommendations

A. Scope

3. At the December 2011 IAASB meeting, a concern was raised by an IAASB member that the concept of “documents prepared and issued in connection with the initial release of the audited financial statements” was unclear. It was noted that in certain jurisdictions, the initial release of information is, for listed entities, the release of the financial information to the securities exchange. This release may not necessarily contain all the information that is provided to the entity's shareholders the first time they receive the audited financial statements, and which is intended to be captured within the scope of the revised ISA (for example, a Chairman's Statement or a Management Discussion and Analysis (MD&A)). It was argued that if the definition were to be applied strictly as drafted, auditors might conclude that annual reports are scoped out.
4. A question was also raised as to whether an offering document such as a prospectus would be in scope if it were the document in which the financial statements were issued for the first time.

TF Recommendations

Initial Release

5. The TF agreed that the description of the concept of “documents prepared and issued in connection with the initial release of the audited financial statements” could be further clarified. The TF agreed that “initial release” is intended to mean the *first time* the audited financial statements and the auditor's report thereon for a reporting period are made available to intended users, rather than a particular *date* on which they are first issued (see **paragraph A1**).¹ To further clarify the concept, the TF proposes to add guidance to explain that documents prepared and issued by the entity in connection with the initial release of the audited financial statements and the auditor's report thereon represents the set of documents prepared for that purpose and that these documents may not all be issued on the *same* date (see **paragraph A2**).

Release of the Audited Financial Statements for the First Time in an Offering Document

6. The TF accepted that offering documents should not automatically be treated as out-of-scope if they meet the criteria for being in scope. Accordingly, the TF proposes guidance in **paragraph A14** to make this clear.

Matter for IAASB Consideration

1. Does the IAASB agree with the TF's proposals above regarding the scope of the proposed ISA?

B. Objective

7. At the December 2011 meeting, a minority of IAASB members raised a concern that the objective did not appear to be complete as it did not include an obligation for the auditor not to be associated with materially false or misleading information.

¹ Paragraph references refer to the proposed ISA 720 (Revised) presented in the agenda material for this meeting, unless otherwise noted.

8. In addition, since that meeting, the TF has also had informal feedback from a number of IAASB members that the objective appeared to focus attention first on possible material misstatements in the audited financial statements when it seemed more likely that reading and considering the OI would lead to the identification of material inconsistencies in the OI.

TF Recommendations

9. With respect to the Board members' concerns that the objective omits an obligation for the auditor not to knowingly be associated with materially false or misleading information, the TF notes that the Board has already agreed that one purpose of revising ISA 720 is to raise the bar as compared with the extant standard. Given how an inconsistency has been described in the proposed ISA (see **paragraph A10**), the TF is of the view that information that is materially false or misleading will by its nature be *materially inconsistent*. In other words, even before the auditor concludes that OI is materially false or misleading, the auditor will have concluded that the OI is materially inconsistent. The TF proposes that this be made clear in **paragraph A10**. Accordingly, the TF does not believe that the objective needs to include a further explicit obligation for the auditor not to knowingly be associated with materially false or misleading information – an obligation that already exists in Section 110.2 of the International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants*.
10. Based on the discussion at the June 2012 IAASB meeting about auditor reporting with respect to OI in the context of the Board's June 2012 Invitation to Comment (ITC) on auditor reporting,² and based on the informal feedback from a number of IAASB members (referred to in paragraph 8 above), the TF considered that the objective could be further improved and proposes the following changes to it:
 - (a) Adding an obligation to report in accordance with the ISA, consistent with the Board's suggested improvement, as set out in the ITC, for an auditor reporting responsibility in relation to OI; and
 - (b) Reversing the bullet points in the draft objective as the TF agreed that it is more likely that the auditor will identify, upon reading and considering the OI, material inconsistencies in the OI than material misstatements in the audited financial statements. The TF concluded that it would therefore be more meaningful to address material inconsistencies in the OI first in the objective.

See **paragraph 8**.

Matter for IAASB Consideration

2. Does the IAASB agree the TF's proposals above regarding the objective?

C. Materiality

11. The December 2011 draft included a requirement for the auditor, in considering financial data in the OI, to "identify financial data where an inconsistency would have a *material effect on the credibility of the audited financial statements...* ." The draft also explained that "the effect of an inconsistency

² Invitation to Comment, *Improving the Auditor's Report*

is considered to be material if, individually or in aggregate, it could reasonably be expected to influence the economic decisions of the intended user taken on the basis of the audited financial statements and the other information as a whole.”

