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23 January 2017

Dear Professor Schilder,

Discussion Paper: Supporting Credibility and Trust in Emerging Forms of External Reporting: Ten Key Challenges for Assurance Engagements

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the IAASB's Discussion Paper concerning credibility and trust in emerging forms of external reporting (EER). We welcome the IAASB's work to extend the discussion on assurance to the many varied forms of emerging external reporting, including but not exclusively, Integrated Reporting. The FRC believes that the discussion paper represents a comprehensive summary of the key issues and challenges in building credibility and trust amongst users of this information, including the various ways in which assurance engagements could play a role.

We agree with the characterisation by the IAASB of the current EER landscape as relatively immature (and diverse), and therefore that it may be too soon to develop bespoke assurance standards. Discussion in our jurisdiction, including with relevant stakeholders, suggests that, whilst there is growing interest in the potential value of assurance engagements in this area in some quarters, the current demand remains limited and has yet to be clearly established. Indeed, we recognise that this is currently a very busy period of work for the IAASB – particularly given the key projects the Board is currently engaged in including revisions to ISAs 315, 540, the Quality Control project and the forthcoming post implementation review on Auditor Reporting. At this stage, it is therefore hard to see the case for a significant standard setting project in this area being a priority for the remainder of the current strategy period to 2019.

We believe that the discussion paper, including the IAASB's analysis of the four key factors that enhance user credibility and trust and of the ten key challenges for assurance engagements, provides an excellent grounding for the necessary understanding of the nature of emerging forms of external reporting, the potential differences in the nature of emerging corporate reporting frameworks as compared with financial reporting frameworks and of the related challenges in obtaining and providing assurance about such reporting. This should enable the IAASB to continue to monitor developments in such reporting and to engage with its stakeholders, including the accountancy profession, about the nature of the corporate reporting frameworks and assurance and other engagements emerging in this area and how they are expected to develop.

We agree that it is possible that further exploring the conceptual issues underlying the ten key challenges and developing new guidance to enable practitioners to apply the requirements of

the IAASB's International Standards for assurance engagements in relation to EER reporting, in due course, might stimulate or enhance demand for assurance engagements. However we believe that the further commitment of limited IAASB resources into this area should be judicious at present, should aim to continue to provide thought leadership and should seek to leverage the work of national standard setters in those jurisdictions where demand is already more advanced and developing. In view of this, the IAASB might look to the wider accountancy profession to take forward the debate in this area.

We also note that the discussion paper highlights that there are open questions about what form of assurance might be appropriate to EER, and whether financial professionals are always likely to be best placed to provide it. To take environmental reporting, as an example, and in the light of recent high profile corporate failures, it is at least questionable whether traditional financial services firms delivering 'limited assurance' engagements dealing with the accuracy and proper presentation of this information is the best way to engender enhanced user confidence in this reporting. The FRC has long taken the view that engagements providing only limited assurance are in themselves of limited value to the users of the material being assured.

We believe that this discussion paper provides a clear and helpful basis for further outreach and discussion, and makes a significant contribution to the wider debate about how the key characteristics of emerging corporate reporting frameworks in this area relate to assurance engagements and might contribute to enhanced user credibility and trust. We also note that some of the ten key challenges, including most particularly materiality and future-oriented information, are closely related to challenges in the audit of financial reporting disclosures. We believe that these are areas where earlier input from the IAASB could be more broadly relevant to the IAASB's current priorities.

Where we have detailed responses to specific questions, these are set out in the following paragraphs.

Q1 Section III describes factors that enhance the credibility of EER reports and engender user trust.

a. Are there any other factors that need to be considered by the IAASB?

b. If so, what are they?

The FRC agrees that the four key factors identified by the IAASB (the existence of a sound reporting framework; strong governance over the reporting process; consistent wider information; and external professional services and other reports) are the key factors that need to be considered in developing a framework for assurance in this area.

