



International Federation of Accountants

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**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** New York

**Meeting Date:** March 8–9, 2011

### **The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon—ISA 720— Report Back and Issues and IAASB Task Force Proposals**

#### **Objectives of Agenda Item**

1. The objectives of this Agenda Item are to:
  - (a) Provide a report back on proposals of the Representatives on this project as discussed at the September 2010 CAG Meeting; and
  - (b) Obtain the Representatives' views on significant issues to be discussed by the IAASB at its March 2011 meeting relating to the revision of ISA 720.<sup>1</sup>

#### **Papers to Be Referred to during Discussion**

2. The discussion on this topic will follow the structure of this CAG Paper.
3. Proposed ISA 720 (Revised)<sup>2</sup> and proposed ISA 560 (Revised)<sup>3</sup> are available for reference and the links to these documents are provided at the end of this CAG paper.

#### **Project Status and Timeline**

4. The IAASB will be discussing similar significant issues that should be addressed in the revision of ISA 720 at its March 2011 meeting.
5. Appendix 1 of this paper provides a project history, including links to the relevant CAG documentation.

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<sup>1</sup> International Standard on Auditing (ISA) 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*

<sup>2</sup> Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*

<sup>3</sup> Proposed ISA 560 (Revised), *Subsequent Events*

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#### September 14-15, 2010 CAG Discussion

6. Below are extracts from the draft minutes of the September 2011 CAG meeting,<sup>4</sup> and an indication of how the project Task Force or IAASB has responded to the Representatives’ comments.

Representatives’ Comments	Task Force/IAASB Response
<b>DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS ADDRESSED BY ISA 720</b>	
<p>Mr. Damant suggested the standard should be clear on what is, and what is not, considered to be other information. For example, he cited the summary and shorter results in the beginning of an entity’s annual report. In his view, this is often where an entity will aim to present its results in the best possible light.</p>	<p>Point accepted.</p> <p>The Task Force proposes the following in proposed ISA 720 (Revised):</p> <ul style="list-style-type: none"> <li>• A definition of “other information.”<sup>5</sup></li> <li>• Requirement for the auditor to perform the appropriate procedures when other information is extracted from or capable of being reconciled to the financial statements.</li> <li>• Guidance on the following: <ul style="list-style-type: none"> <li>○ Whether (i) disclosures required under the framework to be located outside of the audited financial statements; and (ii) unaudited supplementary information presented with the audited financial statements, fall within the definition of other information.</li> <li>○ Examples of financial and non-financial, and historical and prospective other information.</li> <li>○ Description of management commentary in the International</li> </ul> </li> </ul>

<sup>4</sup> The minutes will be approved at the March 2011 IAASB CAG meeting.

<sup>5</sup> Information (other than the financial statements and the auditor’s report thereon) which is included, either by law, regulation, custom or voluntarily, in a document containing or accompanying audited financial statements and the auditor’s report thereon (in the context of ISA 720)

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Representatives’ Comments	Task Force/IAASB Response
	<p style="text-align: center;">Accounting Standards Board’s Practice Statement on management commentary.<sup>6</sup></p> <p><b>See paragraphs 8(a), 11 and A5–A9 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>He also supported the standard covering preliminary announcements, as these are extremely important to investors and are often price-sensitive.</p>	<p>Support noted.</p> <p>In September 2010, the IAASB noted views, including those of some of the CAG Representatives, that it is the public interest for the IAASB to deal with preliminary announcements. The IAASB expressed reservations about addressing the auditor’s responsibilities relating to preliminary announcements in ISA 720 due to inherent differences between annual reports and preliminary announcements. It instructed the Task Force to further consider the matter including the merits of addressing preliminary announcements in a separate ISA.</p> <p>The Task Force encourages the IAASB to consider undertaking work to address whether, and if so, to what extent the auditor has responsibilities relating to preliminary announcements. It believes that it is desirable to do so separately in an ISA in order to give due recognition to the characteristics that are unique to such documents, and accordingly, the auditor’s responsibilities in view of these considerations.</p> <p>This matter will be further considered by the IAASB at its March 2011 meeting.</p> <p><b>See Section D on “Preliminary Announcements” in this CAG paper.</b></p>

<sup>6</sup> IFRS Practice Statement, Management Commentary as at December 2010.

