

# Explanatory Memorandum to the Exposure Draft

## Standard on Auditing (SA) 720

### The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

---

#### Background

The Institute is a member of the International Federation of Accountants (IFAC). Therefore, as a part of its membership obligations, while formulating any Standard on Auditing, it is required to harmonise with the corresponding International Standards on Auditing (ISAs), if any, issued by the International Auditing and Assurance Standards Board (IAASB) of the IFAC. At present, there is no Standard on Auditing corresponding to International Standard on Auditing (ISA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements". Therefore, the Auditing and Assurance Standards Board (AASB) decided to take up the project of preparation of SA corresponding to ISA 720 so that the creditability of the audited financial statements may not to be undermined by material inconsistencies between the audited financial statements and other information.

#### IAASB's Clarity Project

The IAASB had, in December, 2006, issued the Exposure Draft(ED) of the Redrafted ISA 720 meaning thereby that the IAASB proposed a Redrafted version of ISA 720, written pursuant to the style adopted under the Clarity Project. As a part of its Clarity Project, an International Standard on Auditing is divided into two sections, one the Requirements part containing the fundamental principles of the Standard and second, the Application and Other Explanatory Materials section and Appendices, detailing the implementation aspects of the principles. Attention of the readers is also drawn to, "A Guide for National Standard Setters that Adopt IAASB's International Standards but Find it Necessary to Make Limited Modifications"<sup>1</sup>, issued by the IAASB in July, 2006.

#### ICAI's Response

The Council of the Institute, at its 267<sup>th</sup> meeting held in April, 2007, has decided to adopt this approach for writing Standards. The Council, at the said meeting, also decided to rename, re-categorise and re-number the existing Auditing and Assurance Standards on the lines followed by the IAASB. The readers are also requested to refer to

---

<sup>1</sup> The full text of the Policy Position can be downloaded free of charge at [http://www.ifac.org/IAASB/downloads/Modification\\_Policy\\_Position.pdf](http://www.ifac.org/IAASB/downloads/Modification_Policy_Position.pdf).

## Exposure Draft of SA 720

the Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>2</sup>, published in the July, 2007 issue of the Journal. This revised Preface is effective from April 1, 2008.

### This Exposure Draft

This Exposure Draft of the Revised Standard on Auditing (SA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements", is based on the corresponding Redrafted ISA 720 issued by the IAASB in December, 2007 and follows the same writing style. The first, i.e., the Introduction and Requirements section contains the principles. The second, i.e., the Application and Explanatory Material section contains implementation guidance on the topics discussed in the Requirements section. Cross reference to the relevant paragraphs of the Application Material is built within the Requirements section. The paragraphs in the Requirements section have been numbered as 1 to 16 and the paragraphs in the Application and Other Explanatory Material are numbered as A1 to A11.

### Topics Covered by SA 720

The Standard contains the following main aspects:

- i) Scope
- ii) Effective date
- iii) Objective
- iv) Definitions
- v) Requirements
  - (a) Reading Other Information
  - (b) Material Inconsistencies
  - (c) Material Misstatements of Fact
- vi) Application guidance on the above aspects

### Highlights of SA 720

1. SA 720 deals with the auditor's responsibility in relation to the other information in documents containing audited financial statements and the auditor's report thereon. Further, the SA 720 provides that the auditor's

---

<sup>2</sup> The full text of the Preface can be downloaded free of charge at [http://www.icai.org/resource\\_file/7744announ1050.pdf](http://www.icai.org/resource_file/7744announ1050.pdf).

does not require giving his opinion on the other information and not having any responsibility of determining whether or not other information is properly stated if there is no separate requirement in the particular circumstances of the engagement. 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.

2. The objective of the auditor under SA 720 is to respond appropriately when documents 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.
3. SA 720 requires the auditor to read the other information to identify material inconsistencies and if found, to determine whether the audited financial statements or other information needs to be revised.
4. SA 720 requires the auditor to 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.
5. SA 720 states that if the material inconsistencies are identified prior to the date of the audit, and the revision of audited financial statement is necessary and the management refuses to make the revision, the auditor is required to modify his opinion. Further, if the revision of other information is necessary, and the management refuses to make the revision, the auditor is required to communicate the matter to those charged with governance and also to provide paragraph in the auditor's report on other matter; or withdraw from the engagement, if permitted by laws or regulations.
6. SA 720 states that if the material inconsistencies are identified subsequent to the date of the audit, and revision of audited financial statement is necessary, the auditor is required to perform the procedures given in SA 560, "Subsequent Events". Further, if the revision of other information is necessary and if management agrees then to carry out the procedures necessary in the circumstances, otherwise, communicate the same to those charged with governance and take further appropriate actions.
7. SA 720 provides that 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 and if the management refuse to correct it, communicate the same to those charged with governance and take further appropriate actions. Further, the auditor can also request the management to take a legal advice of entity's legal counsel.

## Exposure Draft of SA 720

Your comments on the Exposure Draft should reach us by December 31, 2008. Comments are most helpful if they indicate the specific paragraph(s) to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording. The comments should be sent to:

Secretary, Auditing and Assurance Standards Board  
The Institute of Chartered Accountants of India  
ICAI Bhawan, C-1, Sector-1,  
NOIDA,  
Uttar Pradesh – 201 301.

Comments can also be emailed at: [aasb@icai.in](mailto:aasb@icai.in)

Exposure Draft  
Standard on Auditing 720  
The Auditor's Responsibility in Relation to Other Information in  
Documents Containing Audited Financial Statements

---

Contents

	Paragraph
Introduction	
Scope of this SA .....	1-2
Effective Date .....	3
Objective .....	4
Definitions .....	5
Requirements	
Reading Other Information .....	6-7
Material Inconsistencies.....	8-13
Material Misstatements of Fact.....	14-16
Application and Other Explanatory Material	
Scope of this SA .....	A1-A4
Reading Other Information .....	A5
Material Inconsistencies.....	A6-A9
Material Misstatements of Fact.....	A10-A11

Standard on Auditing (SA) 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements" should be read in conjunction with "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services<sup>3</sup>," which sets out the authority of SAs.

---

<sup>3</sup> Published in the July, 2007 issue of the Journal.

## 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 -----.

## Objective

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

## 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.<sup>4</sup>
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
  - (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)<sup>5</sup>.

---

<sup>4</sup> 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(s) 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 Standards are being revised in the light of the corresponding International Standards. The Auditing and Assurance Standards Board will issue the Exposure Drafts of SA 700, SA 705 and SA 706 corresponding to ISA 700, ISA 705 and ISA 706 in the near future.

<sup>5</sup> Proposed SA 560 (Revised), "Subsequent Events," paragraphs 10-17.

## Exposure Draft of SA 720

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)

\*\*\*

## 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.

## Other Information in Documents Containing Audited Financial Statements

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 to ISA 720, "The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements"

### Deletions

1. Paragraph 10 of ISA 720 deals 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 SA 720, 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.