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Basis for Conclusions: ISA 720  
(Redrafted), The Auditor's  
Responsibility in Relation to  
Other Information in Documents  
Containing Audited Financial  
Statements

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Assurance Standards Board*



**International Federation  
of Accountants**

**BASIS FOR CONCLUSIONS:  
ISA 720 (REDRAFTED),  
THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN  
DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 720 (Redrafted), "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements," which was unanimously approved by the IAASB in September 2007.

## **Background**

1. In September 2006, the IAASB agreed the conventions to be used in drafting future International Standards on Auditing (ISAs). These conventions are commonly referred to as the IAASB's Clarity conventions.<sup>1</sup>
2. The IAASB has undertaken to redraft all of its ISAs in accordance with the Clarity conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. ISA 720 is in the latter category.
3. The IAASB issued an exposure draft of proposed ISA 720 (Redrafted) ("ED-ISA 720") in December 2006, with a comment date of March 31, 2007. The IAASB received forty-six comment letters from a variety of respondents, including regulators, IFAC member bodies, and firms. The IAASB made changes to ED-ISA 720 in response to these comments.
4. This Basis for Conclusions explains the more significant issues raised by respondents on ED-ISA 720, and how the IAASB addressed them.

## **Scope**

### **The Auditor's Responsibilities**

5. ED-ISA 720, paragraphs 1 and 2, described the scope of the proposed ISA. Paragraph A1 provided further explanation of the scope, stating that "the scope of the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated." Many respondents

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<sup>1</sup> The IAASB's Clarity conventions, and the authority and obligation attaching to them, are established in the amended Preface to International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface.) The amended Preface can be accessed at [http://www.ifac.org/download/IAASB\\_Preface.pdf](http://www.ifac.org/download/IAASB_Preface.pdf). Elements of the authority and obligation attaching to the Clarity conventions are currently being exposed as part of proposed ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing."

considered that this statement was so closely linked to the content of paragraph 1 that it should be placed in the Introduction section of the ISA, rather than in the Application and Other Explanatory Material section. The IAASB accepted this suggestion on the basis that there should be no ambiguity as to the auditor's responsibilities under the ISA.

### **Documents Containing Audited Financial Statements**

6. ED-ISA 720, paragraph 2, explained that the ISA “has been drafted in terms of documents containing audited financial statements that are provided to owners on the same terms, and at the same time, as the financial statements; for example documents such as annual reports.” The purpose of this explanation was to define the scope of the ISA with more precision than the extant ISA, and thereby make it clear that ED-ISA 720 did not apply to documents where the financial statements and the auditor's report are subsequently reproduced with other information of which the auditor is unaware.
7. A number of respondents expressed concern about the clarity of the expression “provided to owners on the same terms, and at the same time, as the financial statements.” Whilst the respondents acknowledged that these words are also used in International Financial Reporting Standard (IFRS) 7, “Financial Instruments: Disclosures” in a similar context, they did not consider the analogy with IFRS 7 to be valid and considered the phrase “on the same terms” to be inappropriate.
8. The IAASB accepted these concerns and, accordingly, amended paragraph 2 of ISA 720 (Redrafted) to state that documents containing audited financial statements refer “to annual reports (or similar documents), that are issued to owners (or similar stakeholders) containing audited financial statements and the auditor's report thereon.”

### **Reading of Other Information in Documents Used in Securities Offerings**

9. Consistent with extant ISA 720, ED-ISA 720, paragraph 2, included a statement relating to the applicability of the ISA to reading other information in documents used in securities offerings. In issuing ED-ISA 720, the IAASB sought the views of respondents as to whether to retain that statement. It noted that the ISAs have not been developed to provide the basis for engagements in connection with prospectuses and, as they are not directly applicable to a number of potential engagements relating to securities offerings, the IAASB doubted whether a generic reference of this nature was helpful.
10. Views of respondents on this issue were evenly balanced, with a small majority favoring deletion of the statement. In light of considerations regarding the description of the scope of the ISA, the IAASB concluded that the statement should be retained as it clarifies that other information in documents used in securities offerings are not specifically addressed by ISA 720 (Redrafted). Further, it was considered appropriate to retain the statement as some respondents did find it helpful.

