ASSURANCE ON MANAGEMENT COMMENTARY – WHERE NEXT?
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FOREWORD

The purpose of this paper is to provide a summary of the key messages and feedback received in relation to the ICAS Balanced and reasonable discussion paper, issued in April 2013.

The comments and feedback have been summarised in the following pages and reflect the key deliberations and discussions from events and meetings that took place during the consultation period.

The paper sets out the journey so far and refers back to The future of assurance paper, issued in December 2010, in which the idea of a ‘balanced and reasonable’ positive opinion on the front-half of the annual report was originally recommended.

The paper concludes with a summary of our proposed next steps in this debate based on the feedback received.

We look forward to continuing this journey with all stakeholders.

Brendan Nelson
ICAS President
1 MAIN PROPOSALS IN THE BALANCED AND REASONABLE DISCUSSION PAPER

1.1 Background

The Balanced and reasonable discussion paper on the provision of positive assurance on the front-half of the annual report was released on 30 April 2013 as a follow on to The future of assurance paper which was published by ICAS in December 2010. The discussion paper aimed to assess the feasibility and likely work required of the auditor in relation to the following recommendation made in The future of assurance paper:

“The external audit and assurance report would include an opinion that the annual report (excluding the financial statements) is balanced and reasonable”.

1.2 The journey so far

As mentioned in section 1.1 above, the Balanced and reasonable proposal represented the next stage in the assurance journey which ICAS introduced in The future of assurance publication. The catalyst to The future of assurance was the global economic crisis and previous ICAS research which highlighted that improvements in corporate reporting and the related assurance were required to restore confidence in the profession and, indeed, in corporate reporting.

The future of assurance paper has undoubtedly had some influence on recent reporting and corporate governance developments, and Appendix 1 highlights some examples of developments occurring subsequent to its publication in the following areas:

(i) The corporate reporting function
(ii) The role of the audit committee
(iii) The role of the independent auditor

1.3 The Balanced and reasonable proposal

As noted above, the Balanced and reasonable discussion paper focussed on a particular recommendation made by The Future of Assurance Working Group that assurance should be provided by the auditor on the front-half of the annual report in the form of a new ‘Balanced and reasonable’ positive opinion over the narrative reporting of the board.

The Balanced and reasonable discussion paper itself explored fundamental issues that would need to be considered if the auditor was responsible for the provision of such an opinion, including whether that opinion would be possible under the current International Auditing and Assurance Standards Board (IAASB) assurance framework. These included the following fundamental issues:

(i) The paper took forward the proposal in The future of assurance that the terms ‘balanced’ and ‘reasonable’ should be used for engagements where the auditor was providing a positive opinion over management commentary.
(ii) That the IAASB assurance framework may need to be revisited if a ‘balanced and reasonable’ opinion was to be made possible. In particular, the paper proposed the introduction of a new three-tier assurance framework consisting of high, medium, and low levels of assurance.

(iii) In the light of the variety of types of information included in the management commentary, the paper considered whether:

   (a) for directors’ opinions and matters of a subjective or judgemental nature, for which limited or no supporting evidence was available, the auditors could rely on their knowledge and experience of the company as a basis for assessing the reasonableness of these statements.

   (b) an explanatory paragraph (or even a disclaimer) should be included in the auditor’s report relating to the inherent uncertainty of future-oriented information.

(iv) The work effort required and additional procedures to be undertaken in order for the auditor to provide a positive opinion over management commentary.

(v) The paper proposed substituting the word ‘significant’ for the word ‘material’ to draw a clear distinction between what should be included in the management commentary from the familiar reference to material information which is specific to information presented in the financial statements.

1.4 The consultation

The consultation period ran from the date of issue until 31 October 2013.

During the consultation period, a number of direct responses were received and, at the same time, meetings were conducted to discuss our proposals with representatives from key stakeholder groups, including: investors; audit firms; corporate entities; regulatory bodies and other professional bodies. Two high profile debates were also held, in Brussels and London, as well as a private dinner with key stakeholders in Edinburgh.