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Representatives' Comments	Task Force/IAASB Response
<p>Mr. Koktvedgaard supported the distinction made by the Task Force to clarify that the other information included in the scope of the revised ISA should be that which relates to the financial statement objectives. In his view, it would not be appropriate to suggest that the auditor has to deal with other information for which it would be impracticable to expect that the auditors would have knowledge.</p>	<p>Support noted.</p> <p>The Task Force proposes guidance to clarify that the auditor is not expected to substitute his professional judgment for that of management and that there might be valid differences of judgment between the auditor and management</p> <p><b><i>See paragraph A20 of Agenda Item 7-C of the March 2011 IAASB meeting.</i></b></p>
<p>Mr. Koktvedgaard questioned whether corporate governance and corporate social responsibility (CSR) statements, as well as sharia requirements, would be considered to be in the scope of proposed revised ISA 720. In the Working Group's view, if such information is included in the glossy annual report, the auditor should have some responsibility for reading this information. He explained the view that the same principle should apply if these matters are published on an entity's internet at the same time as the financial statements, with the timing of the release being the critical point in scoping in this information.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Gélard clarified that both scenarios would be covered by the proposed revised standard and that, if information was only available on the internet, the auditor would be responsible for making appropriate arrangements with management or those charged with governance to obtain the other information, and reading and considering such material in accordance with ISA 720.</p> <p><b><i>See paragraphs 9–10 of Agenda Item 7-C of the March 2011 IAASB meeting.</i></b></p>
<p>Mr. Robberecht questioned whether, based on the proposed description of the key features of documents covered by ISA 720, XBRL would be included in the scope of ISA 720.</p> <p>Ms. Blomme suggested further thought may need to be given to the matter. While she understood the IAASB had previously communicated its position that ISA 720 was not meant to apply to XBRL, reading the description of documents proposed to be included in the revised ISA, auditors and users may interpret XBRL now to be included in its scope. Mr. Koktvedgaard agreed that this particularly may also be the case when jurisdictions require the final financial statements to be published in XBRL only (that is, if XBRL is the only format of the financial statements made publicly available, most users</p>	<p>During the meeting, Mr. Gélard replied that he did not believe this to be the case.</p> <p>As described in the IAASB's Staff Questions and Answers, <i>XBRL: The Emerging Landscape</i>, XBRL is a language for the electronic communication of business and financial data. Fundamentally, individual disclosure items within business reports are assigned unique, electronically readable tags that allow computers to sort, group, and categorize these information. Auditors cannot practically be expected to read and understand XBRL tagged-data.</p> <p>Where entities only produce their financial statements and other information from XBRL-</p>

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<p>would assume that it had been covered by ISA 720). He also noted that, if XBRL information also accompanies the audited financial statements and is published on the internet at the same time the financial statements are issued, it would appear to be included in the scope of the proposed revised ISA.</p>	<p>tagged data, the auditor would be responsible for making appropriate arrangements with management or those charged with governance to obtain such information in readily readable form, and would read and consider such material in accordance with proposed ISA 720 (Revised).</p> <p><b>See paragraphs 9–10 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. Johnson supported the inclusion of the preliminary announcement within the scope of ISA 720. In his experience with the UK listing rules, the auditor typically agrees in writing to the issuance of the preliminary announcement. He would suggest therefore that, if the auditor is not complete at that time, that the auditor is taking a risk in relation to the numbers that are issued. He explained that in a number of audit firms, there is a stipulation that the audit must be complete before clearance can be given on the preliminary announcement to mitigate the risk that the audit may find differences after the preliminary announcement has been made. He supported Mr. Damant’s view that investment decisions increasingly are being made on information other than the audited financial statements and noted that information that may be provided in a preliminary announcement could be misleading if presented inappropriately.</p>	<p>Support noted. As noted above, this matter will be further considered by the IAASB at its March 2011 meeting.</p> <p><b>See Section D on “Preliminary Announcements” in this CAG paper.</b></p>
<p>Mr. White questioned whether the proposed revised standard deals with what the auditor would do having looked at a preliminary announcement and later finding differences. He suggested that this topic should be specifically addressed to advise auditors of appropriate actions should this circumstance occur. Ms. Sucher suggested there may be guidance in the UK that may be relevant for inclusion in the revised ISA.</p>	<p>Support noted. As noted above, this matter will be further considered by the IAASB at its March 2011 meeting.</p> <p><b>See Section D on “Preliminary Announcements” in this CAG paper.</b></p>
<p>Ms. Blomme cautioned that often the securities listing</p>	<p>Point accepted.</p>

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<p>rules determine the extent to which an auditor is associated with other information. She encouraged the Task Force to determine whether the revised ISA could better explain that certain jurisdictions may have different requirements for auditors, in particular in relation to preliminary announcements and corporate governance statements.</p>	<p>Proposed ISA 720 (Revised) specifies that law or regulation may require the auditor to specifically report on such other information. In these circumstances, the auditor determines and performs the procedures necessary to meet those additional requirements.</p> <p><b>See paragraph 4 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. Koktvedgaard did not agree that preliminary announcements should be covered in the scope of ISA 720, as there is not a requirement for the auditor to audit the preliminary announcement. He noted in practice that if there is a problem with the preliminary announcement that is discovered during the audit, it is management’s responsibility rather than the auditor.</p> <p>Mr. Baumann expressed the view that it would likely be difficult for the auditor to make a statement about the percentage of the audit that has been completed at the time of a preliminary announcement.</p>	<p>During the meeting, Mr. G�elard noted that, while there is no obligation for the auditor to audit a preliminary announcement, regulators in particular jurisdictions (for example, France) recommends to the issuers to state in their the preliminary announcement at what stage of completion is the audit. In his view, work on other information is a continuum of effort and is performed in light of the auditor’s knowledge obtained to date.</p> <p>As noted above, this matter will be further considered by the IAASB at its March 2011 meeting.</p> <p><b>See Section D on “Preliminary Announcements” in this CAG paper.</b></p>
<p>Ms. Sucher questioned the Task Force’s assertion that the annual financial report as prepared in the European Union in accordance with the Transparency directive would be excluded from the scope of the revised ISA. Mr. G�elard explained that it is often arrives after the entity has issued its financial statements and annual report publicly. Ms. Sucher agreed, noting that at that time the auditor would have finished the audit and would therefore not have any responsibility for the transparency report. She suggested, however, that it might not be clear to people reading either the annual report or the transparency report that the work effort is different. Mr. Damant suggested the application material could clarify</p>	<p>Point accepted.</p> <p>The Task Force proposes the following:</p> <ul style="list-style-type: none"> <li>• Clarifying the proposed description of key features of documents in the scope of proposed ISA 720 (Revised) to indicate that such documents are intended to be made available along with the <i>initial release</i> of the audited financial statements and the auditor’s report thereon; and</li> <li>• Providing examples of certain documents that are outside of the scope of proposed ISA 720 (Revised) but for which there</li> </ul>

