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Dear Ms Healy

Exposure Draft – ISA 720 (April 2014) Revised

The Financial Reporting Council (FRC) welcomes the opportunity to comment on proposed ISA 720 (Revised) (April 2014), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and The Auditor's Report Thereon* ('proposed standard').

Overall, conditional on our recommendations set out below, we are very supportive of the changes made to the proposed standard since the exposure draft of ISA 720 (Revised) in November 2012. Subject to refinement and clarifications as determined through due process, we strongly encourage the IAASB to finalise this standard urgently.

As requested in the explanatory memorandum accompanying the proposed standard, we have provided responses to specific questions posed below.

1. *Question 1 Whether, in your view, the stated objectives, the scope and definitions, and the requirements addressing the auditor's work effort (together with related introductory, application and other explanatory material) in the proposed ISA adequately describe and set forth appropriate responsibilities for the auditor in relation to other information.*

Requirements addressing the auditor's work effort

We understand from the explanatory memorandum that respondents were concerned that the proposed work effort was ambiguous as to the nature and extent of work to be performed on the other information. However, the IAASB received significant support to 'raise the bar' in respect of the auditor's work effort. The IAASB has introduced new requirements and application material in order to make the auditor's work effort clearer and more understandable.

In principle we support the introduction of the new requirements in paragraphs 14 and 15 and the related enhanced application material that clarify the auditor's responsibilities with respect to other information. However, we believe the requirements, as drafted, are still not sufficiently clear as to the extent and nature of the work effort required and should be enhanced in three areas as follows:

- (a) *The requirements in paragraphs 14(a) and (b) should be described in terms of performance outcomes.*

The requirements in paragraphs 14(a) and (b) should be described in terms of outcome, otherwise there is insufficient context intended for the auditor's judgment as to the appropriate nature and extent of procedures that should be performed as a basis for the consideration of the other information (accepting that paragraph 15 does address this in part for paragraph 14(a)).

The requirements in paragraph 16 are conditional on the auditor having identified that a material inconsistency may exist. Consistent with that requirement, paragraph 14(a) and 14(b) should begin: "The auditor shall read and consider the other information in order to identify whether there is a material inconsistency..."

This form of requirement is already familiar to auditors as extant ISA 720 paragraph 6 requires the auditor to "read the other information to identify inconsistencies..." Making this amendment would also give the auditor an appropriate context for determining the nature and extent of procedures to apply in meeting the required outcome. We therefore suggest that the IAASB rephrase the requirement in terms of the outcome to "identify" inconsistencies.

- (b) *The modifier 'limited' in paragraph 15 in relation to procedures the auditor is required to perform should be removed.*

Currently the modifier could suggest that the auditors' work effort should be restricted. Other modifiers the IAASB considered and rejected, such as "certain" and "specified", also imply that the auditor is required to perform exact procedures and nothing more.

In fact, as any modifier is likely to imply that an auditors' work effort is controlled in some manner, it would be much clearer and more understandable if the modifier "limited" was removed. The paragraph would simply state that "the auditor shall perform procedures to evaluate the consistency between the amounts or other items in the other information that are intended to be the same..."

We are not suggesting that the auditor should be required to do an exhaustive consistency check but instead should carry out such procedures as they judge are necessary to achieve the required outcome. Indeed the application material in paragraph A24 gives the auditor guidance on applying professional judgment when determining the most appropriate procedures in the circumstances. If the IAASB is concerned that A24 is not sufficient to prevent the auditor from performing an exhaustive consistency check, additional application material could be drafted to clarify that the auditor is not required to do so.

- (c) *Paragraph 15 should be extended to also address the evaluation of consistencies between the other information and the auditor's knowledge.*

Currently paragraph 15 requires that as a basis for the consideration required for paragraph 14(a) the auditor 'shall perform limited procedures to evaluate the consistency between the amounts or other items in the other information that are intended to be the same...as the financial statements'. We strongly support such a requirement as it helps to clarify the work effort that the auditor should undertake in achieving the objectives of the proposed standard.

