For the attention of Ms Kathleen Healy
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
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USA

[Submitted via IAASB website]

18 July 2014

Dear Ms Healy

IAASB Exposure Draft ISA 720 (Revised) – 'The Auditor's Responsibilities Relating to Other Information'

We[1] appreciate the opportunity to comment on the IAASB's proposed re-exposure draft of revisions to International Standard on Auditing, ISA 720 (Revised), 'The Auditor's Responsibilities Relating to Other Information'.

Overview of our key messages

Overall, we support the direction now being proposed in the Exposure Draft of ISA 720 (Revised). We commend the IAASB for listening to the significant concerns that we and other respondents expressed with respect to the clarity and practicability of the 2012 proposals and for making substantive changes in response.

It is important that the standard be based on what can reasonably be expected of, and achieved by, auditors with respect to their involvement in other information reported by an entity, within the overall context of the audit of the financial statements. In that respect, we strongly support the change made to the work effort requirements to clearly explain that the 'limited procedures' to be performed by the auditor are restricted to being the basis for evaluating the consistency of the other information with the financial statements. We believe this change is a clear step forward in that direction.

We recognise that simply limiting the auditor's work effort to assessing whether there are material inconsistencies between the other information and the audited financial statements will not meet all stakeholders' expectations. Therefore, we support, in principle, the intended aim of the additional elements of the proposed work effort requirements to leverage the auditor's wider knowledge of the entity and its environment. The auditor can bring that knowledge to bear when reading and considering the other information – but there are boundaries to what is practically achievable and reasonable to expect. As the nature of other information moves progressively further away from being related to the audited financial statements, so too does the auditor's ability to identify potential 'misstatements' of the other information and to influence the entity's reporting. For this reason, it is very difficult to explain the auditor's proposed expanded involvement with the other information in

[1] This response is being filed on behalf of PricewaterhouseCoopers International Limited (PwCIL). References to "PwC", "we" and "our" refer to PwCIL and its global network of member firms, each of which is a separate and independent legal entity.

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the auditor's report in a manner that does not risk exacerbating the expectations gap that already exists.

While we believe that the Exposure Draft is much improved from the previous proposals, we draw to your attention below a number of specific areas that could still inadvertently create unclear, and potentially unrealistic, boundaries on the auditor's work effort and that may cause some confusion, both to auditors and users of the auditor's report, if not clarified in finalising the standard. In the appendix to this letter, as part of our responses to the specific questions posed in the exposure draft, we offer specific comments on the wording of the definitions, requirements and report content that would address these concerns.

Definition of 'Misstatement of the other information'

We believe the definition of 'misstatement of the other information' is too broad.

The term, as described, combines the concepts of 'inconsistencies' and 'misleading information' under a single term 'misstatement', which, in the first instance, is inconsistent with how the terms 'misstatement' and 'misleading' are used elsewhere in the IAASB's authoritative literature.

This is more than semantics, however. Given the potential breadth of information that the auditor is being asked to consider in the other information, being able to judge whether there appears to be a "misstatement" in the other information because something has been omitted from, or otherwise obscures, information necessary for a proper understanding is highly judgemental in the absence of criteria or a framework on which to make that judgement (the basis for a 'misstatement' as defined elsewhere in the ISAs and other standards). Depending on the nature of the information, auditors may also not be best placed to make such a judgement. The further the other information is removed from being related to the audited financial statements, the more difficult, if not unrealistic, it will be for the auditor to both identity issues, and be able to *determine* that a 'misstatement' of the other information exists. We are, therefore, concerned that the way the requirements are worded may create unrealistic expectations in this regard, with the result that auditors could be unfairly held responsible for any subsequently detected omission or other problem in that information.

We believe that it would bring greater consistency with the extant standards, help reduce implementation difficulties, and avoid any unintended consequences, if the standard included, as separate definitions:

- Inconsistencies between the other information and the audited financial statements or the auditor's knowledge obtained during the course of the audit; and
- Misstatements of fact or apparent omission of fact that make the other information misleading.

We elaborate further in our response to question 1 in the appendix.

