

March 20, 2013

Mr. James Gunn
Technical Director
International Auditing and Assurance Standards
Board
529 Fifth Avenue, 6th Floor
New York NY 10017
USA

by electronic submission

Dear James,

**Re.: Exposure Draft, 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*

*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 our responses contained in the Appendix to this letter to the important Questions posed in the Explanatory Memorandum; this Appendix also includes other comments by paragraph not directly related to these responses.

As a general comment, we would like to remind the IAASB that its standards are to be written using the clarity conventions – the use of which was a prerequisite for potential EU adoption of ISAs. Unfortunately there is no summary of the clarity conventions in a document so that future IAASB members, TAs, and staff would be aware of those conventions. This draft, as well as other recently issued drafts and standards of the IAASB no longer seem to be applying the

Institut der Wirtschaftsprüfer
in Deutschland e.V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
BLZ 300 700 10
Kto.-Nr. 7480 213

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamannt, RA

page 2/24 to the comment letter to the IAASB dated March 20, 2013

clarity conventions in a consistent manner. In this draft, this is exemplified by the above-noted disconnect between the requirements and the application material, the inclusion of “hidden-requirements” (e.g., see the second sentence of A5) in the application material – including through the use of present tense, the use of different terms and phrases to mean the same thing in different standards, the use of footnotes (see footnotes 2, 3, 5, 7, 15 and 19 in the draft standard) to include substantive material (which the EU Commission had noted would not be acceptable for EU adoption), and a reference to the Glossary of Terms in the standard (which the EU Commission viewed as unacceptable because the Glossary of Terms is non-authoritative). We therefore strongly recommend that the IAASB codify the clarity conventions and improve its quality control procedures over the drafting of its standards in this respect.

Overall, we believe that the IAASB needs to rethink the purpose of ISA 720, which will have pervasive implications for the objectives, definitions, requirements and application material in the standard. We believe that this means that re-exposure would likely be necessary to implement those fundamental changes. This also means that the timeline to complete the project will likely need to be independent of the timeline for the auditor reporting project, and that therefore the auditor reporting project should use extant ISA 720 as a basis for its exposure draft and final standard.

We hope that you find our comments useful and would be very pleased if you were to contact us with any further questions or need for clarification that you may have.

Yours truly,



Klaus-Peter Feld
Executive Director



Wolfgang P. Böhm
Director Assurance Standards,
International Affairs

page 3/24 to the comment letter to the IAASB dated March 20, 2013

APPENDIX:

Responses to the Important Questions Posed In the Explanatory Memorandum

Question 1

Audits of financial statements are performed either when required by law or regulation, or when an engaging party voluntarily engages an auditor to perform such an audit. It is beyond the mandate of the IAASB to require an audit of the financial statements or to require assurance on any other subject matter information. Rather, the mandate of the IAASB is to define the requirements for audits of financial statements under the ISAs or for assurance engagements on other subject matter information, *when these engagements are performed*, whether due to law, regulation or a voluntary engagement.

If stakeholders desire assurance on matters beyond the financial statements – whether as part of the audit of the financial statements or as part of a separate engagement – they must either persuade legislators or regulators to provide for a statutory or regulatory requirement to this effect, or persuade preparers to engage auditors for assurance on these other matters. The fact that such assurance on matters beyond the financial statements may be in the public interest does not mean that the IAASB has the right or responsibility to exceed its mandate in this respect: it is legislators and regulators, and perhaps preparers, that would need to respond to the public interest imperative – not the IAASB in its standards.

It is consequently NOT the purpose of ISA 720 to have auditors perform work on information outside of the financial statements for the purpose of providing comfort in the auditor's report to users as to the credibility of the other information – i.e., to obtain assurance and report on the assurance obtained. Rather, **the primary purpose of ISA 720** is to help ensure that the credibility of the auditor's report is not undermined by other information *with which the auditor is associated* that “appears” to be materially inconsistent with the *audited* financial statements (we use the word “appears” because unless the auditor audits or reviews the other information, the auditor is not in a position to conclude whether the other information “is” or “is not” materially inconsistent, but

page 4/24 to the comment letter to the IAASB dated March 20, 2013

the auditor may hold a *belief* in this respect) and thereby fulfill the auditor's obligations under the IESBA Code of Ethics (hereinafter referred to as the "Code").

These ethical requirements under Section 110.2 of the Code require the auditor to not be **knowingly associated** with information where the professional accountant **believes** that the information:

- (a) Contains a materially false or misleading statement;
- (b) Contains statements or information furnished recklessly; or
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

Hereafter, in line with the usage in ISA 700.19, we will refer to "misleading" information to describe the information identified in (a) to (c) above. A **secondary objective of ISA 720** is for the auditor to fulfill his or her ethical obligations under the Code to not be knowingly associated with information the practitioner believes to be misleading even when such information is not directly related to contents of the financial statements or the auditor's report (which is the reason for the requirements in extant ISA 720 in relation to "material misstatements of fact").

The third potential objective mentioned in paragraph 2 (c) of the draft, that the other information may indicate that the financial statements are materially misstated is, in our view, a byproduct of the auditor's responsibility for other information, and not a part of the objective. Financial statements can be audited and then issued without any other information, and therefore detecting material misstatements in the financial statements is not the purpose of the auditor's reading and considering the other financial information. In addition, the other information is usually provided to the auditor very late in the audit process, and at that stage it should be rare that an inconsistency would lead the auditor to conclude that the financial statements are materially misstated.

