

4 July 2014

Mr. James Gunn
Technical Director
International Auditing and Assurance Standards
Board
529 Fifth Avenue, 6th Floor
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by electronic submission through the IAASB website

Dear James,

494/584

Proposed International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, Proposed Consequential and Conforming Amendments to Other ISAs

We would like to thank you for the opportunity to provide the International Auditing and Assurance Standards Board (IAASB) with our comments on the above-noted Exposure Draft (hereinafter referred to as "the draft"). Other than the general comments below, we have chosen to provide the details of our concerns and the arguments supporting them in the Appendix to this letter, which contains our response to the Questions posed in the Explanatory Memorandum.

In general, we are very pleased to see that the IAASB has taken on board our comments from our previous comment letter dated March 20, 2013 on the Exposure Draft of ISA 720 in relation to the consistent application of the clarity conventions, and we note the improved drafting in this respect. We are also particularly pleased that, as suggested by our previous comment letter, the IAASB sought to rethink the purpose of ISA 720, which has pervasive implications for the objectives, definitions, requirements and application material in the draft, and as we predicted would be necessary, that the IAASB has chosen to re-expose the draft to obtain input on the fundamental changes since the last draft.

We also welcome the clarification that the purpose of the standard is not for the auditor to obtain assurance on „other information“. As we had pointed out previously, this is not the purpose of this standard, but a matter that should be addressed in law or regulation or in a separate engagement (i.e., it is not the responsibility of the IAASB to require assurance on „other information“ as a part

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of an audit of the financial statements). Furthermore, we are pleased to see that the requirement in paragraph 16 that deals with the auditor's responsibilities to react to identified indications of problems has been rationalized to recognize that there are three possible determinations that are not mutually exclusive (the problem is in the other information, in the financial statements or in the auditor's knowledge). We are also pleased that the draft now attempts to align the work effort with the objectives.

That being said, we still have some serious concerns with the draft that we believe the IAASB needs to address. First, the clarification that the purpose is not for the auditor to obtain assurance, or provide comfort, on the other information is not reflected in every respect of the introductory section of the draft or in the key definitions. Second, we have identified a number of what we consider to be serious issues with the definitions. Getting the definitions right is "half the battle" in standards setting, since these definitions delineate the scope and purpose of the standard and the nature and extent of work effort. In this respect, the IAASB should ensure that its use of words is consistent with that in other ISAs and IAASB pronouncements, which is currently not the case in the draft. Third, we are concerned that the work-effort related requirements confuse what is required for the initial work effort versus what is part of the response to the results of the initial work effort. Fourth, we take the view that for ISA 720, the objectives should be a succinct statement of purpose, rather than an inaccurate restatement of the requirements. Finally, because the purpose of reporting on other information is to provide transparency to users, rather than provide comfort on the other information, we have come to the conclusion that auditors should not be responsible for information received after the date of the auditor's report, and that therefore auditors should explicitly disclaim in the auditor's report their responsibility for such information. Without resolving these issues, we believe that auditors and audit regulators will have difficulties in applying the standard consistently and that the wording used may increase the expectations gap.

We would be pleased to discuss the contents of this letter with you at your convenience.

Yours faithfully,



Klaus-Peter Feld
Executive Director



Wolfgang Böhm
Director Assurance Standards,
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APPENDIX:

Responses to the Questions Posed in the Explanatory Memorandum

Questions 1 and 2

The major issues in these interrelated questions are addressed together. Our response addresses ISA 720's purpose, the definitions, requirements and objectives. Relevant application material is addressed when applicable, but not all changes to it that would result from our comments are addressed.

a) Purpose of ISA 720

We are pleased that paragraph 8 of the draft states that the standard does not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information, and that paragraph 2 states that the auditor's opinion on the financial statements does not cover the other information, nor does the ISA require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements. We also agree with the part of the first sentence of paragraph 3 of the draft that states that the ISA requires the auditor to read and consider other information because such other information "may undermine the credibility of the financial statements and the auditor's report thereon", and with paragraph 4 of the draft that essentially states that the ISA may also assist the auditor in complying with relevant ethical requirements to avoid being knowingly associated with information the auditor believes is "misleading". These assertions clarify that it is not the purpose of ISA 720 to provide comfort about the other information to users for the purpose of enhancing the credibility of that information to help users make economic decisions.

