



European Federation of Accountants and Auditors for SMEs

International Auditing and Assurance Standards Board (IAASB)
529 Fifth Avenue, 6th Floor
New York, New York
10017 USA
Attn. IAASB Technical Director
Brussels, 15 March 2013

Dear Sir

Comment on IAASB Exposure Draft ISA 720 (Revised) – The Auditor’s Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor’s Report Thereon

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs.

EFAA appreciates the opportunity to comment on the IAASB Exposure Draft – The Auditor’s Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor’s Report Thereon Report (proposed ISA 720). Our comments are made in relation to the areas outlined below.

Request for Specific Comments

Our comments on specific matters are set out below.

Scope of the Proposed ISA

- 1. Do respondents agree that there is a need to strengthen the auditor’s responsibilities with respect to other information? In particular do respondents believe that extending the auditor’s responsibilities with respect to the other information reflects costs and benefits appropriately and is in the public interest?**

Yes. EFAA supports the revision of ISA 720 as it is our experience that corporate reporting has expanded with more methods being used to communicate with the intended users of financial statements, and more disclosures of a qualitative nature.

Later in this response, however, we draw attention to the difficulties in auditors becoming associated with elements of other information about which they have insufficient knowledge and understanding. Association would not be valued by users and is a danger to the ethical principles of the auditor. Costs associated with that work would not, we suggest, be in the public interest. Therefore, it may be that certain information in the future should be dealt with in a separate assurance engagement.

The issue of other information is more obviously relevant to companies listed on major capital markets. We believe that reporting targeted at such entities should not be mandated for smaller entities. There will remain a



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necessity, for all audits, that the auditor's opinion on the financial statements is informed by scrutiny of the other information.

We call on the IAASB, therefore, to ensure that any changes to proposed ISA 720 are not to the detriment of smaller entities. To this end, despite any complication introduced by the changes, it should still be made easy to understand and meet the requirements of ISA 720 in circumstances with limited other information.

In Europe it is common for there to be statutory requirements affecting the auditor's responsibility for aspects of other information and we think that the application material could be improved in respect of such circumstances. We also recommend IAASB to mention in the introduction that it is possible that certain other information might be subject to a separate assurance engagement with corresponding responsibilities.

In Europe, also, many small companies are exempt from statutory audit. If a voluntary audit is commissioned, as we have already commented on other documents issued for consultation by the IAASB, it would be helpful if auditors could explain to users their expertise and capabilities, so that users appreciate the professionalism of the report. In relation to other information, it is particularly relevant to users that auditors are allowed to mention their obligations under professional ethics that address association with inappropriate information [paragraph 110.2 of the International Ethics Standards Board for Accountants "Code of Ethics for Professional Accountants"].

2. Do respondents agree that broadening the scope of the proposed ISA to include documents that accompany the audited financial statements and the auditor's report thereon is appropriate?

We agree that it is no longer appropriate to consider other information only if it is in the document containing the audited financial statements. Information that users may read together with the audited financial statements may arrive with them in documents that accompany the annual report and indeed it is often difficult to establish what is or is not the annual report, especially when presented on a website.

In practice, auditors will consider drafts of information that they expect to be finalised and issued with the intention that users of the audited financial statements will refer to it in that context. We agree that for practical reasons some sort of cut-off point in time must be adopted but we also believe that a similar cut-off must be applied to information that is not within the auditors understanding. This is for two reasons: firstly, users will not expect the auditor to know about such information and will not value their views on it as they are not experts in the subject matter and secondly, auditors should not contemplate holding themselves as capable of forming views in relation to subject matter when they know that their expertise does not extend to that. This matter is one of professional ethics and is referenced in other standards of IAASB.

It may well be that proposed ISA 720, by referring to documents, could introduce a considerable expectation gap and it should be clear that the auditor considered the other information for consistency only on the basis of his understanding of that other information in relation to the financial statements. It is, in our view necessary and right to exclude information that is beyond the ordinary knowledge and experience of the auditor to ensure that when defining documents, and definition can include individual sub documents within an overall document so as to allow exclusion of information that the auditor does not possess sufficient knowledge and experience of. As the auditor is required to explain what documents have been examined then this will provide good transparency for users.



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3. Do respondents find the concept of initial release clear and understandable? In particular, is it clear that initial release may be different from the date the financial statements are issued as defined in ISA 560?

Although the concept of initial release is clear and understandable to auditors, it is not one that is readily communicated to users nor indeed do we believe that it is necessary to do so. Once users are informed of the particular other information that the auditor has read and considered in connection with the audited financial statements it is not necessary for them to also appreciate the concept of initial release. There are other criteria that determine the inclusion or exclusion of other information and these too need not be communicated to users.