Based on our experience of reforms and enhancements to the UK Corporate Governance Code, and more generally to corporate reporting, the factors that the IAASB has identified are typically those that stakeholders see as being required for credibility and trust to be enhanced. They also properly recognise the fundamental importance of the relationship between governance, the quality of financial and broader corporate reporting and the relevance and quality of audit and wider assurance. In the UK, Boards are now required to confirm that the annual report and accounts taken as a whole are fair, balanced and understandable, to ensure that the narrative sections of the report are consistent with the financial statements and fairly reflect the company's performance. Audit Committees have a more direct responsibility for ensuring the quality of financial reporting, and Auditor's Reports now provide significantly more information about the nature of the work done to support the opinion.

The IAASB's Discussion Paper refers interchangeably to credibility and trust. In further developing its thinking, the IAASB may find it helpful to differentiate more clearly between trust, and the factors such as credibility which can contribute towards it. A body of existing academic literature may help contribute towards further evolution of thinking in this area. For example, INSEAD have developed a Trust Equation which depicts user trust in information as the product of factors such as credibility, reliability, intimacy and perceptions of self-interest. Trust can be increased where the user has confidence in the technical credibility of the entity producing information; that entity has a track record of delivering on its promises; and also has a track record of effectively managing and protecting data. By contrast, trust in information can be diminished by the perception of self-interest – or conflicts of interest – by the entity which has produced it.

One further factor which might be considered by the IAASB, is the potential confusion caused by the existence of a multiplicity of reporting frameworks. Each of these may be 'sound' in their own terms, but may have different disclosure requirements, or use different language to describe very similar requirements. In the UK we have seen numerous frameworks being used by companies as the benchmark for the publication of material which might be recognised as within the scope of 'EER' – including, for example, 'Reporting Guidelines' established by companies themselves. These may be the product of strong internal governance processes, and may result in information which is consistent with other sources of information for users – their diversity may nevertheless represent a further challenge for any provider of assurance, and for the users of that assurance and a key debate in developing reporting frameworks will be where the balance between consistency and entity-specificity will need to lie. Although we still consider it important to recognise that the ability to produce information which can be assured, will in itself contribute to enhanced trust on the part of stakeholders.

The majority of 'independent external assurance' reports we have seen in the UK market which cover 'EER' material have been performed in accordance with ISAE 3000 and present a 'properly prepared in accordance with' type limited assurance opinion. The additional question which the IAASB may therefore want to explore is whether the financial reporting framework is not just 'sound' but the extent to which the governance system ensures that the 'right' or 'most appropriate' framework has been applied, given the nature of the external report and the expectations of its users.

Q2 Sections II and IV describe different types of professional services that are either currently performed or could be useful in enhancing credibility and trust.

a. Are there other types of professional services the IAASB needs to consider, that are, or may in future be, relevant in enhancing credibility and trust?

b. If so, what are they?

The FRC believes that the discussion paper describes the full range of professional services which might be relevant to enhancing credibility and trust in EER information. However, the discussion paper does not explicitly consider the potential relevance of Internal Audit to these types of engagement. It may be that in respect of a cost benefit assessment and until frameworks fully mature, the producers and users of EER information may see a case for companies to provide relevant assurance which is built on the work of the internal auditors and their insight and knowledge of the nature of the companies and the business environment in which it operates.

We also suggest that the IAASB remains alert to emerging professional services which may help provide validation for and add credibility to EER information. This might include, for example, the growth in 'big data' analysis and consultancy services which may become increasingly relevant – particularly when considering consistency with wider information.

Q3 Paragraphs 23–26 of Section II describe the responsibilities of the auditor of the financial statements under ISA 720 (Revised) with respect to the other information included in the annual report.

a. Is this sufficient when EER information is included in the annual report; or

b. Is there a need for assurance or other professional services, or for further enhancement of the responsibilities of the financial statement auditor, to enhance credibility and trust when EER information is in the annual report?