12. A concern was raised at the Board regarding whether these two different references to materiality referred to the same threshold. It was noted that having the two of them in the proposed ISA could be confusing. Accordingly, the TF was asked to clarify how the concept of materiality applies to inconsistencies in the OI.

TF Recommendations

13. The TF acknowledges the potential for confusion with these two different references to materiality. Accordingly, the TF proposes to delete the first one and retain the second one with some refinement (see **paragraph A11**). The TF believes that this revised description of materiality is now simpler to understand and thus capable of practical application.

Matter for IAASB Consideration

3. Does the IAASB agree with the TF’s proposals above regarding materiality?

D. Nature and Extent of Work Effort When Reading and Considering OI

14. The December 2011 draft proposed to require the auditor, in considering financial data in the OI, to identify financial data where an inconsistency would have a material effect on the credibility of the audited financial statements and:
 - (a) For financial data that are intended to be the same as those in the audited financial statements, compare the financial data to the audited financial statements; and
 - (b) For financial data that are directly reconcilable to the audited financial statements, obtain management’s reconciliation of such data and compare the components of the reconciliation to the audited financial statements.
15. Several Board members expressed concerns about how this requirement would be operationalized in practice. In particular, the concept of financial data that are directly reconcilable appeared unclear; so too did the nature of the reconciliation needed. In addition, the use of the term “financial data” appeared to leave out qualitative OI. It was argued that qualitative information should represent the greater focus of the auditor’s work effort to ensure that it is not materially inconsistent with the auditor’s understanding of the entity and its environment. The IAASB asked the TF to consider developing further application material to assist consistent application of the proposed requirement.

TF Recommendations

16. The TF agreed that the nature and extent of the auditor’s work effort when reading and considering the OI could be further clarified.

Principles-Based Approach vs. Detailed Requirements

17. The TF has subsequently explored two different approaches to establishing the nature and extent of the work effort:
- More detailed requirements that would specify the expected nature and extent of work effort regarding different types of OI.
 - A principle-based approach that would establish an overarching requirement with respect to the work effort, supported by detailed application material that would explain how auditors may operationalize it in practice.
18. The TF agreed that the principles-based approach would be the better approach for a number of reasons:
- Not all possible situations can be anticipated in terms of the nature and type of OI that can be provided, and a specific set of requirements cannot be developed for every situation.
 - In contrast, establishing a principle that the auditor's work effort in considering the OI needs to be sufficient in each case to enable the auditor to be in a position to respond appropriately when there may be material inconsistencies in the OI or material misstatements in the financial statements, would compel the auditor to make judgments about, and tailor the auditor's work effort in response to, each different situation. The principle could then be backed up by informed application material.
 - Where detailed requirements can be developed, they would generally tend to revolve around the lowest value tasks (such as "ticking and tying" amounts that can be found in the financial statements), thereby inappropriately suggesting that these are the areas where the greatest effort would be expected. Such an approach would detract from the more important task of focusing on the more subjective and higher risk areas where greater judgment would be necessary.
 - As a result, an approach of specifying detailed requirements may be seen to:
 - Undermine the quality of the standard by comparison with a principled approach, which can offer a richer explanation in the application material of how the OI can be compared with the auditor's understanding of the entity and its environment; and
 - Encourage a "checklist" mentality that would detract from the exercise of appropriate professional judgment by the auditor.
19. The TF therefore proposes not to retain the above mentioned requirement with respect to financial data. Instead, the TF proposes to retain the overarching requirement with respect to reading and considering the OI in light of the auditor's understanding of the entity and its environment acquired during the audit to respond appropriately when there are indications in the OI that it may contain material inconsistencies or that the financial statements may be materially misstated (see **paragraph 11**). This overarching requirement is then supported by detailed application material explaining the varying work effort that might be undertaken depending on the circumstances (see **paragraphs A27–A41**).

