



International Developments

ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information

Why ISA 720 got Revised

In recent past, great amount of detailed information has become part of corporate reporting.

Users place greater emphasis to narrative and qualitative disclosures such as business models, risk exposures and uncertainties for ways to better inform their analysis and understanding of complex areas in the financial statements. Annual reports now include more narrative and qualitative information than in the past.

Organizations are also making diverse use of documents other than annual reports for external communication purpose such as, management reports, statements on corporate governance or on internal control and risk assessments. Work is being done to explore ways to better integrate information in financial statements, Management's Discussion and Analysis (MD&A), and other reporting areas.

Therefore, IAASB in order to ensure that ISA 720 appropriately reflects today's detailed financial reporting requirement and meet user's expectations and auditor's responsibilities, revised the ISA. IAASB sought to;

- ▶ Improve *audit quality* by bringing greater consistency in the diverse range of OI;
- ▶ Increase the *value of the audit*, through enhancing the auditor's responsibilities with respect to the OI; and
- ▶ Improve *transparency* by explicating auditor's responsibilities in their reports under the ISA 720 (Revised) and the outcome of their work relative to the OI.

What if a Material Inconsistency Exists?

Where there is a material inconsistency between the OI and the financial statements, the auditor is required to compare selected amounts or other items in the OI with such amounts or other items in the financial statements.

The auditor's report will always include a separate Other Information section when the auditor has obtained some or all of the OI as of the date of the auditor's report.

Main Revisions in Scope and Auditor's Work Effort

A. The Scope of Other Information

ISA 720 (Revised) applies to "Other Information." **Other Information** is financial or non financial information (other than financial statements and the auditor's report thereon) included in annual report. An **Annual Report** is prepared on annual basis by



IAASB has retained the concept that Other Information (OI) is not audited (i.e., that auditors do not obtain assurance on the OI).

management or TCWG in accordance with laws, regulation or customs to provide stakeholders about the information on entity's operation, financial results and financial position.

B. Auditor's Work Effort for Other Information

The revised ISA enhances auditor's work for OI and requires auditor to:-

- Read** the other information,
- Consider** material inconsistency between OI and financial statements,
- Consider** material inconsistency between OI and knowledge obtained during the audit,
- Alert** for indications that OI not related to the financial statements or the auditor's knowledge obtained during audit appears to be materially misstated.

ISA 720 (Revised) does not apply to preliminary announcements of financial information or securities offering documents, including prospectuses.

What to Communicate about Other Information in Auditor's Report?

Using the heading "Other Information" or other appropriate heading, the auditor's report will include:

- ▶ A statement of management's responsibility for the OI.
- ▶ Identification of the OI obtained prior to the date of the auditor's report. In the case of a listed entity, the auditor is also required to identify any OI expected to be obtained after the date of the auditor's report.
- ▶ A statement that the auditor's opinion does not cover the OI and, accordingly, auditor does not (or will not) express an audit opinion or any form of assurance conclusion thereon.
- ▶ A description of the auditor's responsibilities relating to reading, considering and reporting on OI as required by revised ISA.
- ▶ When OI has been obtained prior to the date of the auditor's report, either :
 - A statement that the auditor has nothing to report; or
 - If the auditor has concluded that there is an uncorrected material misstatement of the OI, a statement that describes the uncorrected material misstatement of the OI.

Effective Date

This standard is effective for audits of financial statements for period ending on or after **December 15, 2016**.



Local Development

Adoption of Clarified ISA 600 'Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)' by ICAP

Through ICAP circular No.5 /2015, the Council in its 263rd meeting held on April 4, 2015 approved the applicability of the Clarified ISA 600. This ISA will be effective for audits of financial statements for periods beginning on or after July 1, 2015. The circular may be accessed at <http://www.icap.net.pk/archives/2269>

The Institute is following up with the SECP for aligning Form 35C under the Companies Ordinance, 1984 to the clarified ISA 600 requirements and till such notification existing Form 35C will be applicable for audit of companies.