We also note that the discussion paper states in paragraph 26 that. *“...it is important for users to recognize that, despite the auditor diligently meeting these responsibilities in performing the audit, the EER information could still be materially misstated. For example. The EER information could be misstated, but a material inconsistency may not appear to exist because the misstated information is not related to the financial statements and the auditor did not obtain any relevant knowledge of the matter when performing the audit. If this is not understood by users, it could give rise to an expectation gap.”*

We agree that there may be a risk of an expectation gap arising in these circumstances, however, in our view this is not specific or unique to the inclusion of additional EER information in the annual report. ISA 720 (Revised) is clear that any procedures which the auditor carries out to confirm consistency between the financial statements and the 'other information', and between that 'other information' and the knowledge and evidence gained in the course of the audit, does not represent an assurance engagement – and should not be misrepresented in the auditor's report. This is also true even when – as is the case in the UK in respect of 'other statutory information' as defined in ISA (UK) 720 (Revised) – there are additional statutory requirements placed on the auditor. Any concerns about the creation of an 'expectation gap' should therefore be framed in the context of the broader application of ISA 720 to annual reports.

We have found in the UK that users place considerable value on the knowledge that the auditor has diligently considered the consistency of the annual report with the auditor's knowledge. In an area subject to relative immaturity of reporting frameworks and of governance and oversight, this is an effective way to ensure that the auditor's considerable knowledge of the entity is appropriately leveraged in providing users with an independent basis for some level of confidence and trust in the information reported. Whether this is sufficient will depend on whether users need a more robust basis, at least in relation to some types of information. For example, it has been suggested that there could be greater user interest in specific assurance over certain types of information, such as non-GAAP measures where there are relevant reporting frameworks available. This may well be a useful area of focus for the IAASB to explore further, and consideration could be given to providing additional guidance to support auditors in carrying out high-quality and robust reviews over such reporting frameworks.

Q4 Section IV describes the different types of engagements covered by the IAASB's International Standards and Section V suggests that the most effective way to begin to address these challenges would be to explore guidance to support practitioners in applying the existing International Standards for EER assurance engagements.

a. Do you agree?

b. If so, should the IAASB also explore whether such guidance should be extended to assist practitioners in applying the requirements of any other International Standards (agreed-upon procedures or compilation engagements) and, if so, in what areas? (For assurance engagements, see Q6-7)

c. If you disagree, please provide the reasons why and describe what other action(s) you believe the IAASB should take.

We agree that the most effective approach, in the medium term, would be to explore guidance to support practitioners in applying the existing standards, particularly given the current widespread use of ISAE 3000. We also note as indicated in the introductory section of this letter that, in the short term:

- (a) The IAASB should use its limited resources judiciously, to continue to monitor developments, provide further thought leadership and leverage the work of national standard setters in those jurisdictions where demand is already more advanced and developing; and
- (b) Some of the ten key challenges are closely related to challenges in the audit of financial reporting disclosures and that these are areas where earlier input from the IAASB could be more broadly relevant to the IAASB's current priorities.

Q5 The IAASB would like to understand the usefulness of subject-matter specific assurance standards. ISAE 3410, a subject matter specific standard for assurance engagements relating to Greenhouse Gas Statements, was issued in 2013.

a. Please indicate the extent to which assurance reports under ISAE 3410 engagements are being obtained, issued or used in practice by your organization.

b. If not to any great extent, why not and what other form of pronouncement from the IAASB might be useful?

We have spoken with a number of stakeholders, both auditors and investors to understand to what extent ISAE 3410 is used in the UK. The results of those discussions show that UK assurance engagements tend not to be undertaken purely in respect of greenhouse gas statements, but tend to be broader engagements (as noted earlier in this response) covering a wider range of subject matter information, and therefore subject to assurance using ISAE 3000 which gives the assurance provider greater flexibility. Our stakeholders told us that they felt ISAE 3410 to be too narrow and too precise to support the sort of engagements they were being asked to undertake, and that there was no demand for a further pronouncement from the IAASB at this stage.

