

Agenda Item 1



Other Information

Objective of Agenda Item

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*.

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 SAS No. 118 superseded the requirements and guidance in AU section 550 and, along with SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, superseded AU section 551.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 the explanatory memorandum that accompanied the exposure draft, the IAASB explained its reasons for proposing revisions to ISA 720 as follows:

In recent years, there have been a number of developments in the corporate reporting environment that have led to significant changes in the nature and extent of information included in documents containing audited financial statements and the auditor's report thereon (such as annual reports). In particular:

- There has been a change in emphasis towards more qualitative disclosures as entities endeavor to put their financial information into context with the aim of achieving better communication with their stakeholders. Annual reports, in particular, now include more narrative and qualitative information, such as descriptions of the entity's business model, risk exposures and uncertainties, than in the past. Users have been attaching increasingly more importance to such information as they look for ways to better inform their analysis and understanding of the more complex areas in the financial statements.

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- There has been a movement towards exploring ways in which to better integrate information in financial statements, Management Discussion and Analysis (MD&A), and other parts of an entity's public reporting package.
- There has been an evolution in the manner in which an entity disseminates and communicates information to its stakeholders. For example, while entities have traditionally distributed hard-copy annual reports to their stakeholders and for regulatory filing purposes, they have increasingly turned to electronic means to do so.
- Entities also have been making increasing and more diverse use of documents other than the annual report, whether pursuant to law or regulation or voluntarily, for their external communication purposes in connection with the issuance of their audited financial statements. In many jurisdictions, for example, entities are presenting information such as management reports, or statements on corporate governance or on internal control and risk assessment, in documents *accompanying* the audited financial statements, instead of in documents *containing* the financial statements.

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;
- 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;
- 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.

Comments on the proposed revised ISA were due on March 14, 2013 and the Auditing Standards Board issued a comment letter which, among other things expressed concern:

- That the proposed expansion of documents that the auditor would be required to consider as other information would expand the costs and risks incurred at levels that would exceed any benefits. Chief among those issues was the proposed expansion of the auditor's responsibilities to documents *accompanying* the audited financial statements.
- That the objectives of the proposed ISA (and the definition of material inconsistency) do not clearly differentiate the auditor's responsibility with respect to other information that contradicts information contained in the audited financial statements (material inconsistency) from the auditor's responsibility for apparent material misstatements of fact contained in the other information.
- That the illustrative auditor's report included in the proposed revised ISA does not clearly articulate the nature and limitations of the auditor's understanding of the entity of the entity and its environment acquired during the course of the audit.
- That the proposed work effort implies that the auditor would obtain assurance on information on which the auditor is not required to opine or issue a review conclusion.
- That the application guidance stating that documents within the scope of the proposed ISA may be included on the entity's website contrasts with extant ISA 720.
- That the proposed ISA does not include a requirement for the auditor to obtain a written representation from management that it acknowledges its responsibility for 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 ASB issued a comment letter on the exposure draft which, among other things expressed concern:

- That the proposed revised ISA 720 requires the auditor to perform limited procedures to *evaluate* the consistency between the amounts or other items in the other information 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. The ASB proposed that a

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verb such as *compare* would be more appropriate than *evaluate*. The ASB stated that *evaluate* implies that the auditor is performing procedures to obtain assurance for the purpose of expressing a conclusion regarding the consistency between the amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or items in the financial statements, with such amounts or other items in the financial statements.

- That the proposed revised ISA 720 includes application guidance that precludes an auditor from fulfilling his or her reporting responsibilities with respect to other information when the auditor disclaims an opinion on the financial statements.
- That the required documentation should include the auditor's agreement with management as to which documents comprise the annual report and the planned timing of the entity's issuance of such documents.
- That there should be a requirement that the auditor obtain a written representation with respect to the completeness, accuracy, and consistency of the other information provided to the auditor.

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

A Task Force has been 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
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 issues with respect to which the Task Force is requesting ASB input as it prepares to propose revisions to AU-C section 720. The Task Force plans to present a first draft of proposed revisions to AU-C section 720 at the ASB's meeting in May 2015.

Please note that the final version of ISA 720 (Revised) was not made available to the Task Force so, the Task Force used the draft of ISA 720 (Revised) that was included as part of the IAASB agenda materials for its December 2014 meeting (hereinafter referred to as "draft ISA 720 (Revised)."

Issues for Discussion with the ASB

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

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.

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).

Because the definition of *other information* included in draft ISA 720 (Revised) runs to documents in annual reports (as opposed to a more opened ended population of documents), the Task Force does not oppose the definition of *annual reports* including documents that accompany the financial statements and the auditor's report thereon.

Action Requested of the ASB

The ASB is asked to consider whether it agrees with the Task Force that the definitions of *other information* and *annual report* would not be problematic if included in a proposed revised AU-C section 720 and provide the Task Force with guidance.

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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 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).

The Task Force does not object to the terms used in draft ISA 720 (Revised) and does not anticipate any issues with respect to converging US GAAS to the ISA in this regard. However, the Task Force recommends that a definition of *inconsistency* be included in any revision of AU-C section 720 as such a definition would help to clarify the requirements in draft ISA 720 (Revised).

Action Requested of the ASB

The ASB is asked to consider whether it agrees with the Task Force that the terms used in the draft ISA 720 (Revised) are acceptable and do not create any convergence issues. The ASB is also asked whether it agrees with the Task Force that a definition of the term *inconsistency* should be included in any revision of AU-C section 720.

