Exposure draft

International Standard on Auditing (UK and Ireland) 720 (REVISED)

SECTION A - THE AUDITOR'S STATUTORY REPORTING RESPONSIBILITY IN RELATION TO DIRECTORS' REPORTS

SECTION B - THE AUDITOR'S REPORTING RESPONSIBILITY IN RELATION TO OPERATING AND FINANCIAL REVIEWS

SECTION C - OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

October 2005

The Auditing Practices Board

THE AUDITING PRACTICES BOARD LIMITED

The Auditing Practices Board Limited, which is part of the Financial Reporting Council, prepares for use within the United Kingdom and the Republic of Ireland:

- Standards and guidance for auditing;
- Standards and guidance for the work of reporting accountants in connection with investment circulars; and
- Standards and guidance for auditors' integrity, objectivity and independence

with the objective of enhancing public confidence in the audit process and the quality and relevance of audit services in the public interest.

The Auditing Practices Board Limited discharges its responsibilities through a Board ('the APB') comprising individuals who are eligible for appointment as company auditors, and those who are not so eligible. Those who are eligible for appointment as company auditors may not exceed 40% of the APB by number.

Neither the Auditing Practices Board Limited nor the APB accepts any liability to any party for any loss, damage or costs howsoever arising, whether directly or indirectly, whether in contract, tort or otherwise from any action or decision taken (or not taken) as a result of any person relying or otherwise using this document or arising from any omission from it.

INVITATION TO COMMENT

The APB is issuing for public comment this proposed revised International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 720. The purpose of the revision is to introduce standards and guidance in respect of the auditor's new statutory reporting responsibilities in relation to directors' reports and operating and financial reviews.

Summary of Legal Requirements

"The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005" (SI 2005/1011 "the Regulations")[1] amended the Companies Act 1985 to require, for financial years which begin on or after 1 April 2005:

- The auditors to state in their report whether, in their opinion, the information given in the directors' report for the financial year for which the annual accounts are prepared is consistent with the financial statements.
- For quoted companies, the auditors to "state in their report:
  - (a) whether in their opinion the information given in the operating and financial review for the financial year for which the annual accounts are prepared is consistent with those accounts; and
  - (b) whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the operating and financial review."

The auditors are not required by the Regulations to determine, nor to report on, whether all the information in the operating and financial review has been properly prepared in compliance with the Regulations and/or relevant reporting standards[2].

Proposed Revisions to ISA (UK and Ireland) 720

The extent of the work auditors should undertake in relation to operating and financial reviews has been the subject of extensive consideration and consultation by the DTI as part of the Company Law Reform. The proposed new requirements in

1 In Northern Ireland, "The Companies (1986 Order) (Operating and Financial Review and Directors' Report etc.) Regulations (Northern Ireland) 2005" (Statutory Rule 2005 No.61).

2 Reporting Standard 1 "Operating and Financial Review", issued by the Accounting Standards Board, is mandatory for all GB quoted companies and any other entities that purport to prepare an operating and financial review

this exposure draft are designed to enable auditors to meet the statutory reporting requirements that have been introduced by the Regulations.

The proposed revision to ISA (UK and Ireland) 720 takes the form of two new sections:

Section A addresses the statutory requirement for the auditor to report whether the information in the directors' report is consistent with the financial statements. The standards and guidance in this Section also apply to other information for which the auditor is required by law or regulation to report on consistency with the financial statements, including in relation to an operating and financial review.

The auditor is required to read the information in the directors' report and assess whether it is consistent with the financial statements. If the auditor identifies inconsistencies the auditor is required to seek to resolve them.

Section B is primarily concerned with the statutory requirement for the auditor to report whether information in the OFR is inconsistent with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company. The requirement to consider consistency with the financial statements being covered by a link to Section A.

The auditor is required to read the information in the OFR and consider whether it is inconsistent with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company. If the auditor identifies inconsistencies the auditor is required to seek to resolve them. It is important, however, to note that the auditor is <u>not</u> required to design and perform audit procedures, nor to document matters, beyond those required for the audit of the financial statements specifically to verify information in the OFR or to determine whether there are inconsistencies.

The original text of ISA (UK and Ireland) 720 is retained in ***Section C***, providing standards and guidance for the auditor's consideration of other information in documents containing audited financial statements. Some consequential changes, shown in mark-up, have been made to address the changes in the legislation and moving some material to Sections A and B.

Regulatory Impact Assessment

The DTI performed a Regulatory Impact Assessment during the development of the changes to the legislation in relation to operating and financial reviews and directors' reports. This can be obtained from the internet: **www.dti.gov.uk/cld/OFR_RIA.pdf**

The APB thought that it would be useful to perform its own assessment of the impact of the proposed changes to ISA (UK and Ireland) 720 on the cost of an audit; no attempt has been made to quantify the additional management time spent in responding to the auditor's inquiries. . The APB believes that the proposals are those required for the purposes of enabling auditors to comply with their new statutory responsibilities. The purpose of the APB's cost assessment is, therefore, <u>not</u> to seek to generate a debate on whether the costs of the proposed new standards are justified or whether lesser requirements should be developed, but to illustrate the possible magnitude of the increased audit costs.

A summary of the APB's assessment of the possible impact on audit costs, assuming no material inconsistencies with the financial statements are identified, is shown below.

Entity preparing	**Estimated current audit cost**	**Estimated increase in annual ongoing costs**	**Estimated additional first year cost**
Complex OFR	£2.5m	£24,500 (1%)	£8,000 (0.3%)
Simple OFR	£275,000	£7,100 (2.5%)	£4,000 (1.5%)
Enhanced Directors' Report	£25,000	£400 (1.6%)	-

Tables showing in more detail how the above figures have been calculated are published separately in the "Exposure Draft" section of the APB's website. It is, however, important to understand that the specific impact on the costs of any particular audit will depend on the circumstances, including a number of variables such as:

- The absolute amount of information the directors include; the amount that is directly related to information in the financial statements; and the amount that relates to matters that have come to the auditor's attention in the performance of the auditor's functions as auditor,
- The extent to which disclosures are already made in directors' reports and operating and financial reviews and substantiated by the auditor,

- Whether material inconsistencies are identified by the auditor and the time taken to resolve them,
- The auditor's charge out rates.

Accordingly the specific impact on a particular audit is not capable of precise determination and may be other than the estimates shown above.

Guide for Commentators

The APB welcomes comments on the proposed revised ISA (UK and Ireland) 720. The APB is seeking comments on all matters addressed in the exposure draft, including but not limited to the matter discussed below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make explicit suggestions for any proposed changes to wording.

Application of the reporting requirements to all operating and financial reviews included with audited financial statements

The statutory requirements in relation to operating and financial reviews apply only to quoted companies. It is, however, possible that other entities may choose to prepare an operating and financial review, and the relevant reporting standard for preparers, Reporting Standard 1 "Operating and Financial Review", states that it applies to "all GB quoted companies <u>and any other entities that purport to prepare an OFR"</u> (emphasis added). APB has taken the view that the audit requirements relating to operating and financial reviews set out in revised ISA (UK and Ireland) 720 should be applied in all cases where an entity's annual report includes a review that purports to be an "operating and financial review" This goes beyond the requirements of the legislation, with a consequential increase in the cost of audits of those entities that prepare an operating and financial review on a voluntary basis, but the APB believes that consistency of work and reporting by auditors on reviews described as operating and financial reviews is important to avoid possible confusion as to the degree of the auditor's involvement leading to an "expectation gap". Additional costs can be avoided by the entity not describing a review as an operating and financial review.

