



15 March 2013

Our ref: ICAEW Rep 44/13

Mr James Gunn
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017
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Dear James

International Standard on Auditing (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

ICAEW is pleased to respond to your request for comments on 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*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

INTERNATIONAL STANDARD ON AUDITING (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*

Memorandum of comment submitted March by ICAEW, in response to IAASB consultation paper (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* published on 14 November 2012.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the 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 published by the IAASB on 14 November 2012, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

MAJOR POINTS

The significance of proposed changes

5. We welcome the strengthening of auditor responsibilities regarding other information to prevent inappropriate information being associated with and undermining audited financial statements. ISA 720 is in need of revision to accommodate developments in reporting and to clarify the work effort and expectations of auditors in a highly judgemental but increasingly important area. Clarification will also help audit inspectors and investors, who may decide that additional assurance on other information is required.
6. Many firms do a great deal more than what is required of them under extant ISA 720, but IAASB has gone far beyond codifying those extra steps, and these proposals raise the bar significantly. The changes proposed are more radical than the ED admits, transparency is essential and IAASB needs to make the effect on audit costs clear, and communicate the significance of the changes to all stakeholders, particularly preparers, audit committees and auditors. Communications accompanying the issue of a revised ISA 720 should refer unequivocally to IAASB's decision to raise standards in this area and to the fact that additional audit resource will be required.

Why significant changes to the proposals are needed

7. For IAASB to achieve the desired changes in auditor behaviour without creating unrealistic expectations about what auditors can reasonably be expected to do with other information, significant changes to the current proposals are needed, as outlined in our answers to IAASB's specific questions below. Re-exposure should not be ruled out.

8. Unfortunately, IAASB's strenuous attempts to use existing terminology and require more of auditors at the same time means that the proposals as they stand simultaneously manage to understate what auditors actually do, by using the term 'inconsistency', and unrealistically raise expectations of what they can do, by stretching the meaning of that term and by appearing to effectively mandate some sort of review of the other information.
9. We recognise the problems created by the need to use the existing term 'inconsistency'. It is embedded in the legislation of many jurisdictions. But we urge IAASB to consider the very real need for firms to limit the extent of the work they are expected to perform on other information. Auditors doing more than is required as is the case at present is one thing, defining and mandating it is quite another.

Changes needed to make the proposals workable

10. We note below that without circumscription of the proposed requirements, the work effort will not be clear from the audit report which will increase the expectation gap. We suggest significant changes to make the proposals workable including:
 - making it clearer that the work performed on other information during an audit is limited;
 - restricting the auditor's 'knowledge of the business' to that of senior audit team members;
 - making the requirements less open-ended by including a high-level description of the processes and procedures performed to fulfil the objectives;
 - restricting the procedures performed on the 'remaining other information', to reading it and dealing with any apparent inconsistencies.
11. The interaction of these proposals with national legislation, which often covers this area, and in particular draft European legislation, is not likely to be straightforward. It is important that IAASB's proposals are not rendered obsolete or irrelevant by changes in legislation.

What users want

12. We also note below that what users really want from auditors is assurance on the other information itself, not assurance on its consistency with the audited financial statements. We therefore urge IAASB to consider the merits of an ISAE-3000 style engagement for other information. We have sent under separate cover details of a high profile limited assurance engagement based on ISAE 3000 and performed by KPMG on other information prepared by the UK's Channel 4 Television Corporation.¹ ICAEW is tracking practical developments in this area closely and we will be happy to discuss this in more detail.

RESPONSE TO SPECIFIC QUESTIONS

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?**
13. We note in our major points above that we welcome the strengthening of auditor responsibilities regarding other information but we also note the fact that IAASB should not underestimate or downplay the effect of raising the bar in the manner proposed.

