

# The Auditor's Responsibilities Relating to Other Information

## Proposed Consequential and Conforming Amendments to Other ISAs

An exposure draft of a proposed revision of International Standard on Auditing 720

Comments from ACCA to the International Auditing and Assurance Standards Board

17 July 2014

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ACCA welcomes the opportunity to comment on the proposals issued by the International Auditing and Assurance Standards Board (the IAASB). The ACCA Global Forum for Audit and Assurance has considered the matters raised and the views of its members are represented in the following.

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## OVERALL COMMENTS

We support the proposed revision of International Standard on Auditing 720 (Revised) *The Auditor's Responsibilities Relating to Other Information* (proposed ISA 720). As we said in our response to the related November 2012 exposure draft,<sup>1</sup> this revision recognises that annual reports are including more and more disclosures outside the financial statements, often of a qualitative nature, and that there are calls for more informative reporting by auditors. The increased audit emphasis on other information is a strong signal to management and those charged with governance that such information is important to users of the financial statements.

In our comments on the November 2012 exposure draft, we identified many 'technical' problems with the material and we are pleased to see that the current proposals eliminate many of those. In response to a request in the exposure draft, we have included in this response a section explaining whether proposed ISA 720 addresses concerns we previously raised. Some of those concerns have not been adequately addressed, so, in that section, we explain our continuing concerns.

We also take issue with some of the new material. In our specific comments below, we disagree with several important aspects of proposed ISA 720. In view of this, we cannot support the revision of ISA 720 in the manner now proposed.

Our key areas of concern are:

- interpreting inconsistency in relation to 'the auditor's knowledge obtained during the course of the audit'
- the proposed requirement to carry out 'limited procedures'
- the inclusion of a restricted requirement to 'remain alert'

Our analysis of these issues is again 'technical' and involves consideration of the validity of concepts and the use of language in standard setting. For all these issues we propose solutions.

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<sup>1</sup> Proposed 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*.

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## SPECIFIC COMMENTS

In this section of our response, we answer the four questions set out in the exposure draft section *Request for Comments*. Our answers refer, where necessary, to a section of this response in which we examine whether concerns raised in relation to the November 2012 exposure draft have been adequately addressed.

**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.**

Overall, we believe that proposed ISA 720 will drive the right auditor behaviour to meet user needs in respect of other information in the context of an audit.

If users demand assurance on such information, however, proposed ISA 720 does not meet their needs. Instead, information must either form part of the financial statements and be audited, or be subject to a separate assurance engagement. This is a matter for law and regulation, or commercial contract.

We acknowledge that users may, nevertheless entertain higher expectations of the revised auditor work and reporting and we caution that the implementation process must seek to manage any resulting expectations gap.

On the detail of the stated objectives, the scope and definitions, and the requirements addressing the auditor's work effort, we comment as follows.

### **Objectives and definitions**

In our comments on the November 2012 exposure draft, we concluded that the proposed objectives were not appropriate. Our concerns related mainly to the narrow focus of the objectives on responding and reporting<sup>2</sup> and in relation to the phrase 'in light of the auditor's understanding of the entity and its environment acquired during the audit'.

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<sup>2</sup> We consider this further in the section of this response *Concerns previously raised*.

The latter has changed, but we now have similar concerns about the auditor's objective 'To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained during the course of the audit.' Our analysis of this issue involves consideration of the validity of concepts and the use of language in standard setting.

We understand that the wording is intended to signal to users that the auditor does no specific extra work to identify problems within the other information and that any reporting is a by-product of the audit (including the specific work done under proposed ISA 720 to identify and respond to inconsistencies between other information and the financial statements).

However, as argued below, the auditor's knowledge cannot be constrained to that 'obtained during the course of the audit', so such wording is not suitable for inclusion in a standard. Moreover, users may be misled and raise questions about whether the auditor has ignored something from a previous audit, or has deliberately excluded information from other engagements or component auditors.

Under ISAs, it is not possible to constrain the obtaining of knowledge to an audit engagement. ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* requires that:

'7. The auditor shall consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement.

8. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying risks of material misstatement.'

Moreover, the nature of professional judgement<sup>3</sup> means that it is not possible to disregard relevant knowledge; even when that is obtained from a previous audit.

