30 min CPD VERIFIABLE ARTICLE

AUDITOR FOCUS ON 'OTHER INFORMATION'

Ashika Mohan gives an overview of the auditor's revised responsibilities under international standards to read and report on other information included in an entity's annual report, focusing on the continued importance of the auditor's responsibilities in this area and the main changes

The International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, was issued by the International Auditing and Assurance Standards Board (IAASB) in April 2015 and is effective for audits of financial statements for periods ending on or after 15 December 2016 (early adoption is allowed).

WHAT IS 'OTHER INFORMATION' IN THE CONTEXT OF ISA 720 (REVISED)?

'Other information' is financial or non-financial information other than financial statements and the auditor's report thereon included in an entity's annual report.

In recent years the amount of detail included in entities' annual reports, and other corporate and external reports, besides the audited financial statements and the auditor's report, has changed significantly.

Annual reports now include more narrative and qualitative information, such as descriptions of the entity's business model and integrated reports. Users have been attaching more importance to such information and disclosures, using these to analyse the risks of the business and for decision-making purposes. There has also been a movement towards exploring ways in which to better integrate information in financial statements with other parts of an entity's public reporting package.

WHY WAS EXTANT ISA 720 REVISED?

The IAASB's revised extant ISA 720 to ensure that the ISA continues to enhance the credibility of financial statements through specifying appropriate responsibilities of the auditor relating to the range of other information in documents containing audited financial statements, taking into account how such information is distributed.

WHAT IS THE SCOPE OF ISA 720 (REVISED)?

The introduction to the standard asserts that the standard is written in the context of an audit of financial statements by an independent auditor. The auditor's opinion on the financial statements does not cover the other information, nor does this ISA require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.

The auditor needs to read and consider other information for material inconsistency with the financial statements or the auditor's knowledge obtained during the audit. Any material inconsistency may either indicate a material misstatement of the financial statements or of the other information, either of which may undermine the credibility of the financial statements and the auditor's report.

The revised standard assists the auditor in avoiding being knowingly associated with information the auditor believes contains materially false or misleading statements.

ISA 720 (Revised) does not apply to preliminary announcements of financial information or securities offering documents, including prospectuses.

WHAT ARE THE MAIN CHANGES IN RELATION TO THE SCOPE AND AUDITOR'S WORK EFFORT?

The main changes to the ISA are:

- Broadening and clarifying the scope of other information by relating it to the concept of an 'annual report'. In the ISA an annual report is defined as a document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or stakeholders) with information on the entity's operations, financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report and usually includes information about the entity's developments; its outlook, risks and uncertainties; a statement by the entity's governing body; and reports covering governance matters.

THE STANDARD DOES NOT CONSTITUTE AN ASSURANCE ENGAGEMENT ON OTHER INFORMATION, NOR DOES IT REQUIRE THE AUDITOR TO OBTAIN ASSURANCE ABOUT THE OTHER INFORMATION

- Enhancing and explaining the auditor's work effort with respect to other information. The auditor is required to:
  - o Obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the other information (that is, the document(s) comprising the annual report)
  - o Read the other information and consider whether a material inconsistency exists between the other information and the financial statements, and the auditor's knowledge obtained in the audit. As the basis for this consideration the auditor is also required to compare selected amounts or other items in the other information with such amounts or other items in the financial statements (paragraph A27 in the revised standard provides additional guidance with respect to factors to consider in selecting the amounts or other items to compare)
  - o Remain alert for indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated
- Introducing documentation requirements in terms of which the auditor includes in the audit documentation:
  - o The procedures performed under this ISA, and
  - o The final version of the other information on which the auditor has performed the work required under this ISA
- Providing transparency by requiring reporting on the auditor's work relating to other information Importantly, the IAASB has retained the concept that the standard does not constitute an assurance engagement on other information nor does it require the auditor to obtain assurance about the other information.

WHAT WAS THE IAASB TRYING TO ACHIEVE IN UNDERTAKING THIS PROJECT?

As the range of other information has diversified, the IAASB aims to improve audit quality by broadening and clarifying the scope of other information, in addition to enhancing and explaining the auditor's work effort. This will help bring greater consistency around the world regarding auditors' consideration of other information.

The intentions are to increase the value of the audit, without changing its scope, in a cost beneficial manner, through enhancing the auditor's responsibilities with respect to other information, and improve transparency by requiring auditors to articulate in their reports their responsibilities under ISA 720 (Revised) and the outcome of their work relative to the other information.

WHAT IS THE AUDITOR'S RESPONSE IF THERE IS A MATERIAL MISSTATEMENT OF THE OTHER INFORMATION?

The auditor may conclude that after reviewing the other information, discussing with management and performing such other procedures as may be required, that there is a material misstatement of other information. The auditor requests management and, if applicable, those charged with governance, to correct the material misstatement. If the corrections are not made, the auditor is required to take appropriate action, including considering the implications for the auditor's report, or possibly withdrawing from the engagement, taking into consideration the requirements of local legislation with regards to withdrawal from an audit.