On this basis, in answer to the first question posed, we do not believe it to be within the mandate of the IAASB or the scope of the ISAs to increase, or strengthen, the auditor's responsibility with respect to other information (however defined) beyond that required by the Code. However, we do believe that the IAASB has a mandate to clarify the nature and extent of such responsibility in a revision of ISA 720, including by taking into account new developments (e.g., electronic communications or amendments need to align ISA 720 to the Code).

page 5/24 to the comment letter to the IAASB dated March 20, 2013

In this respect, the second question on respondents' beliefs on whether extending the auditor's responsibilities with respect to the other information reflects costs and benefits appropriately and is in the public interest is not a relevant question and is, in fact, misleading. Even if the benefits of extending such responsibilities were to significantly outweigh the costs and such extension were in the public interest, this would not imply that the IAASB has a mandate to increase those responsibilities beyond what law, regulation or voluntary engagements set forth. *Such an extension of responsibility would reflect a "scope creep" in audits of financial statements for which there is no basis in law, regulation or voluntary engagements. **However, we would like to be clear that the audit profession would welcome the opportunity to express assurance on other information as part of the audit of financial statements or as part of a separate engagement, if this were required by law or regulation, or if provided for by the terms of engagement.***

Question 2

Given the changes in how documents relate to the audited financial statements on websites and perhaps other social media, as a matter of principle, ***we believe that it is necessary to broaden the scope of "other information" to include information beyond that in documents containing the audited financial statements. In particular, the inclusion of information on websites and perhaps other social media causes an entirely new set of problems that require new solutions with respect to criteria in relation to timing and nature for other information.*** In this context, such a broadening of the scope stands and falls by the precision of the criteria (both in relation to nature and timing) used to define such other information, because unclear criteria will lead to conflict among auditors, management, audit oversight authorities, and users as to the information for which auditors ought to have a responsibility. The criteria used to define other information beyond that currently covered in extant ISA 720 are set forth in paragraphs 9 (b) and (c)(ii) of the draft that define "other information" and "initial release", respectively.

Our review of these provisions and related application material indicates that the criteria in paragraph 9 of the draft are unclear in some respects, and not useful in others. We will address the shortcomings of the concept of "initial release" in our response to Question 3 and focus our response to Question 2 on the definition in 9 (c) and (c) (ii), but not address (c) (i), since this is in extant ISA 720.

page 6/24 to the comment letter to the IAASB dated March 20, 2013

We are concerned with the phrase in 9 (c) “*in connection with* the initial release.” The words “in connection with” are rather vague and could lead to a wide range of information that meets the criteria with respect to nature being included under other information. In particular, it is unclear what the time period before, and especially after, initial release would be covered by “in connection with”. This is very critical to the inclusion in “other information” of information “accompanying the audited financial statements and the auditor’s report thereon” in 9 (c) (ii). This problem is magnified by the uncertainty related to the meaning of “initial release” (see our response to Question 3). These quandaries have led us to the conclusion that there needs to be a clearer delineation between that information with which an auditor is associated, and that not. **We will address the issues relating to the timing criteria first.**

With respect to information issued by management to any third parties (including the general public) prior to the date of the auditor’s report, the auditor might draw upon such information as audit evidence, but because the audit has not yet been completed, the auditor is not associated with that information and this information cannot undermine the credibility of the yet unissued audited financial statements. Consequently, like preliminary announcements, which are not in the scope of extant ISA 720 or the draft, information issued to any third parties prior to the date of the auditor’s report or the issuance of the audited financial statements to those parties cannot be “other information”.

With respect to information issued to any third parties after the date of the auditor’s report, we have come to the conclusion that there needs to be greater alignment between the responsibilities under ISA 720 and ISA 560 in relation to timing. Under ISA 560.10 and .14, the auditor has no obligation to perform any audit procedures regarding the financial statements 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. Since both the auditor reporting project and the draft contemplate auditor reporting on other information in the auditor’s report, it follows that such information must be made available to the auditor by management prior to the date of the auditor’s report. In this respect, we believe that the auditor’s responsibility for other information ought to be aligned with the reporting requirement. This implies that if information is not provided to the auditor prior to the date of the auditor’s report, such information should not be classified as other information for which the auditor has more than a stumble over responsibility under ISA 560. This approach has the added advantage of clarifying auditor association by clearly associating the auditor in the auditor’s report with the information for which the auditor has taken responsibility under

page 7/24 to the comment letter to the IAASB dated March 20, 2013

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 11). 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 addressed as other information in the auditor's report. In addition, financial reporting and securities regulators in particular jurisdictions can stipulate which information or documents are to be classified as such other information for these purposes, which, under this approach, would create a responsibility for management to provide that information or those documents prior to the date of the auditor's report.

We have also come to the conclusion that there needs to be a clearer distinction between situations in which documents contain the audited financial statements under 9 (c) (i) and where they just “accompany” the financial statements under 9 (c) (ii). Furthermore, clarification may also be necessary for cases in which the audited financial statements (i.e., the financial statements and the auditor's report thereon) are made public.