However, the last sentence of paragraph 3 of the draft directly contradicts these assertions by stating that "such misstatements may also inappropriately influence the economic decisions of users for whom the auditor's report is prepared". This sentence signifies that the IAASB has not achieved consensus about the purpose of ISA 720: some apparently continue to believe that the purpose of ISA 720 is also to provide comfort to users about other information to help them make economic decisions. This inherent contradiction in the draft has resulted in definitions that serve the objective of providing comfort to users about other information to help them make economic decisions, rather than to serve the

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objectives noted in the preceding paragraph above, which in turn affects the scope of ISA 720 and the work effort that it requires.

b) Problems with the Definitions

(i) Definition of Annual Report

General Problems with Definition of Annual Report and Open-Ended Qualifiers

Paragraph 10 in the Explanatory Memorandum states that the IAASB believes that the concept of an annual report is well understood in most jurisdictions and that therefore the definition in the proposed standard should be capable of being easily applied. This is an inherent contradiction: if the concept of an annual report is well understood in most jurisdictions, then no definition is required. The inclusion of a definition shows that there is no common understanding of what an annual report is. Hence, a clear definition delineating an annual report from other reports or documents is needed to clarify the scope of ISA 720.

The definition of “annual report” does not fulfill the prerequisites for being a definition – a concise description, which stands on its own without examples, of only those characteristics needed to distinguish the matter being described from other matters. Examples in the application material should serve to help clarify the concept to readers, but not add or subtract from the meaning in the definition. Open-ended qualifying words in the definition such as “typically” or “usually” do not serve the clarity of a definition because these words mean that the characteristics being described after these qualifiers are not distinguishing characteristics of the matter being defined.

Auditors will have difficulty in practice in determining whether a document is an annual report as defined due to the words “typically” and “usually” in the definition. The inclusion in the definition of these words and the phrases they qualify seems to relate to the view that these phrases should be in the definition because auditors deal with annual reports in an audit of the financial statements to provide comfort to users in making economic decisions in relation to these matters. However, as we posit above, it is not the purpose of ISA 720 to attend to user needs in this respect: hence these matters need not be in the definition. However, it may be helpful to include these matters in application material to describe what annual reports often include.

For Whom Annual Reports are Prepared

The definition in the first sentence of paragraph 12 (a) states that the purpose of the annual report is to provide “owners (or similar stakeholders)” with certain information. In the EU, general purpose financial statements of business corporations are required to be filed with the Commercial Register. Unlike under

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English law, in many continental EU jurisdictions, including Germany, the law also specifies that the “intended users” of these financial statements and the management report (which is supposedly other information) are directed towards a wide range of users beyond just owners and similar stakeholders, including creditors, suppliers, customers, employees and their representatives, tax authorities, etc. By restricting, in the definition, those for whom the annual report is prepared to owners (or similar stakeholders), the management report in these jurisdictions would not qualify as an “annual report” as defined because the “intended users” are not only owners or similar stakeholders. This cannot have been intention of the IAASB. For these reasons, we recommend that the term “owners (or similar stakeholders)” be changed to “intended users”, which is a term used throughout the ISAs and, in particular, in ISAs 200 and 700.