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explicitly why certain items have been excluded from the scope.	<p>might be ambiguity.</p> <p><b>See paragraphs 2 and A4 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
Mr. White also questioned whether the ISA takes into account that an entity may prepare multiple annual reports using different frameworks (for example, under IFRS and home country GAAP).	<p>Point noted.</p> <p>During the meeting, Mr. Gélard noted that, if financial statements presented under each framework were audited, then the auditor would have a responsibility for both annual reports.</p>
<b>WHAT ARE THE AUDITOR'S RESPONSIBILITIES RELATING TO OTHER INFORMATION?</b>	
Mr. Baumann asked for clarification as to what the auditor does if, in reading the other information, he finds it to be misleading. Mr. Gélard explains that the auditor first discusses the matter with management and requests the information to be changed and, if management does not agree, then raises the matter with those charged with governance. Mr. Baumann supported this position.	<p>Point accepted.</p> <p>The Task Force proposes that if the auditor identifies a matter(s) that leads the auditor to believe that the other information may be materially misrepresented, the auditor needs to discuss the matter(s) with management and, if needed, those charged with governance.</p> <p><b>See paragraphs 14, 16(b)(ii) and 19(b) of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. Cassel noted that it is important for the auditor to understand the reason for any misstatements in other information. In his view, in the public sector, management may have more incentive to include information that may be misleading in the annual report. This may be the case when, for example, when management wishes to make its results seem more positive in communicating to the citizens or conversely may be seeking to obtain more resources from taxpayers. In his view, the revised ISA should seek to give as much guidance as possible to auditors as to what should be done if both management and those charged with governance will not change information that the auditor has deemed to be misleading.</p> <p>Ms. Sucher agreed, noting that IOSCO had previously</p>	<p>Points accepted.</p> <p>The Task Force proposes the following:</p> <ul style="list-style-type: none"> <li>• Including guidance to emphasize the importance for the auditor to maintain professional skepticism when reading and considering the other information; <b>See paragraph A15 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></li> <li>• Strengthening the actions required of the auditor when auditor has determined that the matter(s) causes the other information to be materially misrepresented and management refuses to correct the other information; and <b>See paragraphs 16–20</b></li> </ul>

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<p>encouraged the IAASB to avoid phrases such as “The auditor shall take further appropriate action and procedures necessary under the circumstances.” In her view, it is important for the IAASB to provide as much guidance as possible, while acknowledging that judgment may be required in the circumstances.</p>	<p><b>and A23–A27 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p> <ul style="list-style-type: none"> <li>• Providing guidance on the actions the auditor may take, or procedures that the auditor may perform, in cases where the ISA requires the auditor to “take further appropriate action” or “perform further procedures as appropriate.” <b>See paragraphs 15, 20, A21–A22 and A26–A27 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></li> </ul>
<p>Mr. Kuramochi noted IOSCO’s support for the direction taken on the auditor’s responsibilities for other information extracted from the audited financial statements. He suggested the revised standard should seek to be as explicit as possible in the type of procedures and the level of supporting documentation that is necessary in dealing with other information that is not extracted from the audited financial statements. In his view, this is important for enforceability and investor protection. He also believed that the financial statement user view would be helpful in determining what procedures should be done by auditors. He suggested that, if this question was not included in the CFA Institute survey, a question should be posed in the exposure draft.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Gélard noted this had been included in the CFA Institute survey.</p> <p>The Task Force proposes to strengthen the auditor’s work effort when dealing with matters relating to the other information.</p> <p><b>See paragraphs 14–20 and A20–A27 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. Kuramochi also questioned what the Task Force’s view would be in relation to other information included in prospectuses, which is dealt with under ISAE 3400.<sup>7</sup> He suggested that, for prospective financial information, the auditor could check for consistency with the entity’s business plan we can also check consistency with their business plan.</p>	<p>Point not accepted.</p> <p>The scope of extant ISA 720 does not include offer documents for raising capital or other funds such as prospectuses. The Task Force is of the view that this continues to be appropriate.</p> <p><b>See Section A on “Describing Documents in the Scope of ISA 720” in this CAG paper.</b></p>

<sup>7</sup> ISAE 3400, *The Examination of Prospective Financial Information*

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	<p>The Task Force proposes to clarify that the auditor’s reading and considering of the other information, including those of a prospective nature, is performed in light of the auditor’s understanding of the entity and its environment, and information acquired during the course of the audit. A reference to ISA 315,<sup>8</sup> which sets out the matters that the auditor is expected to obtain an understanding of for purposes of the audit, is also proposed.</p> <p><b>See paragraphs 10 and A14 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. White observed that, in many cases, the other information will be contained in a portion of the annual report that is subject to particular disclosure standards, whether prescribed by the accounting framework or other regulatory requirements. He believed that the auditor’s responsibility is broader than just reading and considering the disclosures, because the auditor is looking at whether management has adequately responded to the disclosure requirements.</p>	<p>Point accepted.</p> <p>The Task Force proposes to clarify that where the applicable financial reporting framework permits disclosures required under the framework to be located outside of the audited financial statements, such information is covered by the audit, and does not constitute, other information for the purpose of proposed ISA 720 (Revised).</p> <p><b>See paragraph A5 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Mr. Hansen noted that challenges in defining the auditor’s responsibilities without becoming too prescriptive. In his view, it is difficult to define whether other information is inconsistent with the financial statements. He suggested the auditor’s approach may differ depending on whether the other information was qualitative or quantitative.</p> <p>Mr. Uchino suggested the auditor’s knowledge of how management is operating the entity would be important</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Gélard confirmed that the Task Force is aiming to provide examples of what would be considered obviously misleading (“misrepresented” in the proposed ISA 720 (Revised)), in particular when information is omitted or misstated.</p> <p>The Task Force proposes that the auditor’s principle concern is where there is any</p>

