

## Agenda Item 7



### Other Information

#### Objective of Agenda Item

To continue to discuss issues with respect to the Other Information Task Force's project to harmonize AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* with ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* while minimizing differences with the proposed PCAOB standard dealing with Other Information. The Task Force is presenting a first read draft of the proposed revised SAS for discussion.

Ms. Gantnier will refer to agenda item 7A when discussing the first read draft of the proposed SAS.

#### 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 SAS No. 118 superseded the requirements and guidance in AU section 550 and, along with SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, superseded AU section 551.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.

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:

- 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

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- 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 consists of:

Elizabeth S. Gantnier –Task Force Chair – ASB member  
Gerry Boaz – ASB member  
David Johnson – TIC member  
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

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

The following represents certain of the issues that the Task Force requested ASB input at the January 2015 ASB meeting. In certain areas, the Task Force is requesting additional input. In other areas, the Task Force is presenting proposed revisions to the standard as a

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result of its discussions and the ASB input received in January. The Task Force is also presenting a first read draft of proposed revisions to AU-C section 720.

### **Issues for Discussion with the ASB**

#### Consideration of the proposed PCAOB standard

As stated in the objective section of this document, while harmonizing with ISA 720 (Revised), the Task Force is attempting to minimize differences with the proposed PCAOB standard dealing with Other Information. It is the Task Force's understanding that the PCAOB is expected to issue a re-proposal for public comment in June 2015.

The Task Force has been directed to work with the current public draft of the proposed PCAOB standard. This contradicts with the directive given to the Auditor's Report Task Force which was requested to monitor the status of the PCAOB standard and discuss issues with respect to the proposed revised SAS at the October 2015 ASB meeting.

#### **Action Requested of the ASB**

The Task Force requests that the ASB consider whether it remains productive for the Task Force to work with the current draft of the PCAOB proposed standard.

#### What is an Annual Report?

While the term *annual report* is not new to the literature with respect to Other Information, it is a very important cornerstone to understanding the application of the proposed revised AU-C section 720.

Paragraph .02 of AU-C section 720 states that *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 (***emphasis*** added). So, in order to understand what documents were in the scope of extant AU-C section 720, the auditor has to understand what entailed the entity's *annual report*.

ISA 720 (Revised) defines *annual report* 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 or accompanies 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.

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In order to make clear that it is management's responsibility to identify what their annual report entails, the Task Force proposes the following revision to paragraph .06 of AU-C section 210, *Terms of the Engagement* as follows (new language is in boldface italics):

- .06** In order to establish whether the preconditions for an audit are present, the auditor should
- a. determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable and (Ref: par. .A2-.A8)
  - b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A9-.A12 and .A17)
    - i. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; (Ref: par. .A13)
    - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: par. .A14-.A16)
  - iii. to provide the auditor with
    - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
    - (2) additional information that the auditor may request from management for the purpose of the audit; and
    - (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
  - iv. to determine which documents comprise the entity's annual report and to advise the auditor of the identity of such documents.***

**Action Requested of the ASB**

The ASB is asked whether the proposed revised AU-C section 720 is clear as to what *annual report* means and whether it agrees with the proposed precondition of an audit engagement as proposed by the Task Force. Additionally, the ASB is asked whether it envisions any issues with management being responsible for identifying the annual report.

Documents included in Other Information

Paragraph .05 of AU-C section 720 defines *other information* as financial and nonfinancial information (other than the financial statements and the auditor's report

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thereon) that is ***included*** in a document containing audited financial statements and the auditor's report thereon, excluding required supplementary information (emphasis added).

Paragraph 12 of draft ISA 720 (Revised) defines *other information* as financial or nonfinancial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

The primary difference between the two definitions is AU-C section 720's reference to *a document containing audited financial statements and the auditor's report thereon* and draft ISA 720 (Revised)'s reference to *an entity's annual report*. Note that the ISAs do not consider required supplementary information.

As previously stated, paragraph .02 of AU-C section 720 states that *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 (***emphasis*** added).

Paragraph .12 of draft ISA 720 (Revised) defines *annual report* as a document, or combination of documents, prepared 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 or accompanies*** 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 (***emphasis*** added).

At the January 2015 ASB meeting, the Board stated that it was not opposed to the definition of *annual reports* including documents that ***accompany*** the financial statements and the auditor's report thereon. However, upon further consideration, the Task Force has concluded that in the American environment, to require the auditor to consider documents that ***accompany*** the financial statements would be problematic and would lead to confusion as to what the auditor is required to consider. Therefore, the Task Force has drafted the proposed revised AU-C section 720 so that only that information that is in a document that also contains the audited financial statements and the auditor's report thereon are in the scope.

The Task Force proposes that the definition of *annual report* be revised as follows (the base is the definition from ISA 720 (Revised) and the proposed deletions are in strikethrough and the proposed additions are in boldface italics):

***Annual report.*** A document, ~~or combination of documents,~~ ***that contains the financial statements and the auditor's report thereon and is*** 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

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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 accompanies 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.