Q6 Section V suggests it may be too early to develop a subject-matter specific assurance engagement standard on EER or particular EER frameworks due to the current stage of development of EER frameworks and related standards. Do you agree or disagree and why?

We agree with the overall characterisation in the discussion paper of the relative immaturity of many EER frameworks, and therefore with the IAASB's assessment that it may be too early

to develop a subject-matter specific assurance engagement standard on EER or particular EER frameworks such as Integrated Reporting.

We would, nevertheless, encourage the IAASB to remain alert to increased demand for assurance in particular areas or in relation to particular types of reporting rather than seeking to develop a more comprehensive EER assurance standard. For example, in respect of environmental reporting some stakeholders have told us of increasing demand for assurance over certain types of emissions data which might eventually justify specific guidance. As mentioned earlier in our response, a question mark remains over whether financial auditors and other financial professionals are always the right people to be providing assurance in these cases rather than – for example – specialist environmental practitioners.

Q7 Section V describes assurance engagements and the Ten Key Challenges we have identified in addressing EER in such engagements and suggests that the most effective way to begin to address these challenges would be to explore guidance to support practitioners in applying the IAASB's existing International Standards to EER assurance engagements.

a. Do you agree with our analysis of the key challenges?

b. For each key challenge in Section V, do you agree that guidance may be helpful in addressing the challenge?

c. If so, what priority should the IAASB give to addressing each key challenge and why?

d. If not, why and describe any other actions that you believe the IAASB should take.

e. Are there any other key challenges that need to be addressed by the IAASB's International Standards or new guidance and, if so, what are they, and why?

We agree with the IAASB's analysis of the ten key challenges. We believe that priority should be given to dealing with the challenges of materiality and future oriented information in the context of an EER engagement. The assessment of materiality is a key driver for any assurance activity – together with future-oriented information, the challenges in these areas are closely related to challenges in the audit of financial reporting disclosures. Consistent with our comments elsewhere in our response we also believe the IAASB should give particular consideration to questions around the competence and skillsets of those who might provide EER assurance, and to the evaluation of criteria on a consistent basis (given the variety of frameworks which currently exist).

Q8 The IAASB wishes to understand the impact on potential demand for assurance engagements, if the Ten Key Challenges we have identified can be addressed appropriately, and in particular whether:

- **Doing so would enhance the usefulness of EER assurance engagements for users**
- **Such demand would come from internal or external users or both**
- **There are barriers to such demand and alternative approaches should be considered.**

a. Do you believe that there is likely to be substantial user demand for EER assurance engagements if the key challenges can be appropriately addressed?

b. If so, do you believe such demand:

i. Will come from internal or external users or both?

ii. Will lead to more EER assurance engagements being obtained voluntarily or that this outcome would require legal or regulatory requirements?

c. If not, is your reasoning that:

i. EER frameworks and governance will first need to mature further?

ii. Users would prefer other type(s) of professional services or external inputs (if so, what type(s) – see box below for examples of possible types)?

iii. There are cost-benefit or other reasons (please explain)?

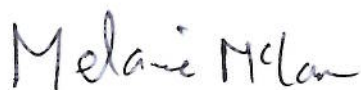
We have no comments to make in response to this question.

Q9 The IAASB would like to understand stakeholder views on areas where the IAASB should be collaborating with other organizations in relation to EER reporting. For which actions would collaboration with, or actions by, other organizations also be needed?

We encourage the IAASB to continue its outreach work with potential and actual users of EER reporting in order to establish clearly: (i) the nature and extent of the demand for assurance that may develop and how this may depend on the nature and maturity of the reporting frameworks in this area; and (ii) what form of assurance activity might best meet their needs. We also encourage the IAASB to continue its outreach with reporting framework providers in this area, to explore the implications of the nature of their frameworks for the ten key challenges identified in relation to the performance of assurance engagements.

If you require further information or would like to discuss our comments in more detail, then please contact the FRC's Deputy Director of Audit Policy, Mark Babington on m.babington@frc.org.uk or by telephone on +44-207-492-2323.

Yours sincerely,



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