When financial statements remain private, the auditor will generally have come to an understanding with management as to the identity of the *intended* users of the financial statements as part of the engagement acceptance process (e.g., the owners and other capital providers, such as banks and other lenders). In this case, any documents containing the audited financial statements by which the financial statements are made available to any of those *intended* users for the first time, and any other information that meets the criteria for the nature of other information, issued with the audited financial statements to any of those intended users for the first time (whether in paper form, electronically or by means of social media), would be defined as “other information” on the condition that such information be provided to the auditor prior to the date of the auditor's report. This approach would exclude documents that do not contain the financial statements and information provided to those users after the financial statements have been made available to them for the first time. In line with ISA 560 (and in contrast to extant ISA 720), auditors are not associated with and therefore should not have any responsibility for information provided after the financial statements have been made available for the first time to any *intended users*. This approach would also exclude information issued in connection with the provision of the financial statements (and any other documents that contain or accompany them) to users that are not *intended* users.

page 8/24 to the comment letter to the IAASB dated March 20, 2013

When the financial statements are made public (whether by filing or by entity website), the restriction to *intended* users is applicable as above in all respects, but only prior to the financial statements being made public (in this case, the public are the intended users, but some users may obtain the financial statements sooner than the general public). When made public by means of filing, only those documents containing the financial statements, and any documents publicly filed together with the audited financial statements that meet the criteria for the nature of “other information”, would be “other information”. When made public by means of a website, only those documents on the website containing the financial statements, and any information made public together with audited financial statements (that is, at substantially the same time) that meet the criteria for the nature of “other information” would be “other information”. Documents and information made public substantially after the financial statements are made public cannot be “other information” unless so defined by law, regulation or the terms of engagement because otherwise it would be impossible to delineate auditor responsibilities from a timing perspective for such information, particularly for information in the internet, which can be changed at will by management after it is first posted.

If information is not issued together with, or substantially at the same time as, the auditor’s report to intended users (and is defined as other information by law, regulation or the terms of engagement), and no reference is made to that other information in the auditor’s report, then there is no association of the auditor with that information requiring the application of the requirements of the Code.

The appropriateness of criteria relating to the nature of the information also needs to be addressed. The only additional criterion in 9 (c) (ii) for including information that accompanies the audited financial statements in “other information” is that such information “has the *primary purpose* of providing commentary to enhance users’ *understanding of the financial statements* or the *financial reporting process*”. We believe that this is a very clear criterion, but are convinced that its application has not been thought through. We would like to point out that none of the examples of accompanying documents in A12 of the draft would meet this criterion because none have such a *primary purpose*. Our review of publicly available chairman’s statements, corporate governance statements, and internal control and risk assessment reports indicates that these focus *primarily* on strategy and operations in the first two cases, and internal control and risk assessment over operations and compliance in the last case, rather than on the financial statements or financial reporting processes. While they may make reference to matters disclosed in the

page 9/24 to the comment letter to the IAASB dated March 20, 2013

financial statements, even the management (or director's) report and operating and financial review concentrate on the position of the enterprise, its future prospects and strategy, and its risks and opportunities, rather than on the financial statements or the financial reporting process. On this basis, the IAASB needs to ask itself whether this criterion is useful at all. Perhaps a better criterion would be whether the information includes significant references to matters in relation to the financial statements or the auditor's report. In any other case, when the information is not in documents that contain the audited financial statements, such information can only be classified as "other information" when law, regulation or the engagement terms require it to be.

In summary, based on this analysis, we believe "other information" ought to be defined somewhat as follows:

"Information (other than the audited financial statements and the auditor's report thereon) that:

- (a) Is provided by management to the auditor prior to the date of the auditor's report so that the auditor is able to read and consider that information prior to that date and address the information in the auditor's report;

And

- (b) Is
 - (i) Provided to any intended users, with the audited financial statements and auditor's reports thereon when these are made available to any of those intended users by any means for the first time,
 - (1) In a document containing the audited financial statements and the auditor's report thereon, or
 - (2) At substantially the same time as the audited financial statements and the auditor's report thereon, and the information includes significant references to matters relating to the financial statements or the auditor's report;

Or

- (ii) Required by law, regulation, or the terms of engagement, to be addressed in the auditor's report as other information and be provided to intended users."

page 10/24 to the comment letter to the IAASB dated March 20, 2013

On this basis, we also suggest using a more informative title than “other information”: we suggest using the term “relevant accompanying information”.