ICAS would like to thank all those who responded and participated in the events and meetings for their support in our efforts to move the assurance agenda forward.

A summary of the main comments received during this process are contained in Section 2 and Appendix 2.
2  KEY MESSAGES AND FEEDBACK FROM THE BALANCED AND REASONABLE CONSULTATION PROCESS

2.1 Summary of key messages from the consultation process

The following summarises the comments received during the consultation process. Further detail on the individual questions and responses is included in Appendix 2.

Overall

• The formal responses received and discussions and comments raised during the debates and meetings indicate that there is support for our proposal, with many respondents, mainly representing the audit firms, seeing this type of additional assurance as inevitable over time.

• The responses, however, demonstrate that there may be some confusion amongst users over the extent of assurance they believe they are currently receiving over the narrative content in the front-half.

• There is a need to demonstrate conclusively that there is user demand for this type of assurance.

Assurance framework (see also section 2.2)

• Many respondents struggled with the concept of a third level of assurance, or medium assurance as we referred to in the paper. There is strong support for the current IAASB framework because of the current familiarity and workability of this framework. There was an almost equal split over whether our proposals could be or could not be adapted to fit within the existing framework.

• Many respondents expressed concern over how a clean opinion could be expressed on some of the qualitative information in the front-half, on the basis of professional judgement alone, in the absence of any appropriate evidence.

• There was some interest in the development of an assurance spectrum describing different percentages of assurance levels although there were doubts as to how practical this was.

• There is some uncertainty and inconsistency, identified in the responses, as to how much and what type of assurance is currently provided by auditors under the Financial Reporting Council’s (FRC’s) ‘fair, balanced and understandable’ requirement.

• Many respondents would prefer to monitor how the FRC’s ‘fair, balanced and understandable’ requirement in the UK develops before proposing any further changes to the assurance agenda.
Work effort required/process

- There was overall agreement on the appropriateness of the additional procedures listed, although one of the firms suggested some additional steps.

Material vs significant

- Many respondents disagreed with the substitution of the term ‘material’ with the term ‘significant’, but there was some acknowledgement that the use of the word ‘material’ might not be appropriate for the front-half of the annual report.

Costs vs benefits

- The importance of being able to demonstrate, and perhaps quantify, the costs versus the benefits of such assurance was raised frequently. The audit firms had concerns about the cost implications of such work. However, a few of the investors did not see the likely additional costs as a major issue.

Barriers to implementation

- A number of user and preparer respondents questioned whether auditors had the necessary skills and ability to undertake this type of work, recognising that greater expertise and reliance on subject experts and specialists might be required.
- Many saw the auditor liability regime as an obstacle to be negotiated in order for auditors to be able to conduct this type of work.
- Some of the information contained in the front-half of the annual report is seen as unassurable therefore an option might be to identify specific elements of the content over which positive assurance might be provided.
- Many of the users and some of the auditors felt that a formal assurance requirement on the front-half of the annual report might deter directors from expressing their opinion and judgement and thereby render the narrative less useful.
- A number of user and preparer respondents expressed concern over the use of the terms ‘balanced’ and ‘reasonable’ as potentially confusing with:
  (i) ‘reasonable assurance’ as defined in the IAASB assurance framework; and
  (ii) reference to the term ‘balanced’ in the FRC’s ‘fair, balanced and understandable’ requirement for annual reports in the UK.

**There would, however, be real benefits of a proper understanding of what assurance they (investors) currently get.**

**Investor**

**...a particular priority for investors is evidence-based assurance over key performance indicators (KPIs), especially non-financial KPIs.**

**Big 4 firm**
2.2 Specific feedback on the current IAASB assurance framework

As noted in section 2.1, many respondents indicated that adding a third tier to the existing two tiers of assurance in the current IAASB assurance framework would cause greater confusion, and strongly believed that the current two-tier assurance framework was sufficient. In addition, the IAASB assurance framework makes it clear that in the absence of ‘suitable criteria’, an auditor cannot rely on his/her judgement to evaluate a subject matter. This contrasts with the proposal in the discussion document that the application of the auditor’s judgement could be acceptable in relation to a ‘balanced and reasonable’ opinion which provides a lower level of assurance than an audit. It is clear that our proposal for a new level of assurance could only be implemented if the current IAASB assurance framework was revisited.