Objectives of ISA 600

This standard deals with auditing of group audits which involves component auditors. This standard is also useful when audit involves other auditors that are not group audit. The objectives of ISA 600 are:

- ▶ Determine whether to act as the auditor of the group financial statements; and
- ▶ If acting as group auditor:
 - Communicate with component auditors about the scope and timing of their work on financial information related to components and their findings; and
 - Obtain sufficient appropriate audit evidence regarding the financial information of components and consolidation process to express an opinion on whether group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Difference in Clarified ISA 600

Under the old ISA 600, the principal auditor can base the audit opinion on financial statements taken as a whole solely upon the report of another auditor, however, as per clarified ISA 600, the audit report on group financial statements may only refer to component auditor, if required by law or regulation but such group report shall also indicate that reference to component auditor does not reduce the engagement partner or engagement partner's firm's responsibility.

Under clarified ISA 600, the group auditor has to take ownership and responsibility of component audit as well and they will have to satisfy themselves on all the matters of the component whose audit was performed by another auditor.



Revision in the Form of Audit Reports

At present in Pakistan, Form 35A, 35B & 35C formats of audit reports given in Companies Ordinance 1984 are not in accordance with ISA 700. Considering that the Institute has adopted all ISAs, the existing Auditors' report formats should also be in accordance with the format as prescribed in IAS 700 and for consolidated financial statement ISA 600.

In view of above, the relevant committee of the Institute amended the above auditor's report formats by incorporating the requirements of Form 35A in the clarified ISA 700 report.

For Form 35B, the relevant committee removed the reference to branches from the audit report format and aligned it with the requirements of ISA 700.

In case of Form 35C, the opinion paragraph of the Auditor's Report is inadvertently not included the reference of accounting framework and report format is not in accordance with ISA 600. Owing to this reason, the relevant committee developed revised Form 35C report to align it in accordance with ISA 700 and clarified ISA 600.

The revised Form 35A & 35C audit report formats were sent to SECP for their consideration and recently, SECP has exposed revised Form 35A and 35C format proposed by the Institute for public comments with minor changes wide SRO 446 dated May 25, 2015. The relevant committee again reconsidered the exposed reports and has sent its comments to SECP.

Revised Form 35B has been sent to SBP for their consideration.



Legal and Regulatory Requirements

1. Revised ICAP Code of Ethics for Chartered Accountants 2015

The Institute's Council vide its Circular no. 04/2015, dated April 28, 2015 revised Code of Ethics for Chartered Accountants (the Code) which is effective for audits of financial statements for periods beginning on or after July 01, 2015.

Background

The existing Code of Ethics was revised in May 2008 and issued to members. The journey of the revised code started since 2009, when International Ethics Standards Board for Accountants (IESBA) of IFAC made major structural changes and introduced new requirements. In order to adopt the revised IESBA Code, the relevant Committee of the Institute took up the review of Codes issued by IESBA from 2009 to 2014 and after an exhaustive study, adopted the latest IESBA Code subject to some changes.

Key Changes to the CODE

1. Split of current section 290 'Independence' into Section 290, dealing with audit and review engagements and Section 291, dealing with other assurance engagements;
2. New and consistent drafting conventions have been adopted throughout the revised Code i.e. the term 'should' has been replaced with 'shall';
3. Enhanced explanation of the 'Conceptual Framework Approach'. This includes a requirement to apply safeguards, when necessary, to eliminate threats or reduce them to an 'acceptable level';
4. The Code includes a revised description of the 'threats', together with modified examples of circumstances which create threats;
5. Network firms are required to be independent of audit clients of other firms within the network;
6. Requirements and application guidance addressing situations where, as a result of a merger or acquisition, an entity becomes a related entity of an audit client;
7. A new section of Management Responsibilities has been introduced;
8. New terms are defined: 'Public Interest Entities (PIE)', 'Key Audit Partner (KAP)', 'Those Charged with Governance', 'Engagement Team', 'Professional Activity';
9. Extending independence requirements for audits of listed entities to all PIEs;
10. Cooling off period must be met before a KAP or firm Managing Partner joins PIE audit clients as Director, Officer or employee on important position;
11. Extending partner rotation requirements to all PIEs and to all KAPs;
12. Strengthening some of the provisions related to non-assurance services to audit clients;
13. Requiring a pre or post issuance review if total fees from a public interest audit client exceed 15% of the total fees of the firm for two consecutive years;

