

## Agenda Item 5



### Other Information

#### Objective of Agenda Item

To discuss 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 revised draft of the proposed SAS for discussion. The proposed standard uses ISA 720 (Revised) as a base.

#### Background

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
- 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

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- 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.

The IAASB 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 – Former ASB member  
Gerry Boaz – ASB member  
David Johnson – ARSC 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 – Former ASB member  
Dan Werke – TIC member

Mike Glynn serves as the staff liaison to the Task Force.

The Task Force presented certain issues with respect to the development of the proposed standard to the ASB at the ASB's meetings in August and October 2016 and requested feedback.

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

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

#### **Issue #1 – Title of the Proposed Standard**

ISA 720 (Revised) is entitled "The Auditor's Responsibilities Relating to Other Information." However, to clarify that AU-C section 720 is required to be applied only to other information in the annual report, the Task Force proposes to revise the title of the section to "The Auditor's Responsibilities Regarding Other Information *in Annual Reports*" (emphasis added). In addition to clarify, the proposed title helps to differentiate the proposed revised AU-C section 720 from AU-C sections 725, *Supplementary Information in Relation to the Financial Statements as a Whole* and 730, *Required Supplementary Information*. The international standards do not include equivalent sections to AU-C sections 725 and 730.

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

The Task Force requests that the ASB consider whether it agrees with the title of the revised AU-C section 720 as proposed by the Task Force.

**Issue #2 – Documents/Information Within the Scope of the Standard**

Paragraph 13 of the proposed standard includes the following definition of *other information* (language added to the ISA 720 (Revised) definition of *other information* shown in boldface italics; deleted language showing in strikethrough):

**Other information.** Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report, *excluding required supplementary information.*<sup>1</sup> (Ref: par. A11-A12)

<sup>1</sup> **Required supplementary information is defined in paragraph .04 of section 730, Required Supplementary Information.**

~~(Ref: Para. A8–A10)~~

The corresponding application guidance reads as follows:

*Other Information* (Ref: par. 13)

~~A8–A11. For purposes of this proposed standard, other information does not encompass, for example, the following:~~

- ~~• A press release or similar memorandum or cover letter accompanying the document containing audited financial statements and the auditor's report thereon.~~
- ~~• Information contained in analyst briefings.~~
- ~~• Information contained on the entity's website. Websites are a means of distributing information and are not, themselves, documents containing audited financial statements.~~

~~A9. In some cases, the applicable financial reporting framework may require specific disclosures but permit them to be located outside of the financial statements.<sup>5</sup> As such disclosures are required by the applicable financial reporting framework, they form part of the financial statements. Accordingly, they do not constitute other information for the purpose of this ISA.~~

~~<sup>5</sup> For example, IFRS 7, *Financial Instruments: Disclosures*, permits certain disclosures required by the IFRSs to either be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.~~

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~~A10. eXtensible Business Reporting Language (XBRL) tags do not represent other information as defined in this ISA.~~

**A12.** The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

- A report by management or those charged with governance on operations
- Financial summaries or highlights
- Employment data
- Planned capital expenditures
- Financial ratios
- Names of officers and directors
- Selected quarterly data

~~Appendix 1 contains examples of amounts or other items that may be included in the other information.~~

Paragraph A11 preceding was taken from paragraph A4 of extant AU-C section 720. At the ASB's meeting in October 2016, the Board directed that an additional bullet be added excluding "information accessed via hyperlinks included in the annual report." However, the Task Force believes that such information should be included as the hyperlink could be a form of "incorporation by reference". Since paragraph 13(a) of the proposed standard requires that the auditor "determine, through discussion with management, which document(s) comprises the annual report...", such an exclusion is not necessary.

**Action Requested of the ASB**

The Task Force requests that the ASB consider whether it agrees with the definition of *other information* and the corresponding application guidance as presented in the proposed standard.