¹ www.icaew.com/~media/Files/Technical/Audit-and-assurance/assurance/assurance-insights-kpmg-c4.pdf

Auditor responsibilities for other information

- 14.** The level of work that would constitute an ‘appropriate response’ to situations in which there ‘may’ be a material inconsistency is significant, because inconsistencies:
- are with the auditor’s ‘knowledge of the business’, which easily can be read as meaning the collective knowledge and experience of the entire firm; and
 - as we note in our answer to question 6 below, they include inaccuracies and omissions, stretching the sense of the term ‘inconsistency’ far beyond its current generally accepted meaning.
- 15.** The scope of the work on other information, although ostensibly tied to the financial statements, in practice covers increasingly specialised areas including technical provisions in the financial services and extraction industries, for example. While auditors do in fact look at these documents and many of the procedures suggested in these proposals are already applied, mandating them will create expectations regarding the level of specialist expertise applied that cannot be met by audits of general purpose financial statement within current cost constraints.
- 16.** Some circumscription of objectives and requirements by means of a clear identification of those whose knowledge of the business is relevant, and by means of clear procedural boundaries, is necessary to make these proposals workable.
- 17.** We note below the very open-ended characteristics of the proposed requirements. In well-established areas, descriptions of audit processes and procedures are unnecessary but in this case, some high-level description of the types of processes and procedures that auditors need to have in place in order to achieve the objectives will not only help auditors, but will help manage expectations. Without this, we believe that the considerable additional work effort potentially required by the proposed standard would be better suited to a separate limited assurance engagement.
- 18.** What users really want from auditors is assurance on the completeness, accuracy and reliability of other information, not assurance on its consistency with the audited financial statements. Much of the other information is not, and probably never has been issued to support, enhance or supplement the audited financial statements. It stands alone. Without circumscription, the strengthened requirements risk serving only to increase the expectation gap because the work effort will not be clear from the audit report. An ISAE 3000 report would be much clearer about this, but it comes at a price.
- 19.** We therefore strongly encourage IAASB to consider some combination of the following:
- making it clearer than it does in the proposals that the work performed on other information as part of the audit of financial statements is limited;
 - restricting the auditor’s knowledge of the business to the knowledge of senior audit team members;
 - making the requirements less open-ended by including in paragraph 11 a high-level description of the types of processes and procedures that firms have in place to fulfil the objectives, ie a summary of the requirements in paragraph A37;
 - restricting the procedures performed on the ‘remaining other information’, ie the information on the peripheries of the audited financial statements in which auditors are least skilled, perhaps to reading the other information and dealing with any apparent inconsistencies if they come to the auditor’s attention.

- 20.** We also encourage IAASB to consider the merits of developing a limited assurance engagement which might be provided on 'general purpose' other information, based on and ISAE 3000 and the proposals already developed.

Costs, benefits and the public interest

- 21.** We do not believe that IAASB can legitimately continue to ask questions about costs and benefits unless it makes some effort, however small, to include some sort of cost-benefit, impact or similar analysis in its proposals, including quantitative and/or qualitative evaluations. Simply stating that IAASB 'believes' that benefits will exceed costs is not enough. In the absence of any sort of evidence, the belief amounts to uninformed speculation. A project such as ISA 720 would be a good starting point for such an analysis. Member bodies are in a good position to work with practitioners to perform dry-run exercises on current other information.
- 22.** We fully recognise the time, costs and the challenges involved in developing metrics for these analyses and IAASB needs to build this work into its work program. IAASB's actions have consequences for audit costs worldwide. Getting the proposals right the first time by performing these analyses is right in principle, and preferable to asking practitioners to bear the costs by finding out through implementation that proposals are not workable. Other standard-setters of IAASB's stature have performed these analyses for many years. We are aware that IAASB has in the recent past made some attempt to perform these analyses on other projects and we strongly encourage IAASB to perform such an analysis for ISA 720, however rudimentary, before these proposals are finalised.
- 23.** In the absence of such an analysis, we do not believe that IAASB can or should pronounce on whether the public interest is likely to be served, nor is it in a position to ask respondents the same question, particularly given the level of concern over these proposals in some quarters.

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?

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?

- 24.** In principle we 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 do not envisage scoping causing problems for UK practitioners. However, judgement will be required in determining the purpose of other information and this may lead to inconsistencies. We note in our response to question 1 above, our belief that limited procedures should be required in respect of the 'remaining other information', ie the information that is not directly reconcilable to the audited financial statements and that does not cover the same or similar qualitative ground.
- 25.** The reference to 'documents' is out of date. Companies increasingly provide electronic information with, and directly relevant to, audited financial statements. Slide presentations and video clips are now commonplace and the exclusions in paragraph 3(a) should be widened to include any such electronic information and any information associated with preliminary announcements, such as information provided at analysts briefings.
- 26.** IAASB should make it clear that 'initial release' is not the same as the date that the financial statements are issued under ISA 560, and that it is an undefined period. We note on-going problems in jurisdictions in which there is no obligation for management to provide auditors with other information prior to the initial release.

