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Update on Supplemental + Other Information Requirements

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In October 2010, our founder, Dr. Thomas A. Ratcliffe issued a report on Statement on Auditing Standards (SAS) 118 – 120. As a result of some current questions the CPEA has received on supplemental and other information, we have updated that report to reflect recent amendments and member inquiries.

In 2010, the Auditing Standards Board (ASB) issued three standards associated with performance and reporting standards when a variety of information accompanies the basic financial statements. These three standards were:

- SAS 118, *Other Information in Documents Containing Audited Financial Statements*. SAS 118 was superseded via SAS 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, and is codified as AU-C 720, by the same name.
- SAS 119, *Supplementary Information in Relation to the Financial Statements as a Whole.* SAS 119 was amended via SAS 137 and is codified as AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.
- SAS 120, *Required Supplementary Information*. SAS 120 was amended via SAS 137 and is codified as AU-C 730, *Required Supplementary Information*

While SASs 118, 119, and 120 have been effective for a number of years, SAS 137, which superseded or amended these previous SASs, is effective for audits of financial statements for periods ending on or after December 15, 2021.

AU-C 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

When practitioners see the words "annual report" they will often think of a public company's annual report or maybe an annual report of a nonprofit. A practitioner may not think that the term annual report could include something as simple as a PDF file that contains the auditor's report, the entity's financial statements, and other information (OI).

Therefore, practitioners should not be lulled to sleep by the words "annual reports" in the title. The definition of annual reports, as used in AU-C 720 includes:

> "…a document, or combination of documents, typically prepared 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 similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements."

The determination as to what constitutes an entity's annual report is subject to judgment and can be difficult to determine if the entity does not have a regulatory requirement to prepare an annual report or a framework that dictates what that annual report should constitute. Key to the auditor making this judgment is the discussion, as required by AU-C 720,[1] with management regarding which document or documents comprise the annual report, if any. If management and the auditor conclude that the entity does not prepare an annual report AU-C 720 would not apply.

AU-C 720 clarifies that even though a document may be referred to as an *annual report*, such document may not meet the definition of an *annual report* for purposes of required application of AU-C 720.[2] On the other hand, an annual report does not have to be titled "annual report" to meet the definition. An annual report for purposes of applying AU-C 720 could be any document (electronic or paper) containing annual audited financial statements and the auditor's report, if it also includes other information (OI). The OI could be financial or nonfinancial. This could include any document, even if drafted in whole or in part by the auditor.

Example

The following are examples of information that may appear within an annual report (the existence of such information in a document does not determine whether or not an "annual report" has been prepared):

- A summary of key financial results, such as net income, sales and other operating revenues, and purchases and operating expenses.
- Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.

[1] Paragraph .13a of AU-C 720.
[2] Paragraph .A9 of AU-C 720.

- Schedules of various accounts such as a schedule of management and administration expenses, a consolidating balance sheet or income statement schedule, or a schedule of property, plant, and equipment.
- General descriptions of the business environment, outlook, or strategy.
- Explanations of specific factors influencing the entity's profitability in specific segments.

AU-C 720 does not apply to supplemental information (SI) when AU-C 725 applies, nor does it apply to required supplementary information (RSI) addressed by AU-C 730. (AU-C 720.09)[3]

Practice Note: Let's assume that management includes, in a document containing annual audited financial statements and the auditor's report thereon, consolidating information and a schedule of administrative expenses that provides a detailed breakdown of the administrative expense line in the basic income statement. Are these schedules SI or OI? The answer depends.

If the auditor is engaged to report on whether the consolidating information and administrative expenses are fairly stated in relation to the financial statements as a whole, the information is considered SI and the auditor would apply AU-C 725.

If the auditor is not engaged to report on the information <u>and such information is included in an annual report (as defined)</u>, the information is considered OI and the auditor would apply AU-C 720.

We discuss our views below if neither AU-C 725 nor AU-C 720 apply to a document containing annual audited financial statements and the auditor's report.

If, based on discussion with management, it is determined that the entity prepares an annual report (as defined), the auditor is required to obtain management's written acknowledgement regarding which document or documents comprise the annual report.

