

SA 720*

THE AUDITOR'S RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Standard on Auditing (SA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements" issued by the Council of the Institute of Chartered Accounts of India. This should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services¹", which sets out the authority of SAs and proposed SA 200 (Revised), "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing"².

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated. However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. (*Ref: Para. A1*)

2. In this SA "documents containing audited financial statements" refers to annual reports (or similar documents), that are issued to owners (or similar stakeholders), containing audited financial statements and the auditor's report thereon. This SA may also be applied, adapted as necessary in the circumstances, to other documents containing audited financial statements. (*Ref: Para. A2-A4*)

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Objective

4. The objective of the auditor is to respond appropriately when documents containing audited

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¹ Published in the July, 2007 issue of the Journal.

² Presently, SA 200, "Basic Principles Governing an Audit" and SA 200A, "Objective and Scope of an Audit of Financial Statements" correspond to International Standard on Auditing (ISA) 200 (Revised and Redrafted). Both the SAs are currently being revised in the light of the ISA 200 (Revised and Redrafted). Post revision, the principles covered by SA 200 (AAS 1) and SA 200A (AAS 2) will be merged into one Standard, i.e., SA 200.

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.

Definitions

5. For purposes of the SAs the following terms have the meanings attributed below:
- (a) Other information – Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon.
 - (b) Inconsistency – Other information that contradicts 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.
 - (c) 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.

Requirements

Reading Other Information

6. The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements.
7. The auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable. (Ref: Para. A5)

Material Inconsistencies

8. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the audited financial statements or the other information needs to be revised.

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report

9. When revision of the audited financial statements is necessary and management refuses to make the revision, the auditor shall modify the opinion in accordance with [proposed] SA 705.³
10. When revision of the other information is necessary and management refuses to make the revision, the auditor shall communicate this matter to those charged with governance; and

³ At present, there is no separate Standard on Auditing (SA) corresponding to International Standards on Auditing (ISA) 705, "Modifications to the Opinion in the Independent Auditor's Report" and ISA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report". However, the concepts of 'modified audit report' and 'emphasis of matter paragraph' have been discussed in SA 700, "The Auditor's Report on Financial Statements". The Auditing and Assurance Standards Board has issued the Exposure Drafts of Revised SA 700, "Forming an opinion and Reporting on Financial Statements", SA 705, "Modifications to the opinion in the Independent Auditor's Report" and SA 706, "Emphasis of Matter paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" corresponding to ISA 700, ISA 705 and ISA 706. These Exposure Drafts have been published in the June, 2009 issue of the Journal.

- (a) Include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with [proposed] SA 706; or
- (b) Where withdrawal is legally permitted, withdraw from the engagement. (*Ref: Para. A6- A7*)

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report

- 11. When revision of the audited financial statements is necessary, the auditor shall follow the relevant requirements in SA 560 (Revised).⁴
- 12. When revision of the other information is necessary and management agrees to make the revision, the auditor shall carry out the procedures necessary under the circumstances. (*Ref: Para. A8*)
- 13. When revision of the other information is necessary, but management refuses to make the revision, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. (*Ref: Para. A9*)

Material Misstatements of Fact

- 14. 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 shall discuss the matter with management. (*Ref: Para. A10*)
- 15. When, following such discussions, the auditor still considers that there is an apparent material misstatement of fact, the auditor shall request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor shall consider the advice received.
- 16. When the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor shall notify those charged with governance of the auditor's concern regarding the other information and take any further appropriate action. (*Ref: Para. A11*)

⁴ SA 560 (Revised), "Subsequent Events", paragraphs 10-17.

Application and Other Explanatory Material

Scope of this SA (Ref: Para. 1-2)

A1. The auditor may have additional responsibilities, through statutory or other regulatory requirements, in relation to other information that are beyond the scope of this SA. For example, certain statutory and regulatory requirements may require the auditor to apply specific procedures to certain of the other information such as required supplementary data or to express an opinion on the reliability of performance indicators described in the other information. When there are such obligations, the auditor's additional responsibilities are determined by the nature of the engagement and by law, regulation and professional standards. If such other information is omitted or contains deficiencies, the auditor may be required by law or regulation to refer to the matter in the auditor's report.

A2. Other information may comprise, for example:

- A report by management or those charged with governance on operations.
- Financial summaries or highlights.
- Planned capital expenditures.
- Financial ratios.
- Selected quarterly data.

A3. For purposes of the SAs, other information does not encompass, for example:

- A press release or a transmittal memorandum, such as a covering 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 web site.

Considerations Specific to Smaller Entities (Ref: Para. 2)

A4. Unless required by law or regulation, smaller entities are less likely to issue documents containing audited financial statements. However, an example of such a document would be where a legal requirement exists for an accompanying report by those charged with governance.

Reading Other Information (Ref: Para. 7)

A5. Obtaining the other information prior to the date of the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of fact with management on a timely basis. An agreement with management as to when the other information will be available may be helpful.

Material Inconsistencies

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: Para. 10)

A6. 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.

A7. In case of certain entities such as, Central/State governments and related government entities (for example, agencies, boards, commissions), withdrawal from the engagement may not be an option. In such cases the auditor may issue a report to the appropriate statutory body giving details of the inconsistency.

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report (Ref: Para. 12-13)

A8. When management agrees to revise the other information, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued financial statements, the auditor's report thereon, and the other information are informed of the revision.

A9. When management refuses to make the revision of such other information that the auditor concludes is necessary, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Misstatements of Fact (Ref: Para. 14-16)

A10. 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.

A11. 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 advice from the auditor's legal counsel.

Material Modifications *vis a vis* ISA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements"

Deletions

1. Paragraph 10 of ISA 720 dealt with the circumstances where the revision of the financial statements is necessary and management refuses to make the revision. In these circumstances, the auditor shall communicate this matter to those charged with governance and include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with ISA 706; or withhold the auditor's report; or where withdrawal is legally permitted, withdraw from the engagement. Since in India, the practice of withholding the auditor's report is not in vogue, an option of withholding the auditor's report by the auditor has been deleted. Similarly in paragraph A7 of the Application Section, an option of withholding the auditor's report by the auditor has been deleted.
2. Paragraph A2 of ISA 720 provides the examples of the other information including 'employment data' and 'names of officers and directors'. Reference to these two specific examples has been deleted so

that the auditor can focus on more relevant aspects of other information.

3. Paragraph A4 of ISA 720 provides an example of the other information that may be included in a document containing the audited financial statements of a smaller entity are a detailed income statement and a management report..Since, in India, the terminology of “detailed income statement” and a “management report” do not exist; these have been deleted completely from the SA.

4. Paragraph A7 of ISA 720 provides that in case of public sector entities, withdrawal from the engagement or withholding the auditor's report may not be the options. In such cases the auditor may issue a report to the appropriate statutory body giving details of the inconsistency. Since as mentioned in the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that withdrawal from the engagement may not be an option even in case of non public sector entities pursuant to a requirement under the statute or regulation under which they operate. Paragraph A7 has, accordingly, been made more generic in its application.