Question 1 - Do commentators agree that the audit requirements relating to operating and financial reviews set out in revised ISA (UK and Ireland) 720 should be applied in all circumstances where an entity presents a review that purports to be an operating and financial review with documents containing audited financial statements?

The scope of the auditor’s responsibilities

The auditor is not required by the Regulations to determine, nor to report on, whether all the information in the operating and financial review has been properly prepared in compliance with the Regulations and/or relevant reporting standards. This principle is reflected in Section B paragraphs 7 and 22 and the example wording for the auditor’s report of the proposed revised ISA (UK and Ireland). This means, in particular, that the auditor is not required to check whether the OFR includes all the information required by Reporting Standard 1.

As indicated above, the auditor’s statutory responsibility is to report:

(a) whether in their opinion the information given in the OFR for the financial year for which the annual accounts are prepared is consistent with those accounts; and

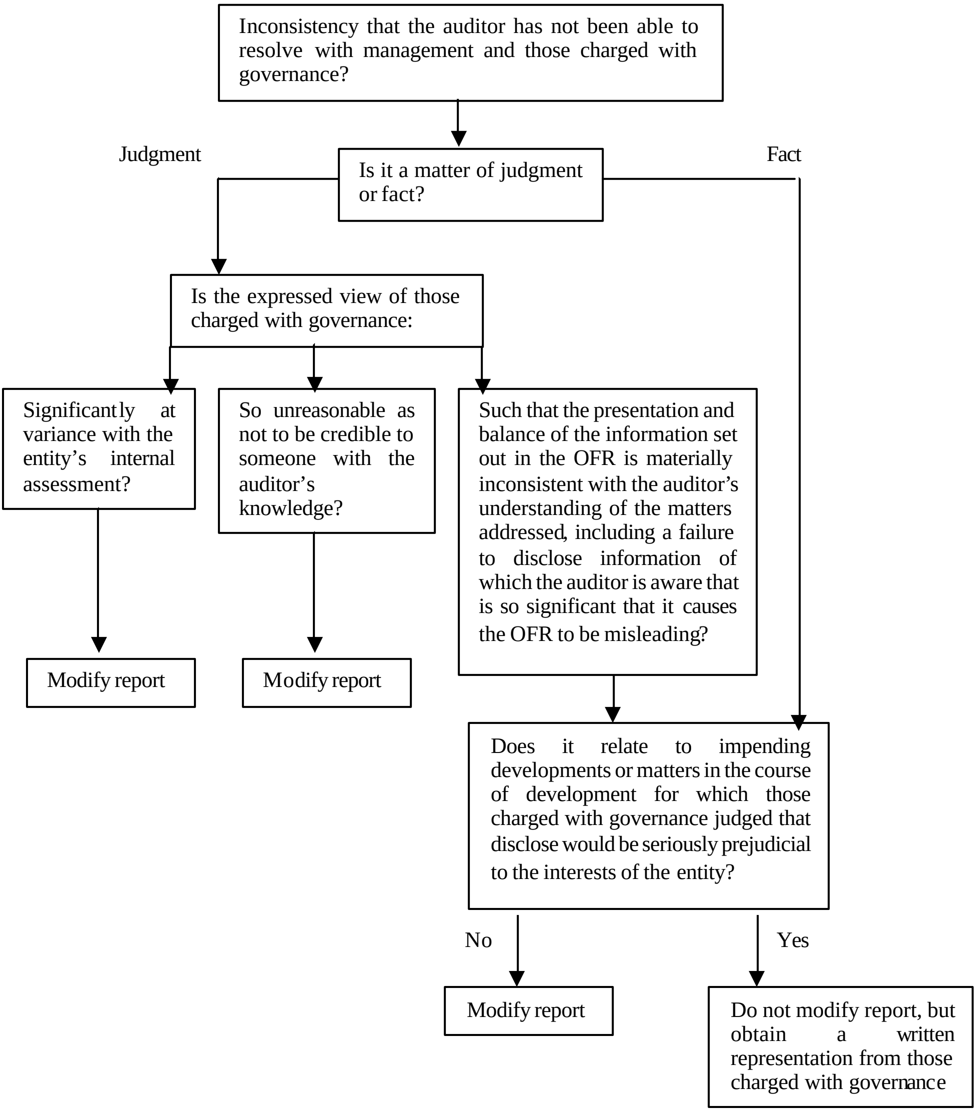
(b) whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the OFR.

Inconsistencies in the OFR may be either quantitative or qualitative. Qualitative issues are likely to be the more difficult to resolve and lead to the greatest difficulties in practice. While it is not the APB’s intention that the auditor should “second guess” the directors on matters of judgment, the APB believes that it is necessary for the auditor to consider whether the presentation and balance of the information set out in the OFR is consistent with the auditor’s understanding of the matters addressed and, where relevant, challenge a failure to disclosure a matter of which the auditor is aware that is so significant that it causes the OFR to be misleading. The auditor’s powers in relation to omissions are however limited as Reporting Standard 1 does not require disclosure of information about impending developments or matters in the course of negotiation that, in the opinion of the directors, would be seriously prejudicial to the interests of the entity. In such circumstances the auditor obtains confirmation of this position in writing but is not expected to qualify the report on the OFR (Section B, paragraph 19).

This thought process can be summarized as follows:

OFR – Inconsistencies with matters that have come to the come to the auditor’s attention in the performance of the auditor’s functions as auditor of the company

Modifications to the auditor’s report – flowchart of decisions



Question 2 – Do you support the APB's conclusion as to the auditors responsibilities in relation to qualitative judgments (covered by the guidance in Section B paragraphs 18 and 19)?

Question 3 - Are the auditor's responsibilities regarding qualitative judgments concerning the content of the OFR clear? If not, how could they be made more clear?

The APB would prefer to receive letters of comment in electronic form: these may be sent by e-mail to **k.billing@frc-apb.org.uk.** If this is not possible, please send letters of comment to:

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London WC2B 4HN

In order to facilitate the APB issuing the final standard before 31 March 2006, the APB requests that letters of comment on this exposure draft should be sent so as to be received no later than ***9 January 2006***.

All comments will be regarded as being on the public record, unless otherwise requested.

PROPOSED INTERNATIONAL STANDARD ON AUDITING (UK AND IRELAND) 720 (REVISED)

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Introduction to ISA (UK and Ireland) 720 (Revised)

SECTION A - THE AUDITOR'S STATUTORY REPORTING RESPONSIBILITY IN RELATION TO DIRECTORS' REPORTS

SECTION B - THE AUDITOR'S REPORTING RESPONSIBILITY IN RELATION TO OPERATING AND FINANCIAL REVIEWS

SECTION C - OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) 720 "Other Information in Documents Containing Audited Financial Statements" should be read in the context of the Auditing Practices Board's Statement "The Auditing Practices Board - Scope and Authority of Pronouncements (Revised)" which sets out the application and authority of ISAs (UK and Ireland).