Our conclusion is that, despite its good intentions and everyday acceptability, the wording 'the auditor's knowledge obtained during the course of the audit' has no place in this standard.

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<sup>3</sup> According to the IFAC Glossary of Terms, professional judgment is 'The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.'

We propose a choice of three solutions:

1. eliminate the words *'obtained during the course of the audit'* and signal the limitation in another way
2. retain the words but add a definition saying what the words are intended to mean; a definition is needed, not just application material
3. modify the wording of the objectives to eliminate the need for reference to inconsistency with the auditor's knowledge

The third approach above was the one we advanced in our response to the November 2012 exposure draft. We were not only concerned then with language but also with the indirectness of the approach. In that draft, the objectives were slightly different, but the verbatim quote below remains valid:

'The artificial construct of expressing inaccuracy (or inappropriate presentation) as an inconsistency between other information and the (to the user) unknown understanding [knowledge] of the auditor is indirect and imprecise. If the intention is to inform users about inaccuracy [misstatement] in other information, it would be better to use that word.'

We believe that users can be told about the restriction on the auditor's work in a better way and that they will more easily understand reporting (especially if a problem is identified) if our solution is adopted. We suggested amending the objectives to be:

'The objectives of the auditor are:

- (a) To determine the other information that is within the scope of this ISA;
- (b) To obtain, read and consider such other information to assess it for the purpose below;
- (c) To respond appropriately when other information is identified that:
  - (i) could undermine the credibility of the financial statements and the auditor's report, or
  - (ii) is materially misstated; and
- (d) To report in accordance with this ISA.'

This form of objectives (with some textual updating), together with suitable guidance, would remedy all of the above problems.

### **Requirements – limited procedures**

Paragraph 15 requires the auditor to perform 'limited procedures'. The term is not defined. The objective of performing limited procedures is given and examples are provided in application material (paragraph A23).

We understand that the use of the word 'limited' is intended to signal to users that the auditor is not carrying out audit work on the relevant other information. However, as argued below, whether intended as a defined term or in its ordinary language meaning, 'limited procedures' is (or are) conceptually flawed, so such wording is not suitable for inclusion in a standard. Moreover, users may be misled and raise questions about whether the auditor has deliberately limited procedures, so as to avoid reporting significant matters.

As a preliminary point, the term 'limited procedures' is not used elsewhere in ISAs.<sup>4</sup>

Paragraph 15 sets out the objective of 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').

Paragraph A23 provides examples of limited procedures and makes the point that 'Determining the nature and extent of [limited] procedures is a matter of professional judgment.' This introduces a problem into the standard because, if this statement is true, then the procedures cannot be limited in nature or extent.<sup>5</sup>

The concept of limited procedures fails, therefore, because the procedures are not limited.

The concept of limited procedures could be repaired by changing the terminology so as to refer to 'other information procedure' (or 'procedure on other information')<sup>6</sup> but that no longer signals to users that the auditor is not carrying out audit work on the relevant other information.

We suggest that a better way is found to address the expectations gap that is driving the IAASB's conclusion that it is necessary to communicate the fact that the auditor is not carrying out audit work on the relevant other information.

<sup>4</sup> Exceptionally, the wording 'limited analytical procedures' is found in a note of considerations specific to smaller entities that limit the auditor's choice of procedures. In circumstances where there is no interim or monthly financial information, the auditor may only be able to perform limited analytical procedures (ISA 315, paragraph A10).

<sup>5</sup> In relation to procedures it is normal also to use the word 'timing', as in 'nature, timing and extent'. This may have been omitted in error.

<sup>6</sup> The term would be defined by the objective(s) of such procedures (as is done for eg '*Substantive procedure*—An **audit** procedure designed to detect material misstatements at the assertion level.') [emphasis added] The term 'audit' would not be used.

This is because we also comment, later in this response,<sup>7</sup> on the words 'amounts or other items . . . 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'. We do not agree with continuing with this wording as it amounts to a categorisation of other information.

#### Requirements – remain alert

We do not agree with the inclusion of proposed requirement 14(c), which requires the auditor to 'remain alert'.

'14. The auditor shall read the other information and, in doing so shall:

. . .

(c) Remain alert for other indications that the other information appears to be materially misstated.'

Paragraph 15 contains a requirement to perform limited procedures as the basis for consideration 14(a) but does not reference either 14(b) or 14(c).