Work effort – 'remaining alert' for other indications that the other information appears to be materially misstated

The final element of the proposed work effort in paragraph 14(c) is not well understood. The distinction between this obligation and the separate obligation under paragraph 14(b) to 'consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained during the course of the audit' is a subtle one. In our discussions, a number of questions were raised about the intent of, and expectations of auditors under, this final element of the requirement and what it is *"beyond the auditor's knowledge obtained during the course of the audit"* that auditors are supposed to be reading and considering the other information in light of. We are not convinced it is necessary.

Concluding and reporting on 'misstatements of the other information'

We can foresee practical issues in the application of requirement 16(a), which requires auditors, upon identifying that a material inconsistency appears to exist (or becoming aware of other information that appears to be materially misstated), to perform further work to *determine* whether a material misstatement of the other information exists. Making such a determination gives rise to questions about the nature and extent of additional procedures the auditor might need to perform, and how much evidence is required, to be able to make such a determination with sufficient confidence – if the auditor is even able to do so in all circumstances given the nature of the information, as we explain above. This also represents an inherent conflict as the standard does not require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements. We propose some alternative wording, applying our proposed alternative definitions, for consideration in the appendix.

Reporting

Derived from the comments above, we are concerned that the proposed wording for the auditor's report, in particular the use of the words 'determine' and 'misstatement', may be susceptible to misinterpretation and lead users of the financial statements to draw inappropriate conclusions about the extent of work performed by the auditor in relation to the other information. We provide suggested alternative report wording in the appendix in response to question 3.

Jurisdiction implementation

We recognise that there are challenges in drafting an international standard that can address the many different practices that exist in jurisdictions around the world with respect to what is considered to be part of an entity's 'annual report' and the timing of release of those documents. We believe the IAASB proposals are a sensible compromise and any further specificity in requirements and practical guidance is best left to national standard setters, who can tailor their local standard to explain how these ISA requirements should be applied in their particular circumstances.

We have, however, included some further observations on circumstances when no other information is available at the date of the auditor's report in our response to question 4, in the appendix to this letter.

In conclusion, we believe the proposed standard is much closer to being a robust and workable framework for the auditor's involvement with other information in the context of the audit of financial statements, but the refinements described above are needed to bring clarity to boundaries of the auditor's work effort and avoid creating unrealistic expectations.

We continue to see demand growing for separate 'assurance' over key performance indicators disclosed by companies in their annual reports. But as we acknowledged in our response to the 2012 exposure draft, ISA 720 – addressing the auditor's responsibilities for the other information as a basis for forming an opinion on the financial statements – is not the appropriate vehicle to address that demand.

However, with the changes we are proposing, we believe that the proposed revised standard will leverage the knowledge gained in the financial statement audit to the other information in a meaningful and practical way and is an important first step in addressing calls from users of financial statements for greater involvement of auditors in the other information published by companies.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Jamie Shannon, at jamie.shannon@uk.pwc.com or me, at richard.g.sexton@uk.pwc.com.

Yours sincerely,

Richard G. Sexton
Vice Chairman, Global Assurance

Appendix

Request for specific comments

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.**

Objective and scope

We believe the scope of the proposed standard is appropriate.

We broadly support the revised objective but note that, based on our comments in this response letter, some revisions to the wording would be necessary. In particular, part (c) of paragraph 11 would need updating if our recommendations for the definitions and work effort requirements set out below were to be adopted.

Definitions

Annual report

We appreciate that the IAASB needs to draft standards that are capable of being applied globally. In that context, the proposed definition of 'annual report' is a suitably balanced compromise in trying to define the scope of documents that fall within the scope of the standard. Recognising different reporting practices across jurisdictions, there will be implementation challenges that need to be resolved. In our view, this is best left to local national standard setters to address, who have the requisite experience of territory reporting practices to add additional prescription, as necessary, to support the IAASB's definition.

