Dear Mr Gunn,

IAASB Consultation on International Standard on Auditing (ISA) 720 (Revised) Exposure Draft

The National Audit Office (NAO) is pleased to comment on the above exposure draft. The NAO, on behalf of the Comptroller and Auditor General, carries out the external audit of all UK central government departments and a wide range of other UK and international public bodies.

The National Audit Office applies ISAs (UK and Ireland) issued by the UK Financial Reporting Council and therefore would be affected by any changes to ISA 720 that are adopted in the UK.

Overarching comments

We support the proposal to strengthen the auditor’s responsibilities in respect of the other information presented with the financial statements. However, we have a number of detailed comments on the exposure draft in order to improve its clarity and ensure that the approach adopted by auditors will be consistent.

Detailed comments

Our responses to the detailed questions set out in the exposure draft can be found in the enclosed annex.

If you have any queries in relation to the content of this submission, please feel free to contact me.

Yours sincerely

Maggie McGhee
Director General, Financial Audit
Annex: Detailed responses to questions in exposure draft

1. Do respondents agree that there is a need to strengthen the auditor’s responsibilities with respect to other information? In particular do respondents believe that extending the auditor’s responsibilities with respect to the other information reflects costs and benefits appropriately and is in the public interest?

It appears the intention of the IAASB is to codify best practice relating to other information, and we support this. It is difficult to assess whether the benefits outweigh the costs since there is no analysis within the exposure draft of the expected increased cost. It appears that the IAASB does not intend to increase the work effort significantly, but we have some concerns (see answers to Q5 and Q8 below) that the requirements included in the proposed ISA will incur additional cost which will not be insignificant.

2. Do respondents agree that broadening the scope of the proposed ISA to include documents that accompany the financial statements and the auditor’s report thereon is appropriate?

In principle we agree that broadening the scope is appropriate. However practitioners will need to exercise judgement in determining whether a document has a “primary purpose of providing commentary to enhance the users' understanding of the audited financial statements or the financial reporting process”. The examples given in A12 and A13 fit neatly into the two categories (in scope and out of scope respectively) but we could envisage some documents that would not be so easy to categorise, and could therefor lead to inconsistent practice within the auditing profession.

We also recommend that the IAASB specifically scope out of the standard all other information that is not contained within "documents" but, for example, on an audited entity’s web pages, associated slide shows, social media accounts etc.

3. Do respondents find the concept of initial release clear and understandable? In particular, is it clear that initial release may be different from the date the financial statements are issued as defined in ISA 560?

Yes, this is clear. In the UK central government sector initial release would typically be the date that the Annual Reports and Accounts are laid before the Parliamentary authorities. This can be applied clearly from paragraphs 9(b) and A4.

4. Do respondents agree that the limited circumstances in which a securities offering document would be in scope (e.g. initial release of the audited financial statements in an initial public offering) are appropriate or should securities offering documents simply be scoped out? If other information in a securities offering document is scoped into the requirements of the proposed ISA in these circumstances, would this be duplicating or conflicting with procedures the auditor may otherwise be required to perform pursuant to national requirements?

For clarity, we would recommend scoping out all securities offerings from the proposed ISA.

5. Do respondents consider that the objectives of the proposed ISA are appropriate and clear? In particular:

   a) Do respondents believe that the phrase "in the light of the auditor’s understanding of the entity and its environment acquired during the audit" is understandable for the auditor? In particular, do the requirements and guidance in the proposed ISA help the auditor to understand what it means to read and consider the in light of the auditor’s
understanding of the entity and its environment acquired during the course of the audit?

b) Do respondents believe it is clear that the auditor's responsibilities include reading and considering the other information for consistency with the audited financial statements?

We do not believe that the objectives of the proposed ISA are appropriate and clear, because of the issues relating to the definition of "inconsistency" which are discussed below.

The phrase "in the light of the auditor's understanding of the entity and its environment acquired during the audit" would benefit from clarification. Paragraph A33 goes some way to clarifying that not all engagement team members would necessarily need to read all the other information. However we think it would be much clearer simply to state that the relevant understanding is that of senior members of the engagement team. We do not believe that this would change the outcomes the ISA seeks to achieve, since the senior members of the engagement team, between them, ought to have sufficient understanding of all matters which could be material in the context of the audit.