As the inclusion of other information within the scope of the auditor's work is agreed with management, and is essentially a matter of auditor judgement, we suggest that there is, in fact, no need for this new concept of initial release. Instead, proposed ISA 720 could simply deal with the facts. The extant ISA dealing with subsequent events, to which proposed ISA 720 refers, should be considered for consequential amendment if this concept persists in the finalised ISA 720.

4. Do respondents agree that the limited circumstances in which a securities offering document would be in scope (e.g., initial release of the audited financial statements in an initial public offering) are appropriate or should securities offering documents simply be scoped out? If other information in a securities offering document is scoped into the requirements of the proposed ISA in these circumstances, would this be duplicating or conflicting with procedures the auditor may otherwise be required to perform pursuant to national requirements?

Because securities offering documents are rare in the SME sector, we have no strong views on this question. However, we would comment that the criteria for treating a document as other information, or not, should be clear enough that a bright line rule is not required for securities offering documents, or indeed for the other matter dealt with in paragraph 3 of proposed ISA 720; preliminary announcements. We suggest that guidance should be provided in the application material, as auditors will have to interpret many circumstances, such as may newly occur during the development of the use of social media by entities and indeed the emergence of other media.

As an example, albeit rare in the SME sphere, it may be of use to scope out Securities Offering Documents because the requirements for these are normally established by the relevant regulators and authorities when these documents are being prepared.

Objectives

5. Do respondents consider that the objectives of the proposed ISA are appropriate and clear? In particular:

- (a) Do respondents believe that the phrase “in light of the auditor’s understanding of the entity and its environment acquired during the audit” is understandable for the auditor? In particular, do the requirements and guidance in the proposed ISA help the auditor to understand what it means to read and consider in light of the auditor’s understanding of the entity and its environment acquired during the course of the audit?**
- (b) Do respondents believe it is clear that the auditor’s responsibilities include reading and considering the other information for consistency with the audited financial statements?**



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We do not agree that the objectives are clear and appropriate. Indeed, we believe that there is a considerable danger that the responsibility to address the consistency of audited financial statements with other information is being disguised. Users of the auditor's report should gain reassurance from the fact that the auditor has not only examined the financial statements but has also at least carefully read and considered the consistency of other information with the audited financial statements, else users may be faced with conflicting messages in an annual report.

Taken at face value, we believe auditors will understand the phrase "in light of the auditor's understanding of the entity and its environment acquired during the audit" (although we know that, in English, the definite article should be inserted between "in" and "light" except in American English).

Definition of an Inconsistency in the Other Information

6. Do respondents agree that the definitions of terms of “inconsistency” including the concept of omissions and “a material inconsistency in the other information” are appropriate?

We believe that the word inconsistency, especially when translated, will give rise to difficulties of interpretation. Inconsistency between the financial statements and other information is a well-understood circumstance. It was unnecessary to define the term for the purposes of extant ISA 720 as the word is used with its natural meaning throughout the other ISAs.

It is possible to use the term "inconsistency" in the manner proposed, but it is not immediately understandable and it is not a direct approach. As an illustration of an indirect approach: it would be perfectly feasible to change from discussing a "deficiency in internal control" to discussing an "inconsistency between the operation of internal control and the auditor's understanding of how control ought to operate". The first approach is direct, and it is what is used in ISAs generally; we believe that should act as a precedent for proposed ISA 720.

7. Do respondents believe that users of auditors' reports will understand that an inconsistency relates to an inaccuracy in the other information as described in (a) and (b) of the definition, based on reading and considering the other information in light of the auditor's understanding of the entity and its environment acquired during the course of the audit?

It would be easier for users of auditors' reports to understand that there was inaccuracy in the other information if that word (or a word such as "misstatement") was used, as this would not need any further consideration of what is meant by the word "inconsistency" in the particular ISA.

We think that defining the inconsistency in relation to the auditor's understanding of the entity and its environment is inappropriate because users do not know what that understanding is, and it is not, therefore, a suitable criterion against which to judge a statement by the auditor. The reference to acquiring the understanding during the course of the audit, is either unnecessary or is intended to limit in some way the validity of the auditor's statement. Given that proposed ISA 720 does not itself impose limitations on the auditor's procedures, and that the engagement partner is already required to take account of information received, for example from other engagements on the audited entity, we do not think that this wording is appropriate.



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Nature and Extent of Work Effort

8. Do respondents agree with the approach taken in the proposed ISA regarding the nature and extent of the auditor's work with respect to the other information? In particular:
- (a) Do respondents believe the principles-based approach for determining the extent of work the auditor is expected to undertake when reading and considering the other information is appropriate?
 - (b) Do respondents believe the categories of other information in paragraph A37 and the guidance for the nature and extent of the work effort for each category are appropriate?
 - (c) Do respondents agree that the work effort is at the expected level and does not extend the scope of the audit beyond that necessary for the auditor to express an opinion on the financial statements?