Furthermore, responses to our consultation indicated that there may be confusion and uncertainty over what level of assurance has previously been provided by auditors on the front-half of the annual report and what assurance is being given under the new ‘fair, balanced and understandable’ requirement.

This debate caused us to look again at the current level of assurance in the UK under the ‘fair, balanced and understandable’ requirement, and how it fits within the two permitted levels of assurance within the IAASB assurance framework.

Below is a table illustrating the different levels of scrutiny over the front and back halves of the annual report for those entities applying the UK Corporate Governance Code, pre and post the revised version published in September 2012, and what is required under International Standard on Auditing (ISA) (UK and Ireland) 700 (Revised).

Different levels of scrutiny

<table>
<thead>
<tr>
<th>Elements of the annual report</th>
<th>Prior to September 2012</th>
<th>Post September 2012</th>
<th>Relationship with IAASB assurance framework</th>
</tr>
</thead>
</table>
| Narrative elements of the front-half of the annual report | Review for material inconsistencies with the financial statements | Review for material inconsistencies with the financial statements and the knowledge acquired during the audit.  
and  
Give a positive statement to the effect that there is nothing to report on matters on which the auditor requires to report by exception.  
and  
Report by exception where the director’s statement that the content is fair, balanced and understandable is inconsistent with the auditor’s knowledge acquired while performing the audit. | Broadly consistent with ISA 720, but otherwise falls outside the assurance framework |
| Financial statements | Audit | Audit | Reasonable assurance |
3  NEXT STEPS

As many of our respondents observed, there have been a number of improvements made to the reporting environment in the UK, most of which only came into effect for companies having to comply with the UK Corporate Governance Code for financial years ending on or after 30 September 2013. There was some support from respondents for allowing these improvements, in particular, the ‘fair, balanced and understandable’ requirement to become established before suggesting any further changes to the assurance framework.

ICAS is keen to promote a framework for corporate reporting and assurance which meets the needs of the users, primarily the investment community, at a cost which is acceptable. The views of the users are therefore fundamentally important in this debate, and we note that there is a wide range of users, with potentially varying needs. Our intention is to engage with those users to ensure that they understand the information and assurance they currently receive, and to explore what further assurance, if any, they would find helpful.

With this overarching objective in mind, we therefore propose to take the following next steps:

1  We intend to commission further research into the impact that the ‘fair, balanced and understandable’ requirement has had on corporate reporting in the UK, in particular, on the work undertaken by the auditor. This research would endeavour to explore the additional work that has been required of the auditor under the new regime in its first year of implementation. The research would also seek to inform as to what has been done differently under the new reporting regime and highlight those areas that have proved particularly troublesome for auditors when arriving at their conclusion. In addition, the project will investigate the anticipated additional costs and work involved if a positive audit opinion was to be provided on the management commentary; and will highlight those areas and content over which the auditors do not believe that the provision of a positive opinion would be possible.

2  The results of the above research will be used in discussion with users to assess the extent to which they have received or are currently receiving the level of assurance they desire on the front-half of the annual report, and, consequently, whether they would prefer to receive a positive expression of opinion on the front-half.

3  We propose to develop a straw man of a new assurance framework to assess whether it is feasible to develop a framework which:

   • allows for a variety of assurance engagements to be provided by the auditing/assurance profession;
   • provides a robust conceptual basis for audit and other assurance standards;
   • can be readily explained/communicated to users in an understandable manner; and
   • provides for a more clearly expressed positive statement of opinion and indication of the level of assurance being given.

   In the first instance, this will be for internal debate within ICAS, but we may also issue this publicly for wider debate.

4  We will continue to monitor developments in Integrated Reporting (IR), and, in particular, continue to contribute to the Assurance Technical Collaboration Group.