We believe it is clear that the auditor's responsibilities include reading and considering the other information for consistency with the audited financial statements.

6. Do respondents agree that the definitions of terms of "inconsistency" to include the concept of omissions and "material inconsistency in the other information" are appropriate?

No. The definition of the term "inconsistency" in the ISA does not make sense given the natural meaning of the word. An inconsistency can only occur when two or more items are out of line with each other in some way (not consistent with each other) - it is a relative concept. Other information cannot contain an "inconsistency" in isolation. The definition of "inconsistency" is therefore too wide and needs to be restricted to its plain meaning.

7. Do respondents believe that users of auditors' reports will understand that an inconsistency relates to an inaccuracy in the other information as described in (a) and (b) of the definition, based on reading and considering the other information in the light of the auditor's understanding of the entity and its environment acquired during the course of the audit?

No, for the same reasons as described above, relating to the redefinition of "inconsistency" included in the proposed ISA. In addition, "inconsistencies in the other information" using its plain meaning, would imply that the inconsistencies are between different elements of the other information, rather than between the other information and the auditor's understanding.

8. Do respondents agree with the approach taken in the proposed ISA regarding the nature and extent of the auditor's work with respect to the other information? In particular:

a) Do respondents believe the principles-based approach to determining the extent of work the auditor is expected to undertake when reading and considering the other information is appropriate?

b) Do respondents believe the categories of other information in paragraph A37 and the guidance for the nature and extent of the work effort for each category are appropriate?

c) Do respondents agree that the work effort is at the expected level and does not extend the scope of the audit beyond that necessary for the auditor to express an opinion on the financial statements?

Generally we believe the approach taken in the ISA regarding the nature and extent of the
auditor's work with respect to the other information is appropriate.

a) We agree that a principles-based approach is appropriate.

b) and c) The categories of other information in paragraph A37 are helpful and the work effort described is appropriate in cases where the auditor has reason to believe that a material inconsistency may exist between this other information and either the audited financial statements or the auditor's understanding of the business. The guidance could be interpreted to mean that these procedures need to be performed on all other information, regardless of its relative significance or materiality in the context of the entity and its financial statements. It would help to explicitly state, either in paragraph A37 or the preceding paragraph, that the auditor is not expected to perform these procedures on all items included in the other information. The current wording, despite the apparent intentions of the IAASB, does appear to extend the scope of the audit beyond that necessary for the auditor to express an opinion on the financial statements.

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

Yes, these examples are helpful.

10. Do respondents believe it is clear in the proposed requirements what the auditor's response should be if the auditor discovers that the auditor's prior understanding of the entity and its environment acquired during the audit was incorrect or incomplete?

Yes, this is clear.

11. With respect to reporting:

a) Do respondents believe that the terminology (in particular, "read and consider," "in light of our understanding of the entity and its environment acquired during the course of the audit," and "material inconsistencies") used in the statement to be included in the auditor's report under the proposed ISA is clear and understandable for users of the auditor's report?

b) Do respondents believe it is clear that the conclusion that states "no audit opinion or review conclusion" properly conveys that there is no assurance being expressed with respect to the other information?

a) We do not think this will be clear or understandable to users of audit reports because of the serious concerns we have over the definition of the word "inconsistency" within the proposed ISA. The audit report itself would need to explain more clearly what the auditor's objectives are.

Our suggested wording for paragraph 16(b) is:

"A statement addressing whether, based on reading and considering the other information obtained, the auditor has identified material inconsistencies between the other information and either:

- the audited financial statements, or
- the auditor's understanding of the entity and its environment acquired during the audit."

b) The requirements of paragraph 16(c) and 16(d) appear to be contradictory. A statement by the auditor that states whether or not the auditor has identified "material inconsistencies in the other information" (a phrase which does not make sense in plain English) implies that a limited assurance engagement has been performed. Therefore we do not believe that the proposed
reporting format is appropriate.

12. Do respondents believe that the level of assurance being provided with respect to other information is appropriate? If not, what type of engagement would provide such assurance?

There is a lack of internal consistency within the proposed content of the report, and also between the report and the ISA requirements which makes it unclear what level of assurance would be provided under the proposed ISA.