Question 3

In answer to the first question, we do not find the concept of initial release in paragraph 9 (b) to be clear and understandable; we also have come to the conclusion that the definition is inappropriate for the following reasons:

- The words “for a reporting period” are inappropriate because, even though most financial statements (and hence audit reports) relate to a reporting period, there are exceptions (e.g., an opening balance sheet). Even when the financial statements relate to a reporting period, then the reference to the reporting period in the definition is redundant. The reference to the “same reporting period” in A5, on the other hand, does not aid the definition in this case, and is necessary only because A5 posits that information released after “initial release” is also other information if it meets the other criteria for other information. As we point out in our response to Question 2, this would lead to auditor responsibility for other information being unclear. For these reasons, the reference to “reporting period” in 9 (b) can be deleted.
- The phrase “often the shareholders” in 9 (b) neither belongs in a definition nor does it reflect the situation for many types of entities and audit engagements in many jurisdictions. The word “often” means that shareholders may sometimes not be the group of users for whom the auditor’s report is prepared. Consequently, because the phrase “often the shareholders” relates to a matter that is not a distinguishing characteristic of an initial release required for its definition, the phrase, if appropriate, ought to be placed in the application material. However, we also believe that the phrase is inappropriate because, depending on the jurisdiction, the nature of the entity and the audit engagement, the group of users for whom the auditor’s report is prepared may in many cases not be the shareholders. Since the phrase is not applicable universally, the phrase in 9 (b) should be deleted or, at most provided as an example in the application material.
- It is also unclear to us what the phrase “the group of users for whom the auditor’s report is prepared” signifies. We would like to point out that for whom an auditor’s report is prepared is defined by the terms of the engagement (usually the engaging party for a voluntary audit) or law or regulation for a statutory audit. In many cases, the *intended* users of an

page 11/24 to the comment letter to the IAASB dated March 20, 2013

auditor's report are a broader group of users than for whom the auditor's report is prepared. For example, for certain types of entity in some jurisdictions, the financial statements and the auditors' reports thereon are filed publicly and the intended users include the general public, but under the terms of engagement or the law, those are not the parties to whom the auditor is accountable – i.e., they are not the group of users for whom the auditor's report is prepared (e.g., the engaging party). For this reason, we do not believe that the concept of “the group of users for whom the auditor's report is prepared” is a useful concept to determine when information is “other information”.

- It is also unclear to us what “first made *generally* available to the group of users” means. Does this mean that if the financial statements and auditor's report are made available to other than all of the users in that group, that initial release has not occurred? Or does this mean that initial release has occurred when the financial statements and auditor's report are made available to some (at least one?) or most of those users? *In line with our response to Question 2, we believe that it would be more fruitful for the IAASB to consider having the auditor identify who the intended users are (for financial statements that remain private) and to take responsibility for documents that contain, or are issued with (at substantially the same time as) the financial statements and the auditor's report when these are issued for the first time to any such intended users (for financial statements and auditors' reports that are made publicly available, this means first issuance to intended users up to, and including, that date – but not beyond).*

In answer to the second question, it is clear that the date of the initial release may be different from the date the financial statements are issued as defined in ISA 560. However, based on our previous comments, this is not a helpful distinction for determining when information is “other information”.

Overall, based on our analysis and recommendations in our response to Question 2, there does not seem to be a need to define a term such as “initial release”.

Question 5

We do not believe that the objectives of the proposed ISA are appropriate and clear. Aside from the matters with which we take issue related to our response to Questions 5(a) and 5(b) below, we believe that the objectives are not appropriate also because the objectives should provide the overall aims of the

page 12/24 to the comment letter to the IAASB dated March 20, 2013

requirements in the ISA (that is, what the requirements are seeking to achieve) – not seek to summarize the requirements. The objectives in 8 (a) and (b) seek to summarize the requirements, rather than to set the aims of those requirements.

In addition, the division of paragraph 8 (a) into (a) (i) and (a) (ii) suggests that upon reading and considering the other information *and prior to responding appropriately*, the auditor either identifies whether there may be a material inaccuracy within the other information or identifies whether the audited financial statements may be materially misstated. In fact, an auditor would not be able to conclude whether there may be material inaccuracy within the other information or whether the audited financial statements may be materially misstated until the auditor has performed the procedures and obtained the evidence needed to respond appropriately, which would then permit the auditor to conclude either that the other information is materially inaccurate or the audited financial statements are materially misstated (or both). The same problem applies to paragraph A35 and the division of the requirements in paragraphs 11 and 15. The way the requirements are written now, it suggests that the auditor needs to make a preliminary decision as to where the problem is, which is not how this would be done in practice. This problem stems from the use of the word “inconsistent” in an absolute sense (i.e., an inaccuracy in the other information), rather than using it in its relative sense, which would signify differences between the other information and the financial statements (and perhaps the understanding) – see our responses to Questions 6 and 7.

Based on our analysis in our responses to Questions 1 and 2, we have also concluded that the objective underlying the reporting requirements in the draft CANNOT be to obtain assurance and convey that assurance to users about other information, but to provide transparency to users about the association of the auditor with other information.

Based on our analysis above and in our responses to Question 5(a) and 5(b) below, we believe the objective should read somewhat as follows:

“The objectives of the auditor are:

- (a) To prevent the association of the auditor with other information that:
 - (i) the auditor believes is misleading because it undermines the credibility of the auditor’s report by appearing to be materially inconsistent with the audited financial statements or the auditor’s report, or

page 13/24 to the comment letter to the IAASB dated March 20, 2013

- (ii) would cause the auditor to be knowingly associated with that information when the auditor believes it is otherwise misleading; and
- (b) To provide transparency to users about the association of the auditor with other information.”

Question 5(a)

In answer to the first question, we do not believe that the use of the phrase “in light of the auditor’s understanding of the entity and its environment acquired during the audit” in the objective is clear, and therefore we believe it will be subject to differing interpretation by auditors and audit oversight authorities.