5  We intend to undertake a project to consider the possibility of providing assurance over discrete areas in the front-half of the annual report, such as key performance indicators,
for example: prudential / regulatory returns for banks (including risk weighted assets); estimated untapped oil & gas reserves for oil & gas companies; estimated untapped reserves for mining companies; assets under management for asset management companies and order book volumes, for manufacturing companies.

6 We will engage with representatives from Denmark to gather views on the impact of the removal of the requirement for the front-half of Danish companies’ annual reports to be audited.

7 We will investigate the practicalities of the requirement in Germany for auditors to provide reasonable assurance over the ‘combined management report’.

8 We will continue to liaise with other professional bodies and key stakeholders as appropriate on this topic.

9 We will use the findings from the joint ICAS/FRC research project into the Skill and Competency requirements of auditors in today’s complex business environment to inform further projects, as appropriate.

In light of the above, we will reconsider the original proposals in the Balanced and reasonable discussion paper at a later date, to determine which, if any, will be taken forward.
ENDNOTES


2. ‘Can we meet the needs? Auditor views on external assurance and management commentary’ by Ian Fraser and Jacqueline Pierpoint (2011); and ‘Meeting the needs? User views on external assurance and management commentary’ by Ian Fraser, Jacqueline Pierpoint, Bill Collins and William Henry (2010).

3. The UK Corporate Governance Code June 2010 Sections C1.1 to C1.3 Accountability.


5. The future of assurance - The Institute of Chartered Accountants of Scotland (2010), page 15, ‘Our recommendations’.


7. The UK Corporate Governance Code, September 2012, page 17, Section Code Provisions C1.1 to C1.3.

8. The UK Corporate Governance Code, September 2012, page 6, Section C Accountability.


15. International Standard on Auditing (ISA) 700 (UK & Ireland), page 15, section A18A.
APPENDIX 1 IMPACT OF THE FUTURE OF ASSURANCE PUBLICATION

In 2010, ICAS set up a working group in response to some of the criticism directed towards the accountancy profession in the wake of the global economic crisis. The working group comprised investors; preparers; auditors and audit committee chairs; as well as representatives from academia and the media.

The future of assurance publication presented the working group’s vision of how to promote trust and restore faith in the capital markets following the economic crisis in the form of recommendations for improvements to:

1. The corporate reporting function
2. The role of the audit committee
3. The role of the independent auditor

Details of the impact that The future of assurance publication has had on each of the areas listed above are as follows.

1. The corporate reporting function

1.1 The previous reporting requirements

As at June 2010, the UK Corporate Governance Code required the board to present a balanced and understandable assessment of the company’s position and prospects as follows:

- The directors were required to explain in the annual report their responsibility for preparing the annual report and accounts, which included a statement by the auditor about their reporting responsibilities.
- The inclusion by the directors, in the annual report, of an explanation of the basis on which the company generated or preserved value over the longer term (the business model) and the strategy for delivering the objectives of the company.
- The directors were required to report in annual and half-yearly financial statements that the business was a going concern, with supporting assumptions or qualifications as necessary.

1.2 The future of assurance recommendations

The future of assurance paper recommended an improved corporate report in which “the Board tells a balanced and coherent story of the business – including the business model and strategy, the key risks, assumptions and future prospects”. Key principles were proposed which would be introduced over the content of the front-half of an annual report as follows:

- The narrative should tell a clear, logical and understandable “story” of the business;
- The front-half of the annual report should present a balanced and reasonable picture of the company.

The Future of Assurance Working Group also encouraged boards to disclose the duration of the period to which the going concern conclusion had been applied, based on the business model and strategy and the board’s assessment of the key risks that the business faced, and any assumptions on which that assessment had been based.
1.3 The current reporting environment

When the updated UK Corporate Governance Code was published in September 2012, the above recommendations were reflected to some extent in the revised provisions in the UK Corporate Governance Code in section C1.1 below:

- The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities.

The new UK Corporate Governance Code also requires that the “board should present a fair, balanced and understandable assessment of the company’s position and prospects.”

1.4 Conclusion

To summarise, the new UK Corporate Governance Code reflects some of the recommendations contained in The future of assurance publication in relation to a more transparent and informative account of the company’s strategy, position and prospects.