Introduction to ISA (UK and Ireland) 720 (Revised)

1. The purpose of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the auditor's consideration of other information in documents containing audited financial statements. It is split into three sections. Sections A and B establish standards and guidance in relation to the auditor's statutory reporting responsibilities in respect of directors' reports and operating and financial reviews. Section C establishes standards and provides guidance on the auditor's consideration of other information, on which the auditor has no statutory obligation to report, and includes the content of the underlying ISA 720 issued by the International Auditing and Assurance Standards Board.

2. This ISA (UK and Ireland) uses the terms 'those charged with governance' and 'management'. The term 'governance' describes the role of persons entrusted with the supervision, control and direction of an entity. Ordinarily, those charged with governance are accountable for ensuring that the entity achieves its objectives, and for the quality of its financial reporting and reporting to interested parties. Those charged with governance include management only when they perform such functions.

3. In the UK and Ireland, those charged with governance include the directors (executive and non-executive) of a company or other body, the members of an audit committee where one exists, the partners, proprietors, committee of management or trustees of other forms of entity, or equivalent persons responsible for directing the entity's affairs and preparing its financial statements.

4. 'Management' comprises those persons who perform senior managerial functions.

5. In the UK and Ireland, depending on the nature and circumstances of the entity, management may include some or all of those charged with governance (e.g. executive directors). Management will not normally include non-executive directors.

SECTION A - THE AUDITOR'S STATUTORY REPORTING RESPONSIBILITY IN RELATION TO DIRECTORS' REPORTS

Introduction

1. The purpose of this Section of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the auditor's statutory reporting responsibility in relation to directors' reports.

2. In the United Kingdom and the Republic of Ireland, legislation[1] requires the auditor of a company to state in the auditor's report whether, in the auditor's opinion, the information given in the directors' report is consistent with the financial statements.

3. The standards and guidance in this Section also apply to other information for which the auditor is required by law or regulation to report on consistency with the financial statements (e.g. in relation to an operating and financial review – see Section B of this ISA (UK and Ireland)).

The Auditor's Procedures

4. **The auditor should read the information in the directors' report and assess whether it is consistent with the financial statements.**

5. Much of the information in the directors' report is likely to be extracted or directly derived from the financial statements and will therefore be directly comparable with them. Some financial information may, however, be more detailed or prepared on a different basis from that in the financial statements. Where the financial information is more detailed, the auditor agrees the information to the auditor's working papers or the entity's accounting records. Where the financial information has been prepared on a

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[1] Relevant legislation includes:
- In Great Britain, with effect for financial years that commence on after 1 April 2005, section 235 of the Companies Act 1985 as amended by "The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005" (SI 2005/1011).
- In Northern Ireland, with effect for financial years that commence on after 1 April 2005, Article 243 of the Companies (Northern Ireland) Order 1986 as amended by "The Companies (1986 Order) (Operating and Financial Review and Directors' Report etc.) Regulations (Northern Ireland) 2005" (Statutory Rule 2005 No.61).
- In the Republic of Ireland, Section 15 of the Companies (Amendment) Act 1986.

different basis, the auditor considers whether there is adequate disclosure of the bases of preparation to enable an understanding of the differences in the information, and checks the reconciliation of the information to the financial statements.

6. **If the auditor identifies any inconsistencies between the information in the directors' report and the financial statements the auditor should seek to resolve them.**

7. Inconsistencies include:

- Differences between amounts or narrative appearing in the financial statements and the directors' report.
- Differences between the bases of preparation of related items appearing in the financial statements and the directors' report, where the figures themselves are not directly comparable and the different bases are not disclosed.
- Contradictions between figures contained in the financial statements and narrative explanations of those figures in the directors' report.

The auditor ordinarily seeks to resolve inconsistencies through discussion with management and those charged with governance.

8. **If the auditor is of the opinion that the information in the directors' report is materially inconsistent[2] with the financial statements, and has been unable to resolve the inconsistency, the auditor should state that opinion and describe the inconsistency in the auditor's report.**

9. An example of an auditor's statement on an inconsistency between the directors' report and the financial statements in circumstances where it is the directors' report that requires amendment is set out in the Appendix to this Section.

10. **If an amendment is necessary in the financial statements and management and those charged with governance refuse to make the amendment, the auditor should express a qualified or adverse opinion on the financial statements.**

[2] Materiality is addressed in ISA (UK and Ireland) 320 "Audit Materiality". An inconsistency is "material" if it could influence the economic decisions of users.

Misleading Information

11. If the auditor believes that the information in the directors' report is misleading, and the auditor is unable to resolve the matter with management and those charged with governance, the auditor considers the implications for the auditor's report and what further actions may be appropriate. The auditor has regard to the guidance in paragraphs 18-5 and 18-6 of Section C of this ISA (UK and Ireland).

Documentation

12. **The auditor should document:**

    (a) The results of those procedures performed to assess whether the information in the directors' report in consistent with the financial statements, including details of any material inconsistencies identified and how they were resolved; and

    (b) The conclusion reached as to whether the information in the directors' report is consistent with the financial statements.

Appendix

Example Wording for the Auditor’s Report

Extracts from an auditor’s report with a modified opinion on the directors' report (financial statements prepared under UK GAAP)

Respective responsibilities of directors and auditors–

…..

We report to you whether in our opinion the information given in the directors’ report is consistent with the financial statements.

…..

Opinion

In our opinion:

…..

Material inconsistency between the financial statements and the directors' report

In our opinion, the information given in the seventh paragraph of the directors' report is not consistent with the financial statements. That paragraph states without amplification that “the company's trading for the period resulted in a 10% increase in profit over the previous period’s profit”. The profit and loss account, however, shows that the company’s profit for the period includes a profit of £Z which did not arise from trading but arose from the disposal of assets of a discontinued operation. Without this profit on the disposal of assets the company would have reported a profit for the year of £Y, representing a reduction in profit of 25% over the previous period’s profit on a like for like basis. Except for this matter, in our opinion the information given in the directors’ report is consistent with the financial statements.

SECTION B - THE AUDITOR'S REPORTING RESPONSIBILITY IN RELATION TO OPERATING AND FINANCIAL REVIEWS

Introduction

1. The purpose of this Section of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the auditor's reporting responsibility in relation to operating and financial reviews. The standards and guidance apply in all circumstances where an entity presents a review that purports to be an operating and financial review with documents containing audited financial statements.

Summary of Legal Requirements

2. "The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005" (SI 2005/1011)[1] ("the Regulations") amended the Companies Act 1985 to require the directors of a quoted company[2] to prepare an operating and financial review (OFR) for financial years which begin on or after 1 April 2005.

3. Section 234AA(2) of the Companies Act 1985[3] requires that the OFR must comply with Schedule 7ZA, which sets out the objective of the OFR and requirements as to content, "save that nothing in that Schedule requires the disclosure of information about impending developments or about matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company."