First, it is not clear from the phrase whether a comparison between the auditor’s understanding and the other information is required to determine whether there appears to be a material inconsistency between them, because the phrase “in light of” could suggest that rather than the application of a comparison process, the auditor is only required to use the understanding as context. The wording needs to be aligned with the objective under the Code.

Second, no mention is made of the financial statements. This could be construed as meaning that no comparison is required between the financial statements and the other information to determine whether there is a material inconsistency between them. If one views the “understanding of the entity and its environment acquired during the audit” as including an understanding of the financial statements, it also suggests that no comparison is required between the financial statements and the other information because the auditor would only be required to use the understanding of the financial statements as context. Here as well, the wording needs to be aligned with the objective under the Code.

Third, the phrase “acquired during the audit” suggests that information of which the auditor is aware that was not acquired during the audit need not be applied in considering whether the other information contains a material inaccuracy. This would violate the requirement in the Code for the auditor not to be knowingly associated with information that the auditor believes is misleading (regardless of the source of that belief), and would be narrower than what extant ISA 720 currently requires for material misstatements of fact.

Another question is what the “understanding ... acquired during the audit” encompasses. Does it encompass what is in the mind of the auditor (whether

page 14/24 to the comment letter to the IAASB dated March 20, 2013

the firm, engagement partner or appropriate level of staff) based on the audit, or does it encompass the entire contents of engagement documentation? We note that neither ISA 315 nor the draft define the “understanding” with enough precision for this purpose. This leads to the second question as to whether additional clarity is provided in the requirements and application material.

In answer to the second question, we do not believe 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. In fact, we are convinced that the requirements and guidance add to the confusion.

Paragraph 11 of the draft states that “the auditor shall read *and consider* the other information in light of the auditor’s understanding of the entity and its environment acquired during the course of the audit”.

Under the clarity conventions applied by the clarity project, the IAASB sought to limit the term phrase “the auditor shall consider” to instances in which the auditor is required to apply his or her mind to a particular matter. From this perspective, we welcome the addition of “and consider” to the requirement in paragraph 11 because “read” on its own as used in extant ISA 720 does not reflect what auditors are actually expected to do. The requirement on its own suggests a relatively low level of work effort that would be consistent with the provisions of the Code on association with misleading information. However, in this context we note a complete disconnect between the requirement in paragraph 11 of the draft and the related application material in paragraphs A37 and A43. We note that in paragraph A37 (a) to (c), all of the guidance extends the work effort far beyond having the auditor apply his or her mind to the matters addressed. The same applies to the guidance in A37 (d) in connection with A43. ***In our view, this violates the clarity conventions, since application material is supposed to be used to help clarify a requirement by using explanations and examples to provide auditors with a sense of the boundaries of the requirement – not to include hidden requirements by setting expectations in the application material not covered in the requirement itself. In our view, using the application material in this way is dangerous because it suggests that the word “consider”, which is used throughout the ISAs, can mean considerably more than just applying one’s mind.***

If the IAASB wishes to have auditors do more than just applying their minds, then the requirement in paragraph 11 should be clear on this. If not, then the application material needs considerable revision.

page 15/24 to the comment letter to the IAASB dated March 20, 2013

In our view, the guidance in paragraphs A37 and A43 also violate the underlying foundation of ISA 720 as we have expressed in our proposed objective above for ISA 720 based on our analysis in our responses to Questions 1 and 2. We would like to point out that the cumulation of all of the procedures suggested in A37 (a) to (c) and in A37 (d) in connection with A43 would generally suffice for the auditor to provide an opinion on the consistency of the other information with the financial statements and with the auditor's understanding.

As we pointed out in our response to Question 1, requiring the auditor to engage in a work effort that would support a reasonable assurance or limited assurance conclusion on the other information is beyond the mandate of the IAASB. For this reason, we strongly recommend that the requirement and related application material be limited to “reading and considering” – that is, to reading and applying one’s mind.

Without considering the application material thereto, the weaknesses of the phrase “in light of the auditor’s understanding of the entity and its environment acquired during the course of the audit” that we have identified for the objectives apply to paragraph 11 of the requirements, too. Paragraph A33 provides some guidance on who should read the other information, but the requirement itself is too open-ended in this respect.

We note that the application material in A31 is particularly useful in clarifying that the requirement in paragraph 11 of the draft encompasses being alert to other information that is also inconsistent with the audited financial statements (beyond just being inconsistent with the auditor’s understanding). However, the use of the present tense “involves” suggests that this is a hidden requirement that therefore, in line with the IAASB clarity conventions, ought to be placed in the requirement.

Question 5(b)

The function of the phrase “having read and considered the other information” set off with commas within the introductory clause of the objective in paragraph 8 is unclear. The phrase appears to function as an adjectival participial phrase modifying “auditor”, which means that the objectives in 8(a) and (b) apply to auditors that have read and considered the other information, but then reading and considering the information would be presumed and not a part of the objectives of the auditor. In this case, the objectives paragraph would fail to include reading and considering the other information as a part of the objective.

page 16/24 to the comment letter to the IAASB dated March 20, 2013

Hence, the introductory clause in paragraph 8 does not explain the aim of reading and considering the information, which we believe needs to be a part of the objectives.