When OI exists in an annual report, the practitioner is required to read the OI and consider whether a material inconsistency exists between the OI and the financial statements. While reading the OI, the practitioner should remain alert for indications that a) a material inconsistency exists between the OI and the practitioner's knowledge obtained in the audit or b) a material misstatement of fact exists or the OI is otherwise misleading. A practitioner is not responsible for searching for omitted information or for the completeness of the OI.

[3] Paragraph .09 of AU-C section 720.

As the basis for the auditor's consideration whether a material inconsistency exists between the OI and the financial statements, the auditor should compare selected amounts or other items in the OI (that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements) with such amounts or other items in the financial statements.

If the practitioner identifies what appears to be a material inconsistency (or becomes aware that the other information appears to be materially misstated), the practitioner should discuss the matter with management and, if necessary, perform other procedures to conclude:

- Whether a material misstatement of the OI exists
- Whether a material misstatement of the financial statements exists
- Whether the auditor's understanding of the entity and its environment needs to be updated

If, at the date of the auditor's report on the financial statements, the auditor has obtained all of the OI, while the practitioner is not required to provide an opinion or any form of assurance on the OI, the practitioner is required to report on the OI in a separate section in the auditor's report with the heading "Other Information" or other appropriate heading. AU-C 720.24 sets forth the reporting requirements, including how to report on OI when the practitioner has concluded that an uncorrected material misstatement of the OI exists.

Example

Assume an entity includes in an annual report various financial and nonfinancial information along with their audited annual consolidated financial statements and the auditor's report thereon. The auditor has not been engaged to report on whether the information is fairly stated in relation to the financial statements; therefore, AU-C 720 applies (since it has been determined that an annual report has been prepared). In auditing the entity and from reading the OI, the auditor becomes aware of a material misstatement in the OI. Because the auditor is aware of a material misstatement in the OI, the auditor is required to follow the steps outlined in paragraphs 20-22 of AU-C 720. Assuming that management does not correct the misstatement, the auditor should describe the material misstatement in their report (as per AU-C 720.24).

When some or all of the OI is not available until after the date of the auditor's report on the financial statements, the practitioner should request management to provide a written representation that the final version of the documents will be provided to the auditor when available, and prior to the document's issuance by the entity, such that the auditor can complete the procedures required by AU-C 720.

Example

After the issuance of audited annual financial statements, a nonprofit prepares an annual report for donors, which includes various information about operations and services. If the audited financial statements and the auditor's report thereon are included (or incorporated by reference) in the annual report, the financial and nonfinancial information would all be considered OI. Even though the OI is completed after the date of the auditor's report, the practitioner still is required to apply the requirements of AU-C 720, excluding the reporting requirements, before the entity issues their annual report (per AU-C 720.07).[4]

CPEA Advice - Risk Management Considerations:

When a material misstatement is identified in the OI and management refuses to correct the material misstatement, our advice would be for the practitioner to consider the needs of intended financial statement users and whether a description of the uncorrected material misstatement may negatively impact the comprehension and usefulness of the auditor's report on the basic financial statements. In other words, will users be confused by a clean opinion on the basic financial statements but a qualified report on the OI? Based on the auditor's professional judgement, the auditor may make a risk management decision to withdraw from the engagement (when withdrawal is possible under applicable law or regulation), if the misstatement in the OI is not corrected rather than be associated with what may be confusing reports.

Another risk management consideration is what to do with consolidating schedules or other schedules outside the basic financial statements in a document that includes the auditor's report, but that document is not determined to be an annual report in accordance with AU-C 720 and the auditor is not engaged to report on the information under AU-C 725? In these situations, even though AU-C 720 is not applicable because the document is determined to not be an "annual report," CPEA believes it is a best practice for the auditor to voluntarily apply the requirements of AU-C 720 to documents that include the audited financial statements and the auditor's report. The auditor is associated with such documents through the inclusion of the auditor's report. By voluntarily applying the

[4] In May 2022, the AICPA issued TQA 9195.01, *Auditor Reporting When the Entity Issues Its Annual Report Subsequent to its Financial Statements*, to provide additional guidance in those situations.

requirements of AU-C 720 to these documents, the auditor can reduce their risks of possibly being associated with information that may be materially incorrect or materially inaccurate. Further, in many cases, the auditor is preparing such information as a non-attest service and therefore applying AU-C 720 would not be an inconvenience. In our view, this best practice renders moot the challenging determinations about whether such information is an "annual report" (as defined) when AU-C 725 does not apply.

AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*

For purposes of implementing AU-C 725, SI is defined as "information presented outside the basic financial statements, excluding RSI that is not considered necessary for financial statements to be fairly-presented in accordance with the applicable financial reporting framework." This information may be presented in a document containing audited financial statements, or it may be presented separately from the financial statements.

When applying AU-C 725, a practitioner should never "trip-into" AU-C 725 because this section only applies when the practitioner has been engaged to report on whether the SI is fairly stated in relation to the basic financial statements. Many examples of SI in private company financial reporting exist, including SI related to consolidating information, general and administrative expenses, operating expenses, etc. SI is often significant in governmental financial reporting where, as an example, AU-C 725 would be the appropriate guidance to follow when a practitioner is engaged to issue an opinion on the Single Audit schedule of expenditures of federal awards or on combining and non-major fund financial statements.

> ***Practice Note***: As discussed above, even if the information accompanying the basic financial statements is not subject to AU-C 725 because the practitioner is not engaged to report on the information, the practitioner still is required to apply the requirements of AU-C 720, assuming the information accompanies the entity's annual financial statements in an annual report.

When practitioners are engaged to report on SI, the objectives are to evaluate the presentation in relation to the basic financial statements taken as a whole, and to report on whether the SI is fairly stated, in all material respects, in relation to those financial statements.

As set forth in AU-C 725.07, the practitioner should perform the following procedures using the same materiality level used in the audit of the financial statements:

a. Inquire of management about the purpose of the SI and the criteria used by management to prepare the SI, such as an applicable financial reporting framework, criteria established by a regulator, a contractual agreement, or other requirements

b. Determine whether the form and content of the SI complies with the applicable criteria

c. Obtain an understanding about the methods of preparing the SI and determine whether the methods of preparing the SI have changed from those used in the prior period and, if the methods have changed, the reasons for such changes

d. Compare and reconcile the SI to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves

e. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the SI

f. Evaluate the appropriateness and completeness of the SI, considering the results of the procedures performed and other knowledge obtained during the audit of the financial statements

g. Obtain written representations from management

i. that it acknowledges its responsibility for the presentation of the SI in accordance with the applicable criteria

ii. that it believes the SI, including its form and content, is fairly presented in accordance with the applicable criteria

iii. that the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement or presentation have changed, the reasons for such changes

iv. about any significant assumptions or interpretations underlying the measurement or presentation of the SI, and

v. that when the SI is not presented with the audited financial statements, management will make the audited financial statements readily available to the intended users of the SI no later than the date of issuance by the entity of the SI and the auditor's report thereon

Example

Assume an entity includes consolidating information along with audited annual consolidated financial statements. The auditor has been engaged to report on whether the consolidating information is fairly stated in relation to the financial statements; therefore, AU-C 725 applies (the consolidating information is SI). In auditing the entity's financial statements and from applying the procedures in AU-C 725.07 related to the SI, the auditor becomes aware of a material misstatement in how the entity accounted for related party leases (since all the related party leases were eliminated, the consolidated totals are correct). Because the auditor is aware of a material misstatement in one or more columns of the consolidating information, the auditor is required to follow the requirements of AU-C 725.13. In doing so, the auditor should discuss the matter with management and propose appropriate revision of the consolidating information. If management does not revise the consolidating information, the auditor should either:

a. modify the auditor's opinion on the consolidating information and describe the misstatement in the auditor's report or
b. if a separate report is being issued on the consolidating information, withhold the auditor's report on the consolidating information

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Practice Note: Often overlooked are the preconditions that need to be met before it would be acceptable to report on SI. Those preconditions include:

1. The SI needs to be derived from, and it needs to relate directly to, the accounting records underlying the audited financial statements[5] -- for example, it would be inappropriate to apply AU-C 725 to a schedule of officers and senior management since such a schedule does not relate directly to the accounting records underlying the audited financial statements.

