

Agenda Item 7



Other Information

Objective of Agenda Item

To resume discussion of issues with respect to the Other Information Task Force's project to revise AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*. The Task Force is presenting a first read draft of the proposed revised SAS for discussion. The proposed standard uses ISA 720 (Revised) as a base.

Background

In February 2010, the Auditing Standards Board issued Statement on Auditing Standards No. 118, *Other Information in Documents Containing Audited Financial Statements*. SAS No. 118 superseded the requirements and guidance in AU section 550 and, along with SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, superseded AU section 551. Consistent with the ASB's strategy to converge its standards with those of the International Auditing and Assurance Standards Board, SAS No. 118 was drafted using ISA 720 (Redrafted), *The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements*, as a base.

Some key elements of SAS Nos. 118-120 are as follows:

- AU-C section 720 (Other Information) – SAS 118
 - Required to read other information included in annual reports and consider whether there are any material inconsistencies between other information and the audited financial statements or material misstatements of fact.
 - No reporting requirement
- AU-C section 725 (In Relation To Reporting) – SAS 119
 - Is applicable when the auditor is engaged to report whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole
- AU-C section 730 (Required Supplementary Information) – SAS 120
 - When GASB, FASB, FASAB, or IASB require that supplementary information accompany the basic financial statements.

In November 2012, the International Auditing and Assurance Standards Board issued an exposure draft of a proposed revised ISA 720. In undertaking its project to revise ISA 720, the explanatory memorandum states that the IAASB sought to:

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- Extend the scope of the standard to include documents *accompanying* audited financial statements and the auditor's report thereon (emphasis added by ASB Task Force);
- Extend the auditor's responsibilities (i.e., the work effort) to include not only reading the other information for consistency with the audited financial statements but also reading and considering the other information for consistency with the auditor's understanding of the entity and the environment acquired during the course of the audit. Representatives of the IAASB CAG had, in particular, noted that doing so would be in the public interest; and
- Bring transparency of the auditor's work through new suggested auditor reporting responsibilities with respect to other information.

In extending auditor responsibilities, the IAASB explanatory memorandum stated that the Board gave consideration to the likely costs and benefits of alternative approaches. The IAASB stated that it believed that the proposed ISA would help:

- Improve audit quality by bringing greater consistency around the world regarding auditors' consideration of the diverse range of information that *accompanies* audited financial statements and comes within the scope of the proposed ISA (emphasis added by ASB Task Force);
- Increase the value of the audit, without changing its scope, in a cost beneficial manner, through enhancing the auditor's responsibility with respect to the other information; and
- Narrow the expectations gap through requiring auditors to articulate in their reports their responsibilities under the proposed ISA, and the outcome of their work relative to the other information.

Due to the nature of the comments received on the November 2012 exposure draft, in April 2014, the IAASB issued a revised exposure draft of a proposed revised ISA 720.

The IAASB finalized and approved the proposed revised ISA 720 for submission to the Public Interest Oversight Board at its meeting in December 2014 and issued the final standard in April 2015.

A Task Force was formed to consider ISA 720 (Revised), *The Auditor's Responsibilities Related to Other Information* and whether revisions should be made to AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* in order to converge U.S. GAAS with ISA 720 (Revised). That Task Force consisted of:

Elizabeth S. Gantnier –Task Force Chair – ASB member

Gerry Boaz – ASB member

David Johnson – TIC member

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Jeffrey Markert – Member of the State and Local Government Expert Panel and former Chair of the Task Force that worked on SAS nos. 118-120
Chris Smith – ASB member (since rolled off)

Mike Glynn was appointed as the AICPA Audit and Attest Standards Team liaison to the Task Force.

The Task Force presented a first read draft of a proposed revised AU-C section 720 to the ASB at its meeting in May 2015. The proposed revised SAS used ISA 720 (Revised) as a base and represented the Task Force’s efforts to harmonize AU-C section 720, with ISA 720 (Revised) while minimizing differences with the proposed PCAOB standard dealing with Other Information. At the meeting, the ASB directed the Task Force to redraft the proposed revised SAS and instead of using ISA 720 (Revised) as a base, to use extant AU-C 720 as a base and:

- Define the term *annual report* so that practitioners are clear as to what documents are in the scope of the standard
- Retain work effort/performance requirements from extant AU-C section 720
- Retain reporting requirements from extant AU-C section 720 (that is, while the auditor is not precluded from reporting, there is no reporting requirement)

While the Task Force recognized that the ASB directed it to retain the reporting requirements from extant AU-C section 720, the Task Force determined that the omission of reporting requirements was a significant “minus” from both ISA 720 (Revised) and the proposed PCAOB standard. The Task Force prepared and included a revised draft standard in the ASB agenda materials for the July 2015 meeting. However, the discussion was deferred and subsequently, the ASB determined that the proposed standard should not be presented again to the Board until after the PCAOB finalizes its standard.

In July 2016, it was determined that the Task Force should present its draft standard to the Board – but that the standard should be presented using ISA 720 (Revised) as a base.

The following represents issues that the Task Force is requesting ASB input or concurrence.

Issues for Discussion with the ASB

Definition of *annual report* and clarification of the documents in the scope of the SAS

Extant AU-C section 720 is often misapplied by practitioners as they do not understand what documents they are required to consider. While the title of AU-C section 720 is *Other Information in Documents Containing Audited Financial Statements*, paragraph .02 of AU-C section 720 states *documents containing audited financial statements* refers to annual reports (or similar documents) that are issued to owners (or similar stakeholders)

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and annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public that contain audited financial statements and the auditor's report thereon.