Misstatement of the other information

As we note in our cover letter, we have concerns over the proposed definition of 'misstatement of the other information'. The term 'misstatement' is clearly defined and applied in the ISAs and ISAEs in terms of a departure from an applicable financial reporting framework or applicable criteria. There is therefore a clear frame of reference for determining a misstatement – and one that is fully within the auditor's knowledge and competence. Similarly the term 'misstatement of fact' as used in extant ISA 720 is clearly defined and unambiguous. Our concerns over the proposed definition are thus:

- Incorporating the concept of 'omits or obscures'[2] into the definition of 'misstatement of the other information' is problematic. Without an appropriate framework or criteria against which to assess the other information, how can an auditor determine that an omission or obscured presentation constitutes a misstatement? Depending on the underlying nature of that required information, auditors may also not be best placed to determine omissions;

[2] 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).

- The inclusion of the term 'misleading' as an integral part of the definition is inconsistent with the definition of misstatement and the use of the term misleading in the ISA literature. ISA 700 paragraph 19 addresses them as separate concepts – in fact, it makes the point that in the context of a compliance framework, the financial statements may be misleading even though there is no misstatement. Therefore one does not always equate to the other; and
- Determining whether other information is misstated is a much lower threshold than determining that which is apparently misleading.

This definition has direct implications for the auditor's work effort. As we explain in our comments on the work effort requirements below, in our cover letter, and in response to question 2, we believe that, given the broad nature of other information that auditors are being asked to consider, this single definition that encompasses concepts of inconsistencies, misstatements of fact and misleading information cannot be appropriately applied against all aspects of the auditor's work effort. The further the other information is removed from being related to the audited financial statements, the greater the likelihood that it is unrealistic and impracticable for an auditor to be able to determine that a *misstatement* of the other information exists. However, by virtue of the construct of the standard and, in particular, the need to make such a *determination*, auditors may be unfairly held responsible for any subsequently detected omission in that information. This is particularly problematic when used to describe the auditor's responsibility in the auditor's report because it risks exacerbating users' expectations gap as it implies that auditors will be able to identify and conclude any misstatement in the other information.

We recommend that the standard include two separate definitions, to provide a basis for the auditor's work effort, as follows:

- Inconsistencies between the other information and the audited financial statements or the auditor's knowledge obtained during the course of the audit; and
- Misstatements of fact or apparent omission of fact that make the other information misleading.

These definitions can be leveraged from extant the ISA 720 definitions, updated as appropriate to incorporate both reference to the auditor's knowledge obtained during the course of the audit and the concept of 'misleading information (with the latter drawing on other existing ISA literature).

We explain below how these revised definitions provide clearly defined boundaries for what the auditor can realistically achieve with respect to discharging the work effort requirements.

Requirements

With respect to the requirements, we believe the clarity and boundaries of the work effort requirements have significantly improved compared to the 2012 exposure draft and, subject to the areas that we have identified as needing some further clarification, in conjunction with our proposed revised definitions above, should now be practicable.

As we note in our cover letter, we believe further consideration needs to be given to paragraph 14(c), to better explain the intended aim of this element of the requirement and how it is distinct from paragraph 14(b). It is unclear to us what this element of the requirement is intending to achieve. Many questions have been raised in our internal discussions in that respect. The explanatory memorandum states that *"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."*

Drawing a distinction between the knowledge the auditor acquires during the course of the audit and the auditor's knowledge of the entity more broadly is an incredibly subtle distinction and not one that we believe can be made in practice – an auditor cannot segregate their knowledge by how or where they became aware of something. We believe part (b) therefore suffices in this respect. Secondly, if the real intention of part (c) is simply to reflect the auditor's ethical responsibilities not to be knowingly associated with other information that is otherwise misleading then, in our view, this is best left in the ethical standards. The concept applied in (c) is not built into any other ISA and we believe should be deleted.

However, if the Board nevertheless decides that the requirement is to be retained, and recognising the concerns we have expressed about the diminishing ability of auditors to determine whether a misstatement of the information exists the further removed that information is from the audited financial statements, we believe it is necessary to amend the wording to provide a clearer boundary for the expectations of the auditor's work effort. Our suggestion, leveraging our proposed revised definitions is:

"(c) Remain alert for other indications that the other information contains a material misstatement of fact, or apparent omission of fact, making the other information misleading ~~appears to be materially misstated~~."