The Task Force also considered whether to retain the wording "annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public" in the definition of *annual report* in the proposed revised AU-C section 720. However, the Task Force concluded that the proposed revised definition as previous stated would clearly include such reports.

At the January 2015 ASB meeting, the ASB directed that the Task Force reach out to AICPA industry expert panels to determine whether the proposed definition would cause any issues for any particular industry. The Task Force will reach out to such expert panels once a definition of *annual report* is agreed upon.

**Action Requested of the ASB**

The ASB is asked to consider whether it agrees with the Task Force that the scope of documents that the auditor would be required to consider should be only those documents that are *contained* in the annual report.

Obtaining the Other Information

A key component of the draft 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, draft ISA 720 (Redrafted) 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 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)

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As previously stated, the Task Force proposes that, as a precondition for the audit, management identify what constitutes the annual report. Therefore, there is no need for a requirement for the auditor to identify which documents comprise the annual report.

The Task Force also revised the work effort requirements so that the auditor is only required to perform procedures on Other Information *of which the auditor is aware*. This is consistent with the requirements in extant AU-C section 720.

If the ASB agrees with the proposed revision to AU-C section 210, the Task Force proposes that the requirement from paragraph 13 of ISA 720 (Revised) be revised as follows (deleted language is in strikethrough, new language in boldface italics, application paragraph references are excluded):

13. The auditor ~~shall~~ **should**:
  - (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)~~ **its annual report**;
  - (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)~~ **that comprise the annual report** will not be available until after the date of the auditor's report, 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 this **ISASAS**.

**Action Requested of the ASB**

The ASB is asked whether it agrees with the proposed omission of the requirement to determine, through discussions with management, which documents comprise the annual report.

Inconsistency/Misstatement of Fact

AU-C section 720 defines *inconsistency* as other information that conflicts with information contained in the audited financial statements and *misstatement of fact* as other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. AU-C section 720 included different responses when the auditor identifies a material inconsistency or a material misstatement of fact.

Draft ISA 720 (Restated) does not define inconsistency or misstatement of fact and instead defines *misstatement of the other information* stating that 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). In the explanatory material

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accompanying the April 2014 exposure draft, the IAASB explained that it believes that the term *misstatement of the other information* better encapsulates both factual and qualitative misstatements than the terms in extant ISA 720 (which correspond to the terms in AU-C section 720).

At the January 2015 ASB meeting, it was determined that the definition of *misstatement of the other information* is fatally flawed for use in the SASs as the standards do not include criteria for determining when information is *misleading*.

The proposed revised AU-C section 720 does not include a definition of *misstatement of the other information* and instead retains the definitions of the separate terms *inconsistency* and *misstatement of fact* from 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.

The proposed revised AU-C section 720 contains separate auditor responses for inconsistencies and misstatements of fact.

**Action Requested of the ASB**

The ASB is asked whether it agrees with the approach the Task Force has adopted with respect to inconsistencies and misstatements of fact.

By deleting the definition of *misstatement of the other information*, the proposed revised AU-C section 720 would not require the auditor to consider omitted other information). This is consistent with extant AU-C section 720. ISA 720 (Revised) includes a consideration of omitted information to assist the auditor in complying with relevant ethical requirements that require the auditor to avoid being knowingly associated with other information that the auditor believes contains a materially false or misleading statement, a statement furnished recklessly, or *omits* or obscures necessary information such that the other information is misleading (International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants*, paragraph 110.2).

The Task Force consulted with the AICPA Professional Ethics Division staff and was advised that the following interpretations are included under the Integrity & Objectivity rule and that the staff believes would be the equivalent of the IESBA rule:

**1.130.010 Knowing Misrepresentations in the Preparation of Financial Statements or Records**

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**.01** *Threats* to compliance with the “Integrity and Objectivity Rule” [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *member* would be considered to have knowingly misrepresented facts in violation of the “Integrity and Objectivity Rule,” if the *member*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity’s *financial statements* or records;
- b. fails to correct an entity’s *financial statements* or records that are materially false and misleading when the *member* has the authority to record the entries;  
or
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Prior reference: paragraph .02 of ET section 102]

The Code also contains the following under the Acts Discreditable rule that covers negligence (as opposed to knowingly):

**1.400.040 Negligence in the Preparation of Financial Statements or Records**

**.01** A *member* shall be considered in violation of the “Acts Discreditable Rule” [1.400.001] if the *member*, by virtue of his or her negligence, does any of the following:

- a. Makes, or permits or directs another to make, materially false and misleading entries in the *financial statements* or records of an entity.
- b. Fails to correct an entity’s *financial statements* that are materially false and misleading when the *member* has the authority to record an entry.
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Prior reference: paragraph .05 of ET section 501]

The Task Force believes that omitting a requirement to consider omitted information would not result in an ISA minus situation and concluded to retain the construct from extant AU-C section 720.

**Action Requested of the ASB**

The ASB is asked whether it agrees with the approach the Task Force has adopted with respect to omitted other information.

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**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
- Agenda item 7B      Proposed Revised AU-C section 720 in a format showing requirements and application guidance side-by-side