However, it is not clear why paragraph 15 does not require the auditor to perform procedures as necessary to evaluate the consistency of the amounts or other items in the other information with the auditor's knowledge obtained during the course of the audit as a basis for the consideration required by paragraph 14(b).

In fact, the application material in paragraphs A30 to A32 describes situations when the auditor would carry out procedures to evaluate the consistency of the amounts or other items in the other information with the auditor's knowledge obtained during the course of the audit. For example, the auditor may need to look back at audit documentation to recall a discussion held with management on a matter identified in the other information. Given the requirement in paragraph 15, it is evident that performing such consistency checks (procedures) is not in and of itself the "consideration" required by paragraph 14(a), but supports it. A similar requirement is needed in relation to paragraph 14(b) to clarify that performing consistency checks (procedures) is not optional when such consideration cannot be achieved without doing so. It does not seem appropriate to have important application material (A30 – A32) without a corresponding requirement.

We recognise that the IAASB may not be proposing to introduce a corresponding requirement because it is not always necessary or practicable for the auditor to reference every matter the auditor recalls from their knowledge back to audit documentation. Consistent with the application material in paragraphs A30 to A32 it is not necessary for the auditor to carry out such procedures if their recollection of a matter is sufficient for the purpose of meeting the "consider" requirement.

Accordingly, a corresponding requirement to evaluate consistencies should be included in the proposed standard, but this could be phrased in such a manner that it is "to the extent necessary" to make the required consideration.

Our suggestions for editorial changes to give effect to these enhancements, including consequential amendments to paragraph 14(c), are included in Appendix 1.

The auditor's knowledge obtained during the course of the audit

We understand the rationale for changing the wording in paragraph 11 of the previous exposure draft from "*in light of the auditor's understanding of the entity and its environment acquired during the audit*" to "*auditor's knowledge obtained during the course of the audit*" in paragraph 14(b) to clarify that the knowledge referred to does not extend to all knowledge of the audit firm.

As set out in our response to the exposure draft of ISA 720 (Revised November 2012) in April 2013, clarification of who is the auditor is particularly important when identifying who is required to "read and consider" the other information. The IAASB's glossary of terms defines the "auditor" as the "person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm." It is important therefore for the ISA to clarify that the auditor is not required to have knowledge of matters identified in other engagements being performed by the firm, beyond that which is required to be taken into account in understanding the audited entity and its environment in accordance with ISA 315¹. Paragraphs 8 and 9 of ISA 315 discuss the extent to which the auditor should take into account knowledge from previous experience with the entity, including knowledge from previous audits.

¹ ISA 315 Identifying And Assessing The Risks Of Material Misstatement Through Understanding The Entity And Its Environment

However the new wording proposed does still not communicate clearly that the auditor's obligation does not extend to knowledge of matters identified in all other engagements performed by the firm. This is because the "auditor's knowledge" includes the "firm's knowledge" and "obtained during the course of the audit" may be read as referring to a time period rather than the activity undertaken in the performance of the audit.

Accordingly we propose that the IAASB consider changing the requirement in 14(b) as follows:
"...Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained ~~during the course of~~ in the performance of the audit; and..."
This amendment would also require a corresponding change to a number of other paragraphs and headings, including the objective in paragraph 11(b).

The engagement partner should read and consider the other information

Paragraph A21 of the proposed standard indicates factors that the engagement partner may take into account when determining the appropriate individuals to read and consider the other information, but does not emphasise that the engagement partner should also read the other information.

We support the application material but as explained in our response letter in April 2013, as the overarching role served by the engagement partner on an audit is of such importance, the engagement partner should read the other information as well as delegating this activity, as appropriate, to other members of the engagement team. In addition, given the importance of the annual report to stakeholders, they may rightly assume that the engagement partner would have read all the other information before signing the audit report.

We appreciate that in certain circumstances, it will not be necessary or practical for the engagement partner to read all the other information in each audit, in particular when text is repeated from earlier years or repeated in the other information associated with more than one set of audited financial statements (for example, those of a number of subsidiaries of the same parent entity). The IAASB could extend the guidance in the application material to explain that the requirement for the engagement partner to read the other information could be met in those circumstances by reading the base information once as well as any variations identified by an appropriate member of the engagement team.