The IAASB aims to 'raise the bar' but stop short of assurance on the other information. The aspect of material misstatement of the other information relevant to 14(c) is misstatement that is neither associated with inconsistency with the financial statements (covered by requirement 14(a)) nor with inconsistency with the auditor's knowledge (covered by requirement 14(b)).

The rationale advanced in the *Explanatory Memorandum* for including 14(c) is that 'In part, this recognizes the auditor's ethical obligation not to be knowingly associated with other information that is otherwise misleading, but it also recognizes that those individuals reading and considering the other information may have relevant knowledge that goes beyond the knowledge obtained during the course of the audit.'

Earlier in this response, we expressed disagreement with the position that knowledge can be constrained to that 'obtained during the course of the audit'. If our conclusion in that regard is accepted, there would be no need for requirement 14(c) because all relevant knowledge is employed in 14(b) [which is 'Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained during the course of the audit']].

<sup>7</sup> In the section *Concerns previously raised* in a subsection *The category of 'directly reconcilable'*.

If our point is not accepted, and there exists knowledge that would allow identification of indications that the other information appears to be materially misstated, then the requirement may be considered for its effectiveness (ie does it help meet the objectives of the ISA – including that relevant to reporting).

The word ‘alert’ is used in different ways in ISAs:

- natural meaning (eg 'the auditor alerts management to . . .'); this is not considered further below
- to indicate a characteristic of an attitude (eg Professional skepticism—An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence
- used in the context of ‘being’ or ‘remaining’ alert - it is an instruction

In relation to ‘being alert’ the surrounding words in an ISA requirement may explain:

1. the objective of being alert in a particular context
2. the information (or possibility of information) the alert is for
3. the context in which being alert takes place

On examining the requirement in proposed ISA 720, it is evident that the objective of being alert is not stated explicitly; the information is specified ‘other indications that the other information appears to be materially misstated’; and the context is given ‘The auditor shall read the other information and, in doing so shall’.

The construction implies that it is only while reading the other information that the requirement to remain alert applies. That interpretation of the intended meaning is reinforced by the example report ‘**In reading the other information**, our responsibility is also to remain alert for other indications that the other information appears to be materially misstated.’ [emphasis added]

We believe that the proposed construction is misleading and that, for the reasons set out below, requirement 14(c) is unacceptable and must be withdrawn or changed.

The auditor is required to plan and perform an audit with professional skepticism.<sup>8</sup> The definition of professional skepticism makes it clear that throughout the audit, the auditor is required, therefore, to be alert to conditions that may indicate possible misstatement due to error or fraud.

<sup>8</sup> Paragraph 15 of ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*.



In requirements, uses of 'remain alert' are emphasised as 'throughout the audit engagement' (ISA 220), or 'during the audit' (ISA 250 and ISA 550), or 'throughout the audit' (ISA 570).

Thus, a 'remain alert' requirement cannot be constrained; it always extends throughout the audit engagement. The fact that other information may not be present throughout the audit is not relevant.

Further, as stated above, we do not believe the requirement is necessary because the auditor's knowledge cannot be limited to that 'obtained during the course of the audit', so technically, 14(c) could be deleted.

If 14(c) is not deleted, it is possible to remedy this drafting error in two ways: either draft a requirement to achieve the intended limitation, or draft a valid 'remain alert' requirement that is properly communicated to users.

We see some merit in including a separate requirement to remain alert as that may be seen as going further to meet user needs. We offer the following as a suggested requirement that is properly effective throughout the audit. Application material could explain more. The example report would also need changing.

A new paragraph 15:

'15. During the audit, the auditor shall remain alert for indications that the other information appears to be materially misstated.'

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

Other than in relation to the matters mentioned in our response to question 1 above, we find the proposals to be clearly stated and hence capable of consistent interpretation and application.

This is principally because the proposals have eliminated several judgements that were implicit in the previous exposure draft and the requirements mainly now flow from the objectives and are supported by appropriate examples of relevant procedures.

**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.**

The proposed reporting (set out in paragraph 21) contains the essential elements for users: it identifies the other information, states the auditor's related responsibilities and provides a statement of the outcome of the work.<sup>9</sup> However, as set out below, the proposed report wording contains some challenges for intended users who do not have a reasonable knowledge of audit, assurance and related professional ethics.

