

Agenda Item 5B



Proposed Revised AU-C section 720 “The Auditor’s Responsibilities Regarding Other Information in Annual Reports Containing Audited Financial Statements and the Auditor’s Report Thereon”

In Track changes to show differences from Extant AU-C section 720

Introduction, Effective Date, Objective, Definitions, and Requirements Paragraphs	Application and Other Explanatory Material	Notes
Introduction		
Scope of this Section	Scope of This Section (Ref: par. .01–.02)	
<p>.01 This section addresses the auditor's responsibility with respect to other information, <u>whether financial or non-financial information (other than financial statements and the auditor's report thereon)</u>, in documents <u>annual reports</u> containing audited financial statements and the auditor's report thereon. <u>For purposes of this standard, other</u></p>	<p>.A1 This section also addresses other information for which a designated accounting standard setter⁶ has issued standards or guidance regarding the format to be used and content to be included when such information is voluntarily presented in a document containing the audited financial statements and the audi-</p>	Additional language is from ISA 720 (Revised).

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<p><u>information in an annual report, other than the audited financial statements and the auditor's report thereon, includes information incorporated by reference in that annual report that is available to the auditor prior to the issuance of the auditor's report.</u> In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the financial statements does not cover other information, and the auditor has no responsibility for determining whether such information is properly stated. This section establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information <u>in the annual report. This 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.</u> (Ref: par. .A1–.A2)</p>	<p>tor's report thereonan annual report. The auditor's responsibility for other information presented in a document containing audited financial statementsan annual report that is required to be included by a designated accounting standards setter is addressed in section 730, <i>Required Supplementary Information</i>.</p> <p>⁶ <i>Designated accounting standards setter</i> is defined in paragraph .04 of section 730.</p> <p>.A2 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. Exhibit A, "Example of an Other Matter Paragraph to Disclaim an Opinion on Other Information," has an example of how an auditor may word such a dis-</p>	<p>“Incorporated by reference” guidance is from the proposed AS to be more appropriate for American auditors.</p> <p>The AU-C glossary includes the following definitions:</p> <p>incorporated by reference. See included and included or the inclusion of.</p> <p>included (in the context of section 920). References to information that is included in a document are to be read to also encompass information that is incorporated by reference in that document.</p> <p>ASB to consider whether revisions to the definitions are needed (or if the reference to “incorporated by reference” is needed in AU-C section 720).</p> <p>Paragraph A2 will be reinstated if the ASB determines that the reporting requirements from</p>

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	claimer of opinion on other information.	extant AU-C section 720 should be retained.
<p>.02 In this section, 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. This section also may be applied, adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention. (Ref: par. A3A2-A5A4)</p>	<p>.A3 <u>.A2</u> Other information may comprise the following:</p> <ul style="list-style-type: none"> • 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 <p>.A4 <u>.A3</u> For purposes of GAAS, other information does not encompass, for example, the following:</p> <ul style="list-style-type: none"> • A press release or similar memorandum or cover letter accompanying the document 	<p>The first sentence of paragraph .02 is not needed as the revised standard includes a clear definition of <i>annual reports</i>.</p> <p>ISA 720 (Revised) includes an appendix with examples of amounts or other items that may be included in other information. The draft revised AU-C section 720 will include that appendix.</p>

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	<p>containing audited financial statements and the auditor's report thereon.</p> <ul style="list-style-type: none"> • 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. <p><i>Considerations Specific to Governmental Entities (Ref: par. .02)</i></p> <p>.A5-A4 The term <i>annual reports of governments</i> is intended to include comprehensive annual reports or other annual financial reports that include the government's financial statements and the auditor's report thereon.</p>	
Effective Date		
.03 This section is effective for audits of financial statements for periods beginning on or after		Effective date to be determined.

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December 15, 2010 X . Early application is permitted.		
Objectives		
<p>.04 The objectives of the auditor, <u>having read the other information, are:</u></p> <p><u>a. is 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; and when the auditor becomes aware that documents the entity's annual report containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.</u></p> <p><u>b. When issuing an auditor's report, to communicate in the auditor's report the auditor's responsibilities for other information</u></p>		<p>Additional language taken from ISA 720 (Revised).</p> <p>The objective from the extant standard is revised and included in subparagraph a. The revised objective uses the term "consider" consistent with ISA 720 (Revised) but otherwise is consistent with the objective in the corresponding subparagraph a of the proposed PCAOB AS.</p> <p>Consistent with proposed PCAOB AS.</p>