Furthermore, as we note in our response to 5(a) above, it is not clear from the wording of the objectives or the requirement alone (without reference to the application material) whether the objective includes considering the other information for consistency with the audited financial statements. This is, from our point of view, untenable, because it may lead practitioners to believe that considering the other information for consistency with the audited financial statements is not required in every case.

We note that the word “consistency” in the Question is being used in its relative sense, which shows how difficult it is to limit its use to an absolute sense.

Questions 6 and 7

We do not agree that the definitions of terms of “inconsistency” including the concept of omissions and “a material inconsistency in the other information” are appropriate, nor do we believe that users of auditors’ reports will understand the concept of consistency as defined.

As we note in our response to Question 5, the word “inconsistency” is being used in an absolute (i.e., an inaccuracy within the other information) rather than a relative sense (i.e., a difference between the other information, and the audited financial statements or auditor’s report). The word “inconsistency” in common English and technical usage is only used in the relative sense. It is therefore entirely counterintuitive to use it in an absolute sense. Neither auditors nor users are likely to understand this shift in meaning – particularly users, because no explanation of the meaning of an inconsistency is provided in the wording of the statement to be included in the auditor’s report in paragraph A57 of the draft. We therefore strongly recommend that the IAASB use the word inconsistency to refer to a difference between other information, and the financial statement or auditor’s report. This implies that the IAASB apply another term to refer to inaccuracies in the other information that are not inconsistencies. Extant ISA 720 uses the term “material misstatements of fact”. We recognize that the word “fact” may be too narrow to satisfy the requirements under the Code not to be knowingly associated with information the auditor believes to be misleading, since even if the presentation of a fact is true, it may still not be fair (i.e., still be misleading). We suggest that the term “misleading” encapsulates the meaning and intention of the Code, and would be in line with

page 17/24 to the comment letter to the IAASB dated March 20, 2013

the “misleading test” for compliance frameworks under ISA 700.19. If the term “misleading” in relation to other information is used, it would be necessary for the definitions section to include a definition thereof that then cites Section 110.2 (a) to (c) of the Code of Ethics.

The use of the word inconsistency in an absolute sense also leads to the problem of the division of the objectives into 8 (a) (i) and (ii), which suggests that the auditor either identifies whether there may be a material inaccuracy within the other information or identifies whether the audited financial statements may be materially misstated. In fact, an auditor would not be able to conclude whether there may be material inaccuracy within the other information or whether the audited financial statements may be materially misstated until the auditor has performed the procedures and obtained the evidence needed to respond appropriately, which would then permit the auditor to conclude either that the other information is materially inaccurate or the audited financial statements are materially misstated (or both). The same problem applies to paragraph A35 and the division of the requirements into paragraphs 11 and 15. The way the requirements are written now, it suggests that the auditor needs to make a preliminary decision as to where the problem is, which is not how this would be done in practice.

In this respect, we believe that the descriptions in paragraph 9 (a) (i) and (ii) of the definition of inconsistency cause considerable confusion and are therefore not helpful. As we pointed out in our responses to Questions 1, 2 and 5, the responsibility of the auditor is to fulfill relevant ethical requirements under the Code (Section 110.2) relating to auditor association with other information. In this respect, the definition in 9 (a) (i) and (ii) is neither in line with the wording of the Code, nor aligned with the objectives of ISA 720 as we propose them in our response to Question 5. We believe that the definitions in 9 (a) need to be aligned with the Code and the objectives. In particular, an inconsistency should result from differences between the other information and the financial statements and misleading information should be defined in line with our proposal for the objectives by reference to Section 110.2 of the Code of Ethics, rather than defining an inconsistency as information that is “incorrect”, unreasonable, or inappropriate” or “is presented in a way that omits or obscures information ... necessary to properly understand...”.

We note that “incorrect”, “unreasonable” and “inappropriate” are not defined in the draft (nor is there any application material provided thereto), and it is not clear how these relate to the definition of “misleading information” that would result from the application of the Code. The application material in paragraph A2

page 18/24 to the comment letter to the IAASB dated March 20, 2013

seems to suggest that these terms in the Code and the draft all mean the same thing (and then adds another term “materially false or misleading”¹ to add to the confusion), but if that is the case, why is the IAASB creating new terminology to define what is already described in the Code? This approach will cause more confusion for practitioners than aid in their application of the standard. In addition, without clear criteria as to when information is incorrect, unreasonable or inappropriate, audit oversight authorities will develop their own interpretations of what is “incorrect”, “unreasonable” or “inappropriate”. On the whole, we would not favor using, and therefore needing to define, these terms in this context when the Code provides the needed terminology.

In relation to the further definition of “materiality” as part of this definition, we have the following reservations:

- It introduces the concept of influencing economic decisions of users for whom the auditor’s report is prepared, which, as we point out in our response to Question 3, is neither a clear nor a helpful concept.
- It introduces the concept of “material ... taken on the basis of the audited financial statements *and the other information as a whole*.” Does this mean that auditors need to determine a level of materiality for the financial statements and other information as a whole through analogous application of ISA 320? If not, how is this concept to be applied? We do not believe that it is appropriate to extend the concept of materiality in this way.