## **Objective**

11. The majority of respondents were of the view that the proposed objective stated in ED-ISA 720 was inappropriate. Several of these respondents did not agree with the use of the expression “avoiding association with” and preferred that the objective be expressed in terms of protecting the interests of users. Others were concerned that the inclusion of the sub-paragraphs (a) and (b) in the objective made the objective too procedural and lengthy, and duplicative of the requirements of the ISA.
12. The IAASB accepted these concerns and, in particular, believed that change to the objective is necessary to avoid the impression that it is too concerned with risks to the auditor, which had not been IAASB’s intention. Accordingly, the IAASB revised the objective:
  - To express it in terms of the auditor responding appropriately when other information could undermine the credibility of the financial statements and the auditor’s report thereon; and
  - To remove sub-paragraphs (a) and (b).

## **Material Misstatements of Fact**

13. Extant ISA 720 refers to “material misstatements of fact,” and explains that such a misstatement exists when other information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented. ED-ISA 720, however, excluded the word “material” in connection with the proposed definition of “misstatements of fact” and related requirements. The IAASB was of the view that reference to “material” was unnecessary as the definition was concerned with misstatements of fact. The requirements, however, applied only where such misstatements were material.
14. Many respondents expressed serious reservations about this proposed change in terminology, as it may have indicated a change in the scope of the ISA. The respondents considered that the applicable requirements of ED-ISA 720 should apply only to material misstatements of fact and that the ISA should be clear on this by incorporating materiality within the definition. The IAASB concurred with this view and, accordingly, amended ISA 720 (Redrafted):
  - To retain the definition of “misstatement of fact” in ED-ISA 720, but to add the following sentence to provide the materiality threshold, “A material misstatement of fact may undermine the credibility of the document containing audited financial statements;” and
  - To express related requirements in terms of “material misstatements of fact.”

## **Timing of the Availability of Other Information to the Auditor**

15. ED-ISA 720, paragraph 7, proposed a requirement for the auditor to make appropriate arrangements with the entity to obtain the other information on a timely basis and, if it is not possible to obtain the other information prior to the date of the auditor’s report, to read the other information at the earliest practicable opportunity.

16. Respondents noted that extant ISA 720 directs the auditor to make arrangements with the entity to obtain other information “prior to the date of the auditor’s report.” Accordingly, the respondents were concerned that to require that the auditor make arrangements to obtain the other information on a timely basis would result in a weakening of the extant ISA. The IAASB agreed with this comment and, accordingly, to improve the clarity of the requirement, amended ISA 720 (Redrafted) to require that the auditor make appropriate arrangements to obtain the other information prior to the date of the auditor’s report. Proposed ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements” has been similarly clarified by IAASB by stating that an audit engagement letter may make reference to “the agreement of management or those charged with governance to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.”
17. Some respondents were also of the view that all “other information” should be required to be available to the auditor prior to the date of the auditor’s report. The IAASB considered that making such a change would result in a substantive change to the extant ISA and thus go beyond the scope of redrafting the ISA to reflect only the IAASB’s new drafting conventions and matters of clarity generally. Further, the IAASB considered that appropriate research would be required to determine whether it is appropriate and practical in all jurisdictions to require other information to be made available prior to the date of the auditor’s report. The IAASB noted these matters as important considerations if and when ISA 720 (Redrafted) is revised in the future.

