



## Agenda Item 2D

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# EXPOSURE DRAFT

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## PROPOSED STATEMENT ON AUDITING STANDARDS

### *THE AUDITOR'S RESPONSIBILITIES RELATING TO OTHER INFORMATION INCLUDED IN ANNUAL REPORTS*

*(To supersede AU-C section 720, Other Information in Documents Containing Audited Financial Statements  
[AICPA, Professional Standards].)*

**August X, 2017**

**Comments are requested by November X, 2017**

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues

Comments should be addressed to Mike Glynn at [mike.glynn@aicpa-cima.com](mailto:mike.glynn@aicpa-cima.com)



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## EXPLANATORY MEMORANDUM

### Introduction

This memorandum provides background on the proposed Statement on Auditing Standards (SAS) *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. The proposed SAS will supersede AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*. No other AU-C sections will be directly affected.

### Background

#### Issuance of ISA 720 (Revised)

The International Auditing and Assurance Standards Board issued ISA 720 (Revised), "The Auditor's Responsibilities Relating to Other Information" in April 2015.

In the explanatory memorandum that accompanied the exposure draft of the proposed standard that ultimately was issued as ISA 720 (Revised), the IAASB stated that it sought to:

- Extend the scope of the standard to include documents *accompanying* audited financial statements and the auditor's report thereon;
- 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; 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;
- 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.

## Effective Date

The effective date of this proposed SAS has not been determined. It is anticipated that the effective date will not be before December 15, 2019, depending on the timing of finalizing the proposed standard.

## Changes from Extant Standards

### Clarification of documents that are within the scope of the standard

The proposed standard may change practice for some practitioners by clarifying the scope of documents that the auditor is required to subject to the procedures. Extant AU-C section 720 is often misapplied by practitioners as they believe that all documents that contain audited financial statements and the auditor's report thereon are within the scope of the standard. 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) 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. Therefore, extant AU-C section 720 is intended to require the auditor to apply procedures only to other information included in annual reports (or similar documents). To clarify that AU-C section 720 is required to be applied only to annual reports, the title of the proposed SAS is *The Auditor's Responsibilities Regarding Other Information Included in Annual Reports*.

*Annual report* is defined in paragraph 12 of the proposed SAS as follows:

**Annual report.** 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 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, accompanies, or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public.

To further clarify, paragraph .A9 of the proposed standard states while a document may be referred to as an annual report, such document may not meet the definition of annual report for purposes of this SAS. For example, often IRS Form 990 is referred to as a not-for-profit's "annual report."

Paragraph .09 of the proposed standard states that the standard does not apply to supplemental information addressed by AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* or required supplementary information addressed by AU-C section 730, *Required Supplementary Information*. Paragraph .A2 further states that other AU-C sections provide requirements and guidance with respect to information in certain documents other than annual reports (for example, AU-C section 945, *Auditor Involvement with Exempt Offering Documents* and proposed AU-C section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*).

### Determining which documents constitute the entity's annual report

A significant change in practice that would result from the issuance of the proposed standard is a requirement for the auditor to determine, through discussion with management, and obtain management's written

acknowledgement as to, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s).<sup>1</sup> This requirement is intended to ensure that both the auditor and management understand the documents that are considered to constitute the entity's annual report and therefore are subject to the auditor's required procedures.

Obtaining the other information

Paragraph .07 of extant AU-C section 720 requires the auditor to make appropriate arrangements with management or those charged with governance to obtain the other information prior to the report release date. If it is not possible to obtain all of the other information prior to the report release date, the auditor is required to read such other information as soon as practicable. Paragraph 13 of the proposed standard would require the auditor to

- (a) 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
- (b) when some or all of the document(s) determined to comprise the annual report will not be available until after the date of the auditor's report on the financial statements, request management to provide a written representation that the final version 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 the proposed SAS.

While the requirement in the proposed SAS may be more prescriptive than that in extant AU-C section 720, it is not anticipated that the requirement will result in a substantive change in practice.

Reading the other information

Paragraph .06 of extant AU-C section 720 requires the auditor to read the other information of which the auditor is aware in order to identify material inconsistencies, if any, with the *audited financial statements* (*emphasis added*). Paragraph .16 of extant AU-C section 720 further states that, if, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor should discuss the matter with management. *Inconsistency* and *misstatement of fact* are defined in paragraph .05 of extant AU-C section 720 as follows:

**Inconsistency.** Other information that conflicts with information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

**Misstatement of fact.** 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 audited financial statements.

However, paragraph .14(b) of the proposed SAS extends the auditor's consideration to include whether there is a material inconsistency between the other information and *the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit* (*emphasis added*). While reading the

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<sup>1</sup> Paragraph .13 of the proposed SAS, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

other information, the auditor is required to 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.

*Knowledge of Component Auditors When the Group Auditor Does Not Assume Responsibility for the Work of Component Auditors*

The proposed requirement in paragraph .14(b) of the proposed SAS extending the auditor's consideration to include whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit, would have implications in a group audit situation. The group auditor is responsible for reading the entire annual report but if the group auditor does not assume responsibility for the work of component auditors, the group auditor's knowledge does not include the component auditor's knowledge.

The following application paragraph is included the proposed standard:

**A36.** In the case of a group audit, while the group auditor is required to read the entirety of the other information, if, in accordance with paragraph .24 of AU-C section 600, the group auditor decides to make reference to a component auditor in the auditor's report on the group financial statements, the auditor's knowledge does not extend beyond that obtained during the audit of the group financial statements.

*Omitted Information*

Misstatement of the other information is defined in paragraph .12 of the proposed SAS as:

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*). (*Emphasis added*)

Extant AU-C section 720 does not require the auditor to consider omitted or obscured information. To provide guidance to auditors with respect to such omitted information or obscured information, the proposed SAS includes the following application paragraphs:

**A11.** When a particular matter is disclosed in the other information, the other information may omit information that is necessary for a proper understanding of that matter or, in the light of the circumstances, to keep the other information from being misleading. For example, the omission may present a misleading impression of the entity's financial position, results of operations, or cash flows. The auditor is not responsible to search for omitted information or for the completeness of the other information.

**A12.** Other information may be undermined by the inclusion of information that is not relevant or that obscures a proper understanding of the matters disclosed.

It is not anticipated that the proposed requirement will result in a significant change in practice.

*Reporting*

Paragraph .A2 of extant AU-C section 720 states the auditor is not required to make reference to the other information in the auditor's report on the financial statements. However, the auditor may include an other-matter

paragraph disclaiming an opinion on the other information. For example, an auditor may choose to include a disclaimer on the other information when the auditor believes that the auditor could be associated with the information and the user may infer a level of assurance that is not intended.

The proposed SAS significantly revises the reporting requirements with respect to other information. Paragraph .21 of the proposed SAS requires the auditor's report to include an other-matter paragraph with a heading "Other Information", or other appropriate heading, when, at the date of the auditor's report the auditor has obtained some or all of the other information.

This will result in a significant change in practice.

### **Guide for Respondents**

Respondents are asked to provide comments on the content of the proposed SAS.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and (when appropriate) make specific recommendations for any suggested changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA offices after November X, 2017, for a period of one year. Responses should be sent to Mike Glynn at [mike.glynn@aicpa-cima.com](mailto:mike.glynn@aicpa-cima.com) by November X, 2017.

### **Comment Period**

The comment period for this exposure draft ends on November X, 2017.



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(2016–2017)

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