Our preference is for this responsibility to be achieved through an additional requirement in paragraph 14, but alternatively the IAASB may be able to address this through application material.

Our suggestions for editorial changes to the requirement or application material in this regard is included in Appendix 1.

2. *Question 2 Whether, in your view, the proposals in the ISA are capable of being consistently interpreted and applied.*

Subject to our comments set out in our response to questions 1, 3 and 4, the proposals in the ISA are capable of being consistently interpreted and applied.

3. *Question 3 Whether, in your view, the proposed auditor reporting requirements result in effective communication to users about the auditor's work relating to other information*

Notwithstanding our comment set out in the response to Question 4 (regarding the decision of the IAASB not to include a requirement for the auditor to identify, in the auditor's report, other

information that has not been obtained at the date of the auditor report), we agree that the proposed auditor reporting requirement would result in more effective communication to users about the auditor's work relating to other information than under extant ISA 720.

4. Question 4 Whether you agree with the IAASB's conclusion to require the auditor to read and consider other information only obtained after the date of the auditor's report, but not to require identification of such other information in the auditor's report or subsequent reporting on such other information.

We do not agree with the IAASB's conclusion in this respect. The proposed standard extends the auditor's responsibility to read and consider other information (as determined in accordance with paragraph 13) obtained after the date of the auditor's report, but requires neither identification of such other information in the auditor's report nor transparency about the actions the auditor would be able to take if the auditor were subsequently to determine that there is a material misstatement of that other information.

Taking the first point regarding the identification of such other information, we understand that the IAASB decided not to pursue this because, among other things, a reference in the auditor's report to the auditor's future actions would be inconsistent with the auditor's report focus on actions the auditor has taken up to the date of the auditor's report. We do not share these concerns. We believe that considerable benefit would accrue to stakeholders from the identification of such other information.

It is important to communicate the scope of the other information to which the auditor's responsibilities and their work effort extend as clearly as possible in the auditor's report. This is because identifying other information that is planned to be issued (and therefore obtained by the auditor) after date in the auditor's report will enhance transparency about the nature and extent of the auditor's responsibilities for such other information. Stakeholders will understand what other information the auditor reviewed or expects to review after the date of the auditor's report. This will also make the auditor's determination of documents comprising the other information, as required by paragraph 13, wholly transparent to stakeholders. In addition, if certain documents were not available to be read as of the date of the auditor's report this fact would also be made transparent to stakeholders.

Regarding the second point, we understand the IAASB considered, but subsequently rejected a requirement for the auditor to re-issue or amend the auditor's report to enable reporting on such other information received after the date of the auditor's report, due to potential conflicts with law and regulation. We agree with this conclusion. However, as set out in the application material, the auditor may have a number of possible actions that could be taken when the other information is not corrected, some of which would not conflict with law or regulation. In our view, stakeholders would value understanding exactly what actions are available to the auditor in those circumstances. At the very least this transparency helps stakeholders understand any limitations on the auditor's ability to take action beyond communicating the matters to those charged with governance, and that the auditor will take some action, even if only to communicate in that way.

Accordingly we strongly suggest the IAASB enhance the requirements in paragraph 21 "Reporting" to address these two matters. In relation to the first point we recommend that the IAASB include a requirement to the effect that, in the event certain documents determined by the auditor to comprise other information in accordance with paragraph 13(a) are not available as at the date of the auditor's report, the auditor shall identify these documents in the auditor's report. Regarding the second point, we recommend that the IAASB include a requirement that when other information is expected to be received after the date of the auditor's report, the

auditor shall describe, as part of the auditor's responsibilities, the actions the auditor can take consistent with law and regulations if the auditor determines that a material misstatement of other information exists.

Our suggestions for editorial changes in this regard are included in Appendix 1.

Signing the auditor's report before all other information has been received

As highlighted in the explanatory memorandum, the IAASB did not support a requirement that the auditor should withhold the release of the auditor's report until all other information had been received.

It is in the public interest for management to be encouraged to release other information to stakeholders on a timely basis. For that reason some stakeholders believe that the auditor should not sign the auditors' report until all the other information has been approved by management and those charged with governance, and the auditor has been able to achieve the objectives set out in the proposed standard.