14. Prohibiting KAPs from being evaluated on or compensated for selling non-assurance services to their audit clients;
15. Provisions relating to conflict of interest situations and addressing breach of a requirement of the Code have been added;
16. In order to avoid duplication, all sections/clauses related to Companies Ordinance 1984, listing regulations and Code of Corporate Governance reproduced anywhere in the ICAP Code of Ethics have now been deleted.

The revised Code may be accessed at <http://www.icap.net.pk/wp-content/uploads/2013/12/ICAP-Code-of-Ethics-2015.pdf>.

For guidance of members, a detailed presentation covering the key changes of the Code has also been made which can be accessed from Institute's website at: <http://www.icap.net.pk/wp-content/uploads/2013/12/Presentation-on-revised-ICAP-Code-of-Ethics-2015.pdf>.

2. Framework for External Audit Function

SBP issued BPRD Circular no. 07 of 2015, dated April 29, 2015 regarding *Framework for External Audit Function*. External Audit function is statutory and crucial requirement for banks and other financial institutions to ensure true and fair view of the financial statements. Accordingly, the framework, which comprises of two parts, has been devised to cater all revised developments.

Part A involves revised regulatory requirements relating to enlistment of audit firms, their up-gradation/ down-gradation/ removal from the SBP panel, essential qualifications for external auditors, fitness and propriety criteria of capacity and competence, independence and financial integrity, IFAC Code requirements, functional areas requiring special attention of the auditors, guidance on supervisory expectations and relationships relating to role and responsibilities of the external auditors.

Part B embraces existing legal and regulatory instructions.

This framework can be accessed at <http://www.sbp.org.pk/bprd/2015/C7.htm>





Events

1. Maximizing Internal Audit Impact for 2015 & Beyond – Are You Set For It?

When & Where?

Terrabiz Pakistan International Audit Summit, PIAS 2015 held on 16 June 2015 at Marriott hotel, Karachi. Many leading personalities from Privatization Commission, professional audit firms, top companies and others threw light on complex web of Governance, Risk and Compliance to achieve effective internal control system. Among other, eminent professionals like S.M. Shabbar Zaidi, Yacoob Suttar, Khalilahullah Shaikh, Zulfikar Causar, Moneeza Butt & Lubna Farooq were the panelists.

Conference Synopsis

Speakers talked over the horizon for risk, innovation and opportunity, expectations from internal audit professionals of the future, varied functions of internal audit and audit committee, regulatory compliances and good governance particularly in banking sector, alignment of internal auditor's role in governance, risk and compliance for maximum impact, IT audit and assurance and enterprise risk management.

Not only this, an interactive panel session on "Emerging audit issues: what's on the horizon" was conducted where participants shared their views and discussed the way forward for upcoming audit challenges.

The Summit also facilitated participants with a practical and legal guide to new challenges regarding fraud and corruption within organizations. Key discussion points were definition of frauds & corruption as per local applicable laws, its types within organization, preventive, detective and corrective measures and legal recourses.

2. Transparency of Audit Reporting and Enhancing Audit Quality

When & Where?

IAASB and Federation of European Accountants (FEE) conducted a roundtable of "Transparency of audit reporting and enhancing audit quality" on 28 May 2015 in Brussels, Belgium. Professionals from across EU member states participated in the debate and openly share their views on these strategic topics.

Auditor Reporting

Revised auditor reporting standards are intended to revamp and promote the auditor's report, not solely as a means to an end, but rather an informative, valuable and meaningful product of the audit of the financial statements. Among key changes, the most significant and interesting outcome is the inclusion of a new section to describe Key Audit Matters (KAM). KAMs are intended to provide transparency to the users of the auditor's report. Most participants questioned about what constitutes a KAM, the basis of assessment of it and who should be deciding it. Considering the queries, it was explained in the roundtable that a natural starting point for KAM should be from the matters communicated to the audit committee as they are typically the matters that required the most of the auditor's attention.