4. If the directors are preparing group accounts, the Companies Act requires that the OFR must be a consolidated review (a "group OFR") relating to the parent company and its subsidiary undertakings included in the consolidation.

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1 In Northern Ireland, "The Companies (1986 Order) (Operating and Financial Review and Directors' Report etc.) Regulations (Northern Ireland) 2005" (Statutory Rule 2005 No.61).

2 A quoted company is defined in Section 262 of the Companies Act 1985 as "a company whose equity share capital:
(a) has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000; or
(b) is officially listed in an EEA state; or
(c) is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq."

3 In Northern Ireland, Article 242AA(2) of the 1986 Order,

5. For quoted companies in Great Britain, the OFR must state whether it has been prepared in accordance with relevant reporting standards, and contain particulars of, and reasons for, any departure from such standards[4]. "Relevant reporting standards" are those issued by the Accounting Standards Board (ASB) and comprise "Reporting Standard 1: Operating and Financial Review"[5].

6. Section 235(3A) of the Companies Act 1985[6] requires for a quoted company that "the auditors must state in their report:

   (a) whether in their opinion the information given in the operating and financial review for the financial year for which the annual accounts[7] are prepared is consistent with those accounts; and

   (b) whether any matters have come to their attention, in the performance of their functions as auditors of the company, which in their opinion are inconsistent with the information given in the operating and financial review."

7. The auditor is not required by the Regulations to determine, nor to report on, whether all the information in the OFR has been properly prepared in compliance with the requirements of the Regulations and/or Reporting Standard 1.

Consistency With the Financial Statements

8. **The auditor should apply the standards and guidance in paragraphs 4 to 12 of Section A of this ISA (UK and Ireland) when forming the opinion as to whether the information in the OFR is consistent with the financial statements**.

9. Consistent with paragraph 7 of Section A, inconsistencies include differences between the bases of preparation of related items appearing in

[4] In Northern Ireland, there is no corresponding provision at present. The Department of Enterprise, Trade and Investment intends to make such a provision in the future.

[5] Reporting Standard 1 includes a statement that it "applies to all Great Britain quoted companies and any other entities that purport to prepare an OFR." Reporting Standard 1 does not apply to reviews that are presented as something other than an OFR by GB non quoted entities.

[6] In Northern Ireland, Article 243(3A) of the 1986 Order.

[7] In ISAs (UK and Ireland) the term "financial statements" is generally used in place of "annual accounts"

the financial statements and the OFR, where the figures themselves are not directly comparable and the different bases are not disclosed[8].

10. An example statement, where the auditor has not identified any inconsistencies, is given in the Appendix to this Section (B), example 1.

Inconsistency With Matters That Have Come to the Auditor's Attention During the Audit

11. **The auditor should read the information in the OFR and consider whether it is inconsistent with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company.**

12. The engagement partner takes responsibility for the consideration of whether information in the OFR, including information that is incorporated by way of cross reference[9], is inconsistent with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company. The engagement partner determines which other members of the engagement team read the OFR or parts thereof. This would normally include other senior members of the engagement team who can reasonably be expected to be aware of the more important matters arising during the audit that may relate to information in the OFR. In addition, the engagement partner considers whether those senior members of the engagement team selected to read the OFR have knowledge of the audit work in all areas where there is related information in the OFR and, if not, asks other members of the audit team with such knowledge also to read the OFR.

13. In judging whether there are inconsistencies, the engagement partner and other members of the engagement team referred to in paragraph 12 who read the OFR consider whether there are material[10] differences between the

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[8] Reporting Standard 1 requires that for each key performance indicator (KPI) disclosed in the OFR, where information from the financial statements has been adjusted for inclusion in the OFR, that fact shall be highlighted and a reconciliation provided.

[9] Reporting Standard 1 indicates that "directors will need to consider the key issues to include in the OFR that will provide members with focused and relevant information. … Where additional information is discussed elsewhere in the annual report, or in other reports, cross referencing to those sources will assist members."

[10] Materiality is addressed in ISA (UK and Ireland) 320 "Audit Materiality". A difference is "material" if it could influence the economic decisions of users.

information in the OFR and matters that have come to their attention in the performance of the auditor's functions as auditor of the entity.

14. Matters related to information in the OFR may be identified during any part of the audit. The OFR will, however, ordinarily include information about matters that the auditor does not need to consider for the purpose of forming an opinion on the financial statements. The auditor is not required to design and perform audit procedures, nor to document matters, beyond those required for the audit of the financial statements specifically to verify information in the OFR or to determine whether there are inconsistencies with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the entity.

15. The engagement partner, and other members of the engagement team referred to in paragraph 12 who read the OFR, obtain an understanding of the planned content of the OFR as early as practicable in the audit. Procedures to obtain such an understanding ordinarily include discussion with management and those charged with governance of the company and reading the prior year OFR. This understanding assists the engagement partner and those other members of the engagement team to be alert to matters that may relate to information in the OFR when performing their audit responsibilities.

16. In a group OFR, some information may relate to components that were audited by another auditor[11]. The group auditor considers whether the information in the group OFR is inconsistent with matters that came to the group auditor's attention in the performance of the audit of the group and involvement in the work performed by the other auditor. For example, the group auditor may be aware of information related to that in the group OFR as a result of:

- Meetings with component management to obtain an understanding of the component and its environment.
- Risk assessment and other audit procedures performed by the group auditor in relation to the component.

[11] The "group auditor" is the auditor who signs the auditor's report on the group financial statements. An "other auditor" is an auditor, other than the group auditor, with responsibility for reporting on the financial information of a component, which is included in the financial statements audited by the group auditor. "Other auditors" include both related auditors and unrelated auditors. A "related auditor" is an auditor from the group auditor's firm or from a network firm who operates under, and complies with, common monitoring policies and procedures as provided for in International Standard on Quality Control (UK and Ireland) 1.

- Participation in the closing and other key meetings between the other auditor and component management.
- Review of the other auditor's audit documentation.
- Matters communicated by the other auditor in a memorandum or report of work performed on the financial information of the component.

17. **If the auditor identifies material inconsistencies between the information in the OFR and matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company, the auditor should seek to resolve them and determine whether the OFR or, possibly, the financial statements need to be amended.**

18. The auditor has regard to the nature of a material inconsistency that in the auditor's opinion exists. A distinction may be drawn between a matter of fact and one of judgment. It is generally more difficult for the auditor to take issue with a matter of judgment (such as the view of those charged with governance of the likely out-turn for the following year) than a factual error. Although an auditor does not substitute the auditor's judgment for that of those charged with governance in such matters, there may be circumstances in which the auditor is aware that the expressed view of those charged with governance is:

    - significantly at variance with the entity's internal assessment, or
    - so unreasonable as not to be credible to someone with the auditor's knowledge, or
    - such that the presentation and balance of the information set out in the OFR is materially inconsistent with the auditor's understanding of the matters addressed[12].