## **Structure**

18. Several respondents were of the view that the structure of ED-ISA 720 did not make it clear which of the requirements apply to other information obtained prior to the date of the auditor’s report and which apply to other information obtained after that date.
19. The IAASB agreed that the structure of ED-ISA 720 should be improved and, accordingly, modified ISA 720 (Redrafted) to:
  - Make greater use of sub-headings to more clearly signal which requirements apply to which circumstance; and
  - Group related requirements appropriately in accordance with the new sub-headings.
20. As a result of this restructuring, ED-ISA 720, paragraph 14, which addressed the need to determine whether the audited financial statements require amendment as a result of an identified material inconsistency, became unnecessary and was therefore deleted.
21. The IAASB did not change the ordering of the paragraphs relating to material misstatements of fact because these requirements apply equally to misstatements identified in other information regardless of when the other information was obtained.

## **Clarity of Expected Auditor Actions**

22. Some respondents were concerned about the use of imprecise or unclear phrases in ED-ISA 720, such as “procedures necessary under the circumstances” or “further appropriate actions” (which were also contained in the extant ISA). The respondents were of the view that such phrases made the proposed ISA unclear as to what is actually required of auditors. Further, respondents were concerned about certain inconsistencies in the application and other explanatory material of ED-ISA 720, in particular the fact that the auditor is guided to notify those charged with governance when the auditor concludes that there is a material misstatement of fact, but not in the case of an identified material inconsistency.
23. The IAASB agreed with these concerns and concluded, in the interest of eliminating any ambiguity about what is expected of the auditor, that where there are procedures or actions that should be taken in all cases or where there are only a limited number of possible actions that could be taken, these should be specified accordingly in the requirements. Accordingly, the IAASB agreed that ISA 720 (Redrafted) should include a requirement for the auditor to communicate with those charged with governance in each of paragraphs 10 and 13 (which address material inconsistencies identified in other information where revision of that information is necessary and management refuses to do so) and 16 (which addresses material misstatements of fact in other information which management refuses to correct). The IAASB concluded that these changes were justified both on the merits of respondents’ comments, and on the basis that such matters clearly warrant attention by those charged with governance and, therefore, communication to them by the auditor.
24. In addition, in response to comments received, the IAASB amended the requirement at paragraph 10 of ED-ISA 720 (and ISA 720 (Redrafted)) to include all the possible appropriate actions, as identified in the related application material at paragraph A8 of ED-ISA 720 (specifically, for the auditor to withhold the auditor’s report or to withdraw from the engagement).

## **Other Information that is Subject to Audit**

25. One respondent expressed the view that the requirement and related application material of paragraph 10 of ED-ISA 720, which addressed material inconsistencies identified in other information where revision of that information is necessary and management refuses to do so, does not take due account of those circumstances where other information is also subject to audit. This respondent suggested, among other things, that the definition of other information should be amended so as to exclude other information that is subject to audit when the auditor is required to express an opinion on the consistency of that information with the financial statements. Alternatively, the ISA should provide guidance that another appropriate action may include qualifying the auditor’s separate opinion on the other information (e.g., a directors’ report) within the auditor’s report.
26. The IAASB concluded that the ISA did not require amendment on the basis that it is important that all “other information” should be subject to the requirements of ISA 720 (Redrafted). Derogation from the requirements of ISA 720 (Redrafted) should not be provided in respect of “other information” on which auditors are required, by law or regulation, to report on consistency with the financial statements. Such derogation may

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result in an auditor not meeting the requirements of ISA 720 (Redrafted) with its focus on the relationship between other information and the financial statements. Further, ISA 720 (Redrafted), paragraph A1, acknowledges that an auditor may have additional responsibilities through statutory or other regulatory requirements but that they are beyond the scope of ISA 720 (Redrafted), and states that, where there are such obligations, “the auditor’s additional responsibilities are determined by the nature of the engagement and by law regulation and professional standards. If such other information is omitted or contains deficiencies, the auditor may be required by law or regulation to refer to the matter in the auditor’s report.”

27. The IAASB, therefore, was of the view that ISA 720 (Redrafted) does not preclude auditors from qualifying any opinion they are required to give on the consistency of other information with the financial statements, in circumstances where the auditor is of the opinion that revision of the other information is necessary but management refuses to make the revision.



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