Conventionally, the user perspective is related to the financial statements as a whole and to the users as a whole; the needs of the latter conventionally represented by the needs of the investors as a group.

Paragraph 4 of ISA 320 *Materiality in Planning and Performing an Audit* explains that it is reasonable for auditors to assume that users possess certain knowledge and attributes in relation to the financial statements. However, in relation to auditing, users are only assumed to know that financial statements are audited to levels of materiality. We see scope in ISAs, therefore, for adding explanation of the reasonable assumptions about users in relation to auditing, including the auditor's role in relation to other information.

We identify the following areas where reporting may be improved:

- The example responsibility statement states that 'our responsibility is also to remain alert for other indications that the other information appears to be materially misstated', whereas the example report states that 'we have not audited the other information'. As 'remaining alert' is a common audit 'procedure' intended users may challenge the assertion that no auditing is involved.
- The example report refers to 'an assurance conclusion' and in doing so extends the range of knowledge necessary for the intended user beyond that of auditing.
- The example refers to information 'obtained at the date of this auditor's report', which will leave a reasonable user wondering how all the consideration required by ISA 720 could have been carried out in so short a time.

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<sup>9</sup> Reporting must necessarily be considered together with the outputs of the wider auditor reporting project of the IAASB.

- The example responsibility statement states that 'Our responsibility is to read this 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.' The reasonable intended user will not know what constitutes 'our knowledge obtained during the course of the audit'. We have explained the problems with this concept earlier in our response.

**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 agree with the IAASB's conclusion. We find the arguments for it in the *Explanatory Memorandum* persuasive (paragraphs 30 to 32 and 41 to 44). In particular, we appreciate that it would not be appropriate to require less of the auditor than is in extant ISA 720.

We note that concerns have been expressed that other information received after the date of the auditor's report should be identified in it (paragraph 43). Although the proposals do not require identification, we note that nothing precludes such action by an auditor and this we believe is a necessary freedom.

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## GENERAL MATTERS

In this section of our response, we address the four general matters identified in the section *Request for Comments* of the exposure draft.

The IAASB is seeking comments on the general matters set out below:

**(a) Preparers (including Small- and Medium-Sized Entities (SMEs)), and users (including Regulators)** – The IAASB invites comments on the proposed ISA from preparers (particularly with respect to the practical impacts of the proposed ISA), and users (particularly with respect to the reporting aspects of the proposed ISA).

**(b) Developing Nations** – Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment on the proposed ISA, in particular, on any foreseeable difficulties in applying it in a developing nation environment.

**(c) Translations** – Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed ISA.

**(d) Effective Date** – Recognizing that the proposed ISA results in changes to the auditor's report, the IAASB believes that to the extent possible, the effective date should be aligned with that of the IAASB's Auditor Reporting project. Accordingly, the IAASB believes that an appropriate effective date for the standard would be 12-15 months after issuance of the final standard, but may be longer or shorter to align with the effective date of the revisions arising from the auditor reporting project. Earlier application would be permitted. The IAASB welcomes comment on whether this would provide a sufficient period to support effective implementation of the ISA.

ACCA has developed this response following an internal due process involving preparers and users, those in developing nations, and those who will use the ISA in translation. This input, such as from our Global Forum for Audit and Assurance, has informed the whole of this response. However, in relation to (a) to (c) above we would particularly highlight the following matters.

### Preparers

As we have set out in our earlier response, we believe that the increased emphasis on other information will improve such reporting. However, the cost implications of the changes will disproportionately affect small and medium-sized entities and, while the extent of their other information is less than for listed and large entities, there is no demand for enhanced auditor reporting on other information for small and medium-sized entities.

### Users

In our answer to question 3 in the exposure draft, concerning effective communication to users, we explain the difficulty for intended users of understanding what the auditor has done and whether any comfort can be drawn from the report.

We believe that users may question the value of the changes, given the absence of reference to the ethical considerations and the negative tone of the proposed statement of the auditor.

### Translations

We have commented in our answer to question 1 above on difficulties attaching to words being used other than with their natural meanings. Translation of such terms may also prove challenging.

### Effective date (paragraph (d) above)

An earlier concern over the manner in which the proposals are to be commenced has not been resolved. We refer to this below in the *Concerns previously raised* section of this response.