<sup>8</sup> ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs A17–A104

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in this regard.	<p>“misrepresentation” of the other information. A definition of “misrepresentation of other information” is proposed.</p> <p><b>See paragraphs 8(b) and A10–A11 of Agenda Item 7-C of the March 2011 IAASB meeting.</b></p>
<p>Ms. Sucher questioned whether the proposed standard will contain a “stand-back” provision for the auditor to consider the other information. She noted this is covered in some ways in ISA 700<sup>9</sup> and, in her view, it is important for the auditor to look at the financial statements as a whole to determine whether the financial statements and other information make sense.</p>	<p>Point accepted.</p> <p>During the meeting, Mr. Gélard confirmed that the Task Force is considering introducing a requirement for the auditor to consider whether there are any remaining matters relating to the other information that could undermine the credibility of the audited financial statements and the auditor’s report, or make the other information obviously misleading.</p> <p>In developing its proposals, the Task Force has aimed for a strengthened approach to the auditor’s consideration of other information:</p> <ul style="list-style-type: none"> <li>• Requiring the auditor to perform the appropriate procedures when other information is extracted from or capable of being reconciled to the financial statements.</li> <li>• Expanding the concept of “apparent material misstatement of fact” in extant ISA 720 to other information that may be “materially misrepresented.”</li> <li>• Clarifying the auditor’s responsibilities and actions in the circumstances where the auditor identifies matters that lead the auditor to believe the audited financial statements may be materially misstated.</li> <li>• Specifying the auditor’s responsibilities and actions when the auditor identifies a matter</li> </ul>

<sup>9</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

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	<p>that leads the auditor to believe the other information may be materially misrepresented.</p> <p>The approach aims to instill in the auditor the need to be on alert <i>throughout</i> the process of reading and considering the other information for matters that may lead the audited financial statements to be materially misstated or the other information to be materially misrepresented.</p> <p><b><i>See Section B on “Strengthening the Auditor’s Approach to Other Information” in this CAG paper.</i></b></p>
<b>THE AUDITOR’S OBJECTIVES UNDER ISA 720 AND THE TITLE OF THE ISA</b>	
<p>Mr. Damant suggested the title of the standard could be changed further, given the negative connotation that might result in dealing with “other information” when, in his view, this information is critical.</p>	<p>Point taken into account.</p> <p>The Task Force proposes revision to the title of ISA 720, but continues to believe that referring to “other information” is appropriate, in light of the enhancements to the description of what constitutes other information in the proposed revised ISA.</p> <p><b><i>See title of proposed ISA 720 (Revised) in Agenda Item 7-C of the March 2011 IAASB meeting and Section A below.</i></b></p>

### Matters for CAG Consideration

#### A. Documents in the Scope of ISA 720

7. Extant ISA 720 deals with annual reports (or similar documents), which the ISA refers to as documents containing audited financial statements and the auditor’s report thereon that are issued to owners (or similar stakeholders). During the Task Force’s previous two discussions with the IAASB, the IAASB maintained its support for retaining the ISA’s scope on these documents on the premise that the intent of ISA 720 is to focus on documents that have *direct* linkages to the audited financial statements and therefore the auditor’s report. Notwithstanding this, the IAASB recognized that, in a number of cases, other information

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may be located *separately* from the audited financial statements and the auditor's report in an *accompanying* document (whereas in annual reports other information is presented *together* with the audited financial statements and the auditor's report thereon). The IAASB agrees that, because the other information in such documents is in essence identical in nature to those in annual reports, the auditor's responsibilities under ISA 720 should extend to these.

7. To address this, the IAASB further agreed that there is merit in developing a description of key features of the documents that would be covered by ISA 720. Unlike defined terms, a broad-based description has the advantage of accommodating national differences in terminology. The clarity of such a description would, however, be critical.
8. The Task Force has identified the following key distinguishing features of annual reports and documents that are intended to accompany audited financial statements and the auditor's report:
  - (a) *Nature*. These documents are linked directly to the audited financial statements and the auditor's report—they either contain or accompany the audited financial statements and the auditor's report. As such, these documents command specific attention from the auditor.
  - (b) *Purpose*. These documents provide further commentary by management that is aimed at enhancing the user's understanding of the audited financial statements or the entity, and its state of affairs. Such commentary provides explanations of the amounts presented in the financial statements, the entity's prospects and further information on the audited financial statements. Such other information may be financial or non-financial in nature, historical or prospective.
  - (c) *Timing*. These documents are ordinarily issued on an annual basis and intended to be made available along with the initial release of the audited financial statements and the auditor's report.
  - (d) *Users*. The intended users of these documents are the same as the intended users of the audited financial statements.