Furthermore, the first sentence in paragraph A3 in the application material to the definition excludes annual reports prepared to meet the information needs of a specific stakeholder group or prepared to comply with a specific reporting objective. This contradicts the definition because “owners (or similar stakeholders)” are a specific stakeholder group. Changing the term in the definition to “intended users” as suggested above would alleviate this problem. Extant ISA 720 also applies to audits of special purpose financial statements under ISA 800, where the intended users may be a specific group. There are cases, for example, in Germany in which civil partnerships prepare only tax basis financial statements for their users together with some form of “annual report”, or in other jurisdictions (such as the U.S.), cases in which limited partnerships prepare only tax basis financial statements for their users together with some form of “annual report”. When these special purpose financial statements are audited, the IAASB presumably intends that these accompanying “annual reports” be covered, as they were under extant ISA 720. If so, then the application material in the first sentence of paragraph A3 requires amendment so as to not exclude annual reports in relation to audits of special purpose financial statements.

The reference to “owners (or similar stakeholders)” results from the erroneous view that ISA 720 serves to help these owners or similar stakeholders make economic decisions. Once it is clear that this is not the purpose of ISA 720, then there is no barrier to broadening the definition to encompass all intended users of the financial statements and “annual report”.

Conclusion

The following suggested simpler definition alleviates our concerns: it reduces the annual report to its distinguishing characteristics and, in particular, to its

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connection to the provision of explanations about matters presented in the financial statements:

“Annual report – A document, or combination of documents, that contains or accompanies the audited financial statements, and is prepared by management or those charged with governance in accordance with law, regulation or custom, to provide intended users of the financial statements with additional information about the entity’s financial performance, financial position or changes therein presented in the audited financial statements.”

(ii) The Term, and Definition of, Misstatement of the Other Information

Problems with the Use of the Term “Misstatement of the Other Information”

The term “misstatement” is defined in ISA 450.4 (a) in terms of departures from the financial reporting framework, in ISAE 3000.12 (a) in terms of departures from the applicable criteria, and in terms of a departure from “facts” in the term “material misstatement fact” in extant ISA 720.5(c). As a result, the term “misstatement” makes sense in relation to departures from facts, suitable criteria, or a framework, but it does not make sense when referring to information that is otherwise misleading without reference to facts, criteria, or a framework. This differentiation between “misstatement” and “misleading” is in line with ISA 700.19, which implicitly clarifies that misleading financial statements prepared in accordance with a compliance framework are not necessarily misstated, because otherwise ISA 700.19 would have required a modified opinion, rather than leaving it open as to if and how to communicate the misleading matter. In addition, ISRS 4410.34 (b) and (c) distinguish between material misstatements and information that is otherwise misleading, as do ISAE 3000.12 (a) and ISAE 3000.A50. Annual reports, and in particular the information in the “glossies” beyond the MD&A or management report, often include what jurisprudence would classify as “puff”, which cannot be subjected to a determination of departure from facts or criteria, but only as to whether or not such information is “misleading”.

In contrast the term “misstatement of the other information” in the draft includes not only matters that are material misstatements of fact, but also matters that are otherwise misleading, which are related neither to facts nor a departure from a framework or criteria. Consequently, by using the term “material misstatement” to refer to information that is otherwise misleading, IAASB standards would be inconsistent in their use of the term “misstatement” and “misleading”. The use of the term “material misstatement” for information in annual reports not anchored in facts or criteria blurs the distinction between providing comfort or assurance to users on whether the other information is materially “misstated” to help users make economic decisions, with which we disagree, and safeguarding the

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credibility of the audited financial statements and the auditor's report or assist in complying with relevant ethical requirements, as posited above.

We are aware that the recently issued EU Accounting Directive requires the following in relation to the "management report":

"state whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, he, she or it has identified material misstatements in the management report, and shall give an indication of the nature of any such misstatements."

This applies only to the management report as defined in the EU for which it might be argued suitable criteria exist in EU legislation, national law or standards – it does not apply to all of the documents that would be considered an "annual report" as defined by the draft (or as proposed above) without suitable criteria, and therefore the use of "material misstatements" in the EU Directive should not form the basis for the wording used by an ISA that has worldwide application. It is also inappropriate to misuse ISA 720 to define a regulatory matter within the EU that may be subject to considerable discussion within the EU.