19. A material inconsistency arises as a result of a failure to disclose a matter of which the auditor is aware that is so significant that it causes the OFR to be misleading. If the auditor has concerns about such an inconsistency the auditor communicates them to those charged with governance and determines the reasons for the omission. Those charged with governance may have omitted information because they concluded that it relates to

[12] The ASB's Reporting Standard 1 requires that the OFR shall be balanced and neutral, dealing even-handedly with both good and bad aspects.

impending developments or matters in the course of negotiation where disclosure in the OFR would, in the opinion of those charged with governance, be seriously prejudicial to the interests of the company. Reporting Standard 1 does not require disclosure of such information[13] and the auditor is not expected to second guess such a judgment. The omission of information in the circumstances contemplated by Reporting Standard 1 would not result in an OFR that is deemed to be misleading. In such circumstances the auditor obtains confirmation of the conclusion of those charged with governance in writing but is not expected to qualify the opinion on the OFR.

20. If the auditor concludes that the inconsistency arises from an issue related to the other information that came to the auditor's attention, the auditor considers whether that gives rise to doubts about the reliability of audit evidence obtained in relation to the financial statements, and possibly about the basis for the auditor's opinion on the financial statements. If such doubts do arise the auditor seeks to resolve them, performing additional audit procedures if necessary.

21. **If an amendment is necessary in the OFR and management and those charged with governance refuse to make the amendment, the auditor should include in the auditor's report a statement that a matter has come to the auditor's attention, in the performance of the auditor's function as auditor of the company, which in the auditor's opinion is inconsistent with the information given in the OFR, and describe the inconsistency.**

22. As indicated in paragraph 7 above, the auditor is not required to determine, nor to report on, whether all the information in the OFR has been properly prepared in compliance with the requirements of Reporting Standard 1. As a result, however, of determining that there is a matter of inconsistency to describe in the auditor's report, the auditor may become aware that the matter causes the "statement of compliance"[14] in the OFR to be incorrect. If a matter has come to the auditor's attention in the performance of the auditor's functions as auditor of the company which in the auditor's opinion is inconsistent with the statement of compliance, the auditor describes it in the auditor's report.

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[13] Reporting Standard 1, paragraph 81.

[14] Reporting Standard 1 requires that the OFR shall include a statement as to whether it has been prepared in accordance with that Reporting Standard and contain particulars of, and the reasons for, any departure.

23. An example statement of an inconsistency is given in the Appendix to this Section, example 2.

24. **If an amendment is necessary in the financial statements and management and those charged with governance refuse to make the amendment, the auditor should express a qualified or adverse opinion on the financial statements.**

Documentation

25. **The auditor should document:**

    (a) Which members of the engagement team read the information in the OFR and considered whether it was inconsistent with matters that came to their attention in the performance of the auditor's functions as auditor of the company;

    (b) The details of any material inconsistencies identified and how they were resolved; and

    (c) The conclusion reached as to whether the information in the OFR is inconsistent with matters that have come to the auditor's attention in the performance of the auditor's functions as auditor of the company.

Appendix

Example Wording for the Auditor's Report

Example 1 – Extracts from an auditor's report with an unmodified opinion on the OFR

Respective responsibilities of directors and auditors

…..

We report to you whether in our opinion the information given in the Operating and Financial Review is consistent with the financial statements and whether any matters have come to our attention, in the performance of our functions as auditors of the company, which in our opinion are inconsistent with the information given in the Operating and Financial Review. We are not required to determine, and do not report on, whether all the information in the Operating and Financial Review has been properly prepared in compliance with the requirements of Reporting Standard 1 "Operating and Financial Review".

…..

Opinion

In our opinion:

…..

- the information given in the Operating and Financial Review is consistent with the financial statements. No matters have come to our attention, in the performance of our functions as auditors of the company, which in our opinion are inconsistent with the information given in the Operating and Financial Review.

Example 2 – Extracts from an auditor's report on group financial statements with a modified opinion on the OFR

Respective responsibilities of directors and auditors

….

We report to you whether in our opinion the information given in the group Operating and Financial Review is consistent with the financial statements and whether any matters have come to our attention, in the performance of our functions as auditors of the financial statements, which in our opinion are inconsistent with the information given in the group Operating and Financial Review. We are not required to determine, and do not report on, whether all the information in the group Operating and Financial Review has been properly prepared in compliance with the requirements of Reporting Standard 1 "Operating and Financial Review".

….

Opinion

In our opinion:

…..

- the information given in the group Operating and Financial Review is consistent with the financial statements.

Inconsistency between information in the group Operating and Financial Reviewand matters that have come to our attention in the performance of our functions as auditors of the company

The group Operating and Financial Review discloses that 23% of the group's revenue came from new products launched over the past two years compared to 21% in the prior year. During our audit o we became aware that the method of calculation of revenue from new products this year has been changed from that used in the prior year, but the change has not been explained and the prior year amount has not been restated to a comparable basis. Under the method used this year new products were deemed to have been launched on the date they were first available for sale, whereas under the previous method products were deemed to have been launched on the date they were announced in a press release. The group's internal papers show that had revenue from new products been calculated on the same basis as last year it would constitute 19% of the group's revenue this year.

The group Operating and Financial Review includes a statement that it has been prepared in accordance with Reporting Standard 1 "Operating and Financial Review". This is incorrect as, in respect of revenue from new products, the group Operating and Financial Review does not include the disclosure required by Reporting Standard 1 of changes to Key Performance Indicators nor an explanation of the calculation method used compared to the previous financial year.

No other matters have come to our attention, in the performance of our functions as auditors of the group, which in our opinion are inconsistent with the information given in the group Operating and Financial Review.

SECTION C – OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Introduction

1. The purpose of this Section of this International Standard on Auditing (UK and Ireland) (ISA (UK and Ireland)) is to establish standards and provide guidance on the auditor's consideration of other information, on which the auditor has no obligation to report, in documents containing audited financial statements. This ISA (UK and Ireland) applies when an annual report is involved; however, it may also apply to other documents, such as those used in securities offerings[1].

1-1 Standards and guidance on the auditor's statutory reporting obligations in relation to directors' reports and operating and financial reviews are given in Sections A and B respectively of this ISA (UK and Ireland).

1-2~~1~~ This Section of this ISA (UK and Ireland) is primarily directed towards the auditor's consideration of other information contained in an entity's published annual report. It is not intended to address issues which may arise if financial information is extracted from the document.

~~1-2. This ISA (UK and Ireland) uses the terms 'those charged with governance' and 'management'. The term 'governance' describes the role of persons entrusted with the supervision, control and direction of an entity. Ordinarily, those charged with governance are accountable for ensuring that the entity achieves its objectives, and for the quality of its financial reporting and reporting to interested parties. Those charged with governance include management only when they perform such functions.~~

~~1-3. In the UK and Ireland, those charged with governance include the directors (executive and non-executive) of a company or other body, the members of an audit committee where one exists, the partners, proprietors, committee of management or trustees of other forms of entity, or equivalent persons responsible for directing the entity's affairs and preparing its financial statements.~~

[1] The guidance in this ISA(UK and Ireland) is limited to Annual Reports and statutory audits. Guidance on other information issued with investment circulars is covered in Statement of Investment Reporting Standard (SIR) 1000.