Based on these, the Task Force proposes a description of key features in paragraph 2 of proposed revised ISA 720 as follows:

Terms used to describe documents that include such other information may vary. However, only a document that displays all of the following key features is within the scope of this ISA:  
(Ref: Para. A1–A4)

- (a) *Nature and purpose*. Contains or accompanies the audited financial statements and the auditor's report thereon for purposes of providing further commentary aimed at enhancing the user's understanding of:
  - (i) The audited financial statements; or

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- (ii) The entity, and its state of affairs;
  - (b) *Timing of availability.* Intended to be made available along with the initial release, typically annually, of the audited financial statements and the auditor's report thereon; and
  - (c) *Intended users.* Same as the intended users of the audited financial statements.
9. The Task Force is cognizant that, besides those that are in the scope of ISA 720, there are a myriad of documents that may contain audited financial statements or parts thereof. It is possible that these documents may be perceived to be in the scope of ISA 720. A few stakeholders have raised this matter with the Task Force and recommended that the ISA be clarified accordingly.
10. While the Task Force believes that the proposed description is sufficient for auditors to determine whether documents are in, or outside of, the scope of ISA 720, for the avoidance of doubt, the Task Force recommends that the ISA explicitly identifies certain documents that are outside of the scope of ISA 720 but to some stakeholders, there might be ambiguity. Accordingly, paragraph A4 of proposed revised ISA 720 notes that the following documents are not within the scope of the ISA:
- (a) Preliminary earnings releases.
  - (b) Offer documents for raising capital or other funds, for example, prospectuses.
  - (c) A press release or equivalent.
  - (d) Information contained in analyst briefings.

#### *Field Testing*

11. The Task Force believes there is merit in field testing the application of the proposed description prior to finalization of an exposure draft of proposed revised ISA 720. If there is support for this course of action, the Task Force proposes that an informal survey of a sample of national standard setters, firms and regulators/audit inspection agencies be undertaken to ascertain whether there is consistent reading of the standard in the context of the documents in each country.

#### **Matter for CAG Consideration**

1. Representatives are asked whether they agree with proposed description of key features of documents in the scope of ISA 720.

#### **B. Strengthening the Auditor's Approach to Other Information**

##### *Reading and Considering in Light of the Auditor's Knowledge*

12. In September 2010, the IAASB expressed support for the Task Force's proposal to describe the auditor's work effort as one of "reading and considering" the other information through

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application of a systematic thought process. The IAASB also agreed that the auditor's work effort is based on the auditor's understanding of the entity and its environment (as set out in ISA 315),<sup>10</sup> and information acquired during the course of the audit. Proposals regarding the actions that need to be taken by the auditor when issues arise, consequent of the auditor's procedures under ISA 720, are premised on this principle.

#### *Other Information Extracted from or Capable of Being Reconciled to the Audited Financial Statements*

13. The IAASB encouraged the Task Force, in further developing the proposals, to be explicit about the procedures that the auditor might undertake depending on the nature of the other information. The Task Force believes that, in maintaining the credibility of audited financial statements, other information in the document that is extracted from or capable of being reconciled to the audited financial statements should correspond to the relevant items in the audited financial statements. A Representative of the CAG also raised similar considerations.
14. Accordingly the Task Force proposes that, under these circumstances, there should be a specific requirement for the auditor to perform procedures for the purpose of reconciling such other information to the audited financial statements. The auditor's procedures may include agreeing the extraction, or testing management's reconciliation of the items to the audited financial statements for material items. Paragraph 11 of proposed revised ISA 720 notes:

If financial data in the other information is extracted from or capable of being reconciled to the audited financial statements, the auditor shall perform procedures sufficient to determine whether it is necessary to revise the financial data in the other information or the corresponding items in the audited financial statements. (Ref: Para. A19)

and application material at paragraph A19 notes:

The auditor's procedures relating to financial data in the other information that is extracted from or capable of being reconciled to the audited financial statements may include agreeing the extraction, or testing management's reconciliation of the items to the audited financial statements for material items.

#### **Matter for CAG Consideration**

2. Representatives are asked whether they agree that the auditor should be required to determine whether financial data in the other information that is extracted from or capable of being reconciled to the audited financial statements corresponds to those items in the audited financial statements.

<sup>10</sup> ISA 315, paragraphs A17–A104

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##### *Misrepresentations of Other Information*

15. Extant ISA 720 deals with the auditor's responsibilities when the auditor identifies material inconsistencies with the audited financial statements. The extant ISA also addresses apparent material misstatements of fact in the other information that the auditor may become aware of when reading such information for the purpose of identifying material inconsistencies. The extant ISA defines "material misstatement of fact" as "other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing the audited financial statements." Although these concepts generally remain sound, some stakeholders, including a few CAG Representatives, recommended that the auditor's role relating to other information be clarified, in particular with respect to other information which the auditor feels is critical but has been omitted from the document.
16. The Task Force agrees with these views. To respond to the above, the Task Force recommends that the concept of "apparent material misstatement of fact" be expanded to other information that may be "materially misrepresented" where a "misrepresentation of other information" may arise in one of the following ways, as defined in paragraph 8(b) of proposed revised ISA 720:<sup>11</sup>
  - (a) A statement of fact in the other information that the auditor considers to be incorrect;
  - (b) A statement involving management judgment in the other information that the auditor considers to be unreasonable or inappropriate; or
  - (c) An omission or manner of presentation that the auditor considers may be misleading about a matter(s) in the other information.

in light of the auditor's understanding of the entity and its environment and information acquired during the course of the audit.