4. Do respondents agree that the limited circumstances in which a securities offering document would be in scope (eg, 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?

27. For the sake of clarity, securities offerings should be scoped out. They are subject to extensive and detailed jurisdictional regulation which is likely to overlap with these requirements.

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?

28. We do not consider that the objectives of the proposed ISA are appropriate because the definition of the term ‘material inconsistency’ is inappropriate and too wide, as explained in more detail in our answer to question 6, below.

29. The requirement to [read and] ‘consider’ the other information in this context is used in a significantly different way to the way it is used elsewhere in ISAs. A requirement to ‘consider’ has hitherto meant to ‘reflect upon’ a matter, to ‘think about’ it. Under the proposals, the requirement to ‘consider’ a matter means to do a great deal more. We fear that an unintended consequence of the proposals is that regulators are likely to read the latter meaning into extant requirements.

30. If IAASB does use a form of words similar to those proposed, we suggest that the phrase ‘based on’ [the auditor’s understanding] is used in place of ‘in the light of’ [the auditor’s understanding], because it is clearer, more consistent with ISA 315 and would be more reliably translated.

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?

31. IAASB’s proposals radically alter the meaning of the term ‘inconsistency’ in a manner which is not appropriate.

32. To date, the word ‘inconsistency’ as used in plain British and American English and in this specialised context have made intuitive sense, in that for an inconsistency to exist, two or more clearly defined and discrete items have to be out of line with each other in some way (the other information and the audited financial statements).

33. The proposed definition subsumes the terms ‘incorrect’, ‘unreasonable’ ‘inappropriate’ and ‘omission’ within the meaning of the term ‘inconsistency’. The explanatory memorandum collectively refers to them as an ‘inaccuracy’ arising from a difference between the other information and the auditor’s knowledge of the business and its environment. This is stretching the sense of the term ‘inconsistency’ beyond its natural limits. The terms ‘incorrect’, ‘unreasonable’ ‘inappropriate’ and ‘omission’ are all hard, absolute concepts, certainly by comparison with the term ‘inconsistency’ and are essentially incompatible with it. Describing a

matter as 'incorrect' but then qualifying it by adding the rider 'in the light of the auditor's knowledge of the business' does not make a great deal of sense.

34. Furthermore, the 'auditor's knowledge of the business and its environment' in practice incorporate the auditor's knowledge of the industry, the economic situation, a great deal of history with regard to both and much more, particularly when the firm as a whole is deemed to report. It is not unreasonable to infer from the proposals that as a minimum, the entire audit team would be expected to read all of the other information. Adding the rider 'acquired during the course of the audit' makes no real difference here. Separating out knowledge acquired this year, last year and the year before that is pointless. The auditor's knowledge of the business and its environment is in practice so wide as to be meaningless as a comparator. Referring to such 'inaccuracies' as 'inconsistencies' is similar to responding to an assertion to the effect that the 2012 Olympics were held in Paris, by saying that the statement is 'inconsistent with our knowledge of the Olympics'. The more appropriate response is either that the assertion is wrong, or that it is inaccurate, in that the last Paris Olympics were held in 1924.
35. We understand that IAASB needs to continue to use the term 'inconsistency' because of legislation in many jurisdictions. We also understand the fact that many firms do more than is currently required, although not necessarily consistently, which is a case for standardisation. We strongly believe that the 'auditor's knowledge of the business and its environment' should be deemed to be the knowledge of the senior members of the audit team.

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?