2. The information needs to pertain to the same accounting period as the audited financial statements[6]

[5] Practitioners reporting on a Schedule of Expenditures of Federal Awards (SEFA) in relation to the audited financial statements should be aware of AICPA Technical Question & Answer (TQA) 9160.27, *Providing Opinion on a Schedule of Expenditures of Federal Awards in Relation to an Entity's Financial Statements as a Whole When the Schedule of Expenditures of Federal Awards Is on a Different Basis of Accounting Than the Financial Statements*. The TQA acknowledges that there are situations in practice where the SEFA and financial statements are prepared on different bases of accounting. In those cases, the auditor may provide an in-relation-to opinion on the SEFA as long as the schedule can be reconciled back to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves, and as long as the other conditions and requirements of AU-C 725 are met.

[6] Practitioners reporting on a Schedule of Expenditures of Federal Awards (SEFA) in relation to the audited financial statements should be aware of AICPA Technical Question & Answer (TQA) 9160.36,

3. The information needs to accompany the financial statements, or the statements need to be readily available for end-user access

4. The financial statements themselves need to have been audited, and neither an adverse opinion nor a disclaimer of an opinion was issued on the statements

AU-C 730, *Required Supplementary Information*

For purposes of implementing AU-C 730, RSI is defined as information that a designated accounting standard-setter requires to accompany the basic financial statements. This information is not part of the basic financial statements. However, the designated accounting standard-setter has determined that the information is an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Additionally, authoritative guidelines have been established for methods of measurement and presentation.

It is not uncommon, especially given certain industry practices and in the governmental accounting and reporting arena, to see information requirements that have been established by designated accounting standard-setters. A frequently encountered circumstance exists when practitioners are performing audit engagements for common interest realty associations (CIRAs). In these circumstances, using the guidance in FASB *Accounting Standards Codification* (FASB ASC) 972, *Real Estate – Common Interest Realty Associations*, financial statements of CIRAs are required to include information disclosing estimates of current or future costs of future major repairs and replacements of all existing components, including estimated amounts required, methods used to determine the costs, the basis for calculations, sources used, and the dates of studies, if any, made for these purposes. Also, as discussed earlier, governmental entities often need to provide SI that is required by GASB accounting technical literature.

Practice Note: Remember AU-C 730 only applies to information required by a designated accounting standard setter. Therefore, information required the by U.S. Department of Housing and Urban Development (HUD) or the Federal Deposit Insurance Corporation (FDIC), for example, is not RSI since these two regulators are not designated accounting standard setters. Therefore, AU-C 730 could not apply, although either AU-C 720 or AU-C 725 may apply.

Reporting on the Provider Relief Fund in the Schedule of Expenditures of Federal Awards in Relation to the Financial Statements in a Single Audit. The TQA acknowledges that there are situations in practice where the SEFA and financial statements do not align exactly. In those cases, the auditor may provide an in-relation-to opinion on the SEFA as long as the schedule can be reconciled back to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves, and as long as the other conditions and requirements of AU-C 725 are met.

When AU-C 730 applies, the practitioner should apply the following procedures to RSI (AU-C 730.05):

a. Inquire of management about the methods of preparing the information, including

(i) whether it has been measured and presented in accordance with prescribed guidelines,

(ii) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and

(iii) whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information

b. Compare the information for consistency with (i) management's responses to the foregoing inquiries, (ii) the basic financial statements, and (iii) other knowledge obtained during the audit of the basic financial statements

c. Obtain written representations from management

(i) that it acknowledges its responsibility for the RSI

(ii) about whether the RSI is measured and presented in accordance with prescribed guidelines

(iii) about whether the methods of measurement or presentation have changed from those used in the prior period and, if so, the reasons for such changes

(iv) about any significant assumptions or interpretations underlying the measurement or presentation of the RSI

The auditor is required to add an explanatory paragraph in the auditor's report on the basic financial statements in all circumstances where RSI is presented (AU-C 730.07).

Should you have any specific questions regarding information accompanying the basic audited financial statements, please submit your questions using the CPEA Technical Inquiry Service.

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