~~1-4. 'Management' comprises those persons who perform senior managerial functions.~~

~~1-5. In the UK and Ireland, depending on the nature and circumstances of the entity, management may include some or all of those charged with governance (e.g. executive directors). Management will not normally include non-executive directors.~~

2. **The auditor should read the other information to identify material inconsistencies with the audited financial statements.**

2-1. **If, as a result of reading the other information, the auditor becomes aware of any apparent misstatements therein, or identifies any material inconsistencies with the audited financial statements, the auditor should seek to resolve them.**

3. A "material inconsistency" exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

4. An entity ordinarily issues on an annual basis a document which includes its audited financial statements together with the auditor's report thereon. This document is frequently referred to as the "annual report." In issuing such a document, an entity may also include, either by law or custom, other financial and non-financial information. For the purpose of this ISA (UK and Ireland), such other financial and non-financial information is called "other information."

4-1. When the auditor reads the other information, the auditor does so in the light of the knowledge the auditor has acquired during the audit. The auditor is not expected to verify any of the other information. The audit engagement partner (and, where appropriate, other senior members of the engagement team who can reasonably be expected to be aware of the more important matters arising during the audit and to have a general understanding of the entity's affairs), reads the other information with a view to identifying significant misstatements therein or matters which are inconsistent with the financial statements.

4-2. Guidance to auditors in the UK and Ireland on the consideration of other information where the annual financial statements accompanied by the auditor's report are published on an entity's website, or in Great Britain where companies can meet their statutory reporting obligations to shareholders by distributing annual financial statements and certain other reports electronically, is given in the Appendix ~~1~~ to this Section[2].

5. Examples of other information include a report by management or those charged with governance on operations, financial summaries or highlights, employment data, planned capital expenditures, financial ratios, names of officers and directors and selected quarterly data.

5-1. Further examples relevant in the UK and Ireland are a directors' report required by statute (see Section A), statements relating to corporate governance, as required by the Listing Rules ~~of the Stock Exchange~~, a chairman's statement, an operating and financial review (see Section B) and non-statutory figures included within the annual report[3].

5-2. ~~An auditor allows the auditor's reports to be included in documents containing other information only if the auditor considers that the additional information is not in conflict with matters covered by the auditor's report and has no cause to believe it to be misleading.~~ If the auditor believes that the other information is misleading, and the auditor is unable to resolve the matter with management and those charged with governance, the auditor considers the implications for the auditor's report and what further actions may be appropriate. The auditor has regard to the guidance in paragraphs 18-5 and 18-6 below.

6. In certain circumstances, the auditor has a statutory or contractual obligation to report specifically on other information. In other circumstances, the auditor has no such obligation. However, the auditor needs to give consideration to such other information when issuing a report on the financial statements, as the credibility of the audited financial statements may be undermined by inconsistencies which may exist between the audited financial statements and other information.

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2 In Great Britain The Companies Act (Electronic Communications) Order 2000 enables companies to meet, subject to certain conditions, their statutory reporting obligations to shareholders by distributing annual financial statements and certain other reports electronically, or to post their financial statements on their web site and advise shareholders of this.

3 The APB believes that the inclusion of non-statutory information in annual reports has the potential to be misleading and shareholders may sometimes be misinformed by the manner in which non-statutory information is presented. The APB believes that the potential for non-statutory information to be misleading is considerable when inappropriate prominence is given to the non-statutory information, when there is no description of the non-statutory information and, where appropriate, the adjusted numbers are not reconciled to the statutory financial information.

6-1. The credibility of the audited financial statements may also be undermined by misstatements within the other information.

7. Some jurisdictions require the auditor to apply specific procedures to certain of the other information, for example, required supplementary data and interim financial information. If such other information is omitted or contains deficiencies, the auditor may be required to refer to the matter in the auditor's report.

7-1 In the UK and Ireland an example of this type of work for a listed company would include the auditor's review of the directors' statement of compliance with the Combined Code.

8. When there is an obligation to report specifically on other information, the auditor's responsibilities are determined by the nature of the engagement and by local legislation and professional standards. When such responsibilities involve the review of other information, the auditor will need to follow the guidance on review engagements in the appropriate ISAs (UK and Ireland).

Access to Other Information

9. In order that an auditor can consider other information included in the annual report, timely access to such information will be required. The auditor therefore needs to make appropriate arrangements with the entity to obtain such information prior to the date of the auditor's report[4]. In certain circumstances, all the other information may not be available prior to such date. In these circumstances, the auditor would follow the guidance in paragraphs 20-23[5].

Consideration of Other Information

10. The objective and scope of an audit of financial statements are formulated on the premise that the auditor's responsibility is restricted to information identified in the auditor's report. Accordingly, the auditor has no specific responsibility to determine that other information is properly stated.

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4 ISA (UK and Ireland) 700 requires that "The auditor should not date the report earlier than the date on which all other information contained in a report of which the audited financial statements form a part have been approved by those charged with governance and the auditor has considered all necessary available evidence."

5 Paragraphs 19 to 23 are not applicable in an audit conducted in compliance with ISAs(UK and Ireland).

Material Inconsistencies

11. **If, on reading the other information, the auditor identifies a material inconsistency, the auditor should determine whether the audited financial statements or the other information needs to be amended.**

11-1. **If the auditor identifies a material inconsistency the auditor should seek to resolve the matter through discussion with those charged with governance.**

~~11-2. In some circumstances, for example when auditing the financial statements of limited companies in the UK and Ireland, an auditor has a statutory responsibility to consider whether the information given in the directors' report is consistent with the financial statements with which it is issued[6]. If the auditor is of the opinion that it is not, the auditor is required to make reference to the inconsistencies in the auditor's report.~~

~~11-3. Matters relevant to such a statutory duty which may require resolution or reference in an explanatory paragraph within the auditor's report include:~~

- ~~An inconsistency between amounts or narrative appearing in the financial statements and the directors' report.~~
- ~~An inconsistency between the bases of preparation of related items appearing in the financial statements and the directors' report, where the figures themselves are not directly comparable and the different bases are not disclosed.~~
- ~~An inconsistency between figures contained in the financial statements and a narrative interpretation of the effect of those figures in the directors' report.~~

~~An example of an auditor's report on an inconsistency between the directors' report and the financial statements in circumstances where it is the directors' report that requires amendment is set out in Appendix 2.~~

~~[6] In Great Britain, Section 235(3) of the Companies Act 1985 sets out one of the statutory responsibilities of auditors.~~

~~In Northern Ireland, the equivalent legislation is Article 243(3) of the Companies (Northern Ireland) Order 1986.~~

~~In the Republic of Ireland, the equivalent legislation is Section 15 of the Companies (Amendment) Act 1986. Regulation 38 of the European Communities (Companies: Group Accounts) Regulations 1992 imposes a similar obligation on auditors of group accounts.~~

11-24. If the auditor concludes that the other information contains inconsistencies with the financial statements, ~~in circumstances other than those in which paragraph 11-2 applies,~~ and the auditor is unable to resolve them through discussion with those charged with governance, the auditor considers requesting those charged with governance to consult with a qualified third party, such as the entity's legal counsel and considers the advice received.