We have some sympathy with this view as such a requirement would provide management and those charged with governance with an additional incentive to enhance their corporate reporting processes and continue to demonstrate good corporate governance. Equally, we recognise that in some jurisdictions national law, regulations and market practice may require or encourage earlier issuance of the financial statements and auditor's report thereon, along with only some or none of the annual report. For this reason we accept the IAASB's conclusion that it isn't practical to require the auditor to withhold the release of the auditor's report in all circumstances.

However, to reinforce the importance of high quality corporate governance and reporting the IAASB could make a conforming amendment to ISA 700² that restricts the ability of the auditor to sign their report unless they are otherwise precluded by law or regulation from withholding their report, as follows:

ISA 700.47A Unless precluded by law or regulation, the auditor shall not sign, and hence date, the auditor's report earlier than the date on which all other information has been approved by those charged with governance.

Other Matters

Supplementary information presented with the financial statements

Paragraph A6 of the proposed standard explains that in some cases, the applicable financial reporting framework may require specific disclosures but permit them to be located outside of the financial statements. As the disclosures are required by the applicable financial reporting framework, then they form part of the financial statements and do not represent other information as defined in the proposed standard. We agree with the conclusion of the IAASB in this regard.

We propose that, for the purpose of clarification, paragraph A6 should be extended to include guidance that explains situations where supplementary information does not represent other information. In accordance with ISA 700 supplementary information that is not required by the

² Proposed ISA 700 (Revised) Forming an Opinion and Reporting on Financial Statements

applicable financial reporting framework, but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented, is covered by the auditor's opinion. Therefore, in our view it should be considered part of the financial statements and as such does not represent other information. Equally, unaudited supplementary information falls within the definition of other information contained in the proposed standard.

Our recommendation for editorial changes to the application material in this regard is included in Appendix 1.

Yours sincerely



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Director of the FRC and Chairman of the FRC's Audit & Assurance Council

Enquires in relation to this letter should be directed to Marek Grabowski, Director of Audit Policy

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APPENDIX 1

We have included our comments by paragraph. Within our recommendations for editorial changes, additions are noted in “underline” and deletions in “strike-through.”

Editorial proposals in respect of responses to questions 1 to 4

Paragraph	Text
14	<p>Reading and Considering the Other Information</p> <p>14. The auditor shall read <u>and consider</u> the other information <u>in order to identify and, in doing so shall:</u> (Ref: Para. A20–A21)</p> <p>(a) Consider Whether there is a material inconsistency between the other information and the financial statements; and (Ref: Para. A22–A26)</p> <p>(b) Consider Whether there is a material inconsistency between the other information and the auditor's knowledge obtained [during the course] of the audit; and (Ref: Para. A27–A32).</p> <p>MOVE AFTER PARAGRAPH 15: 15A <u>The auditor shall</u> remain alert for other indications that the other information appears to be materially misstated. (Ref: Para. A33)</p>
15	<p>15. As the basis for the consideration in paragraph 14: (a)</p> <p><u>15(a) The auditor shall perform limited procedures to evaluate the consistency between the amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements, with such amounts or other items in the financial statements; and (Ref: Para. A22–A26)</u></p> <p><u>15(b) To the extent necessary, the auditor shall perform procedures to evaluate the consistency of amounts or other items in the other information with the auditor's knowledge obtained [during the course] of the audit. (Ref: Para. A27–A32)</u></p>
A23	<p>A23. The following are examples of limited procedures that the auditor may choose to perform to evaluate the consistency between amounts or other items in the other information that are intended to be the same as, to summarize...</p>
14 and A21	<p>The responsibilities of the engagement partner to read and consider other information</p> <p>14. The auditor shall...<u>(a)...(b)...; and in doing so, the engagement partner shall read the other information</u></p> <p>A21. In accordance with ISA 220, the engagement partner is required to take responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements. In the context of this ISA, factors that may be taken into account when determining the appropriate individuals to address the requirements of paragraph 14–15, include:</p> <ul style="list-style-type: none"> • The relative experience of engagement team members.