**Issue #3 – Knowledge of Component Auditors When the Group Auditor Does Not Assume Responsibility for the Work of the Component Auditors**

As stated in the Background section of this discussion memorandum, as a result of the issuance of ISA 720 (Revised), the IAASB extended the auditor's responsibilities with respect to other information to include considering 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. Based on the construct of the ISA, the auditor's knowledge obtained in the audit includes information obtained by component auditors. The following are relevant application paragraphs from ISA 720 (Revised) (the application paragraphs are included in the proposed SAS as paragraphs A33 – A37):

*A32. The auditor's knowledge obtained in the audit may also include matters that are prospective in nature. Such matters may include, for example, business prospects and projected future cash flows that the auditor considered when evaluating the assumptions used by management in performing impairment tests*

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*on intangible assets such as goodwill, or when evaluating management's assessment of the entity's ability to continue as a going concern.*

*A33. In considering whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, the auditor may focus on those matters in the other information that are of sufficient importance that a misstatement of the other information in relation to that matter could be material.*

*A34. In relation to many matters in the other information, the auditor's recollection of the audit evidence obtained and conclusions reached in the audit may be sufficient to enable the auditor to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit. The more experienced and the more familiar with the key aspects of the audit the auditor is, the more likely it is that the auditor's recollection of relevant matters will be sufficient. For example, the auditor may be able to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit in light of the auditor's recollection of discussions held with management or those charged with governance or findings from procedures carried out during the audit such as the reading of board minutes, without the need to take further action.*

*A35. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team or relevant component auditors is appropriate as a basis for the auditor's consideration of whether a material inconsistency exists. For example:*

- When the other information describes the planned cessation of a major product line and, although the auditor is aware of the planned cessation, the auditor may make inquiries of the relevant engagement team member who performed the audit procedures in this area to support the auditor's consideration of whether the description is materially inconsistent with the auditor's knowledge obtained during the audit.*
- When the other information describes important details of a lawsuit addressed in the audit, but the auditor cannot recall them adequately, it may be necessary to refer to the audit documentation where such details are summarized to support the auditor's recollection.*

*A36. Whether, and if so the extent to which, the auditor refers to relevant audit documentation, or makes inquiries of relevant members of the engagement team or relevant component auditors is a matter of professional judgment. However, it may not be necessary for the auditor to refer to relevant audit documentation, or to make inquiries of relevant members of the engagement team or relevant component auditors about any matter included in the other information.*

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ISA 720 (Revised) was developed for an environment in which the group auditor assumes complete responsibility for the audit. Specifically, ISA 600 does not permit the auditor's report on group financial statements to make reference to a component auditor unless required by law or regulation to include such reference. AU-C section 600 permits the auditor, in the auditor's report on the group financial statements, to make reference to the audit of a component auditor.

Because the ISAs require the group auditor to take responsibility for the work of component auditors, the "auditor's knowledge" would run to the group auditor's knowledge. However, since, in accordance with GAAS, the group auditor is not required to take responsibility for the entire audit, the "auditor's knowledge" would run only to the group auditor and those component auditors for whom the group auditor assumes responsibility for the work of.

The Task Force proposes that paragraph A36 of ISA 720 (Revised) be incorporated as paragraph A37 of the proposed SAS and be revised as follows (new language in boldface italics):

A37. Whether, and ~~if so the~~ **to what** extent ~~to which~~, the auditor refers to relevant audit documentation, or makes inquiries of relevant members of the engagement team or relevant component auditors (**when the auditor assumes responsibility for the work of component auditors**) is a matter of professional judgment. However, it may not be necessary for the auditor to refer to relevant audit documentation, or to make inquiries of relevant members of the engagement team or relevant component auditors about any matter included in the other information.

The Task Force further proposes that an additional paragraph be added regarding the description of the auditor's responsibility relating to reading, considering and reporting on other information, when the auditor does not assume responsibility for the work of component auditors. The Task Force proposes that such paragraph read as follows (note that the proposed paragraph is not included in the draft standard):

**25.** When the auditor's report includes a reference to the audit of a component auditor in the auditor's report on the group financial statements, the auditor's responsibilities do not include consideration whether the other information is materially inconsistent with the component auditor's knowledge obtained in the audit of the component. In such instances, the auditor should clearly indicate that the auditor's knowledge does not include the component auditor's knowledge obtained during the audit of the component financial statements.