We have included within appendix 2 suggested conforming amendments to requirements 16 through 19. We have not addressed any changes that may be necessary to the application material.

With respect to paragraph 16(a) the concerns we have set out in our cover letter and in the matters set out above come to the fore. Determining what procedures need to be performed and what 'evidence' is needed to be able to make a determination that other information is misstated may be impracticable, depending on the nature of the information. Because the scope of the information the auditor is asked to consider extends beyond information related to the financial statements, the subject matter may be well beyond the auditor's expertise. The application material itself, highlights the challenges:

"As there is a wide range of possible material misstatements of the other information, the nature and extent of other procedures the auditor may perform to determine whether a material misstatement of the other information does exist are a matter of the auditor's professional judgment in the circumstances."

In addition, ISA 540 paragraph A10 provides a relevant parallel to the considerations being asked of auditors here. This states that:

"Management bias can be difficult to detect at an account level. It may only be identified when considered in the aggregate of groups of accounting estimates or all accounting estimates, or when observed over a number of accounting periods. Although some form of management bias is inherent in subjective decisions, in making such judgments there may be no intention by management to mislead the users of financial statements…."

The same can be said of the auditor's consideration of other information, especially other information that is unrelated to the financial statements. Auditors inevitably will need to apply subjective judgement in reading such other information. In doing so, and considering the other information in aggregate, the auditor may form a view that due to a misstatement of fact, or apparent omission of fact, the other information appears to be misleading. We doubt that a determination can be made that the other information is 'misstated'.

Consequently, we believe there is a risk of inconsistent application of this requirement and the very real possibility of an expectation gap regarding the auditor's ability to identify and judge the significance of matters in the other information that are beyond the auditor's expertise. We believe our proposed amendments to this requirement, as set out above and in appendix 2, would help address this issue. See also our comment on the implications for the reporting, in our response to question 3.

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

Refer to our response to question 1 regarding the revised definition of the "annual report".

We recognise that the primary work effort requirements in paragraphs 14 (a) and (b) and 15 (the "limited procedures") necessarily allow for, and require, auditor judgement in determining the exact nature and extent of the auditor's work. We believe this is appropriate for two reasons. It is important for the ISAs to remain principles based standards and not move towards a detailed checklist of procedures. Secondly, the facts and circumstances of individual engagements will vary, both in size, complexity and nature of other information that may exist. Therefore, flexibility for auditors in determining, using professional judgement, how best to discharge the requirements in the standard is appropriate. We do not see this as representing a significant change from the judgements applied by auditors today under the extant standard.

We set out our concerns with respect to paragraph 14(c) and 16 in our cover letter and question 1 above.

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.**

We support the separate section of the report that describes more explicitly the auditor's responsibilities and work effort with respect to other information. The proposed section will help address the expectations gap that exists in this area. It may be that the more transparent description may highlight to some users of the financial statements that the work effort of the auditor in this area is not as much as they would wish. As we noted in our response letter to the 2012 exposure draft, many investors would value auditors being more involved with other information and, in particular, would value assurance on certain information reported by companies. The increased transparency may usefully serve to progress that dialogue.

In our 2012 response we stated that we believe that users' needs would be met through an audit and assurance model that, as separate propositions:

- Focuses the auditor's responsibilities as part of the financial statement audit on the consistency of other information with the audited financial statements (thereby providing clear boundaries and an unambiguous work effort that supports the auditor in forming an opinion on the financial statements);
- Assists management and those charged with governance in fulfilling their broader corporate reporting responsibilities by requiring auditors to communicate to management and those

charged with governance observations and insights regarding other information leveraged from the knowledge obtained in the course of the audit; and

- Designs a work effort and reporting that would deliver the assurance external users are seeking on selected other information.

We believe the proposed work effort and reporting, as set out in the exposure draft, appropriately address these first two propositions and we encourage the IAASB to continue to explore, outside of ISA 720, how this third proposition might be best addressed.