The proposal to align the effective date with that of the IAASB's Auditor Reporting project is initially attractive given that the changes both affect reporting to users and that implementation costs and actions for both would coincide. The two matters are also included under the same PCAOB Rulemaking Docket Matter and would, we assume, be implemented together for the audit of US listed corporations.

However, we are concerned that the impact of the changes relating to other information may become lost in the more obvious changes to auditor reporting intended to increase the transparency of and hence the value of the audit.

As an alternative, the IAASB may wish to consider aligning the effective date with that of changes to ISAs arising from the exposure draft *Addressing Disclosures in the Audit of Financial Statements*.

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## PROPOSED CONSEQUENTIAL AND CONFORMING AMENDMENTS TO OTHER ISAs

In this section of our response, we comment on the proposed consequential and conforming amendments to other ISAs.

In general, we conclude that the proposed amendments properly reflect the need for such changes arising from proposed ISA 720. We believe, however, that, for the reasons set out below, more consideration needs to be given to the proposals for the following documents.

### ***ISA 210 Agreeing the Terms of Audit Engagements***

We agree with the proposed inclusion of extra wording in the example of an engagement letter.

We suggest, however, that this does not go far enough to recognise that the increased emphasis on other information will potentially add to the time pressure at the completion of the audit, making it doubly important that all parties are adequately prepared.

We suggest that ISA 210 should be amended to recognise that the preconditions for an audit extend to other information. For example, paragraph 6(b)(iii)(a) could be amended by the addition of the underlined text shown below:

'Access to all information of which management is aware that is relevant to the preparation of the financial statements and other information, such as records, documentation and other matters;'

### ***ISA 230 Audit Documentation***

Paragraph 13 of ISA 230 deals with documentation of 'audit procedures' and 'conclusions' after the date of the auditor's report. The application material focusses on exceptional circumstances (ie subsequent events) but proposed ISA 720 introduces the prospect of routine procedures on other information received after the date of the auditor's report.

ISA 230 should be amended to reflect the consequences of this. In view of the large number of ways that this could be done, we do not suggest specific wording.

### ***ISA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment***

In our response to question 1 above, we drew attention to difficulties introduced by the concept of 'the auditor's knowledge obtained during the course of the audit'. Should our suggestions not be accepted, and if the wording is used only in ISA 720, that would introduce inconsistency between ISAs. We believe that instances of inconsistency would be pervasive but most obvious in ISA 315 where it would be necessary to use the words 'during the course of the audit' in relation to many requirements.

### ***ISA 500 Audit Evidence***

We note the proposed change to paragraph 5(c) reproduced below:

'5. For purposes of the ISAs, the following terms have the meanings attributed below:

(c) Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other types of information.'

We acknowledge that the extant paragraph 5(c) is potentially misleading, but that is mainly attributable to the use of the term 'other information' to denote a category of information (ie outside the financial statements and auditor's report).

We assume that this change is intended to clarify that the paragraph does not apply to 'other information', ie other information is not 'other information' in terms of ISA 720.

The change is, however, unnecessary as 'other information' in terms of ISA 720 is part of the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.

This a further illustration of the problems caused by using words contrary to their natural meaning. We have, on many occasions, drawn attention to the long-standing need for a review of the fundamental principles of assurance and the nature of standards. The matters that we have drawn attention to in our answer to question 1 above, indicate that clarification is necessary of the definitions and interaction between: information, knowledge and evidence; in the context of an audit that includes an opinion and a statement on other information.

### **ISA 560 *Subsequent Events***

It is proposed to introduce a new paragraph A16A as follows:

'The auditor's obligations regarding other information received after the date of the auditor's report are addressed in ISA 720 (Revised). While the auditor has no obligation to perform any audit procedures regarding the financial statements after the financial statements have been issued, ISA 720 (Revised) contains requirements and guidance with respect to other information obtained after the date of the auditor's report.'

The paragraph is repetitious. The first sentence could be eliminated with no loss of meaning.

The paragraph makes a distinction between 'audit procedures regarding the financial statements' and 'requirements and guidance with respect to other information obtained after the date of the auditor's report.' We do not believe that audit procedures can be categorised into 'audit procedures regarding the financial statements' and 'other audit procedures'. Indeed, the first term itself embodies difficulties, not least that it has never been used in ISAs before.