The importance of communication between the auditor and the audit committee was emphasized. The impact of new requirements was discussed on the workload of the audit committee and auditor. It was clarified that the matters to be discussed between the audit committee and the auditor are not intended to change to meet these new requirements. KAMs are not meant to add burden, nor limit or replace discussions between the auditor and the audit committee.

Audit Quality

Participants accredited the difficulty of defining Audit Quality (AQ). They agreed that internal audit is one of the key players in ensuring audit quality in the AQ Framework. Members also observed an impact on audit quality in the long term caused by declining audit fees. There was a consensus that the development of staff and investment in technology are the key differentiators for accounting firms, and are proven to positively influence audit quality. The diversity of personnel with different backgrounds (personal experience, education, training, soft skills) is seen as add on.

Details of event can be viewed on:

<https://www.ifac.org/news-events/2015-04/iaasb-fee-lunch-debate-auditor-quality-and-auditor-reporting-0>





Updates from Auditing Standards Committee (AuSC)

1. Road Map for Implementation of New Auditor Reporting in Pakistan

Considering revision of ISA 700 "Forming an Opinion and Reporting on Financial Statements" that would be effective for audits of financial statements for periods ending on or after December 15, 2016, the AuSC has started working on revising Form 35A & 35C audit report in accordance with revised ISA 700 and clarified ISA 600.

A Committee is developing a road map for next two years for implementation of new auditor's report and plan for organising awareness sessions with all stakeholders to discuss key changes, formats of the new report and its impact on the industry and also to minimize expectation gaps on key audit matters required under ISA 701.



2. Adoption of ISA 701 "Communicating Key Audit Matters in the Independent Auditor's Report"

Key Audit Matters (KAM) are those matters that in the auditor's judgment are most significant in the audit of current period financial statements. The ISA requires the auditor to describe, in relation to each KAM, a reference related to financial statement disclosures, why the matter was considered to be the most significant one and how it was addressed.

Bearing in mind the scope and impact of describing KAMs in audit report, the adoption of this standard is currently under consideration of the AuSC.



3. Assurance & Related Services Guidance Booklet for Stakeholder's Awareness

This Booklet is developed by AuSC for the benefit of members and other stakeholders. It aims to look at the types of services being provided by the Chartered Accountants in practice and the relevant pronouncements of the International Auditing and Assurance Standards Board (IAASB) and ICAP in order to ensure consistency and enhance the quality of the profession.

Members are advised to use this Booklet as a reference guide when selecting type of assurance and related services. The Booklet is in printing stage and will be available from ICAP Facilitation center soon.

4. Guide for Implementation of ISQC 1 for SMPs

ISQC 1 acknowledges that smaller firms may have more limited internal resources but the standard allows SMPs to customize their firms' policies keeping in view of their size of firm. Despite this flexibility SMP faces practical difficulties in practical implementation of this standard.

SMPs feel that the policies and procedures referred to in ISQC 1 depend upon the various factors such as the size and operating characteristics of the firm but no guidance in respect of the policies and procedures is provided in ISQC 1. SMPs also fear that Human Resource requirement of ISQC 1 are very subjective and in the absence of any clear guidance/standardized documentation this may lead to confrontation with the reviewer/inspector of the Institute at the time QCR visit to firm.

EQCR and Monitoring are other areas where SMPs faces challenges & major hindrance in full implementation of ISQC 1. This matter was under debate since long, therefore, the Council considering the practical problems of SMPs, advised the Committee to develop guide for Implementation of ISQC 1. The matter is currently under discussion of the Committee.

disclaimer This publication is intended to provide a summary of developments relating to audit during the quarter, legal and regulatory matters and matters under consideration of AuSc.

This information should not form the basis of any decision; nor it should be relied upon as a legal and professional guidance regarded as a substitute for specific advice.

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