Based on these arguments, we conclude that the use of the term "misstatement of the other information" is inappropriate in the context of ISA 720 and should therefore not be used when referring to information that is otherwise misleading.

Problems with the Definition of "Misstatement of the Other Information"

In IAASB standards, the concept of "misleading" already includes the concept of materiality (see also the use of the term "misleading" in ISA 700.19 and ISAE 3000.A50, which presume that what is misleading is, by definition, material). This means that the wording of the definition of materiality in the second sentence of paragraph 12 (b) together with the reference to "misleading" in the first sentence leads to the concept of "materially misleading", which is an inherent redundancy.

Given this consideration and those described in the previous subsection above relating to the term "material misstatement of the other information", we recommend that when dealing with matters in the other information that are "materially incorrect" or otherwise misleading, that the phrase "the other information contains material misstatements of fact or is otherwise misleading" be used. Using such a phrase will not be unnecessarily cumbersome. It may be helpful to provide a definition of "misstatement of fact" and "otherwise misleading" by drawing on the words in the current definition in ISA 720 and drawing in part on the words that were applied in the first sentence of the definition in paragraph 12 (b) of the draft. This would align the definitions with their meaning in ISA 450.4 (a), 700.19, ISRS 4410.34 (b) and (c), and ISAE 3000 12 (a) and .A50:

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“Misstatement of fact – A factual matter is that incorrectly stated or presented.”

“Otherwise misleading – Other information is otherwise misleading when it leads users to draw inappropriate conclusions that undermine the credibility of documents comprising the annual report. This includes leading users to draw such inappropriate conclusions because information necessary for a proper understanding is omitted or obscured.”

This approach would have the added advantage of clarifying to auditors that a matter addressed in the latter definition is a new requirement (i.e., raising the bar), whereas the former definition was required in extant ISA 720.

Problems with the Application of the Concept of Materiality in the Definition

ISA 320 did not define materiality for financial statements because there are differing definitions in different financial reporting frameworks; some frameworks do not define materiality. Due to the latter case, the IAASB did choose to describe in general terms how materiality is described in many financial reporting frameworks. Law, regulation or court decisions in some jurisdictions define materiality in relation to documents within the scope of ISA 720 for the purposes of filings with securities regulators. Hence, it is not appropriate to define materiality in relation to these documents for the purposes of “misstatements”.

In addition defining materiality in relation to influence on economic decisions of users, as described in the draft, is not only inappropriate because it is not the purpose of ISA 720 to do so, defining materiality in relation to influencing the economic decisions of intended users also has two unhelpful practical consequences: 1. Sometimes the “materiality” threshold will be too low because, even though the economic decisions of users might be influenced, the matter would not undermine the credibility of the financial statements or the documents comprising the annual report (e.g., even though the economic decisions of users may be affected by differing presentations of certain information due to such factors as anchoring, it does not imply that these presentations undermine the credibility of the financial statements or the documents comprising the annual report); and 2. Sometimes the “materiality” threshold will be too high because even though the economic decisions of users might not be influenced, the matter may nevertheless affect the credibility of the financial statements or the annual report (e.g., obvious numerical discrepancies, between the financial statements and the other information, substantially more than rounding differences that do not affect users’ economic decisions, yet which might cause users to question either the credibility of the financial statements or the other information) or be otherwise “misleading” (e.g., matters included in the other information that substantially misrepresent or obscure matters, not related to economic decisions,

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that undermine the credibility of the financial statements or the documents comprising the annual report).

The phrase “recognizing that the other information is only part of the overall information available to users” in the last sentence of 12 (b) suggests that in considering materiality, the auditor needs to consider the content of information other than that in an annual report to determine whether a matter is material. These words in the definition represent an open-ended requirement to consider the impact of information outside of the annual report on the materiality of information inside the annual report. This phrase should therefore be deleted.

