

Agenda Item 3



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

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

- 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 – 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 – Former ASB 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 meeting in August 2016 and requested feedback.

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

Issues for Discussion with the ASB

Issue #1 - Definition of annual report and clarification of the documents in the scope of the SAS

An issue with extant AU-C section 720 is that practitioners often misapply the standard as they feel that it applies to all instances where the audited financial statements are included in documents containing other information – when, in fact, the scope of the standard is limited 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”.

To clarify that AU-C section 720 is required to be applied only to 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”. In addition, the Task Force proposes to include the following definition of *annual report* in the proposed revised AU-C section 720:

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

Annual report. A document, or combination of documents, 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. An annual report contains or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public. (Ref: Para. A5–A9)

The Task Force also determined to include the following application guidance from ISA 720 (Revised):

A5. An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.

A6. In some cases, an entity's annual report may be a single document and referred to by the title "annual report" or by some other title. In other cases, law, regulation or custom may require the entity to report to owners (or similar stakeholders) information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (i.e., an annual report) by way of a single document, or by way of two or more separate documents that in combination serve the same purpose. For example, depending on law, regulation or custom in a particular jurisdiction, one or more of the following documents may form part of the annual report:

- Management report, management commentary, or operating and financial review or similar reports by those charged with governance (for example, a directors' report).
- Chairman's statement.
- Corporate governance statement.
- Internal control and risk assessment reports.

A7. An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document (or combination of documents) may meet the definition of an annual report, irrespective of the manner in which it is made available to users.

A8. An annual report is different in nature, purpose and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or a report prepared to comply with a specific regulatory reporting objective (even when such a report is required to be publicly available). Examples of reports

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

that, when issued as standalone documents, are not typically part of the combination of documents that comprise an annual report (subject to law, regulation or custom), and that, therefore, are not other information within the scope of this ISA, include:

- Separate industry or regulatory reports (for example, capital adequacy reports), such as may be prepared in the banking, insurance, and pension industries.
- Corporate social responsibility reports.
- Sustainability reports.
- Diversity and equal opportunity reports.
- Product responsibility reports.
- Labor practices and working conditions reports.
- Human rights reports.

At the ASB's suggestion, the Task Force also added the following application paragraph:

A9. While an entity may refer to a document as an annual report, such document may not meet the definition of annual report for purposes of this proposed standard.

The proposed SAS definition includes the ISA 720 (Revised) concepts of "combination of documents" and "documents accompanying the audited financial statements and the auditor's report thereon". At its meeting in August 2017, the ASB directed that such concepts be included as occasionally annual reports are in multiple documents. A concern was raised however that "combination of documents" wording may scope in certain documents that are not intended to be part of the annual report as the IAASB was addressing documents that are not relevant in the United States of America. Another thought was raised that perhaps the proposed standard may be more understandable if it ran to just what is included in the annual report document.

The proposed SAS definition states that the annual report includes *or incorporates by reference* the financial statements and auditor's report thereon. ISA 720 (Revised) does not include the "incorporates by reference" wording and instead states that the annual report may *accompany* the financial statements and the auditor's report thereon. The Task Force felt that *incorporates by reference* is more appropriate for American auditors. In addition, it is consistent with the proposed SAS, *Auditor Involvement with Exempt Offerings*. The AU-C glossary includes the following definitions:

incorporated by reference. See **included** and **included or the inclusion of**.

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.

The Task Force does not believe that any additional clarification as to "incorporated by reference is needed".

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

Consistent with ISA 720 (Revised), the proposed standard includes an exercise that the auditor is required to go through with management to determine what the annual report consists of. That exercise includes:

- Discussions with management as to what is in the annual report and the timing of issuance of documents
- Making arrangements with management to obtain the documents
- If documents will not be available until after the date of the auditor's report, obtaining a representation that the documents will be provided to the auditor and that the auditor will apply the required procedures prior to issuance of those documents.

The proposed standard also includes an additional requirement for the auditor to obtain a written representation regarding management's understanding as to what the annual report consists of.

The Task Force discussed how to maximize clarity with respect to documents in the scope of the standard and considered replacing the term *other information* with a term such as *other information in annual reports* and using an acronym such as OIAM for readability. However, it was ultimately determined that the term *other information* should be retained so as to be consistent with ISA 720 (Revised) and because practitioners who deal with such information are comfortable with the term.

The Task Force also considered including guidance that while the actual form of the annual report may be a combination of documents that it is intended to be in substance one document.

Action Requested of the ASB

The Task Force requests that the ASB consider whether the proposed standard is clear as to what documents are included in the scope of the standard and provide feedback to the Task Force.

Issue #2 - Omitted Information

ISA 720 (Revised) includes the concept that the 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 include requirements with respect to omitted information. The proposed SAS does not include a requirement or guidance with respect to omitted information.

Further, ISA 720 (Restated) states 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

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

disclosed in the other information). The proposed SAS does not run to “misstatements of the other information” but instead retains the concepts from AU-C section 720 of *inconsistency* (other information that conflicts with information contained in the audited financial statements) and *misstatement of fact* (other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented). The proposed SAS also retains the AU-C section 720 required responses when the auditor identifies a material inconsistency or a material misstatement of fact.

The ASB previously concluded that retaining the construct from extant AU-C section 720 would not result in an ISA minus scenario as long as the work effort is the same.

The International Ethics Standards Board for Accountants, *Code of Ethics for Professional Accountants* 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. Corresponding language is not included in the AICPA *Code of Professional Conduct*. AICPA Professional Ethics Team staff advised that the following Code paragraph is considered to incorporate the essence of the IESBA standard (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 misrepresent facts or subordinate his or her judgment to others.*** [Prior reference: paragraph .01 of ET section 102]

Action Requested of the ASB

The Task Force requests that the ASB consider whether it continues to believe that the proposed standard should not include requirements with respect to omitted information.

Issue #3 - Reporting

At its meeting in August 2016, the ASB concluded some form of required auditor reporting is in the public interest.

Action Requested of the ASB

The ASB is asked whether it agrees with the proposed reporting requirements and guidance and to provide feedback to the Task Force.

Next Steps

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

Other Information
Discussion Memorandum
ASB Meeting, October 17-20, 2016

- January 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.
- May 2017 – Consideration of comment letters on exposure draft.
- July 2017 – Final draft presented to the ASB with a request that the ASB consider voting to issue as a final standard.

Agenda Items Presented:

Agenda item 3A Draft proposed standard showing requirements and application guidance in side-to-side format – redline to show changes from ISA 720 (Revised)