2. The role of the audit committee

2.1 The previous reporting requirement

The UK Corporate Governance Code, at June 2010, required that the annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

2.2 The future of assurance recommendations

Whilst The Future of Assurance Working Group acknowledged that the audit committee was ‘best placed to make the recommendation on the appointment of the external auditor’, the working group proposed an enhanced and more transparent audit committee report which communicated how they had discharged their duties and key areas of discussion between the committee and the external auditor. They also recommended that guidance should be included in the UK Corporate Governance Code as follows:

(i) In relation to risk management, the audit committee report should include, amongst other things:
   - How it has satisfied itself that the risk and control processes are operating effectively.
   - Confirmation that action has been taken where appropriate to address any significant weaknesses in the risk and control framework.

(ii) In relation to the appointment of the external auditor, the audit committee report should include:
   - The date the audit firm was first appointed as the external auditor.
   - The date the external audit appointment was last subject to a full tendering process.
   - The policy on the expected timescale after which the company would normally expect to tender the audit appointment.
2.3 The current reporting environment

The revised UK Corporate Governance Code states within section C3.8 that “a separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include:

- The significant issues that the committee considered in relation to the financial statements, and how these issues were addressed.
- An explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm and when a tender was last conducted.  
- FTSE 350 companies are required to retender the audit appointment every ten years on a comply or explain basis.

Following on from this latter point of length of tenure of the auditor, the political landscape has changed, and the final report from the Competition Commission of its inquiry into the large company audit market in the UK, has mandated the retendering of the audit appointment at least every ten years. Additionally, the European Union is likely to introduce a measure that will require public interest entity companies to change their auditors at least every twenty/twenty four years.

2.4 Conclusion

To summarise: The Working Group’s recommendation to include actions taken to address significant weaknesses within the audit committee report has influenced the requirement in the revised UK Corporate Governance Code to describe the significant issues considered and how these have been addressed.

The Future of Assurance Working Group’s proposed approach to tendering has been overtaken by subsequent developments.

3. The role of the independent auditor

3.1 The previous reporting requirement

The earlier version of ISA 700, issued in February 2011, required the auditor, per paragraph 16(c), to read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If the auditor became aware of any apparent material misstatements or inconsistencies, he/she was required to consider the implications for his/her report.

3.2 The future of assurance recommendations

The Future of Assurance Working Group recommended that the independent auditor should provide:

- An opinion that, following the review of the assumptions made by the Board in their assessment of the going concern, the conclusion is considered reasonable;
- An opinion that the annual report is balanced and reasonable; and
• A reference to the content of the audit committee report and confirmation that the audit committee report contains an appropriate reflection of the key issues discussed between the audit committee and the external auditor.

3.3 The current reporting environment

The FRC’s International Standard on Auditing (ISA) 700 (UK & Ireland): The independent auditor’s report on financial statements, as updated for the changes to the UK Corporate Governance Code introduced in September 2012 highlights, for entities that report under that code, that:

“The directors are required to give a statement in the annual report that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the entity’s performance, business model and strategy. Such entities are also required to include a separate section of the annual report that describes the work of the audit committee in discharging its responsibilities. This should include, inter alia, the significant issues that the audit committee considered in relation to the financial statements, including appropriate matters considered that were communicated to it by the auditor, and how these issues were addressed.”

The auditor is required to state, on an exception basis, where he/she has identified that the information in the annual report is materially inconsistent with the information in the audited financial statements or with the knowledge acquired in the course of performing the audit. Specifically, the auditor is required to consider whether there are any inconsistencies between the knowledge acquired during the audit and the directors’ statement that they consider the annual report to be ‘fair, balanced and understandable’.

3.4 Conclusion

To summarise: Following the recommendations in The future of assurance publication, greater responsibility has been placed upon both directors and auditors for ensuring that the front-half of the annual report is ‘fair, balanced and understandable’. The use of the word ‘balanced’ in both The future of assurance publication and the revised UK Corporate Governance Code demonstrates the importance of this concept of ‘balanced’ as being unbiased and presenting the realistic position of the company, without ‘spin’ or ‘prejudice’.