Further, the Task Force proposes that an additional illustrative other matter paragraph be included in the appendix to the proposed standard to illustrate how the auditor may report in such instances. Such illustration may read as follows:

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***Other Information [Included in the Annual Report]***

Management is responsible for the other information [included in the annual report]. The other information comprises the [information included in the annual report, but does not include the financial statements and our auditor’s report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express an opinion, a conclusion, or any form of assurance on it.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. As described in the Auditor’s Responsibility section, we did not audit the financial statements of B Company and therefore, our knowledge does not include the knowledge that other auditors obtained during their audit of the financial statements of B Company. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact. We have nothing to report in this regard.

**Action Requested of the ASB**

The ASB is asked to consider whether it agrees with how the Task Force dealt with the issue of the auditor’s knowledge obtained during the course of the audit when the auditor does not assume responsibility for the work of component auditors.

**Issue #4 – Omitted Information**

The definition of *misstatement of the other information* included in the proposed standard is substantively convergent with the definition included in ISA 720 (Revised). However, ISA 720 (Revised) includes the concept that other information is *misleading* if it “omits or obscures information necessary for a proper understanding of a matter disclosed in the other information.” Extant AU-C section 720 does not address omitted information.

The “omitted information” concept is included in ISA 720 (Revised) because the international code of conduct includes a requirement for the auditor to avoid being “knowingly associated with information that the auditor believes contains a materially false or misleading statement, statements or information furnished recklessly, or omits or obscures information required to be included where such omission or obscurity would be misleading.” As confirmed with AICPA Professional Ethics Team staff, the AICPA Code does not include similar language. Instead, the Code includes the following concept (emphasis added):

**“1.100.001 Integrity and Objectivity Rule**

**.01** In the performance of any *professional service*, a *member* shall maintain objectivity and integrity, shall be free of conflicts of interest, ***and shall not knowingly***

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*misrepresent facts or subordinate his or her judgment to others.* [Prior reference: paragraph .01 of ET section 102]”

The Task Force recognizes that the issue is related to the “intelligent read” concept in that such an “intelligent read” might lead the auditor to conclude that information has been omitted. The Task Force feels that the concept of “omitted information” is implied as information would be considered to be misleading if information is known to be needed that is instead omitted. Further, there was some concern that the term “omits” may imply that the auditor has some responsibility with respect to the completeness of the other information.

**Action Requested of the ASB**

The ASB is asked to consider whether it agrees with the Task Force that the proposed standard need not explicitly address omitted information.

**Issue #5 – Reporting**

At its meeting in October 2016, the ASB directed that the auditor’s report focus on describing the auditor’s responsibility for other information as opposed to what has been received.

The Task Force believes that the reporting requirements in ISA 720 (Revised) provides a clear and transparent communication as to what the auditor has done. Further, ISA 720 (Revised) requires that the report identify other information, if any, expected to be obtained after the date of the auditor’s report only for “listed entities” (the equivalent of U.S. public companies). The Task Force believes that since paragraph 13(d) of the proposed standard requires the auditor to obtain management’s written acknowledgment of which documents comprise the annual report and the expected timing that such documents will be presented to the auditor, the disclosure of documents that have not been received would not be difficult for the auditor. The Task Force proposes that the standard include a requirement for the auditor to identify other information, if any, expected to be obtained after the date of the auditor’s report.

**Action Requested of the ASB**

The ASB is asked to consider whether it agrees with the Task Force that the standard should include a requirement for the auditor to identify other information, if any, expected to be obtained after the date of the auditor’s report.

**Next Steps**

The following represents the Task Force’s timetable for future presentations to the ASB and ultimate issuance of the proposed standard:

- May 2017– Revised draft standard to be presented to the ASB with a request that the ASB consider voting to expose the proposed standard for public comment. The standard will be exposed with the proposed auditor’s report standards.

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- October 2017 – Assuming that the standard is exposed for comment in May/June 2017, consideration of comment letters on exposure draft.
- January 2018 – Final draft presented to the ASB with a request that the ASB consider voting to issue as a final standard. The standard will be issued with the auditor's report standards

**Agenda Items Presented:**

Agenda item 5A      Draft proposed standard showing requirements and application guidance in side-to-side format – redline to show changes from ISA 720 (Revised)

Agenda item 5B      Comparison of ISA 720 (Revised), extant AU-C section 720, and the draft proposed standard.

Ms. Gantnier will use agenda item 5A for the walk through of the proposed standard.