

IAASB CAG PAPER

IAASB CAG Agenda (March 2010)

Agenda Item N.1

Other Information in Documents Containing Audited Financial Statements – ISA 720 – Project Proposal

The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements – ISA 720 – IAASB Project Proposal

I. Subject

1. Revision of ISA 720, “The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements.”

II. Background and Relevant Developments

Background

2. Extant ISA 720¹ was last revised in 1993.² As part of the IAASB’s Clarity project, extant ISA 720 was redrafted (but not revised) and the clarified ISA 720³ was released in March 2009.
3. During the Clarity redrafting of extant ISA 720 and the consultations on IAASB’s *Strategy and Work Program, 2009-2011*, several stakeholders drew the IAASB’s attention to the need to update and revise the standard to ensure that it is sufficient and fit-for-purpose in the context of today’s financial reporting environment. This view was shared by members of the IAASB Consultative Advisory Group (CAG). The IAASB considered the input received and agreed to include consideration of a proposal to revise ISA 720 (Redrafted) in its 2009-2011 work program.

Relevant Developments

DEVELOPMENTS IN CORPORATE FINANCIAL REPORTING

Contents and Form of Annual Reports

4. Over the last decade there have been a number of significant developments in the corporate reporting environment, particularly in relation to companies’ annual reports. Many of these were not contemplated during the formulation of extant ISA 720. Relevant developments include:
 - (i) **Exponential increase in nature, extent and range of mandatory and voluntary disclosures**

¹ ISA 720, “Other Information in Documents Containing Audited Financial Statements.”

² Subsequently, conforming amendments were made to the extant ISA 720 when the IAASB issued its audit risk standards in October 2003.

³ ISA 720 (Redrafted), “The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements.”

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Recent studies⁴ have shown that in general, the average volume of companies' annual reports has experienced a consistent increase. Similarly, the nature of information in annual reports has also undergone changes; there have been sharp increases in the amount of voluntary disclosures. In addition, companies are releasing materials of a more diverse nature. Increasingly, there are different types of management statements (for example, corporate governance statements, statements of directors' remuneration) although not audited are nevertheless being presented together with audited financial statements.

(ii) Changing emphasis towards more qualitative disclosures

As preparers attempted to put financial information into context with the aim of achieving better communication with their stakeholders, annual reports increasingly now include more narrative information and qualitative disclosures. Such disclosures address to a greater extent matters such as features of an entity's business model, risk exposures and uncertainties, and risk management strategies. There is also a trend to exploring ways in which to better integrate information in financial statements, Management Discussion and Analysis and other parts of an entity's public reporting package. The challenge that arises, however, is achieving balance between transparency, completeness and understandability.

(iii) Leveraging technology to better communicate and disseminate information

In contrast to producing traditional printed hard-copy annual reports, preparers are increasingly disseminating these documents through their websites typically taking electronic formats such as HyperText Markup Language (HTML) or Acrobat Portable Document Format (PDF).

More significantly, many entities are now beginning to use eXtensible business reporting language (XBRL) – a tool that involves processes and outputs that are evolving the way in which entities and users analyze, interpret and process financial information and disclosures, often in a way where there is a much greater distance from the historical static paper format.

Developments continue to evolve in this space, for example: some U.S. companies have taken to posting video annual reports on-line;⁵ others are embedding video elements into their online annual report linking into other media such as webcasts. Regulatory developments have played an important role in encouraging the adoption of new methods for disseminating annual reports.⁶

⁴ For example, Beattie and Dhanani (2008) examined changes in annual reports of U.K. listed companies from 1965 to 2004. Of those examined, an approximate threefold increase in size of the reports was observed (26 pages in 1965 to 75 pages in 2004) with increases in both regulatory and voluntary materials.

⁵ For example, California Pizza Kitchen Inc, Marriott International Inc., Pike Electric Corporation and Sealy Inc.

⁶ Relevant regulatory changes included the U.S. Securities Exchange Commission's new proxy rules passed in January 2007 permitting electronic distribution of key shareholder materials by companies and the passing of the Australian Corporate Law Economic Reform Program Act (2004) Sections 314(4) and (5) which allows for the electronic distribution of the annual report to shareholders in place of the traditional print reports.