For the reasons we note, we strongly recommend that an inconsistency be defined as a discrepancy or difference between the other information, and the financial statements and auditor’s report. A material inconsistency would be defined as such an inconsistency that is misleading as described in Section 110.2 of the Code. Other information that does not relate to the financial statements or the auditor’s report, but that meets the criteria for “misleading” under Section 110.2 of the Code would be

¹ The term “materially false or misleading” was originally proposed in a draft of ISRS 4410 as a replacement for „materially misstated“ and the association requirements of Section 110.2 of the Code and was thereupon used in subsequent drafts of ISA 720. However, “materially false or misleading” was rejected thereafter by the IAASB for ISRS 4410 not only because “material misstatement” was considered appropriate for ISRS 4410, but also because “materially false or misleading” did not appropriately reflect the content of Section 110.2 of the Code, and because ISA 700.19 summarizes the content of that Section using the word “misleading”. Furthermore, it is unclear whether the adjective “materially” also applies to misleading, which would be incorrect because information that is misleading is, by definition, material. The latter three reasons for rejecting “materially false or misleading” also apply to ISA 720. It is therefore unclear why the IAASB chose to retain that term in the draft.

page 19/24 to the comment letter to the IAASB dated March 20, 2013

considered as otherwise misleading (an extension of the concept of a “material misstatement of fact”).

Question 8

The important issue with respect to the fulfillment of the auditor’s responsibility under Section 110.2 of the Code is the nature and extent of the work effort required as a basis for the belief as to whether the other information “appears” to be materially inconsistent with the audited financial statements and to not “knowingly” be associated with information that the practitioner “believes” is misleading.

In our response to Question 5 (a), we come to the conclusion that we do not agree with the nature and extent of the auditor’s work effort with respect to other information. We provide our reasons in our responses to 8 (a) to (c) below, which are derived from our response to Question 5 (a).

Question 8(a)

We do not believe that a principles-based approach has been applied to determining the extent of work the auditor is expected to undertake when reading and considering the other information. A principles-based approach means that the requirement contains a principle that is then further explained and then supported by means of examples so that auditors (and audit oversight authorities) understand the requirement by, for example, shedding light on the boundaries of the requirement. Instead the approach in the draft includes a low-level requirement with application material that depicts a work effort that exceeds the underlying requirement in every respect.

Under the clarity conventions applied by the clarity project, the IAASB sought to limit the term phrase “the auditor shall consider” to instances in which the auditor is required to apply his or her mind to a particular matter. From this perspective, we welcome the addition of “and consider” to the requirement in paragraph 11 because “read” on its own as used in extant ISA 720 does not reflect what auditors are actually expected to do. The requirement on its own suggests a relatively low level of work effort that would be consistent with the provisions of the Code dealing with association with misleading information.

However, in this context we note a complete disconnect between the requirement in paragraph 11 of the draft and the related application material in paragraphs A37 and A43. We note that in paragraph A37 (a) to (c), all of the

page 20/24 to the comment letter to the IAASB dated March 20, 2013

guidance extends the work effort far beyond having the auditor apply his or her mind to the matters addressed. The same applies to the guidance in A37 (d) in connection with A43. ***In our view, this is a clear violation of the clarity conventions, since application material is supposed to be used to help clarify a requirement by using explanations and examples to provide auditors with a sense of the boundaries of the requirement – not to include hidden requirements by setting expectations in the application material not covered in the requirement itself. In our view, using the application material in this way is dangerous because it suggests that the word “consider”, which is used throughout the ISAs, can mean considerably more than just applying one’s mind.***

If the IAASB wishes to have auditors do more than just applying their minds, then the requirement in paragraph 11 should be clear on this. If not, then the application material needs considerable revision.

In our view, the guidance in paragraphs A37 and A43 also violate the underlying foundation of ISA 720 as we have expressed in our proposed objective above for ISA 720 based on our analysis in our responses to Questions 1 and 2. We would like to point out that the cumulation of all of the procedures suggested in A37 (a) to (c) and in A37 (d) in connection with A43 would generally suffice for the auditor to provide an opinion on the consistency of the other information with the financial statements and with the auditor’s understanding.

As we pointed out in our response to Question 1, requiring the auditor to engage in a work effort that would support a reasonable assurance or limited assurance conclusion on the other information is beyond the mandate of the IAASB. We recognize that some (not all) audit firms already perform some or a large portion of these procedures for firm risk management reasons. However, auditing standards should not include requirements to satisfy firm risk management objectives – that is within the purview of the firms. For this reason, we strongly recommend that the requirement and related application material be limited to “reading and considering” – that is, to reading and applying one’s mind.

Without considering the application material thereto, the weaknesses of the phrase “in light of the auditor’s understanding of the entity and its environment acquired during the course of the audit” that we have identified for the objectives apply to paragraph 11 of the requirements, too. Paragraph A33 provides some guidance on who should read the other information, but the requirement itself is too open-ended in this respect.

page 21/24 to the comment letter to the IAASB dated March 20, 2013

We note that the application material in A31 is particularly useful in clarifying that the requirement in paragraph 11 of the draft encompasses being alert to other information that is also inconsistent with the audited financial statements (beyond just being inconsistent with the auditor's understanding). However, the use of the present tense "involves" suggests that this is a hidden requirement that therefore, in line with the IAASB clarity conventions, ought to be placed in the requirement.