The IFAC Glossary of Terms does not explicitly define 'audit procedures'. The word is used in the definitions of 'analytical procedures', 'audit documentation', 'audit sampling', 'computer-assisted audit techniques', 'detection risk', etc. in a manner that indicates that 'procedure' takes its dictionary definition and 'audit' describes those procedures in an audit. Under ISAs, an audit is (in full) an audit of financial statements;<sup>10</sup> so, all audit procedures are 'audit procedures regarding the financial statements'.

We recommend redrafting the paragraph to eliminate the above issues.

### **ISA 810 *Engagements to Report on Summary Financial Statements***

Proposed changes to paragraph 24 implement what are essentially just changes in terminology. The concept of comparing the other information to the auditor's knowledge is not mentioned explicitly. Given our comments in our answer to question 1 this is perhaps to be welcomed.

Given that there is no real change to the engagement requirements, we question whether it is worth reopening ISA 810 purely to make these changes.

<sup>10</sup> ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*, begins 'This International Standard on Auditing (ISA) deals with the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with ISAs.'



### Glossary of Terms

We see no valid reason to extend the definition of annual report from two to nine lines. The new definition is overly long and includes unnecessary elements, such as the identity of preparers and its usual contents.

The one key change is from the annual report being a document that includes the financial statements and the auditor's report to one which can also accompany them. 'Accompanying' was a concept introduced in the November 2012 exposure draft as part of the definition of 'other information' and we do not agree with it now being used to define annual report.

We believe that any documents accompanying the financial statements and auditor's report cannot on their own constitute the annual report. We would define annual report as including the financial statements and auditor's report and extending to other information whether in the same physical document or a separate document intended to accompany them.

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## CONCERNS PREVIOUSLY RAISED

In response to a request in the *Guide for Respondents*, directed towards those who commented on the November 2012 exposure draft, we are pleased to indicate in this section of our response whether proposed ISA 720 (revised) addresses concerns we previously raised.

Because of the summarised and selective manner in which the material below is presented, it does not reflect the overall balance of our earlier response, which supported the intentions of the IAASB to improve ISA 720.<sup>11</sup>

### Scope

We did not agree with extending the scope of other information by reference to documents. This was because the traditional concept of 'document' is no longer relevant as information is increasingly communicated in other ways and it is important that the requirements extend to all information that could reasonably be expected to give rise to a material inconsistency between it and the financial statements.

Our concern was linked to a concern that, because it was in a document within scope, other information beyond the auditor's understanding of the entity and its environment would become associated with the auditor.

We identified technical issues with the way mechanisms had been created to attempt to deal with difficulties arising from the above.<sup>12</sup> While those mechanisms have been changed and are now more workable, the fundamental problems remain. We restate the most important problem below.

The primary purpose of the auditor's reading of other information is to identify and respond to material inconsistency with the financial statements. The scope as currently proposed will result in auditors not reading information and justifying that with the argument that 'the standard only applies to the annual report'.<sup>13</sup> This cannot be in the public interest.

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<sup>11</sup> The earlier ACCA response may be viewed at <http://www.accaglobal.com/content/accaglobal/uk/en/technical-activities/technical-resources-search/2013/march/proposed-revision-isa-720.html>

<sup>12</sup> These issues related to: 'accompanying documents', unclear wording in the scope and definitions sections, 'primary purpose', 'financial reporting process' and 'initial release'.

<sup>13</sup> Some may argue that a firm will mitigate commercial risk by, for example, monitoring a company's website and social media and watching corporate videos. If that is done, it represents best practice and should be considered for inclusion in a standard. If it is not done, then investors are being deprived of useful auditor association.

The solution we continue to propose is for auditors to use professional judgement to determine the other information in scope (this would be identified in their report).

The *Explanatory Memorandum* explains the IAASB's thinking behind the currently proposed scope of other information (constrained to the 'annual report'). The proposed scope is a response to concerns that the previous approach 'was seen as being overly complex to apply and would place an open-ended obligation on the auditor with no time limit on which documents would be included in scope'.<sup>14</sup>

This itself does not justify the currently proposed scope. The decision is not explained other than by saying 'the IAASB debated other alternatives, such as defining other information by reference only to the purpose or content of the documents. However, consistent with the input provided by respondents to ED 720 (2012), the IAASB concluded that approaches like these had many drawbacks and few advantages'.<sup>15</sup>

Given the technical issues mentioned above, we would have expected the input from respondents to be critical of 'purpose' and fearful of 'content' but that in itself does not justify the currently proposed scope.