We agree that a principles-based approach is necessary for determining the extent of the auditor's work, because of the diversity of other information. While the categorisation of other information in the application material is helpful, we would not like this to be seen as a suggested audit approach as that is a matter for the audit firm to determine.

It seems unnecessary to create a category of directly reconcilable information when the extent of testing by reconciliation is dependent on the cost, feasibility and other factors (such as whether there is a statutory requirement) for such work. It should be noted that, in an SME environment, management may not have the expertise to provide the reconciliations envisaged.

As we have commented earlier, we are uncomfortable about the auditor being associated with information that is beyond the auditor's knowledge and understanding.

Regarding question 8(c), when there are changes to ISAs, they often "extend the scope of the audit" but that then constitutes "an ISA audit," as the audit expands to include them. If the question is intended to explore whether more information is read than has hitherto been the case, or indeed that the information is more than might yield changes to the financial statements, we would say that an expansion has occurred. Proposed ISA 720 creates the expectation, if not the actuality, that the auditor will have to extend work beyond that absolutely necessary in connection with the audit in order to make the statement envisaged.

9. Do respondents believe that the examples of qualitative and quantitative information included in the Appendix in the proposed ISA are helpful?

Yes.

Responding When the Auditor Identifies That the Audited Financial Statements may be Materially Misstated

10. Do respondents believe it is clear in the proposed requirements what the auditor's response should be if the auditor discovers that the auditor's prior understanding of the entity and its environment acquired during the audit was incorrect or incomplete?

Yes.



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Reporting

11. With respect to reporting:

- (a) Do respondents believe that the terminology (in particular, “read and consider,” “in light of our understanding of the entity and its environment acquired during our audit,” and “material inconsistencies”) used in the statement to be included in the auditor’s report under the proposed ISA is clear and understandable for users of the auditor’s report?**
- (b) Do respondents believe it is clear that the conclusion that states “no audit opinion or review conclusion” properly conveys that there is no assurance being expressed with respect to the other information?**

Although users are likely to form some understanding of the terminology used in the statement, there are considerable technical issues about the nature of materiality in this context and to what extent the wording about "is required during our audit" limits the auditor's work. On balance, we would prefer to avoid reference to the fact that read and consider is only in the light of the auditor's understanding of the entity and its environment acquired during the audit. This would allow the statement to be referenced to "material misstatement," as that is really what is being investigated, rather than some comparison between the other information and the knowledge of the auditor, to which users have no access.

We find inclusion of the statement concerning absence of an audit opinion or review conclusion unnecessary. There is no separate engagement taking place, the statement made is merely part of the audit.

12. Do respondents believe that the level of assurance being provided with respect to other information is appropriate? If not, what type of engagement would provide such assurance?

The level of assurance is appropriate as it would not be feasible to extend reasonable assurance to all other information. As we have noted earlier, the auditor does not have sufficient knowledge of some of the other information to do that and it is unlikely that entities will be prepared to pay for such assurance. It may well be that, particularly in the case of a voluntary audit, reference by the auditor to the obligations under professional ethics to avoid association with misleading information will provide users with a better understanding than the simple wording proposed for the auditor's statement in relation to other information. As currently proposed we think the proposed ISA 720 wording would tend to increase the expectation gap. Currently there is a danger that users will believe that assurance is being provided.

If the responsibilities towards other information are constrained to those of which the auditor has appropriate understanding, it would be feasible to consider engagements of the nature of: limited assurance, or compilation, or agreed-upon procedures. It would be for the market to decide if any of these engagements met user needs.



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Other comments

The IAASB is seeks general comments on the:

- (a) Preparers (including Small- and Medium-Sized Entities (SMEs)), and users (including Regulators)—The IAASB invites comments on the proposed ISA from preparers (particularly with respect to the practical impacts of the proposed ISA), and users (particularly with respect to the reporting aspects of the proposed ISA).
- (b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposed ISA, in particular, on any foreseeable difficulties in applying it in a developing nation environment.
- (c) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed ISA.
- (d) Effective Date—Recognizing that the proposed ISA is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be 12–15 months after issuance of the final standard. Earlier application would be permitted. The IAASB welcomes comment on whether this would provide a sufficient period to support effective implementation of the ISA.

As explained in our earlier comments, EFAA has developed this response from the perspective of preparers and users in the SME sector. We also inform the IAASB that many of our members use the ISAs translated into their language and we would comment on potential translation issues as follows:

Partly because of the need to allow for translation and also to allow sufficient time to implement the final ISA 720 we would favour an effective date that is sufficiently long to accommodate these needs. We appreciate, however, that there is a need to implement the changes in step with those that may arise in relation to auditor reporting general. The developments in the revised ISA 700 relating to auditor's reporting are also relevant for the revised ISA 720. Auditor commentary might include commentary regarding other information. Therefore we recommend that IAASB publish the revised ISA 720 in conjunction with the revised ISA 700.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Federico Diomeda

Chief Executive Officer