Work Effort with Respect to the OI

20. The TF felt it important to first recognize that when reading and considering the OI in light of the auditor's understanding of the entity and its environment acquired during the audit, the auditor may refer to the audit documentation if needed as the latter will often contain a record of the auditor's more detailed understanding of the entity and its environment acquired during the audit. Accordingly, the TF proposes application material to make this clear (see **paragraph A30**).
21. In thinking about how to articulate the nature and extent of the auditor's work effort when reading and considering the OI, the TF agreed that it would be necessary to first determine on which parts or aspects of the OI the auditor should *focus*. This is because, while the auditor would be required to read *all* of the OI, not all of it may merit further consideration to the same degree. The TF believes that various factors may assist the auditor in making an informed judgment in this regard. Accordingly the TF proposes new application material in the proposed ISA that describes these factors (see **paragraph A34**).
22. The TF further agreed that the nature of the procedures the auditor might perform when further considering the OI would depend on the nature of the information. Accordingly, the TF proposes application material that describes the nature of these procedures (see **paragraph A35**). In support of this, the TF also proposes application material that describes the different types of OI the auditor may encounter (see **paragraph A17** and the **Appendix**). Additional considerations are set out below.

Category 1 OI – amounts same as in the financial statements

23. The TF believes that “ticking and tying” all such information to the audited financial statements is already done to a large extent in practice. However, the TF believes it would be helpful to include application material to guide the auditor in agreeing amounts in the OI that are intended to be the same as amounts in the audited financial statements (see **paragraph A35**).

Category 2 OI – narrative disclosures intended to convey same meaning as in the financial statements

24. The TF felt that it should be a matter for the auditor's professional judgment as to which items in this category to further consider. While slightly greater judgment may be involved here when considering the OI, the level of difficulty involved may not be significantly greater than that relative to Category 1 OI (see **paragraph A35**).

Category 3 OI – directly reconcilable financial information

25. The Board had generally agreed to limit directly reconcilable financial information to quantitative financial information that is supportable by a management reconciliation, all the items within which can be agreed to specific elements, accounts or items *in the financial statements*. The TF has made this clear in the proposed ISA (see **paragraph A36**). The TF proposes additional application material to provide examples of amounts that would be considered directly reconcilable or, on the contrary, not directly reconcilable (see **paragraphs A37–A38**).
26. The TF notes that the Board generally did not agree that it would be appropriate for the proposed ISA to extend the previously proposed requirement regarding testing of “directly reconcilable financial information” to cover amounts in the OI that could only be reconciled by agreeing items in the reconciliation to the entity's accounting records. Doing so may inappropriately suggest that the

auditor is required to gather new audit evidence about the OI rather than just comparing the OI with the auditor's understanding based on the audit work. Further, if no boundary were established around directly reconcilable financial information, everything would be reconcilable to some extent and the work effort would become disproportionate. Therefore, the application material states that for directly reconcilable financial information, the auditor may consider obtaining a reconciliation from management and agreeing items in the reconciliation to the audited financial statements (see **paragraph A35**). Nonetheless, there may also be circumstances where the auditor judges that agreeing items to the audit documentation or to other appropriate sources may be an appropriate way to consider the OI in light of the auditor's understanding (for example, see **paragraph A41**).

Category 4 OI – all other financial and non-financial information

27. The TF believes that the greatest need for judgment, and therefore effort, by the auditor will in practice be on all the other remaining financial information and the non-financial information. The auditor would not be expected to have an understanding of all this OI. However, when considering it, the auditor may be guided as to which items in this remaining OI may merit further consideration based on whether the auditor expects to have a relevant understanding of them obtained during the audit. The TF proposes that application material to this effect be added in the proposed ISA (see **paragraph A39**).
28. The TF also proposes further application material to explain the factors the auditor may consider in determining the procedures the auditor may judge necessary to perform with respect to the OI in these circumstances (see **paragraph A40**). Finally, the TF proposes application material, including illustrative examples, in **paragraph A41** regarding the procedures the auditor may perform in these circumstances.
29. The TF believes that, taken together, all the above new application material has clarified and improved the proposed ISA through enhancing the auditor's work effort regarding the OI, and will facilitate effective application of the overarching "read and consider" requirement.

Matter for IAASB Consideration

4. Does the IAASB agree with the TF's proposals above regarding the nature and extent of work effort when reading and considering the OI?

E. Reporting

30. At its December 2011 meeting, the IAASB asked the TF to consider whether the revised standard should include specific reporting responsibilities about the auditor's work effort relating to OI, taking into account the highly favorable responses to the Board's May 2011 Auditor Reporting Consultation Paper³ and bearing in mind the expanded scope of the revised ISA.

³ The Board's Consultation Paper, *Enhancing the Value of Auditor Reporting: Exploring Options for Change* specifically asked for respondents' views as to whether there would be benefit in including a statement about the auditor's responsibilities regarding other information in the auditor's report. An overwhelming majority of respondents expressed support for doing so, either because this would increase transparency about the auditor's work in this area, or because it is already local practice. Many respondents also expressed support for some form of auditor conclusion with respect to the other information for greater clarity.