Misrepresentations of other information are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the other information and the audited financial statements. (Ref: Para. A10–A11)
17. The final text within paragraph 8(b) of proposed revised ISA 720 reflects the Task Force's recommendation that "materially" misrepresented be explained in the context of misrepresentation of other information that, individually or in the aggregate, could reasonably be expected, in the view of the auditor, to influence the economic decisions of users taken on the basis of the other information and the audited financial statements.

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<sup>11</sup> The Task Force considered other terms such as "misstated," "misleading," and "inconsistent," but felt that these terms are inappropriate as they have either been accorded a specific meaning in extant ISA 720 or in other ISAs.

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##### Matter for CAG Consideration

3. Representatives are asked whether they agree with expansion of the auditor's responsibility to respond to other information that the auditor believes to be materially misrepresented.
  - If so, whether Representatives agree with the proposed definition of "misrepresentation of other information."

##### *The Auditor's Actions Regarding Matters Relating to the Audited Financial Statements and the Other Information*

18. Although extant ISA 720 covers the auditor's responsibilities relating to other information, the ISA mainly deals with the auditor's work effort for identifying matters that are inconsistent with the audited financial statements. Extant ISA 720 also addresses those matters that only have implications for the other information but the boundary is currently drawn where such matters relate to statements of fact.
19. The IAASB encouraged the Task Force, in further developing its proposals, to be explicit about the actions that the auditor should take when issues arise from the auditor's consideration of the other information. Some stakeholders, including a few CAG Representatives, also emphasized this point.
20. The Task Force makes the following recommendations:
  - (a) To revise the structure of the ISA to clearly articulate requirements of the auditor with regard to matters that relate to the audited financial statements and those that relate to the other information. **[See paragraphs 12–20 of Agenda Item 7-C of the March 2011 IAASB meeting.]**
  - (b) To clarify the auditor's responsibilities and actions that need to be taken in the circumstances where the auditor identifies a matter that leads the auditor to believe the audited financial statements may be materially misstated. ISA 450<sup>12</sup> deals with the auditor's responsibilities regarding misstatements identified during the audit. The ISA indicates that circumstances that may affect the auditor's evaluation of misstatements identified during the audit include the extent to which the misstatement affects other information that will be communicated in documents containing the audited financial statements (as addressed in ISA 720).<sup>13</sup> **[See paragraphs 12–13 of Agenda Item 7-C of the March 2011 IAASB meeting.]**

<sup>12</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*

<sup>13</sup> ISA 450, paragraph A16

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- (c) To clarify actions that need to be taken by the auditor when issues relating to the other information arise, specifically to:
- (i) Require the auditor to discuss with management the other information that the auditor believes may be materially misrepresented;
  - (ii) Require the auditor to determine, by performing other procedures if necessary, whether individually or collectively the matter(s) identified is likely to cause the other information to be materially misrepresented; and
  - (iii) Specify the course of action the auditor is required to take thereon depending on the following:
    - The timing at which the auditor obtains the other information from the entity; and
    - Whether or not management and, where applicable, those charged with governance agree to make the revision.

The Task Force is of the view that, when discussing the matter with management, the auditor may consider that, due to the nature of such other information, the auditor may not be able to assess management's responses to the auditor's inquiries and accordingly the validity of management's assertion. In such circumstances, the auditor would not be able to determine whether the other information is materially misrepresented. Possible actions the auditor may consider taking under these circumstances are proposed. **[See paragraphs 14–20 and A20–A27 of Agenda Item 7-C of the March 2011 IAASB meeting.]**

#### Responsibility for Reading and Considering Other Information

21. Depending on the circumstances, certain of the procedures required by ISA 720 may be performed by members of the engagement team *other than* the engagement partner. The Task Force believes that ISA 720 should acknowledge this.
22. Accordingly, the Task Force recommends the inclusion of guidance on the factors that the engagement partner should be considering when identifying the individuals on the engagement team to be assigned tasks relating to reading and considering other information.

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##### Matters for CAG Consideration

4. Representatives are asked whether they agree with the proposals in paragraph 20, in particular to:
  - Structure the ISA to focus on the auditor's actions to respond to matters relating to the audited financial statements and those relating to the other information.
  - Clarify the auditor's responsibilities and actions in the circumstances where the auditor identifies a matter that leads the auditor to believe the audited financial statements may be materially misstated.
  - Specify the actions to be taken by the auditor when auditor identifies a matter that leads the auditor to believe the other information may be materially misrepresented.

#### C. Auditor Reporting

23. The matter of auditor reporting arose during the Task Force's discussion, in particular the question of whether the auditor's report should include a reference to the auditor's work effort undertaken in relation to the other information. The Task Force noted that there may be merit in doing so in order to clarify and better communicate the auditor's responsibility with respect to such other information.
24. The Task Force is aware that the Auditor Reporting Working Group is currently considering this matter and will be following the Working Group's progress in this regard with interest for any implications on the current revision of ISA 720. **See Agenda Item M.1 for further discussion on auditor reporting.**

#### D. Preliminary Announcements and Auditor Association

##### *The Auditor's Responsibilities Relating to Preliminary Announcements*

25. In September 2010, the Task Force made the IAASB aware of views, including those of some of the CAG Representatives, about the importance of the IAASB dealing with preliminary announcements. In general, these views reflect the fact that this is believed to be in the public interest.<sup>14</sup>

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<sup>14</sup> These stakeholders thought that, although preliminary announcements are not currently within the remit of the audit, these documents are closely related to the entities' annual reporting cycle and may be aimed at communicating the entity's annual financial results. In some cases, it may be the first public communication by the entity of its annual performance and financial position and, as such, may command investor interest and, consequently, may "move the market." These stakeholders felt the auditor's knowledge of the entity obtained through the conduct of the audit may be leveraged in the context of these documents.