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(iv) Increased importance of other information to users

Users of annual reports are also attaching greater importance to, and placing increasing reliance on, other information presented in documents containing audited financial information, especially those of a qualitative nature in order to better interpret the more sophisticated disclosures in the financial statements. In response, preparers have incorporated more diverse information in annual reports through voluntary disclosures. In this regard, the IASB has undertaken a project on management commentary in 2002, the objective of which is to develop a best practice model for a narrative report that would accompany but be presented outside of the financial statements, setting out management's explanation of the enterprise's financial condition, changes in financial condition, results of operations, and causes of changes in material line items.

Users are also increasingly looking to documents other than annual reports, some of which may contain audited financial information, for example, interim reports, for more timely disclosures.

5. The developments outlined above have relevance to ISA 720 given their connection and interaction with the auditor's report and the audited financial statements.

DEVELOPMENTS IN NATIONAL AUDITING STANDARDS

6. Since the development of extant ISA 720, some national standard setters have identified areas in connection with other information, not presently dealt with in ISA 720, where further guidance is necessary to promote consistency of practice and to respond to reporting developments. These include, for example:

- **Responsibilities of the auditor in regard to the electronic publication of the auditor's report** - In particular, the auditor's consideration of other information issued with an electronic auditor's report and limitation of the auditor's association with such other information.

In this regard, the UK Auditing Practices Board's (APB's) ISA 720 (UK and Ireland) (Revised)⁷ provides guidance relating to this area (in the form of an appendix). The ISA (UK and Ireland) also provides guidance on auditors' statutory reporting responsibilities in relation to directors' reports.

- **Guidance on whether and to what extent the auditor has responsibilities in connection with other information in electronic sites containing audited financial statements**

In this regard, the US Public Company Accounting Oversight Board's (PCAOB's) / American Institute of Certified Public Accountants (AICPA) Auditing Standards Board's

⁷ ISA 720 (UK and Ireland) (Revised), "Other Information in Documents Containing Audited Financial Statements."

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(ASB's) AU Section 9550⁸ interprets AU Section 550⁹ in the context of these circumstances. It is stated that electronic sites are merely means for disseminating information and are therefore not considered "documents" which is the term used in AU Section 550. The UK APB's ISA 720 (UK and Ireland) (Revised) on the other hand outlines procedures the auditor should perform when companies include audited financial statements and the auditor's report on their website or disseminate these documents electronically.

- **Responsibilities of the auditor in regard to the interim report and other public documents which the auditor may be engaged to read or perform other services with respect to the document** - For example, a prospectus, a private securities offering memorandum or a share exchange takeover bid circular.

In this regard, the Canadian Auditing and Assurance Standards Board (CAASB)'s Assurance Section 7500¹⁰ includes relevant recommendations and guidance.¹¹

OTHER DEVELOPMENTS

7. In the wake of the financial crisis, groups such as the Committee of European Banking Supervisors (CEBS),¹² the UK Financial Services Authority (FSA)¹³ and the US Financial Accounting Standards Board (FASB)¹⁴ have identified the need for greater guidance in the area of disclosures for example, in connection with the entity's risk reporting and financial reporting. These groups have taken action to issue guidelines in this regard targeted at assisting stakeholders improve the nature, timing and extent of their disclosures with particular consideration for the extant economic environment. Developments of such nature may have relevance for the audit in terms of the auditor's responsibilities under ISA 720.

III. Project Objective and How it Serves the Public Interest

Project Objective

8. The objective of this project is to revise ISA 720 to ensure that the ISA continues to be capable of enhancing the credibility of financial statements through specifying appropriate responsibilities of the auditor relating to the range of other information in documents

⁸ AU Section 9550, "Other Information in Documents Containing Audited Financial Statements: Auditing Interpretations of Section 550."

⁹ AU Section 550, "Other Information in Documents Containing Audited Financial Statements."

¹⁰ Assurance Section 7500, "Auditor Association with Annual Report, Interim Reports and Other Public Documents."

¹¹ It is noted however that ISA 720 deals with the auditor's responsibilities relating to other information in annual reports or equivalent documents.

¹² CEBS Consultation Paper 30, "Disclosure Guidelines: Lessons Learnt from the Financial Crisis." (October 2009).

¹³ FSA Discussion Paper 09/5, "Enhancing Financial Reporting Disclosures by UK Credit Institutions." (October 2009).

¹⁴ FASB Project on the Disclosure Framework.

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containing audited financial information and taking account of how such information is disseminated.