We suggest that, in the public interest, the advantages and drawbacks of the currently proposed scope must be viewed primarily from the viewpoint of the investor. As advantage and disadvantage are relative terms, we compare the currently proposed scope to that which would be the case under our alternative proposal:

When viewed from this investor perspective there is no advantage to the currently proposed scope.<sup>16</sup> Whereas the disadvantages are:

- material inconsistency with the financial statements may be excluded from the auditor's responsibilities, restricting the information for investors
- corporate reporting (in its widest sense) could be less rigorous because management knows that the auditors are only concerned with the annual report
- investors may mistakenly assume that the information in the annual report that is beyond the auditor's understanding of the entity and its environment is of enhanced reliability as the auditor is associated with it

<sup>14</sup> Paragraph 8 of the *Explanatory Memorandum*.

<sup>15</sup> Paragraph 11 of the *Explanatory Memorandum*.

<sup>16</sup> This is because, in both the currently proposed scope and the method we advocate, the investor receives equivalent information: identifying the other information and reporting in relation to it.

From the investor viewpoint, the case against the currently proposed scope is overwhelming. The only reason that could be advanced for it relates to its simplicity for auditors, who are required only to 'determine, through discussion with management, which document(s) comprises the annual report'. Turning this around, the only valid argument against our alternative proposal would be if it was not feasible for auditors to determine what information should be within scope as 'other information'. We believe that auditors are capable of making that judgement and we would word the requirement as follows if we were to base it closely on the approach in proposed ISA 720:

'13. The auditor shall:

(a) Determine, through discussion with management, which information comprises the other information, and the entity's planned timing of the issuance of such other information; and . . .'

In the application material (modelled on part of paragraph A8), we would suggest the following wording:

'In some cases, however, it may not be clear which information comprises the other information. In such cases, the intended audience and purpose of the information and consideration of the capacity of the information for giving rise to a material inconsistency with the financial statements are matters that may be relevant to the auditor's determination of which information comprises the other information.'

The definition of 'other information' would be extended by transferring wording from the definition of annual report:

'Other information – Financial and non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report or otherwise available to owners (or similar stakeholders) the purpose of which is to provide them with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements.

Misstatement of the other information – A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter). Misstatements of the other information are material if they could reasonably be expected to influence the economic decisions of users [of the financial statements], recognizing that the other information is only part of the overall information available to users.'

## Objectives

We did not support the proposed objectives.

We were concerned with the narrow focus of the objectives on responding and reporting. We suggested that this might have arisen because of the similar approach to objectives in extant ISA 720. We suggested that the objectives should cover not only responding, but also the actions of the auditor implicit in being able to respond, such an approach is adopted in for example, extant ISA 580 *Written Representations*.

We presented the following example of such a presentation (this implemented suggestions relevant to the objectives made elsewhere in our response and is not wholly relevant to the revised proposals):

'The objectives of the auditor are:

- (e) To determine the other information that is within the scope of this ISA;
- (f) To obtain, read and consider such other information to assess it for the purpose below;
- (g) To respond appropriately when other information is identified that:
  - (iii) could undermine the credibility of the financial statements and the auditor's report, or
  - (iv) is materially misstated; and
- (h) To report in accordance with this ISA.'

We are disappointed that this suggestion was not accepted. As a consequence, proposed ISA 720 now has requirements (paragraphs 13 and 14 – the latter relating to a requirement to read) that are not related to its objectives.

The consequences of this are of little practical impact as obtaining and reading are implicit, but it does introduce further inconsistencies between ISAs in the way objectives are treated.

**The category of 'directly reconcilable'**

We did not agree with categorising other information in certain ways, including the creation of a category of 'directly reconcilable financial information'. This was because the standard was beginning to encourage one methodology over another and, because it introduced extra decisions and procedures, audit procedures would be less efficient.

We are pleased to see that such categorisation has been dropped from the current proposals. However, the thinking behind its introduction has persisted in the form of introducing a requirement for limited procedures on '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'.<sup>17</sup>

This is categorisation by description that will not address our earlier concerns.