We do, however, have one specific concern with regard to the proposed wording of the auditor's 'conclusion', which we believe may be susceptible to misinterpretation. This is in relation to the concern we express in our cover letter and response to question 1 above, on the requirement for the auditor to 'determine', in accordance with paragraph 16, whether there is a 'misstatement' in the other information.

Notwithstanding the introductory wording describing the auditor's responsibilities, and the separate statement that the auditor has not audited the other information and does not express an opinion or any form of assurance conclusion thereon, we believe there remains a risk that users misinterpret the extent of the auditor's involvement with the other information, in particular the extent of work performed, in making the statement: *"If we determine that the other information is materially misstated, we are required to report that fact. We have nothing to report in this regard."*

We suggest the following as a more appropriate form of words for the final paragraph of the report section, building in our other changes suggested in this letter:

"Our responsibility is read this other information and report to you if ~~and to consider whether~~ there is an uncorrected material inconsistency between that information and the financial statements, or our knowledge obtained during the course of the audit, or if we consider that ~~. In reading~~ the other information includes a material misstatement of fact, or apparent omission of fact, making the other information misleading. ~~our responsibility is also to remain alert for other indications that the other information appears to be materially misstated. If we determine that the other information is materially misstated, we are required to report that fact.~~ Based upon reading the other information available at the date of signing this report, we have nothing to report in this regard."

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 believe the proposed position represents a sensible compromise. If other information is received after the date of the auditor's report, the entire population or specific name(s) of the documents that comprise that other information may not be precisely known at the date of the report. Therefore, the auditor may not be in a position to identify that other information in the report. However, it is appropriate for the auditor to read and consider that other information to avoid being associated with incorrect or misleading information.

In the, admittedly rare, circumstances when no other information has been made available by the entity at the date of the auditor's report, we believe it is not appropriate for the auditor's report to remain silent about the auditor's responsibilities and the fact that the other information is not available.

We recommend that the report include the proposed wording describing the responsibilities followed by an appropriate statement that explains that as of the date of the report the other information was not available.

Appendix 2

Suggested conforming amendments to requirement paragraphs 16 through 19

16. If the auditor identifies that a material inconsistency between the other information and the financial statements, or the auditor's knowledge obtained during the course of the audit, appears to exist, or considers that the other information includes a material misstatement of fact, or an apparent omission of fact, making the other information misleading, ~~appears to exist (or becomes aware of other information that appears to be materially misstated misleading)~~, the auditor shall discuss the matter with management and, if necessary, perform other procedures. ~~to determine whether:~~

- ~~(a) A misstatement of fact in the other information, exists;~~
- ~~(b) A material misstatement in the financial statements exists; or~~
- ~~(c) The auditor's understanding of the entity and its environment needs to be updated.~~

17. If the auditor ~~determines~~ still considers that there is a material inconsistency between the other information and the financial statements, or the auditor's knowledge obtained during the course of the audit, or still considers that there is a material misstatement of fact, or an apparent omission of fact, in ~~of~~ the other information making the other information misleading, ~~exists~~ the auditor shall request management to correct the other information. If management:

- (a) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (b) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

18. If the auditor ~~determines~~ still considers that there is a material inconsistency between the other information and the financial statements, or the auditor's knowledge obtained during the course of the audit, or still considers that there is a material misstatement of fact, or apparent omission of fact, making the ~~exists~~ other information misleading, in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance, the auditor shall take appropriate action, including:

- (a) Considering the implications for the auditor's report (see paragraph 21(d)(ii)) and communicating with those charged with governance the proposed wording of the statement in the auditor's report; or
- (b) Withdrawing from the engagement, where withdrawal is possible under the applicable law or regulation.

19. If the auditor ~~determines~~ considers that a material inconsistency between the other information and the financial statements, or the auditor's knowledge obtained during the course of the audit, or considers that there is a material misstatement of fact, or an apparent omission of fact, making the ~~exists~~ other information misleading, in other information obtained after the date of the auditor's report, the auditor shall:

- (a) Perform the procedures necessary under the circumstances if management agrees to correct the other information; or
- (b) Take appropriate action, taking into account the auditor's legal rights and obligations, if the other information is not corrected after communicating with management and those charged with governance.