We recommend that ISA 720 not define materiality in relation to other information, and in particular, not define materiality in relation to the influence on the economic decisions of users. Rather, the application material should provide ample guidance on materiality for material misstatements of fact in the other information, since the definition we propose above for “otherwise misleading” already encompasses a materiality concept. The application material would explain that matters would be considered material if they either undermine the credibility of the audited financial statements and auditor’s report (for material inconsistencies) or if they undermine the credibility of documents comprising the “annual report” containing or accompanying the financial statements (for material misstatements of fact not related to the financial statements).

c) Issues with the Work-Effort Related Requirements

(i) Initial Work Effort vs. the Auditor’s Response to Problems

The distinction between the initial work effort and the response of the auditor, when the initial work indicates that problems exist, is important because, since the response requires the open-ended need to resolve issues identified, it is therefore the required initial work effort alone that determines that the auditor is required to do less than what would be necessary for an assurance engagement. Hence, we support the clear distinction in the draft between the requirements in paragraphs 14 and 15, on the one hand, and paragraphs 16 to 20, on the other hand. However, the connection between the requirements in paragraph 14 (a) and paragraph 15, and the distinction between paragraphs 14 (b) and (c), together with their related application material, suggests that the IAASB is not clearly distinguishing between initial work effort and the auditor’s response.

The Use, or Lack of Use, of the Verb “appears”

Paragraph 16 speaks of the auditor identifying a material inconsistency that “appears” to exist (or becomes aware of other information that “appears” to be misleading). This is correct because, due to the limited initial work effort pursuant

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to paragraphs 14 and 15, the auditor is not able to identify whether, in fact, a material inconsistency exists, or other information that appears “incorrect” is actually incorrect, but only whether these appear to exist or appear to be incorrect. Paragraph 14 (c), which also refers to whether the other information “appears” to be materially misleading, is also correct in this respect. In contrast, paragraph 14 (a) and (b) imply that, based on the limited procedures in paragraph 14 (a) and 15, and in 14 (b), the auditor shall consider whether a material inconsistency *exists*, which implies that the work effort in 14 (a) together with 15, and 14 (b), suffices to consider whether a material inconsistency, in fact, does exist. Such work effort does not suffice, because the auditor is not able to reach a decision based on this limited work effort on whether these exist, but only whether they appear to exist. Hence, in line with paragraph 14 (c) and paragraph 16, and to clearly distinguish the initial work effort from the response to the initial work, the word “appears” should be used within both paragraphs 14 (a) and (b).

Reference to “limited procedures”

Paragraph 15 requires “limited procedures” to “evaluate” the consistency between amounts or other items in the other information and the financial statements as a basis for the consideration in paragraph 14 (a). The term “limited procedures” without further specification and the wide range of possible procedures in the application material blurs the distinction between the initial work effort and the subsequent response. We recognize that the IAASB seeks to write principles-based standards without specifying the procedures required. However, principles-based standards without further specification of the procedures were designed by the IAASB for reasonable assurance and limited assurance engagements, which, under ISA 200, ISRE 2400, and ISAE 3000, involve having the practitioner achieve some notional assurance level. However, speaking of “limited procedures” without some notion of the comfort to be obtained is not principles-based – it is a void without any upper or lower bound on the nature and extent of procedures required. This void cannot be mitigated through application material that provides examples of procedures that “may” be applicable without defining their notional upper and lower bound, which can only be specified in a requirement. The list of possible procedures also extends the initial work effort to include the response to the initial work effort (e.g., the possible need to compare matters to working papers) as part of the initial work effort.

Providing a wide range of possible procedures in the application material (e.g., paragraph A30) without a conceptual boundary in the requirements pre-programs conflicts between audit regulators and the profession because audit regulators will point to procedures in the application material that they believe are necessary

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in the circumstances, whereas the profession will maintain that these are not required by the ISA. This void will ultimately be filled by audit regulators based on the application material. Ultimately, the IAASB will find itself under pressure from regulators to add procedures to the requirements in a few years. Having audit regulators fill such a void may not be an issue for jurisdictions in which auditing standards setting and audit oversight are the responsibility of one regulator, such as the FRC in the U.K., but this is a major issue for many jurisdictions in Continental Europe with a separation of powers between those responsible for promulgating standards and those enforcing them.