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

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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)

The Task Force is supportive of the requirement included in draft ISA 720 (Revised).

Action Requested of the ASB

The ASB is asked to consider the requirement in paragraph 13 of draft ISA 720 (Revised) and whether it agrees with the Task Force that the requirement is appropriate to ensure that the auditor obtains all of the other information included in the annual report.

Work Effort

The key work effort paragraphs included in the draft ISA 720 (Revised) are as follows:

14. The auditor shall read the other information (that is, the documents determined to comprise the annual report in accordance with paragraph 13(a)) and, in doing so shall: (Ref: Para. A20–A21)
 - (a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor shall perform comparison procedures on selected amounts or other items to evaluate the consistency of the amounts or other items in the other information 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; and (Ref: Para. A22–A26)
 - (b) Consider whether there is a material inconsistency between the other information and the auditor’s knowledge obtained in the audit through the auditor’s recollection of relevant matters and, only if necessary to support that recollection, by referring to relevant audit documentation or making inquiries of other relevant members of the engagement team or relevant component auditors. (Ref: Para. A27–A32)

- 15A. While reading the other information in accordance with paragraph 14, the auditor shall 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. (Ref: Para. A33–A33A)

The Task Force is concerned with the requirement in paragraph 14(a) of the draft ISA 720 (Revised) that the auditor perform comparison procedures on the selected amounts or other items to *evaluate* the consistency of the amounts or other items in the other information 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. The Task Force does not believe that it is appropriate for the auditor to be required to perform evaluation procedures when no assurance is

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obtained or provided. The Task Force would be supportive of a requirement that read as follows:

- (a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor ~~shall perform comparison procedures on~~ *should compare* selected amounts or other items to ~~evaluate the consistency of~~ the amounts or other items in the other information 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

Action Requested of the ASB

The ASB is asked to consider the work effort paragraphs included in draft ISA 720 (Revised) and provide the Task Force with feedback as to whether it is supportive of the revisions proposed by the Task Force.

Reporting

AU-C section 720 does not require the auditor to make reference to the other information in the auditor's report (paragraph .A2 of AU-C section 720 does state that the auditor may include an other-matter paragraph disclaiming an opinion on the other information).

Draft ISA 720 (Revised) significantly revises the reporting requirements with respect to other information, as follows:

- 21. The auditor's report shall include a separate section with a heading "Other Information", or other appropriate heading, when, at the date of the auditor's report:
 - (a) For an audit of financial statements of a listed entity, the auditor has obtained, or expects to obtain, the other information; or
 - (b) For an audit of financial statements of an entity other than a listed entity, the auditor has obtained some or all of the other information,
- 21A. When the auditor's report is required to include an Other Information section in accordance with paragraph 21, this section shall include: (Ref: Para. A47)
 - (a) An identification of:
 - (i) Other information, if any, obtained by the auditor prior to the date of the auditor's report; and
 - (ii) For an audit of financial statements of a listed entity, other information, if any, expected to be obtained after the date of the auditor's report;
 - (b) A statement that the auditor's opinion does not cover the other information and accordingly that the auditor does not express (or will

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not express) an audit opinion or any form of assurance conclusion thereon.

- (c) A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by this ISA;
- (d) When other information has been obtained prior to the date of the auditor's report, either:
 - (i) A statement that the auditor has nothing to report; or
 - (ii) If the auditor has determined that there is an uncorrected material misstatement of the other information, a statement that describes the uncorrected material misstatement of the other information.

The IAASB's stated objective in requiring that the auditor report on other information is to increase transparency. The Task Force is supportive of the enhanced reporting requirements. The following is an illustration as to how the auditor may report when the auditor has obtained all of the other information by the date of the auditor's report and has not identified a material misstatement of the other information:

Other Information [or another title if appropriate such as "Information other than the financial statements and auditor's report thereon"]

Other information comprises the [information included in the X report, but does not include the financial statements and our auditor's report thereon.]

Our opinion on the financial statements does not cover other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether there are indications that the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we determine that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

While the Task Force does not object to the language in the illustration, it believes that the illustrative disclaimer included in AU-C section 720 is clearer. That disclaimer reads as follows:

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The [*identify the other information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures

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applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Action Requested of the ASB

The ASB is asked to provide its thoughts on the enhanced reporting requirements included in draft ISA 720 (Revised) and whether it agrees with the Task Force that the reporting illustration included in AU-C section 720 is clearer to users.

Documentation

AU-C section 720 does not include any documentation requirements.

The documentation requirements in draft ISA 720 (Revised) are as follows:

24. In addressing the requirements of ISA 230 as it applies to this ISA, the auditor shall include in the audit documentation: (Ref: Para. A55A)
 - (a) Documentation of the procedures performed under this ISA; and
 - (b) The final version of the other information on which the auditor has performed the work required under this ISA.

The Task Force questions how the auditor can document the primary procedure of reading the other information. The Task Force believes that the documentation requirements would be more operational if revised as follows:

...the auditor *should prepare documentation in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes* ~~shall include in the audit documentation:~~ (Ref: Para. A55A)

- ~~(a) Documentation of the procedures performed under this ISA; and~~
- ~~(b) The final version of the other information on which the auditor has performed the work required under this ISA.~~

Action Requested of the ASB

The ASB is asked for feedback as to whether it agrees with the Task Force's revision to the documentation requirements included in draft ISA 720 (Revised).

Agenda Items Presented:

Agenda item 1A Proposed standard, *Financial Forecasts and Projections*