To clarify that AU-C section 720 is required to be applied only to annual reports, the Task Force proposes to revise the title of the section to read *The Auditor's Responsibilities Regarding Other Information in Annual Reports Containing Audited Financial Statements and the Related Auditor's Report*. This is consistent with the proposed title of the proposed revised PCAOB standard which reads *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*. The Task Force determined to use the term "Annual Reports" as opposed to "Certain Documents" to be as clear as possible.

Then, the Task Force included the following definition of *annual report* in paragraph 11 of the proposed revised AU-C section 720:

Annual report. A document prepared typically on an annual basis by management or those charged with governance, 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. An annual report contains or incorporates by reference the financial statements and the auditor's report thereon. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public. (Ref: Para. A5–A6)

The Task Force also determined to include the following application guidance from ISA 720 (Revised):

A5. An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.

A6. An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document may meet the definition of an annual report, irrespective of the manner in which it is made available to users.

While the definition of *annual report* is primarily from ISA 720 (Revised), there are a few differences of note:

- 1) The SAS definition excludes "combination of documents" as the annual report is intended to be one document.
- 2) For clarity, the SAS excludes the phrase "in accordance with law, regulation or custom" as such phrase is not deemed necessary for American auditors.

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- 3) “Contains or incorporates by reference” wording added to the SAS definition to make clear that to be considered an annual report (and therefore within the scope of the standard), the document must contain or incorporate by reference the audited financial statements and the auditor’s report thereon.
- 4) The SAS includes the concept of annual reports of governments and charitable organizations from extant AU-C section 720.
- 5) The SAS definition excludes documents accompanying the audited financial statements and the auditor’s report thereon but instead, in harmony with the proposed PCAOB AS, includes documents “incorporated by reference”.

Pursuant to paragraph .01 of the proposed revised AU-C section 720, the section applies to both financial and non-financial information included in the annual report but does not apply when the requirements of AU-C sections 725, *Supplementary Information in Relation to the Financial Statements as a Whole* or 730, *Required Supplementary Information* applies.

Action Requested of the ASB

The Task Force requests that the ASB consider whether (1) the proposed title of the revised AU-C section 720 appropriately clarifies the scope of the standard; (2) whether the definition of *annual report* is clear and appropriate – including the exclusion of “combination of documents” wording from ISA 720 (Revised); and (3) whether, consistent with the proposed PCAOB standard, documents “incorporated by reference” in the annual report should be included in the scope of the proposed revised AU-C section 720 or if the standard should apply only to those documents *contained within* the annual report.

A key component of ISA 720 (Revised) is to ensure that the auditor obtains the documents that comprise the annual report. To ensure that the auditor obtains all such documents, ISA 720 (Revised) includes the following requirement:

13. The auditor shall: (Ref: Para. A8–A18)
 - (a) Determine, through discussion with management, which document(s) comprises the annual report, and the entity’s planned manner and timing of the issuance of such document(s);
 - (b) Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor’s report, the final version of the document(s) comprising the annual report; and
 - (c) When some or all of the document(s) determined in (a) will not be available until after the date of the auditor’s report, request management to provide a written representation that the final version

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of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this ISA. (Ref: Para. A19)

However, with the clear definition of annual report included in the proposed revised AU-C section 720, the Task Force does not believe that there is a need for a requirement for the auditor to determine which documents comprise the annual report.

Action Requested of the ASB

The ASB is asked whether it agrees with that the ISA 720 (Revised) requirement to determine, through discussions with management, which documents comprise the annual report should not be included in the revised AU-C section 720.

Auditor's Objectives

The Task Force determined that the proposed auditor objectives should be consistent with the objectives as stated in the proposed PCAOB standard. The proposed objectives of the revised AU-C section 720 are as follows:

10. The objectives of the auditor, having read the other information, are:

- (a) To consider whether the other information contains (1) a material inconsistency with amounts or information, or the manner of their presentation, in the audited financial statements (“material inconsistency”); (2) a material misstatement of fact; or (3) both and, if so to, respond appropriately;
- (b) To report in accordance with this SAS.

A significant difference between the proposed objectives of the revised AU-C section 720 and the proposed PCAOB standard is the use of the term “consider” in subparagraph a as opposed to the PCAOB’s use of the term “evaluate”. The term “consider” is consistent with extant AU-C section 720 and ISA 720 (Revised).

Action Requested of the ASB

The ASB is asked whether it agrees with the proposed objectives – including whether it believes that the proposed revised AU-C section 720 should include a requirement to report on other information in the auditor’s report on the financial statements OR if the ASB reaffirms its position from the May 2015 meeting that the reporting requirements from extant AU-C section 720 should be retained.

Consideration of omitted information

ISA 720 (Revised) includes the following definition of *misstatement of the other information* (***emphasis*** added by the Task Force):

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Misstatement of the other information – A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (*including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information*).

To provide further guidance, ISA 720 (Revised) includes the following:

A6. When a particular matter is disclosed in the other information, the other information may omit or obscure information that is necessary for a proper understanding of that matter. For example, if the other information purports to address the key performance indicators used by management, then omission of a key performance indicator used by management could indicate that the other information is misleading.

Neither the proposed PCAOB standard or extant AU-C section 720 includes requirements with respect to omitted information. The Task Force believes that, since the primary objective is to consider whether the other information contains an inconsistency with the audited financial statements, that not including a requirement or guidance with respect to omitted information is appropriate.

Action Requested of the ASB

The ASB is asked whether it agrees that the proposed revised AU-C section 720 should be consistent with both the proposed PCAOB standard and extant AU-C section 720 and not address the concept of omitted information.

Agenda Items Presented:

Agenda item 7A Comparison of ISA 720 (Revised), the Proposed PCAOB Auditing Standard, and Extant AU-C section 720 to the Proposed Revised AU-C section 720