31. In June 2012, the IAASB issued its ITC on auditor reporting setting out suggested improvements for the future auditor's report, including a statement in relation to OI. The ITC includes an illustrative example of a statement based on the auditor's responsibilities under extant ISA 720 when the auditor has no material inconsistencies to report.

TF Recommendations

32. The TF believes that it would be appropriate for the reporting responsibilities regarding OI to be addressed within the proposed ISA itself. In alignment with the Board's suggested improvement regarding such reporting as set out in the ITC, the TF recommends that the proposed ISA include a requirement for the auditor to provide a statement in the auditor's report comprising the reporting elements set out in the ITC, adjusted to be consistent with the scope of the proposed ISA (see **paragraph 16**). To illustrate how this statement may be worded, the TF proposes two examples addressing circumstances when the auditor has no material inconsistencies to report, and when there is a material inconsistency to report (see **paragraphs A52-A53**).
33. The TF felt it important to emphasize that even when the OI is received after the date of the auditor's report, the auditor has a responsibility to read and consider it if the OI is included in a document that is within the scope of the ISA. However, the OI will not be identified in the auditor's report as it was not available at the time the auditor's report was dated and, unless required by law or regulation, the auditor's report will not be updated or re-issued to refer to such OI (see **paragraph A54**).
34. The TF also believes that it will be necessary for the auditor to consider the implications of modifications of the auditor's opinion on the financial statements for the statement with respect to the OI (see **paragraph 17**). The TF has provided guidance to address this situation, including when the opinion is qualified due to disagreement with management, when the opinion is qualified due to a limitation of scope, and when there is an adverse opinion or a disclaimer of opinion (see **paragraphs A55-A58**).
35. Finally, recognizing that there are national legal or regulatory requirements for the auditor to report with respect to the OI, the TF believes the proposed ISA should address the need to adapt the statement required by the proposed ISA to meet the legal or regulatory requirements and still be in compliance with the ISAs. For this purpose, the TF proposes to include a requirement and related application material based on how ISA 700 deals with similar circumstances when the auditor's report is prescribed by law or regulation (see **paragraphs 18 and A59**).

Matter for IAASB Consideration

5. Does the IAASB agree with the TF's proposals above in relation to reporting?

F. Other Matters

Consideration by IAASB of the Effective Date

36. To allow for effective adoption and implementation of the revised ISA 720 at the national level, the TF believes that an appropriate effective date for the standard would be 12–15 months after issuance of the final ISA. The explanatory memorandum to the exposure draft will invite respondents to comment on whether this would provide a sufficient period to support effective implementation of the revised ISA 720. As set out in the *Preface to the International Quality Control*,

Auditing, Review, Other Assurance, and Related Services Pronouncements, early adoption would be permitted.

Consideration by IAASB of the Need for Further Consultation

37. In addition to consulting with the IAASB CAG throughout the development of the proposed ISA, the TF has received input from the IAASB–NSS Liaison Group in April 2011 and through survey work conducted with the assistance of the CFA Institute and INTOSAI in relation to the scope of the proposed ISA. The TF has also received the benefit of input from dialogue with regulators throughout the development of its proposals.
38. The TF does not believe that it is necessary at this stage to hold a public forum or roundtables, or to issue a consultation paper or conduct field testing, in order to solicit views on a matter under consideration in the revision of ISA 720.

Consequential and Conforming Amendments to Other ISAs

39. The TF believes that a few conforming amendments will be necessary to the Glossary of Terms and ISAs 260 and 450.⁴ In addition, the TF proposes a few consequential amendments to ISAs 260 and 700 that it believes would be helpful as a result of the proposed changes to ISA 720. These proposed conforming and consequential changes are set out in **Agenda Item 2-D**.

Matter for IAASB Consideration

6. Does the IAASB agree with the TF's views and proposals above?

G. Consideration by IAASB of Significant Matters Identified by the TF

40. In the TF's view, the significant matters the TF has identified as a result of its deliberations since the beginning of this project, and the TF's considerations thereon, have all been reflected in the issues papers presented to the IAASB at its meetings. In the TF's view, there are no significant matters discussed within the TF on this project that have not been brought to the IAASB's attention.

⁴ ISA 260, *Communication with Those Charged with Governance*; and ISA 450, *Evaluation of Misstatements Identified during the Audit*