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26. The IAASB, however, expressed reservations about the Task Force's proposal to address the auditor's responsibilities, if any, relating to preliminary announcements in proposed revised ISA 720 due to inherent differences between annual reports and preliminary announcements. Because of these differences, the IAASB was of the view that inclusion of preliminary announcements in the scope of ISA 720 would risk blurring the ISA's focus on documents that have a clear relation to *audited* financial statements. Following are some of the key practical considerations:

- (a) *Extent of application to entities.* Preliminary announcements are issued generally only by listed entities (that is, such documents do not apply to all entities and in all cases), whereas ISA 720 and indeed the ISAs are neutral in this regard.
- (b) *Auditor's involvement.* In many instances, because a requirement for the auditor's involvement with preliminary announcements is absent, entities are not obligated to provide the auditor with access to such documents prior to their issuance. Assuming the need for the auditor's involvement with such documents is established, the question that arises is therefore whether the auditor's involvement should be made mandatory, for example, through law or regulation (although outside the IAASB's remit).

However, in situations where the auditor's involvement remains discretionary, the auditor may be perceived to be associated with preliminary announcements due to their linkage to the entity's financial statements and therefore the audit.

- (c) *Timing of issuance.* In some cases, the preliminary announcement may be issued only at "an advanced stage of the audit" if not close to the completion of the audit, whereas in other cases preliminary announcements may be issued at a time when the audit is at a comparatively earlier stage. Depending upon the stage of the audit when the entity embarks on the preparation of the preliminary announcement, the work effort that can reasonably be expected of the auditor should be reflective of the extent and nature of work that has been done, and that remains to be done, for purposes of the audit.
- (d) *Contents.* In some cases, preliminary announcements are sizable documents containing draft financial statements and comprehensive narrative on these statements, and the entity and its state of affairs—akin to annual reports. In other cases, preliminary announcements are brief and consist only of a few pages that contain high-level financial information and management's highlights thereon.

#### Considerations for the Way Forward

27. Notwithstanding the above, the IAASB noted that there are valid issues relating to preliminary announcements which should be considered; some of which could be addressed through an international auditing standard. The IAASB asked the Task Force to further consider the matter and revert with recommendations for its consideration.

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28. The Task Force encourages the IAASB to consider undertaking work to address whether and, if so, to what extent the auditor has responsibilities relating to preliminary announcements. It believes that it is desirable to do so separately in an ISA in order to give due recognition to the characteristics that are unique to such documents and, accordingly, the auditor's responsibilities in view of these considerations. Following are some matters that the Task Force noted:
- Most members of the Task Force felt that it is impractical to require the auditor's involvement with preliminary announcements in the ISAs where preconditions for the auditor's involvement are not already present. Because preliminary announcements do not directly form the basis of the auditor's opinion, management may in some cases wish to exercise greater discretion regarding the auditor's involvement. Accordingly, the majority of the Task Force believes that such an ISA would apply only if preconditions for the auditor's involvement are present, either: (i) specified in law or regulation (for example, stock exchange listing rules); or (ii) the entity requests the auditor's involvement.
  - The Task Force considered that it may be the case that the auditor's work effort relating to preliminary announcements vis-à-vis documents in the scope of ISA 720 may to some extent be similar. In the event this is the case, cross referencing the auditor's work effort in ISA 720 can be made in order to avoid duplication.
29. Appendix 2 in this paper provides an outline of other matters that could be addressed in an ISA dealing with the auditor's responsibilities relating to preliminary announcements and brief descriptions of the relevant considerations.

#### **Matters for CAG Consideration**

5. Representatives are asked whether they agree that the scope of revised ISA 720 should not address preliminary announcements.
6. The Task Force believes that it is worth considering for the future a separate project to address the questions of whether and, if so, to what extent, the auditor has responsibilities for preliminary announcements. The Task Force asks the Representatives at this time to share their thoughts on any considerations that might be relevant.

#### *Auditor's Association with Documents Issued by the Entity*

30. At its September 2010 meeting, the IAASB noted that the matter of auditor association with documents/information issued or disseminated by the entity has arisen on a number of occasions. The IAASB instructed the Task Force to present relevant considerations regarding this topic for its consideration during the Task Force's next discussion with the Board.

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31. The Task Force has researched relevant material at the national level.<sup>15</sup> In its consideration of the topic, the Task Force noted the following:
- In addition to audits, the matter of association extends similarly to other engagements. A pronouncement in this regard would therefore need to have wide application (that is, beyond audit engagements). The Task Force envisages that, in terms of placement in the overall structure of IAASB pronouncements, it could be placed at a level similar to that accorded to International Standard on Quality Control (ISQC) 1 (that is, it would apply for all services falling under the IAASB's Engagement Standards).<sup>16</sup>
  - The topic of association has direct linkage with the IESBA Code.<sup>17</sup> Under the IESBA Code, the professional accountant has a professional obligation to not knowingly be associated with misleading information.<sup>18</sup> The Task Force noted that involvement of the IESBA, in the manner of consultation, or more desirably cooperation, is essential.
  - Association can arise in a number of ways including: (i) through the actions of the practitioner; (ii) through representations made by the entity regarding the practitioner's involvement (without the auditor's knowledge or agreement); and (iii) by a third party assuming the practitioner's involvement.
  - Accordingly, matters that could be addressed in the pronouncement may include:
    - The need for practitioners to clearly describe their association with information to avoid any potential misunderstanding by issuing a report when they perform procedures with respect to such information.
    - The actions to be taken by the practitioner in the event it is discovered that the practitioner's name has been inappropriately used in connection with the information.
    - The procedures to perform, when a practitioner is requested by an entity to consent to the use of the practitioner's name in connection with information.
32. The Task Force encourages the IAASB to consider undertaking work to address the wider topic of association.