12. **If an amendment is necessary in the audited financial statements and the entity refuses to make the amendment, the auditor should express a qualified or adverse opinion.**

13. **If an amendment is necessary in the other information and the entity refuses to make the amendment, the auditor should consider including in the auditor's report an emphasis of matter paragraph describing the material inconsistency or taking other actions.** The actions taken, such as not issuing the auditor's report or withdrawing from the engagement, will depend upon the particular circumstances and the nature and significance of the inconsistency. The auditor would also consider obtaining legal advice as to further action.

13-1. In circumstances where the auditor has no issues with the financial statements themselves, and the emphasis of matter is being used to report on matters other than those affecting the financial statements, an emphasis of matter paragraph in relation to a material inconsistency does not give rise to a qualified audit opinion.

Material Misstatements of Fact

14. While reading the other information for the purpose of identifying material inconsistencies, the auditor may become aware of an apparent material misstatement of fact.

15. For the purpose of this ISA(UK and Ireland), a "material misstatement of fact" in other information exists when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.

~~15-1. A material misstatement of fact in other information would potentially include an inconsistency between information obtained by the auditor during the audit (such as information obtained as part of the planning process or analytical procedures, or as management representations) and information which is included in the other information.~~

16. **If the auditor becomes aware that the other information appears to include a material misstatement of fact, the auditor should discuss the matter with the entity's management[7].** When discussing the matter with the entity's management, the auditor may not be able to evaluate the validity of the other information and management's responses to the auditor's inquiries, and would need to consider whether valid differences of judgment or opinion exist.

16-1. **The auditor should consider whether the other information requires to be amended.**

17. **When the auditor still considers that there is an apparent misstatement of fact, the auditor should request management[8] to consult with a qualified third party, such as the entity's legal counsel and should consider the advice received.**

18. **If the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor should consider taking further appropriate action.** The actions taken could include such steps as notifying those charged with governance in writing of the auditor's concern regarding the other information and obtaining legal advice.

18-1. In the UK and Ireland the auditor requests those charged with governance to correct any material misstatements of fact in the other information.

18-2. **If an amendment is necessary in the other information and the entity refuses to make the amendment, the auditor should consider including in the auditor's report an emphasis of matter paragraph describing the material misstatement.**

18-3. In circumstances where the auditor has no issues with the financial statements, and the emphasis of matter is being used to report on matters other than those affecting the financial statements, an emphasis of matter paragraph in relation to a material misstatement of fact in the other information does not give rise to a qualified audit opinion.

18-4. The auditor has regard to the nature of the inconsistency or misstatement that in the auditor's opinion exists. A distinction may be drawn between a

7 In the UK and Ireland the auditor discusses such matters with, and obtains responses from, those charged with governance.

8 In the UK and Ireland the auditor requests those charged with governance to consult with a qualified third party.

matter of fact and one of judgment. It is generally more difficult for the auditor to take issue with a matter of judgment (such as the view of those charged with governance of the likely out-turn for the following year) than a factual error. Although an auditor does not substitute the auditor's judgment for that of those charged with governance in such matters, there may be circumstances in which the auditor is aware that the expressed view of those charged with governance is significantly at variance with the entity's internal assessment or is so unreasonable as not to be credible to someone with the auditor's knowledge. ~~When determining whether to add an emphasis of matter paragraph to the audit report, or other appropriate action, the auditor may need to take legal advice, including advice on whether the auditor would be protected by qualified privilege from a defamation claim if they were to refer to the matters in their report or subsequently.~~

Further Actions Available to the Auditor

18-5. The auditor of a limited company in the United Kingdom or the Republic of Ireland may use the auditor's right to be heard at any general meeting of the members 'on any part of the business of the meeting which concerns the~~m~~ auditor as auditor'[9].

18-6. The auditor may also consider resigning from the audit engagement. In the case of auditors of limited companies in the United Kingdom or the Republic of Ireland, the requirements for the auditor to make a statement on ceasing to hold office as auditor apply[10]. When making a statement in these circumstances, the considerations set out in paragraph 18-4 above would normally be applicable.

Availability of Other Information After the Date of the Auditor's Report

Paragraphs 19 to 23 are not applicable in an audit conducted in accordance with ISAs (UK and Ireland). ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements" requires that "The auditor should not date the report earlier

[9] The relevant reference for Great Britain is section 390 of the Companies Act 1985, for Northern Ireland is Article ~~395~~ 398 of the Companies (Northern Ireland) Order 1986 and for the Republic of Ireland is section 193(5) of the Companies Act 1990.

[10] The relevant reference for Great Britain is section 394 of the Companies Act 1985, for Northern Ireland is Article ~~398~~ 401A of the Companies (Northern Ireland) Order 1986 and for the Republic of Ireland is section 185 of the Companies Act 1990.

than the date on which all other information contained in a report of which the audited financial statements forma part have been approved by those charged with governance and the auditor has considered all necessary available evidence.".

19. *When all the other information is not available to the auditor prior to the date of the auditor's report, the auditor would read the other information at the earliest possible opportunity thereafter to identify material inconsistencies.*

20. *If, on reading the other information, the auditor identifies a material inconsistency or becomes aware of an apparent material misstatement of fact, the auditor would determine whether the audited financial statements or the other information need revision.*

21. *When revision of the audited financial statements is appropriate, the guidance in ISA (UK and Ireland) 560, "Subsequent Events" would be followed.*

22. *When revision of the other information is necessary and the entity agrees to make the revision, the auditor would carry out the audit procedures necessary under the circumstances. The audit procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued financial statements, the auditor's report thereon and the other information are informed of the revision.*

23. **When revision of the other information is necessary but management refuses to make the revision, the auditor should consider taking further appropriate action.** *The actions taken could include such steps as notifying those charged with governance in writing of the auditor's concern regarding the other information and obtaining legal advice.*

Effective Date

23-1. This ISA (UK and Ireland) is effective for audits of financial statements for periods commencing on or after 1 April 2005 and ending on or after ~~15 December 2004~~ 31 March 2006.

Public Sector Perspective

Additional guidance for auditors of public sector bodies in the UK and Ireland is given in:

- Practice Note 10 "Audit of Financial Statements of Public Sector Entities in the United Kingdom (Revised)"
- Practice Note 10(I) "The Audit of Central Government Financial Statements in Ireland"

1. *This ISA (UK and Ireland) is applicable in the context of the audit of financial statements. In the public sector, the auditor may often have a statutory or contractual obligation to report specifically on other information. As paragraph 8 of this ISA (UK and Ireland) indicates, the procedures stated in this ISA (UK and Ireland) would not be adequate to satisfy legislative or other audit requirements related to, for example, the expression of an opinion on the reliability of performance indicators and other information contained in the annual report. It would be inappropriate to apply this ISA (UK and Ireland) in circumstances where the auditor does have an obligation to express an opinion on such information. In the absence of specific auditing requirements in relation to "other information," the broad principles contained in this ISA (UK and Ireland) are applicable.*

Appendix ~~1~~

Electronic Publication of the Auditor's Report

Introduction

1. In Great Britain The Companies Act 1985 (Electronic Communications) Order 2000 (the Electronic Communications Order) enables companies to meet, subject to certain conditions, their statutory reporting obligations to shareholders by distributing annual financial statements and certain other reports[11] electronically, or to post their financial statements on their web site and advise shareholders of this.