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<p><i><u>and whether, based on relevant audit evidence obtained and conclusions reached during the audit, the other information contains a material inconsistency, a material misstatement of fact, or both.</u></i></p>		
<p>Definitions</p>	<p><u>Definitions</u></p>	
<p>.05 For purposes of generally accepted auditing standards (GAAS)the SASs, the following terms have the meanings attributed as follows:</p> <p><u>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. Annual reports include 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. An annual report contains or incorporates by reference the financial statements and the auditor’s report thereon and usually in-</u></p>	<p><u>Annual Report (Ref: pPar. 5)</u></p> <p><u>A5. 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.</u></p>	<p>The definition of <i>annual report</i> is primarily from ISA 720 (Revised). A few differences of note:</p> <ol style="list-style-type: none"> 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 phase is not deemed necessary for American auditors. 3) “Contains or incorporates by reference”

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<p><u>cludes 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. (Ref: par. A5)</u></p> <p>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.</p> <p>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.</p> <p>Other information. Financial and nonfinancial information (other than the financial statements and the auditor's report thereon) that is included in a document containing audited financial</p>		<p>wording added 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.</p> <p>4) The SAS includes the concept of annual reports of governments and charitable organizations from extant AU-C section 720.</p> <p>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”.</p>

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<p>statements and the auditor's report thereon <u>an entity's annual report</u>, excluding required supplementary information.¹</p> <p>¹ <i>Required supplementary information</i> is defined in paragraph .04 of section 730, <i>Required Supplementary Information</i>.</p>		
Requirements		
Reading Other Information	Reading Other Information (Ref: par. .07)	
<p>.06 The auditor should read the other information of which the auditor is aware in order to identify material inconsistencies, if any, with the audited financial statements.</p>		
<p>.07 The auditor should make appropriate arrangements with management or those charged with governance to obtain the other information prior to the report release date.² If it is not possible to obtain all of the other information prior to the report release date, the auditor should read such other information as soon as practicable.</p>	<p>.A6 Obtaining the other information prior to the report release date enables the auditor to resolve possible material inconsistencies and apparent material misstatements of fact with management on a timely basis. An agreement with management regarding when other information will be available may be helpful. The auditor may delay the release of the auditor's</p>	

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(Ref: par. .A6) ² See paragraph .06 of section 230, <i>Audit Documentation</i> , for the definition of <i>report release date</i> .	report until management provides the other information to the auditor.	
.08 The auditor should communicate with those charged with governance the auditor's responsibility with respect to the other information, any procedures performed relating to the other information, and the results.		
Material Inconsistencies		
.09 If, on reading the other information, the auditor identifies a material inconsistency, the auditor should determine whether the audited financial statements or the other information needs to be revised.		
<i>Material Inconsistencies Identified Prior to the Date of the Auditor's Report That Require Revision of the Audited Financial Statements</i>		

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<p>.10 When the auditor identifies a material inconsistency prior to the date of the auditor's report that requires revision of the audited financial statements and management refuses to make the revision, the auditor should modify the auditor's opinion in accordance with section 705, <i>Modifications to the Opinion in the Independent Auditor's Report</i>.</p>		
<p><i>Material Inconsistencies Identified After the Date of the Auditor's Report But Prior to the Report Release Date That Require Revision of the Audited Financial Statements</i></p>		
<p>.11 When the auditor identifies a material inconsistency after the date of the auditor's report but prior to the report release date that requires revision of the audited financial statements, the auditor should apply the relevant requirements in section 560, <i>Subsequent Events and Subsequently Discovered Facts</i>.³</p> <p>³ Paragraphs .12–.14 of section 560, <i>Subsequent Events and Subsequently Discovered Facts</i>.</p>		

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<i>Material Inconsistencies Identified Prior to the Report Release Date That Require Revision of the Other Information</i>	<i>Material Inconsistencies Identified Prior to the Report Release Date <u>That Require Revision of the Other Information</u> (Ref: par. <u>.A12</u>)</i>	
<p>.12 When the auditor identifies a material inconsistency prior to the report release date that requires revision of the other information and management refuses to make the revision, the auditor should communicate this matter to those charged with governance and (Ref: par. .A7–.A8)</p> <p>a. include in the auditor's report an other-matter paragraph describing the material inconsistency, in accordance with section 706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i>;⁴</p> <p>b. withhold the auditor's report; or</p> <p>c. when withdrawal is possible under applicable law or regulation, withdraw from the engagement.</p>	<p>.A7 When management refuses to revise the other information, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.</p> <p><i>Considerations Specific to Governmental Entities (Ref: par. <u>.A12</u>)</i></p> <p>.A8 In audits of governmental entities, withdrawal from the engagement or withholding the auditor's report may not be possible under law or regulation. In such cases, the auditor may issue a report to those charged with governance and the appropriate statutory body, if applicable, giving details of the inconsistency.</p>	