How the Project Objective Serves the Public Interest

9. The project's objective serves the public interest by revisiting the auditor's responsibilities with respect to the other information in the context of today's financial reporting environment, thereby promoting further alignment of users' expectations and auditors' responsibilities. It also serves the public interest by increasing the effectiveness of the external audit by ensuring that there is an appropriate auditor response in the event the other information contained such the documents present the likelihood of undermining the credibility of the audited financial statements and the auditor's report.

IV. Outline of the Project

Project Scope

10. The scope of this project is to revise ISA 720 within the context of an audit of financial statements. Accordingly, it does not address the auditor's responsibilities in connection with, for example, other documents issued by companies which may contain audited financial information such as prospectuses, nor engagements that may be undertaken on such information, for which responsibilities may differ from those in an audit of financial statements.

Major Problems and Key Issues that Will Be Addressed

11. Without prejudice to any matters that the project task force may bring to the IAASB for inclusion in the project, the issues that will need to be dealt with in the revision of ISA 720 include the following:

DEFINING OTHER INFORMATION

12. Consideration will be given to whether the current definition of 'other information'¹⁵ in the ISA is adequate in the current environment or whether, in the context of the range of other information being presented concurrently with audited financial statements, a different definition would be appropriate. This may also involve developing additional guidance explaining the different types of other information that are presently being used and clarifying the applicability of the ISA to them.
13. Consideration will also be given to the different methods by which the annual reports and other information are being disseminated in practice. The manner through which annual

¹⁵ 'Other information' is defined in ISA 720 as: "Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon."

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reports may be distributed, for example in XBRL format,¹⁶ is relevant in the context of ISA 720 as it may affect the amount and nature of other information that are presented concurrently with audited financial statements.

14. In connection with this issue, consideration may need to be given to questions from an audit perspective such as what is the boundary between financial statement disclosures and financial disclosures in other information, and how the auditor's responsibilities relate to developments in different financial reporting frameworks.

NATURE AND EXTENT OF THE AUDITOR'S RESPONSIBILITIES

15. Consideration will be given to the nature and extent of the auditor's responsibilities in connection with the other information. This will include consideration of whether such responsibilities should remain directed at reading other information for material inconsistencies and material misstatements of fact, or whether it is appropriate to extend the responsibilities of the auditor. This may include, for example, consideration of the question of whether the auditor should give specific consideration to the adequacy and completeness of the other information, in so far as it relates to the auditor's understanding of the entity and environment obtained during the course of an audit, and if so, the nature and extent of any such responsibility.
16. Consideration will also be given to whether *all* "other information" should be required to be made available to the auditor prior to the date of the auditor's report. In addition, consideration will be given to whether additional guidance should be developed on the "procedure necessary under the circumstances" that the auditor should carry out when material inconsistencies with the audited financial statements are identified in other information subsequent to the date of the auditor's report, and on the "further appropriate action" that the auditor might take when material misstatements of facts are identified in other information.

ELECTRONIC DISSEMINATION OF AUDITED FINANCIAL INFORMATION

17. Consideration will be given to the implications of the electronic dissemination of audited financial statements. These may include consideration of electronic sites with links to other information such as press releases, information about the company and other promotional materials, and the implications of electronic sites whose contents may not be controllable by either the entity or the auditor. Further, other information on electronic sites may continuously be updated or replaced therefore requiring the consideration of the auditor's ongoing

¹⁶ In itself, XBRL-tagged data does not generally represent "other information" as contemplated in ISA 720, because it is simply a machine-readable data rendering of the financial statements, rather than other information. At its September 2009 meeting, the IAASB considered that XBRL-tagged data filed with the local authorities does not constitute a discrete document, and accordingly the auditor's obligations under extant ISA 720 would not be applicable under these circumstances.

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responsibilities in this regard. In connection with this, the project will consider relevant approaches presently adopted in national auditing standards.

OTHER INFORMATION WHICH THE AUDITOR IS NOT EXPECTED TO BE RESPONSIBLE

18. When audited financial statements are included in a document issued to the public, there is the likelihood that the auditor may be perceived to be associated with other financial or non-financial information contained within that document. While the auditor's opinion does not cover the other information and therefore the auditor has no specific responsibility for such information, the auditor may nevertheless be seen to be associated with these other information. The project will seek to clarify the auditor's responsibilities with regards to such information.