We conclude that ISA 720 needs to specify the nature of the required procedures, rather than simply referring to the void of “limited procedures” in the hope that the application material, rather than audit regulators, will fill that void.

Reference to “evaluate”

The term “evaluate” in paragraph 15 also blurs the distinction between the initial work effort and the auditor’s response to the results of the initial work effort. The IAASB Glossary of Terms defines “evaluate” as follows”:

“Identify and analyze the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. “Evaluation,” by convention, is used only in relation to a range of matters, including evidence, the results of procedures and effectiveness of management’s response to risk.”

The inclusion of “performing further procedures as necessary, to come to a specific conclusion on a matter” signifies that the word “evaluate” encompasses more than an initial work effort of “reading”, performing “limited procedures” and then “considering” the matter: “evaluate” includes the response to the initial work effort. Hence, the word “evaluate” for the initial work effort in paragraph 15 is inappropriate. It would therefore be preferable to specify the procedures required for the initial work effort, rather than to seek to use such terms as “evaluate”.

In our view, the appropriate phrase to describe the work effort is “compare, on a test basis, the other information with the audited financial statements”. The application material in paragraph A23 provides some guidance as to what “compare” may mean in different circumstances, and paragraph A24 explains how the auditor may determine the extent of testing. This approach would provide a clear definition of the required procedure with the needed flexibility and is therefore be superior to using the words “limited procedures” and “evaluate”.

The Work Effort Specified in Paragraph 14 (b)

Paragraph 14 (b), requires the consideration of whether there is a “material inconsistency” between the other information and the auditor’s knowledge

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obtained during the course of the audit. In conjunction with the introductory phrase of paragraph 14, the work effort is to “read and consider”. Based on the requirement alone, the work effort is therefore to “read and apply one’s mind”. However, paragraph A30 states that the auditor needs to apply professional judgment in deciding whether the auditor refers to audit documentation or directs inquiries to [other] members of the engagement team or a component auditor. While paragraph A32 points out that it is neither necessary nor practicable for the auditor to reference every matter in the other information to audit documentation, it appears to us paragraphs A30 to A32 confuse the auditor’s initial work effort with the auditor’s response. Reading and considering the other information for “material inconsistencies”, which would be done initially, is different from comparing the other information to the auditor’s documentation or engaging in further enquiries, which would be a response to matters that appear to be untoward upon having read and considered them. This application material will also lead to audit regulators filling the void by requiring tracing matters to audit documentation or performing further inquiries. Consequently, either the procedures required should be specified (e.g., comparing the other information to audit documentation on a test basis), or the work effort should be limited to just reading and considering. We believe that the latter approach is appropriate because tracing matter to audit working papers will involve considerable work effort and hence expense that is disproportionate to the purpose of ISA 720.

(ii) The Distinction between the Work Effort for 14 (b) and (c)

Paragraph 14 (b) requires the active consideration of whether there [appears to be] a material inconsistency between the other information and the auditor’s knowledge obtained during the course of the audit. In contrast, paragraph 14 (c) only requires the auditor to “remain alert” for other indications that the other information appears to be “materially misstated”. The question arises why a different initial work effort is required in (b) and (c). Paragraph 24 of the Explanatory Memorandum explains that a consideration of any knowledge possessed by the auditor was rejected because the term “auditor” under the ISAs can refer to any individual on the engagement team or in the firm, which could be interpreted as requiring firms to establish impracticable processes to consider whether there is a “material inconsistency” between the other information and the knowledge possessed by anyone in the firm.