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⁴ Paragraph .08 of section 706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i> .		
<i>Material Inconsistencies Identified Subsequent to the Report Release Date</i>	<i>Material Inconsistencies Identified Subsequent to the Report Release Date (Ref: par. .1314-.1415)</i>	
<p>.13 When revision of the audited financial statements is necessary as a result of a material inconsistency with other information and the auditor's report on the financial statements has already been released, the auditor should apply the relevant requirements in section 560, <i>Subsequent Events and Subsequently Discovered Facts</i>.⁵</p> <p>⁵ Paragraphs .15–.18 of section 560, <i>Subsequent Events and Subsequently Discovered Facts</i>.</p>		
<p>.14 When revision of the other information is necessary after the report release date and management agrees to make the revision, the auditor should carry out the procedures necessary under the circumstances. (Ref: par. A9)</p>	<p>.A9 When revision of other information is necessary after the report release date and management agrees to make the revision, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued fi-</p>	

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	<p>financial statements, the auditor's report thereon, and the other information are informed of the need for revision.</p>	
<p>.15 When revision of the other information is necessary after the report release date but management refuses to make the revision, the auditor should notify those charged with governance of the auditor's concerns regarding the other information and take any further appropriate action. (Ref: par. .A10)</p>	<p>.A10 When revision of other information is necessary after the report release date but management refuses to make the revision, appropriate further actions by the auditor may include obtaining legal advice.</p>	
<p>Material Misstatements of Fact</p>	<p>Material Misstatements of Fact (Ref: par. .4516 and 4718)</p>	
<p>.16 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. (Ref: par. .A11)</p>	<p>.A11 When discussing an apparent material misstatement of fact with management, the auditor may not be able to evaluate the validity of some disclosures included within the other information and management's responses to the auditor's inquiries and may conclude that valid differences of judgment or opinion exist.</p>	
<p>.17 When, following such discussions, the audi-</p>		

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<p>tor still considers that there is an apparent material misstatement of fact, the auditor should request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor should consider the advice received by the entity in determining whether such matter is a material misstatement of fact.</p>		
<p>.18 When the auditor concludes that there is a material misstatement of fact in the other information that management refuses to correct, the auditor should notify those charged with governance of the auditor's concerns regarding the other information and take any further appropriate action. (Ref: par. .A12)</p>	<p>.A12 When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate further actions by the auditor may include obtaining legal advice, withholding the auditor's report if such report has not been released, or withdrawing from the engagement.</p>	
<p><u>Reporting</u></p>	<p><u>Reporting (Ref: par. 20f(1))</u></p>	
<p><u>19. The auditor's report should include a separate section 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.</u></p>		<p>Consistent with ISA 720 (Revised).</p>

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<p><u><i>20. When the auditor's report is required to include an Other Information section in accordance with paragraph 19, this section should include:</i></u></p> <p><u><i>a. A statement that management is responsible for the other information;</i></u></p> <p><u><i>b. A statement that, in addition to auditing the company's financial statements [and the internal control over financial reporting (if applicable)], in accordance with auditing standards generally accepted in the United States of America, the auditor considered whether the other information contains a material inconsistency with the financial statements, a material misstatement of fact, or both;</i></u></p> <p><u><i>c. Identification of the annual report that contains the other information, and the audited financial statements and the auditor's report;</i></u></p> <p><u><i>d. A statement that the auditor's consideration of the other information was based on relevant audit evidence obtained and conclu-</i></u></p>		<p>Consistent with ISA 720 (Revised).</p> <p>Consistent with ISA 720 (Revised).</p> <p>Consistent with subparagraph a from the proposed PCAOB AS.</p>

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<p><u>sions reached during the audit;</u></p> <p><u>e. A statement that the auditor did not audit the other information and does not express an opinion, a conclusion, or any form of assurance on the other information; and</u></p> <p><u>f. A statement that, based on the consideration, the auditor:</u></p> <p><u>(1) Has not identified a material inconsistency or a material misstatement of fact in the other information; or (Ref: par. A13)</u></p> <p><u>(2) Has identified a material inconsistency, a material misstatement of fact, or both in the other information that has not been appropriately revised and a description of the material inconsistency, the material misstatement of fact, or both.</u></p>	<p><u>A13. The statement required by paragraph 20f(1) is appropriate in situations in which the auditor (1) has not identified a material inconsistency or a material misstatement of fact or (2) has identified a material inconsistency, a material misstatement of fact, or both that management has revised appropriately prior to the issuance of the auditor's report.</u></p>	<p>Replaced “evaluated” with “considered”.</p> <p>Consistent with subparagraph b from the proposed PCAOB AS. Substantially in harmony with subparagraph b of ISA 720 (Revised).</p> <p>Consistent with subparagraph c from the proposed PCAOB AS. Replaced “evaluation” with “consideration”.</p> <p>Consistent with subparagraph d from the pro-</p>

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		<p>posed PCAOB AS. Added “a conclusion, or any form of assurance” to be consistent with disclaimer reporting language.</p> <p>Consistent with subparagraph e from the proposed PCAOB AS. Replaced “evaluation” with “consideration”.</p> <p>Paragraph A13 is from footnote 9 to paragraph 13e(1) of the proposed PCAOB AS.</p>