2. Various types of financial information can be found on web sites including information that has been audited (for example the annual financial statements), information which the auditor may have reviewed (for example interim financial information) and information with which the auditor has had no direct involvement, such as financial highlights from a company's Annual Report or may never have seen, such as presentations for analysts. In addition, web sites typically contain a considerable amount of non-financial information.

3. The purpose of this Appendix is to provide guidance to auditors on the consideration of other information not only if companies decide to take advantage of the Electronic Communications Order, but also in the more common current situation where the annual financial statements accompanied by the auditor's report are published on an entity's web site[12].

The Auditor's Consideration of Other Information Issued with the Annual Report

Checking Information Presented Electronically

4. When companies include the annual financial statements and the auditor's report on their web site or, in Great Britain, decide to distribute annual financial statements to their shareholders electronically, the auditor:

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[11] Other reports include Summary Financial Statements.

[12] This guidance is generally applicable both to auditors in Great Britain (where the Electronic Communications Order applies) and in Northern Ireland and the Republic of Ireland (where it does not)

(a) Reviews the process by which the financial statements to be published electronically are derived from the financial information contained in the manually signed accounts;

(b) Checks that the proposed electronic version is identical in content with the manually signed accounts; and

(c) Checks that the conversion of the manually signed accounts into an electronic format has not distorted the overall presentation of the financial information, for example, by highlighting certain information so as to give it greater prominence.

5. It is recommended that the auditor retains a printout or disk of the final electronic version for future reference if necessary.

Auditor's Report Wording

6. The auditor considers whether the wording of the auditor's report is suitable for electronic distribution. Issues include:

- Identifying the financial statements that have been audited and the information that has been reviewed, or read, by the auditor.
- Identifying the nationality of the accounting and auditing standards applied.
- Limiting the auditor's association with any other information distributed with the Annual Report.

Identification of the Financial Statements That Have Been Audited

7. In Annual Reports produced in a hard copy format, the auditor's report usually identifies the financial statements which have been audited by reference to page numbers. The use of page numbers is often not a suitable method of identifying particular financial information presented on a web site[13]. The auditor's report therefore needs to specify in another way the location and description of the information that has been audited.

8. The APB recommends that the auditor's report describes, by name, the primary statements that comprise the financial statements. The same

[13] The audited financial statements can be presented on the web site using a variety of webfile formats. As at the date of this Bulletin, examples of these are the Portable Document Format (PDF) or Hypertext Mark-up Language (HTML). Page numbers generally continue to be an effective referencing mechanism for PDF files but this is not always the case when data is represented 'in HTML.

technique can also be used to specify the information that has been reviewed or, because it is included in the Annual Report, read by the auditor.

9. The auditor ensures that the auditor's statutory report on the full financial statements is not associated with extracts from, or summaries of, those audited financial statements.

Identification of the Nationality of the Accounting and Auditing Standards Applied

10. Auditor's reports on web sites will be accessible internationally, and it is therefore important that the auditor's report indicates clearly the nationality of the accounting standards used in the preparation of the financial statements and the nationality of the auditing standards applied. For the same reason, the auditor ensures that the auditor's report discloses sufficient of the auditor's address to enable readers to understand in which country the auditor is located.

Limitation of the Auditor's Association With any Other Information Distributed With the Annual Report

11. In addition to the Annual Report many companies publish on their web sites a considerable volume of financial and non-financial information. This information could take the form of additional analyses or alternative presentations of audited financial information. Users of the web site are likely to find it difficult to distinguish financial information which the auditor has audited, or read, from other data. This issue is exacerbated when there are hyperlinks which allow users to move easily from one area of the web site to another.

12. The auditor gives careful consideration to the use of hyperlinks between the audited financial statements and information contained on the web site that has not been subject to audit or 'reading' by the auditor ('other information'). To avoid possible misunderstandings concerning the scope of the audit, the auditor requests those charged with governance to ensure that hyperlinks contain warnings that the linkage is from audited to unaudited information.

13. Sometimes audited information is not included in the financial statements themselves (e.g. certain information relating to directors' remuneration may be set out as part of a company's corporate governance disclosures). The APB is of the view that companies should be encouraged to make disclosures that are required to be audited, as part of the financial

statements or included in the Annual Report in such a way that it is clear which elements of it have been audited. In other circumstances the auditor assesses whether the scope of the audit will be capable of being clearly described. If this cannot be achieved to the satisfaction of the auditor it may be necessary to describe the particulars that have been audited within the auditor's report.

14. The auditor is concerned to establish that the auditor's report on the financial statements is not inappropriately associated with other information. The auditor takes steps to satisfy themselves that information that they have audited or, because it is included in the Annual Report, read, is distinguished from other information in a manner appropriate to the electronic format used by the entity. Techniques that can be used to differentiate material within a web site include

- Icons or watermarks.
- Colour borders.
- Labels/banners such as 'annual report' or 'audited financial statements'.

The appropriate mode of differentiation between audited and unaudited information will be dependent on the electronic format selected, and the nature and extent of other information presented on the web site. The method of differentiation would normally also be clearly stated in an introduction page within the web site.

15. During the course of the audit, the auditor discusses with the those charged with governance or, where appropriate, the audit committee how the financial statements and auditor's report will be presented on the entity's web site with a view to minimizing the possibility that the auditor's report is inappropriately associated with other information. If the auditor is not satisfied with the proposed electronic presentation of the audited financial statements and auditor's report, the auditor requests that the presentation be amended. If the presentation is not amended the auditor will, in accordance with the terms of the engagement, not give consent for the electronic release of the audit opinion.

16. If the auditor's report is used without the auditor's consent, and the auditor has concerns about the electronic presentation of the audited financial statements or the auditor’s report and appropriate action is not taken by those charged with governance, the auditor seeks legal advice as necessary. The auditor also considers whether it would be appropriate to resign.

~~Appendix 2~~

~~Example~~

~~Emphasis of Matter - Material Inconsistency Between the Financial Statements and the Directors' Report~~

~~AUDITORS' REPORT TO THE SHAREHOLDERS OF XYZ LTD - EXTRACTS~~

~~Opinion~~

~~[ISA (UK and Ireland) 700 opinion paragraph]~~

~~Material inconsistency between the financial statements and the directors' report~~

~~In our opinion, the information given in paragraph 7 of the directors' report is not consistent with these financial statements. That paragraph states without amplification that the company's trading resulted in a profit before tax of £X. The profit and loss account, however, states that the company incurred an operating loss for the year of £Y and a profit from the sale of land of £Z.~~

~~Note: This form of report is not a qualified report for the purposes of sections 240(3)(d) or 271(4) of the Companies Act 1985 in the United Kingdom, or section 49(3)(c) of the Companies (Amendment) Act 1983 and section 19(2)(d) of the Companies (Amendment) Act 1986 in the Republic of Ireland as the opinion on the financial statements is unaffected.~~

NOTICE TO READERS

The ISAs (UK and Ireland) are based on International Standards on Auditing of the same titles, which have been issued by the International Auditing and Assurance Standards Board and published by the International Federation of Accountants.