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<sup>15</sup> For example, the Canadian Institute of Chartered Accountants (CICA) General Assurance and Auditing Standards Section 5020, *Association*.

<sup>16</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>17</sup> International Ethics Standards Board for Accountants *Code of Ethics for Professional Accountants* (IESBA Code)

<sup>18</sup> Section 110.2 of the IESBA Code

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##### Matter for CAG Consideration

7. The Task Force believes that it is worth considering for the future a separate project to address the question of auditor association. The Task Force asks the Representatives at this time to share their thoughts on any considerations that might be relevant..

#### Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 7-B of March 2011 IAASB meeting, Draft ISA 560 (Revised) dated March 2011 (Marked from Extant ISA 560)

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6043>

Agenda Item 7-C of March 2011 IAASB meeting, Draft ISA 720 (Revised) dated March 2011

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=6044>

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### Appendix 1

### Project History

**Project: Proposed Revised ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements***

#### Summary

	CAG Meeting	IAASB Meeting
Project Commencement	March 2010	December 2009
Development of Proposed International Pronouncement (up to Exposure)	March 2010 September 2010 March 2011	March 2010 September 2010 March 2011

#### CAG Discussions: Detailed References

<p><b>Project Commencement</b></p>	<p><u>March 2010</u></p> <p>See IAASB CAG meeting material: (in Agenda Item N-1 of the following):  <a href="http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0211&amp;ViewCat=1245">http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0211&amp;ViewCat=1245</a></p> <p>See CAG meeting minutes (in Agenda Item N of the following material):  <a href="http://www.ifac.org/IAASB/Meeting-Minutes.php?MID=0211">http://www.ifac.org/IAASB/Meeting-Minutes.php?MID=0211</a></p> <p>See report back on March 2010 CAG meeting (in paragraph 5 of the following):  <a href="http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364">http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364</a></p>
<p><b>Development of Proposed International Pronouncement (Up to Exposure)</b></p>	<p><u>March 2010</u></p> <p>See IAASB CAG meeting material: (in Agenda Item N-2 of the following):  <a href="http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0211&amp;ViewCat=1245">http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0211&amp;ViewCat=1245</a></p> <p>See CAG meeting minutes (in Agenda Item N of the following):  <a href="http://www.ifac.org/IAASB/Meeting-Minutes.php?MID=0211">http://www.ifac.org/IAASB/Meeting-Minutes.php?MID=0211</a></p> <p>See report back on March 2010 CAG meeting (in paragraph 5 of the following):  <a href="http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364">http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364</a></p>

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	<p><u>September 2010</u></p> <p>See IAASB CAG meeting material: (in Agenda Item M of the following): <a href="http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364">http://www.ifac.org/IAASB/Meeting-BGPapers.php?MID=0214&amp;ViewCat=1364</a></p> <p>See CAG meeting minutes (in Agenda Item M of the following):</p> <p>See draft September 2010 CAG meeting minutes at Agenda Item D.</p> <p>See report back on September 2010 CAG meeting in paragraph 6 of this CAG paper.</p>
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### Appendix 2

#### **Possible ISA on the Auditor's Responsibilities Relating to Preliminary Announcements—Preliminary Matters for Consideration**

In addition to the matters described in the paper, the Task Force noted other matters that could be addressed in an ISA dealing with the auditor's responsibilities relating to preliminary announcements:

- (a) *Terms of Engagement.* Whether the auditor's involvement regarding the preliminary announcement should be set out in the terms of engagement of the audit where the auditor's procedures are clearly described so as to avoid misunderstandings with management. This is particularly important as preliminary announcements are formulated based on financial statements on which the auditor's work on the audit has yet to be completed as opposed to audited financial statements.
- (b) *Objective of the Auditor.* The auditor's considerations will be premised on the auditor's knowledge of the entity and its environment obtained through the conduct of the audit. Importantly, the auditor's work effort should reflect the extent to which the audit has been progressed. Unless prescribed in law or regulation, the timing of issuance of preliminary announcements is expected to vary. Further, it may be necessary to consider whether it is practical for the auditor to perform procedures on preliminary announcements if the audit is at a "less-than-advanced" stage.
- (c) *Procedures of the Auditor.* The auditor's work effort relating to information in the preliminary announcement that: (i) is extracted from or capable of being reconciled to the audited financial statements, (ii) relates to the financial statements; and (iii) relates to the other information.
- (d) *Auditor Reporting.* There are expectations from users that information communicated in preliminary announcements will be consistent with the audited financial statements that are ultimately published by the entity. To some extent, similar expectations may also extend to the commentary provided by management. Consideration will need to be given how best to communicate the auditor's role so as to reduce users' expectation gap.