Question 8(b)

In line with our response to 8(a), we do not believe that the categories of other information, nor nature and extent of the work effort for each category is appropriate.

Question 8(c)

In line with our responses to 8(a) and (b), we believe that the work effort is beyond the expected level and does extend the scope of the audit beyond that necessary for the auditor to express an opinion on the financial statements.

Question 10

Given the issues we have identified with the requirements in paragraphs 11 and 15 as noted in our response to Question 5, we do not believe that 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.

As we note, the division of the requirements to respond to apparent inconsistencies in paragraphs 11 and 15 suggests that upon reading and considering the other information, the auditor either identifies whether there may be a material inaccuracy within the other information or identifies whether the audited financial statements may be materially misstated. In fact, an auditor would not be able to conclude whether there may be material inaccuracy within the other information or whether the audited financial statements may be materially misstated until the auditor has performed the procedures and obtained the evidence needed to respond appropriately, which would then permit the auditor to conclude either that the other information is materially inaccurate or the audited financial statements are materially misstated (or both). The way the requirements are written now, suggests that the auditor needs to

page 22/24 to the comment letter to the IAASB dated March 20, 2013

make a preliminary decision as to where the problem is, which is not how this would be done in practice. Furthermore, in relation to paragraph 15, just because the auditor identifies that the auditor's prior understanding was incorrect or incomplete, does not mean that the auditor believes that the financial statements might be materially misstated. We believe that a requirement that refers to the need to evaluate whether the risks of material misstatement at the assertion level remain appropriate as required by ISA 330.25 would be clearer.

Question 11(a)

In line with our response to Question 5 (a), if the draft were to only require the auditor to "read and consider" other information, rather than also consider the guidance in the A37 to A43, then the terminology "read and consider" is appropriate – otherwise it would not be. Hence, its clarity depends upon how what is meant in the draft. As also noted in our response to Question 5 (a), we do not believe that auditors or users will understand "in light of our understanding of the entity and its environment acquired during our audit" because it is not clear. We also believe that not only information acquired during the audit is relevant because under the Code the auditor is responsible for not being associated with misleading information even if the basis for believing it is misleading was acquired from outside of the audit. Furthermore, in light of our responses to Questions 5, 6 and 7, we do not believe that "material inconsistencies" is clear or understandable because it relates to material inaccuracies within the other information rather than to differences between the other information and the financial statements. Hence, the term "material inconsistencies" is not aligned with the technical or general English usage of the term "inconsistencies".

Question 11(b)

We believe that the conclusion that states "no audit opinion or review conclusion" properly conveys that no assurance is being expressed with respect to the other information. However, in line with our responses to Questions 2 and 5, we believe that there needs to be more transparency with respect to information that is not other information. In particular, the report should expressly disassociate the auditor from information not mentioned in the auditor's report to meet the objective of providing transparency to users. In line with our response to Question 2, we also believe that changing the title of "other

page 23/24 to the comment letter to the IAASB dated March 20, 2013

information” to “relevant accompanying information” would make this paragraph more understandable. On this basis, we would suggest the following wording as the last sentence for the wording of the report in A57 of the draft:

“We have not read or considered, and are therefore not associated as part of our audit of the financial statements in any way with, any other documents or information made available by management to users of the financial statements, other than the Relevant Accompanying Information specified above and the financial statements upon which we express our opinion in this report.”

Question 12

This question is misleading because it suggests that it might be within the remit of the IAASB to require assurance on other information as part of a financial statement audit. First, no assurance is being expressed (assurance cannot be provided, as noted in the Assurance Framework), as noted in Question 11. Second, it is not within the mandate of the IAASB to require assurance on information outside of the financial statements as part of a financial statement audit as noted in our response to Question 1. If users desire assurance, then it is their responsibility to make their case to legislators, regulators and preparers, not the responsibility of the IAASB to require assurance. The profession would welcome the opportunity to express assurance on other information in these circumstances.

Additional Comments By Paragraph

We have limited our comments by paragraph to additional issues identified beyond the issues identified in our responses to the questions posed in the Explanatory Memorandum.

A9. It is unclear to us what the first sentence means by the phrase “translated into other languages”. Other languages than what – the language the document was originally prepared in or that provided to any intended user? The second sentence adds to the confusion by stating that the auditor’s responsibilities do not extend to translated documents. Does this also apply if some intended users receive the documents in one language and other intended users in another? In our view, any information meeting the definition of other information (as we propose in

page 24/24 to the comment letter to the IAASB dated March 20, 2013

our response to Question 2) would need to be in the scope of the ISA, regardless of whether one or more languages were involved.

- A10. This paragraph presumes that documents containing audited financial statements only relate only to annual financial statements and therefore to annual reports (which may be known by a different term). This is not the case because audited financial statements and documents also exist for shorter periods. The paragraph needs amendment accordingly.
- A25. In line with our responses to the Questions, we believe that information that is not provided to the auditor prior to the auditor's report should not be construed as other information. If information is required by law, regulation or the engagement terms to be treated as other information, but that information is not made available prior to the date of the auditor's report, then that information is not other information, but the auditor would need to describe the fact that information required to be other information was not provided to the auditor so that the auditor could read and consider the information so as to be able to make reference to that information in the auditor's report. This approach would make paragraphs A26 and A27 superfluous.