This argument is a “red herring” because it can also be applied to paragraph 14 (b): the knowledge of the “auditor obtained during the audit” can be applied to anyone on the engagement team, or otherwise involved during the audit (e.g., an engagement quality control reviewer or a specialist consulted under ISA 220, or an external expert under ISA 620). The application material to paragraph 14 (b) in

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paragraph A21 also specifies the factors that the engagement partner may take into account in determining the appropriate individuals to address the requirements in paragraphs 14 and 15. Why wouldn't this also apply to paragraph 14 (c), whereby only the knowledge obtained outside the audit of these individuals would be relevant? When considering this limitation on who does the reading and, as described in the application material, and the fact that there does not appear to be an adequate justification for differentiating between the work effort in paragraphs 14 (b) and (c), we believe that 14 (b) and (c) can be merged. This also calls into question whether it is necessary to use the term "material inconsistency" to refer to material differences between the other information and the auditor's knowledge obtained during the course of the audit.

(iii) Conclusion

To clarify the nature and extent of the initial work effort, particularly versus that required as a response to matters identified, and in conjunction with the views we expressed above on the term "material misstatement of the other information", we believe that paragraphs 14 to 16 should be replaced with the following:

"14. The auditor shall:

- (a) Read the other information;
- (b) Compare, on a test basis, the content of the other information with the audited financial statements; and
- (c) On the basis of such reading and comparison, consider whether a material inconsistency between the other information and the audited financial statements appears to exist.

15. When reading the other information, the auditor shall consider, based on the auditor's knowledge and understanding obtained during the audit or otherwise, whether the other information appears to contain material misstatements of fact not related to the financial statements or appears to be otherwise misleading.

16. If the auditor becomes aware that:

- (a) a material inconsistency between the other information and the audited financial statements appears to exist,
- (b) a material misstatement of fact not related to the financial statements appears to exist, or
- (c) the other information appears to be otherwise misleading,

the auditor shall discuss the matter with management and, if necessary, perform other procedures to determine whether:

- (a) The other information contains a material misstatement of fact or is otherwise misleading;
- (b) The financial statements are materially misstated; or
- (c) The auditor's understanding of the entity and its environment requires revision."

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d) Issues with the Objectives

Since the auditor's responsibility for other information in an audit of the financial statements is fundamentally different from the responsibility to obtain sufficient appropriate audit evidence on the financial statements to express an audit opinion thereon, the objective in ISA 720 should be more aligned to that in ISA 200, which describes the purpose of an audit. Hence, the objective in ISA 720 should explain the purpose of ISA 720.

On the basis our comments in sections (a), (b) and (c) above, we suggest that the objective read as follows:

"The objectives of the auditor are to:

- (a) Become aware of whether:
 - (i) Other information accompanying the audited financial statements appears to undermine the credibility of these financial statements and the auditor's report, or
 - (ii) This other information appears to undermine the credibility of the documents containing the other information;
- (b) Respond appropriately when the auditor becomes aware of (a)(i) or (a)(ii);
- (c) Provide transparency to users about the association of the auditor with the other information."

With respect to (c), we refer to our comments in response to Questions 3 and 4 of the Explanatory Memorandum below.

The objectives in the draft suffer from the same weaknesses we noted for the work-effort requirements. In addition, the objective in paragraph 11 (a), which refers to the auditor "considering", does not align with the work effort actually required in the requirements of paragraphs 14 (a) in conjunction with paragraph 15, which require the auditor to read, perform "limited procedures", and on that basis "consider". Hence, the objective 11 (a) suggests that the work effort is the same as in paragraph 11 (b), when in fact it is not.