OTHER MATTERS

19. Consideration will be given to whether and to what extent specific guidance should be included in the ISA on the statutory and contractual requirements in some jurisdictions of auditors of public sector entities in relation to non-financial information. Particularly, the likelihood that by virtue of the auditor's statutory or contractual responsibilities in connection with the non-financial information, such information may be perceived as forming a part of the audited financial statements and therefore associated with the auditor.

Impact Analysis Considerations

20. The primary benefit of this project stems from the potential improvements that may be made to the quality of audits through clarification of the auditor's responsibilities in the context of the range of information contained in companies' annual reports for which the auditor has responsibilities or is perceived to be associated with.
21. As this project has the potential to result in further requirements of auditors in regard to the other information, there may be implications for the cost of the audit as it relates to the auditor and the entity. However, it is anticipated that since larger entities have a greater likelihood of including greater amounts of other information in their annual reports and embracing electronic methods for disseminating these reports, cost increases if any would likely not be significant relative to the overall cost of the external audit. It is anticipated that the revised standard will have varying impacts, if any at all, on smaller practitioners depending on their respective circumstances.
22. IFAC is currently developing an impact analysis framework for its standard setting bodies. This project will be a test case for this purpose.

V. Implications for Any Specific Persons or Groups

23. The project has particular implications for national standards setters who have adopted ISAs, or use them as a basis for their own standards, including the International Organization of Supreme Audit Institutions (INTOSAI). It also has implications in connections with the work

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VI. Development Process, Project Timetable and Project Output

Development Process

24. It is anticipated that the project will follow the normal developmental process of the IAASB for revising an ISA. This includes giving specific consideration to the need for a consultation paper or other form of consultation (for example, focus groups or roundtables) and field testing of proposals. Consideration will also be given to consulting those stakeholders who are not ordinarily respondents to the IAASB's exposure drafts but whose input as identified during the course of the project's development are important to obtain.

Project Timetable

25. The following project timetable is proposed (subject to whether the project Task Force and the IAASB determine the need for a consultation paper or other forms of consultation before exposure of the proposed revised ISA):

Project Stage	Timing
Consideration of issues	March and June 2010
First read of draft revised ISA 720	September 2010
Approval of revised ISA 720 for exposure	December 2010
Review of respondents' comments	September 2011
Second read of proposed revised ISA 720 post-exposure	December 2011
Approval of proposed revised ISA 720	March 2012

Project Output

26. A revised ISA 720.

VII. Resources Required

27. A project Task Force will be created, consisting of 5-6 individuals including IAASB board members and technical advisors. The project will be chaired by an IAASB member. INTOSAI will also be invited to nominate a representative to the Task Force.
28. IAASB technical staff will provide support to the project Task Force.

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VIII. Relevant Sources of Information that Address the Matter Being Proposed

29. Relevant sources of information include the following:

- Australian Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act (2004), Sections 314(4) and (5)
- Beattie, V., and Dhanani A. 2008. Investigating Presentational Change in U.K. Annual Reports. *Journal of Business Communication* 45(2): 181-222
- CAASB's Assurance Section 7500, "Auditor Association with Annual Report, Interim Reports and Other Public Documents"
- CEBS's Consultation Paper 30, "Disclosure Guidelines: Lessons Learnt from the Financial Crisis." (October 2009)
- IAASB's "Strategy and Work Program 2009-2011"
- IAASB's ISA 720 (Redrafted), "Other Information in Documents Containing Audited Financial Statements"
- IASB Exposure Draft (ED/2009/6) on Management Commentary
- Respondents' comments on the IAASB's exposure draft of proposed redrafted ISA 720
- Respondents' comments on the proposed IAASB Strategy and Work Program 2009-2011
- U.S. Securities Exchange Commission's Release Nos. 34-56135, "Shareholder Choice Regarding Proxy Materials"
- UK APB's ISA 720 (UK and Ireland) (Revised), "Other Information in Documents Containing Audited Financial Statements"
- UK FSA's Discussion Paper 09/5, "Enhancing Financial Reporting Disclosures by UK Credit Institutions." (October 2009)
- US PCAOB's / AICPA ASB's AU Section 550, "Other Information in Documents Containing Audited Financial Statements"
- US PCAOB's / AICPA ASB's AU Section 9550, "Other Information in Documents Containing Audited Financial Statements: Auditing Interpretations of Section 550"