Paragraph	Text
	<ul style="list-style-type: none"> • Whether the individuals to be assigned the tasks have the relevant knowledge obtained during the course of the audit to identify inconsistencies between the other information and that knowledge. • The degree of judgment involved in addressing the requirements of paragraph 14–15. For example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced members of the engagement team. • Whether, in the case of a group audit, it is necessary to engage the assistance of a component auditor in addressing the other information related to that component. <p><u>In addition, it may be important for the engagement partner to read the other information in order to leverage their experience and insight.</u></p>
21, A47, new A49a and 19	<p>Reporting Implications of Other Information obtained after the Date of the Auditor's report</p> <p>21. <u>Unless the auditor has determined in accordance with paragraph 13(a) that there are no documents that comprise the annual report, When the auditor has obtained the final version of all or part of the other information prior to the date of the auditor's report, the auditor shall include a separate section under the heading "Other Information" or another title if appropriate, in the auditor's report comprising the following matters:</u> (Ref: Para.A47)</p> <p>(a) Identification of the other information obtained by the auditor prior to the date of the auditor's report <u>and, where relevant, identification of the other information not obtained by the auditor prior to the date of the auditor's report...</u></p> <p>A47. When the auditor has determined in accordance with paragraph 13(a) that there are no documents that comprise the annual report <u>not obtained the final version of all of the other information prior to the date of the auditor's report</u> this ISA does not require the auditor to include a section in the auditor's report addressing other information.</p> <p><u>Illustrative Statement When the Auditor Has Received Part but not All of the Other Information by the Date of the Auditor's Report and Has Not Identified a Material Misstatement of the Other Information</u></p> <p><u>A49a. The following is an example of a statement in the auditor's report when the auditor has not obtained the final version of all or only part of the other information by the date of the auditor's report.</u></p> <p style="padding-left: 40px;"><u>Other Information [or another title if appropriate such as "Information other than the financial statements and auditor's report thereon"]</u></p> <p style="padding-left: 40px;"><u>The other information obtained at the date of this auditor's report is the [/Information included in the X report, other than the financial statements and the auditor's report thereon.]</u></p> <p style="padding-left: 40px;"><u>The other information expected to be issued after the date of this auditor's report is [/describe other information not obtained at the date of the auditor's report as determined in accordance with paragraph 13(a)]</u></p> <p style="padding-left: 40px;"><u>We have not audited the other information and do not express an opinion or any form</u></p>

Paragraph	Text
	<p>of assurance conclusion thereon</p> <p><u>Our responsibility is to read the other information and to consider whether there is a material inconsistency between that information and the financial statements, or our knowledge obtained during the course of the audit. In reading the other information, our responsibility is also to remain alert for other indications that the other information appears to be materially misstated. If we determine that the other information obtained prior to the date of the auditor's report is materially misstated, we are required to report that fact. We have nothing to report in this regard.</u></p> <p><u>If we determine that the other information expected to be obtained after the date of the auditor's report is materially misstated, we will [describe actions the auditor can take (see also paragraph A45)].</u></p>
19	<p>(c) A description of the auditor's responsibilities with respect to the other information, <u>including a description of the actions the auditor can take if the auditor determines that a material misstatement exists in other information obtained after the date of the auditor's report.</u></p>
A6	<p>Supplementary information presented with the financial statements</p> <p>A6 In some cases, the applicable financial reporting framework may require specific disclosures....Accordingly they do not constitute other information for the purpose of this ISA.</p> <p><u>A6a In some circumstances, the entity may be required by law, regulation or national auditing standards, or may voluntarily choose to present, in the annual report, supplementary information that is not required by the applicable financial reporting framework. ISA 700 explains that the auditor's opinion covers supplementary information that is an integral part of the financial statements. Supplementary information is an integral part of the financial statements when it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented. Supplementary information that is determined to be an integral part of the financial statements in accordance with paragraph XX of ISA 700 does not constitute other information for the purpose of this ISA. Unaudited supplementary information included in the annual report falls within the definition of other information contained in this ISA.</u></p>