36. We doubt that users of auditor's reports will understand that an inconsistency relates to an inaccuracy in the other information as described in the definition, for the reasons set out in our answer to question 6, above. Nor do we believe that users will understand that it is based on reading and considering the other information in light of the auditor's understanding of the entity and its environment. This is partly because of the wording in the objective and A57, which refer to material inconsistencies 'in the other information'. The disconnect with the sentence referring to the 'read and consider' requirement means that the proposed wording implies that the inconsistencies are between different items of other information, rather than between the other information and the auditor's knowledge of the business. Inconsistencies are **between** matters and some method must be found to join up the requirement to 'read and consider in the light of etc.' with the outcome, ie to identify inconsistencies **with** the auditor's knowledge of the business. It makes no practical difference whether the words 'in the light of the auditor's knowledge of the business and its environment' are attached to the 'read and consider' requirement, or to the 'inconsistency', as long as all three are joined up.
37. Legislation in many jurisdictions, including the UK, refers to inconsistencies with the audited financial statements. To suggest adding riders widening this scope or using terms such as 'inaccuracy' in the place of 'inconsistency' are likely to start alarm bells ringing, particularly with regard to those peripheral and technical areas of other information with which auditors are less familiar. But to extend the auditor's responsibilities without changing the words by shoehorning the concept of 'inaccuracy' into the term 'inconsistency' without further procedural guidance risks creating several expectation gaps. Firstly, and unusually, the proposed wording will obscure and underplay the extended scope and depth of work performed. Secondly, as it stands, the proposed wording is misleading, as described above. Thirdly, the auditor's ability to detect inconsistencies varies enormously depending on the other information being read, ie there is a wide range of assurance levels obtained by auditors which will rarely be appreciated. These gaps cannot be closed easily but some description of process and procedures may help.

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?

38. We believe that a principles-based approach to the work effort is appropriate. However, we suggest elsewhere in this response that the auditor's responsibilities be defined more clearly by means of additional procedural requirements or guidance. This is not ideal, but it arises from the problems created by the lack of principles-based limitations in the proposals to the nature and extent of work on the other information. Auditors may be construed as taking responsibility for the accuracy of the whole of the accompanying information under these proposals, even if that is not intended. To avoid this, it would be better if the standard were to be much clearer about the limited nature of the additional work.

(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?

39. We are concerned that while the intention is not to extend the scope of the audit, it will be difficult to achieve this in practice. We note in our answer to question 1 above, our belief that procedures relating to the 'remaining information' in paragraph A37 should be limited to reading the other information and dealing with any apparent inconsistencies with the audited financial statements if they come to the auditor's attention. Absent this, they are very likely to be *de facto* additional audit procedures.

40. Other procedures in paragraph A37, such as obtaining management's reconciliations and agreeing items within them to audit documentation will in some cases extend the scope of the audit beyond what is currently performed. We believe that IAASB should admit this.

41. We note in our answer to question 1 above, that considerable additional work will be required by the proposed standard and that it would be better suited to a separate limited assurance engagement. This is because the level of work that would constitute an 'appropriate response' to situations in which there 'may' be a material inconsistency with the auditor's 'knowledge of the business', is very wide indeed. We note in particular that the scope of the work on the other information increasingly covers specialist areas, which reinforces our belief that the proposals are more suited to a separate limited assurance engagement.

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

42. The examples of qualitative and quantitative information included in the Appendix in the proposed ISA are helpful.

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?

43. Yes, the proposed requirements are clear regarding the auditor's response if it becomes apparent that the auditor's prior understanding was incorrect or incomplete.

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?

44. No, we do not believe that the proposed audit report terminology is clear and understandable for the reasons set out in our answer to question 7 above.

(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?

45. A conclusion stating that no audit opinion or review conclusion is expressed does not properly convey the fact that no assurance is being expressed with respect to the other information. This is because it conflicts with the negative assurance implied by the use of the words ‘we have not identified material inconsistencies in the other information....’. These can easily be read as implying that a limited assurance engagement has been performed when this is not the case.

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?

46. We do not believe that the level of assurance being provided with respect to other information is appropriate.

47. We note in our answer to question 7 above, that the proposed wording in the auditor’s report is not clear. We note in our answer to question 1 above, our belief that the considerable additional work effort required by the proposed standard would be better suited to a separate limited assurance engagement. We believe that IAASB should consider such an engagement to provide assurance on general purpose other information, based on ISAE 3000 and the proposals already developed.

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