WHAT WILL BE COMMUNICATED IN THE AUDITOR'S REPORT ABOUT OTHER INFORMATION?

Using the heading 'Other Information' or another appropriate heading, paragraph 22 of the standard requires the auditor's report to include:

- A statement that management is responsible for the other information
- Identification of the other information obtained prior to the date of the auditor's report. In the case of a listed entity, the auditor is also required to identify any other information expected to be obtained after the date of the auditor's report
- A statement that the auditor's opinion does not cover the other information and, accordingly, that the auditor does not express (or will not express) an audit opinion or any form of assurance conclusion thereon
- A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by ISA 720 (Revised)
- When other information has been obtained prior to the date of the auditor's report, either:
  - o A statement that the auditor has nothing to report, or
  - o If the auditor has concluded that there is an uncorrected material misstatement of the other information, a statement that describes the uncorrected material misstatement of the other information

RELATED CONFORMING AMENDMENTS

Registered auditors are required to note that related conforming amendments have been made to the following ISAs:

- ISA 210, *Agreeing the Terms of Audit Engagements*
- ISA 230, *Audit Documentation*
- ISA 260 (Revised), *Communication with Those Charged with Governance*
- ISA 450, *Evaluation of Misstatements Identified during the Audit*
- ISA 500, *Audit Evidence*
- ISA 510, *Initial Audit Engagements – Opening Balances*
- ISA 560, *Subsequent Events*
- ISA 570, *Going Concern*
- ISA 580, *Written Representations*
- ISA 600, *Special Considerations – Audits of Group Financial Statements (including the work of Component Auditors)*
- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
- ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
- ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

'OTHER INFORMATION' IS FINANCIAL OR NON-FINANCIAL INFORMATION OTHER THAN FINANCIAL STATEMENTS AND THE AUDITOR'S REPORT THEREON INCLUDED IN AN ENTITY'S ANNUAL REPORT

- ISA 710, *Comparative Information – Corresponding Figures and Comparative Financial Statements*, and
- ISA 810, *Engagements to Report on Summary Financial Statements*

IN CONCLUSION

The Independent Regulatory Board for Auditors (IRBA) approved the adoption, issue and prescription of ISA 720 (Revised) for use by registered auditors in South Africa in July 2015.

SOURCES

IAASB, The International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, April 2015.

IAASB, At a Glance, The International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, April 2015.

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IASB RELEASES

LONG-AWAITED LEASING STANDARD

The International Accounting Standards Board (IASB) has issued a new leasing standard which may significantly change current lease accounting for lessees. By ***Herman Jonker*** and ***Helen Wise***

Leasing activities are important for most entities in South Africa. By entering into leasing activities, entities are able utilise assets without having to take on the risk associated with the ownership of the asset.

The current lease standard has been criticised by analysts and investors because important information regarding significant assets and liabilities is omitted from the financial statements for operating leases.

In addition, the lack of information on operating leases makes it difficult to compare results and performance of entities that purchase assets compared to those that merely lease assets. Owing to these concerns, the IASB developed the new standard, IFRS 16, which was issued on 13 January 2016.

DEFINITION OF A LEASE

Under IFRS 16 there will likely be a greater focus on identifying whether a contract is a lease, given that most leases will be recognised on the balance sheet of the lessee.

IFRS 16 defines a lease as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

At first sight, the definition looks straightforward but in practice it can be challenging to assess whether a contract really conveys the right to use an asset or whether it is just a service that is provided using the asset. There are several helpful examples in IFRS 16 which illustrate how the definition should be applied.

IMPACT OF LEASES ON LESSEES

Lessees no longer have to distinguish between finance lease contracts (on-balance) and operating lease contracts (off-balance) but are required to recognise a right-of-use asset and a corresponding lease liability for virtually all lease contracts. This is based on the principle that economically a lease contract is the acquisition of a right to use an asset with the purchase price paid in instalments.

The effect of this approach is a significant increase in the amount of financial liabilities for entities that have entered into lease contracts that are currently classified as operating leases.

The expected impact on the financial statements of lessees is illustrated in table 1.

Because the entity would be more leveraged and more assets are now part of total assets than previously, some key financial ratios such as debt-to-equity, current ratios, asset turnover PBIT (profit before interest), EBITDA (earnings before interest tax depreciation and amortisation), interest cover ratio, and return on assets would be impacted.

At the date IFRS 16 was issued, the IASB also issued an effects analysis on the standard. The effects analysis document describes the likely costs and benefits of IFRS 16.

The analysis is based on feedback the IASB received during a wide-spread consultation process which involved all key stakeholders, including preparers and users of financial statements as well as accounting firms worldwide.

In the effects analysis the impact on various industries was considered comparing the result under IAS 17 and IFRS 16 for EBITDA and PBIT, which is set out in table 2.