Question 4

Under extant ISA 720, the auditor is responsible for reading other information obtained after the date of the auditor's report, but does not specify a time limit, which therefore makes auditors responsible for an unlimited time period after the date of the auditor's report. It is unclear how auditors have fulfilled this requirement when other information is issued by the entity a long time after the issuance of the financial statements. Unless the IAASB can develop a reasonable basis for a time limit, we are not convinced that an auditor can have any

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responsibility for other information received after the date of the auditor's report. This implies that, analogous to ISA 560.10 and .14, the auditor should have no obligation to perform any procedures (including reading or considering) on other information after the date of the auditor's report. However, if facts become known to the auditor after that date (a "stumble-over" responsibility), the auditor has further responsibilities as defined in ISA 560. If an auditor completes the engagement at the date of the auditor's report, but a new auditor is engaged soon thereafter, it is difficult to see how the "old auditor" is supposed to perform procedures on other information obtained after the date of the auditor's report, such as discussions with management or obtaining further information from management without a contractual basis therefor.

We recognize that other information, issued after the date of the auditor's report, containing or accompanying the financial statements may, if it is materially inconsistent with the financial statements, undermine those financial statements, or if the other information contains a material misstatement of fact not related to the financial statements or is otherwise misleading, may undermine the documents containing the other information. Since such other information could be issued much later than the date of the auditor's report, there does not appear to be a practical way of counteracting such "undermining": the auditor can only disassociate him- or herself from such other information. This approach has the added advantage of clearly associating, in the auditor's report, the auditor with the information for which the auditor has taken responsibility under ISA 720, while effectively disassociating the auditor from information not mentioned in the auditor's report (this could be reinforced through additional wording in the report — see our response to Question 3 below). This approach would also provide an incentive for management to provide information prior to the date of the auditor's report, if management wants that information identified as other information in the auditor's report. Financial reporting and securities regulators in particular jurisdictions can also stipulate which information or documents are to be classified as other information for these purposes, which would create a responsibility for management to provide that information or those documents prior to the date of the auditor's report. If management seeks to avoid having auditor involvement with other information provided voluntarily because it contains material misstatements of fact or is otherwise misleading, then at least auditors would have explicitly disassociated themselves from that information.

Since it is not the purpose of ISA 720 to provide comfort to users about the other information to help them make economic decisions, then there must be a different purpose for reporting on other information. We believe that the purpose relates solely to providing transparency to users about the auditor's responsibility (or lack

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thereof) for other information and about the results of discharging that responsibility (see the suggested objective in our response to Questions 1 and 2 above).

Question 3

With the exception of not disassociating the auditor from other information obtained after the date of the auditor's report as we propose above, we believe that the proposed reporting requirements result in effective communication to users about the auditor's work relating to other information. However, the wording in the application material implementing the reporting requirements is not transparent with respect to initial auditor work effort: the wording does not reflect the actual initial work effort for potential material inconsistencies between the other information and the financial statements because no mention is made of the "limited procedures" performed. There is also a mismatch between the words expressing that no audit was performed, but that no assurance conclusion was expressed. We have provided suggested wording below, which, among other matters, improves transparency with respect to the initial work effort, adds the needed disclaimer, and uses the wording we have proposed above for the requirements, thus demonstrating that such terms and wording are not cumbersome and do facilitate user understanding:

"The other information obtained by the date of this auditor's report is the [information included in X report, other than the financial statements and the auditor's report thereon.] We disclaim any responsibility for any documents not obtained by the date of the auditor's report that contain or accompanying the audited financial statements.

We have not audited, or obtained any other assurance on, the other information obtained by the date of the auditor's report, and therefore do not express an audit opinion or any other form of assurance conclusion thereon.

Our responsibility is to read the other information obtained by the date of the auditor's report, compare it on a test basis with the audited financial statements, and on the basis of such reading and comparison consider whether there appears to be a material inconsistency between the other information and the audited financial statements that may result from material misstatements of fact in the other information. We also read and consider, based on the knowledge we obtained during our audit and otherwise, whether this other information contains material misstatements of fact not related to the financial statements or whether the other information is otherwise misleading. If we determine that the other information contains any material misstatements of fact or is otherwise misleading, we are required to report that fact. We have nothing to report in this regard."