In our answer to question 1 above, we draw attention to difficulties attaching to the concept of 'limited procedures'. The solution we propose in that part of this response also addressed the above continuing concern.

**Information about which the auditor has no relevant understanding**

We made the point that we did not see value in the auditor being associated with other information about which the auditor has no relevant understanding.<sup>18</sup> The removal of such information from 'other information' in accordance with our proposals for determining the scope of proposed ISA 720 would eliminate the need for its implicit categorisation. This concern remains unaddressed.

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<sup>17</sup> The quotation is from paragraph 15 of proposed ISA 720 and the wording also occurs in the application material.

<sup>18</sup> The November 2012 proposals introduced a residual category of 'All other information, whether financial or non-financial' about which the auditor may have no relevant understanding.

### Ethical obligation

We previously suggest that users should be informed of the ethical obligation on the auditor to avoid association with inappropriate information (under paragraph 110.2 of the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*).<sup>19</sup>

We continue to believe in the value to users of this information. Paragraph 4 of proposed ISA 720 covers the obligation and paragraph 25 of the *Explanatory Memorandum* explains the relationship between this and the requirement to 'remain alert'. This may suffice for users who read professional standards but if the auditor reporting project requires mention of ethical standards, it would be logical to extend that to their relevance in relation to other information.

The latest publicly available version of proposed ISA 700<sup>20</sup> requires that a report contains 'an explanation that the auditor is independent of the entity in accordance with the relevant ethical requirements that apply to the audit of the financial statements, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.' It would be consistent with that to make a statement in relation to other information, because users are not assumed to know (else they would not need informing) that auditor independence is primarily a matter of ethics. Hence, they cannot be assumed to know what obligations exist in relation to other information.

### No audit opinion or review conclusion

We did not agree with the inclusion in the report of a statement that, in relation to other information, there is no audit opinion or review conclusion. One reason for our opposition was the jargon and resulting need for users to understand 'review' as well as audit.

A more important reason we advanced was that material on other information was not contained in a separate report. The audit report conveys assurance and it is wrong to insert a disclaimer in one part of it.

We understand that the wording is intended to head off user misunderstanding about whether piecemeal assurance is being provided on other information. But the risk of users assuming that piecemeal assurance is being given on aspects of the financial statements (such as going concern) or the valuation of a loan portfolio is arguably much more important, but is not separately addressed.

<sup>19</sup> This obligation may best be communicated, along with similar material, through a statement on the website of the appropriate regulator or standard setter.

<sup>20</sup> IAASB agenda papers 16 to 20 June 2014 (paragraph 28(c) of [20140616-IAASB-Agenda Item 2B-Revised Draft ISA 700-Clean-final](#)).

If the report is to include some wording of this nature, we suggest that the construction employed in proposed ISA 701 for introductory language when KAM are communicated would be more appropriate, for example:

'Our procedures in relation to the other information were designed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, but do not provide a basis for a separate opinion on other information.'

### **Auditor responsibilities**

We offered a concise restatement of the responsibilities statement of the report, based on the supposition that our other suggestions had been accepted. This approach is no longer relevant but we still find the wording now included in paragraph A52 in need of improvement.

### **Effective date**

We expressed concern that the commencement of proposed ISA 720 was drafted in terms of 'audits of financial statements for periods ending on or after [date]'. We noted that this was unusual as almost all ISAs have an effective date that refers to periods beginning on or after a particular date. We were also concerned that if the effective date was specified as proposed and was 12 to 15 months after issuance of the final standard, it could be effective immediately for financial reporting years commencing at the time of issuance. That would be inappropriate given that ISA 720 is concerned not just with reporting but with the conduct of the audit.

This matter has not been resolved.

We provide our views on the proposal to align the effective date with that of the IAASB's Auditor Reporting project in the *General matters* section of this response.



**Other matters**

We expressed concerns about the six matters below and are pleased to note that these have been eliminated:

- the concept of 'initial release'
- the definitions of 'inconsistency' including the concept of omissions and 'a material inconsistency in the other information'
- the introduction of a concept of materiality based on the audited financial statements and the other information as a whole
- the mechanism to determine whether securities offering documents should be excluded from the scope of proposed ISA 720
- duplication of requirements in relation to documentation of the identification of a material inconsistency
- the clarity of application material dealing with retention of other information that was subsequently amended by the audited entity

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