4. Other reporting improvements

The FRC has also increased the extent of information included in the auditor’s report by requiring, under ISA 700, that the auditor:

(a) States those assessed risks of material misstatement that were identified by the auditor and which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team;

(b) Provides an explanation of how the auditor applied the concept of materiality in planning and performing the audit. Such explanation shall specify the threshold used by the auditor as being materiality for the financial statements as a whole;

(c) Provides an overview of the scope of the audit, including an explanation of how such scope addressed the assessed risks of material misstatement disclosed in accordance with (a) and was influenced by the auditor’s application of materiality disclosed in accordance with (b); and
(d) Shall report by exception if, when reading the other financial and non-financial information included in the annual report, the auditor has identified information that is materially inconsistent with the information in the audited financial statements or is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by the auditor in the course of performing the audit or that is otherwise misleading.

These additional disclosures have led to greater engagement and interaction between the auditors, those charged with governance and the audit committee; and have provided a greater insight and understanding of the audit process.
## APPENDIX 2  BALANCED AND REASONABLE CONSULTATION QUESTIONS AND RESPONSES

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<th>QUESTION</th>
<th>RESPONSE</th>
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<tr>
<td>(i) Do you agree that users need assurance over the front-half of the annual report? If yes, do you believe that the proposed 'balanced and reasonable' opinion, supported by an appropriate framework based on the guidance in this paper, will meet users’ needs?</td>
<td>Many of the auditor respondents were supportive of the proposal seeing this type of additional assurance as inevitable. Responses from users questioned the value that would be derived from the provision of this type of assurance and expressed concern that it might result in some of the information included in the front-half being 'dumbed down'. However, most respondents stressed the need to demonstrate conclusively that there is user demand for this type of assurance.</td>
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<td>(ii) Should further consideration be given to redefining the terms 'reasonable assurance' and 'limited assurance' within the IAASB's current assurance framework, or should consideration be given to the introduction of a three-tier system of assurance using the terms 'high', 'medium' and 'low'? Do you have any alternative suggestions?</td>
<td>Many respondents expressed strong support for the current IAASB framework with two levels of assurance. Most struggled with the concept of a third level of assurance, or ‘medium assurance’ as we referred to in the paper. No alternatives were suggested but there was an almost equal split over whether our proposals could be adapted to fit within the existing framework.</td>
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<tr>
<td>(iii) Do you have any suggestions as to how the level of assurance might be measured or defined?</td>
<td>No specific suggestions were received, however, some respondents were interested in the idea of a spectrum or a range of percentages applied to assurance levels.</td>
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<td>(iv) Do you agree that the basis for the auditor’s ‘balanced and reasonable’ opinion on the management commentary should be limited to the knowledge of the entity and the business environment, acquired by the auditor in the course of performing the audit and the specific assurance engagement on management commentary, and not extended to include broader knowledge of the entity and the business environment?</td>
<td>Those who responded were in agreement that the basis for such an opinion should be limited to knowledge of the entity and the business environment acquired by the auditor in the course of performing the audit and the specified assurance engagement and not extended to include broader knowledge of the entity and the business environment.</td>
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<tr>
<td>(v) Do you believe that the approach advocated in this paper could be adapted to provide a positive assurance opinion on 'integrated reports' and other narrative engagements?</td>
<td>Few respondents commented specifically on this question but those who did acknowledged that the provision of assurance on an 'integrated report' would rely upon the development of appropriate assurance standards and criteria as required in the IAASB’s assurance framework.</td>
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### QUESTION

(vi) Do you consider that the term ‘balanced and reasonable’ is the appropriate form of opinion to be expressed over management commentary, or do you believe that the opinion expressed should be limited to reporting on an exception basis where the narrative information is not considered to be ‘fair, balanced and understandable’? Reference should be made to the definitions of ‘balanced’ and ‘reasonable’ in section 2.1 when preparing your response.

**RESPONSE**

There were mixed responses to this question. A number of respondents expressed concern over the use of the terms ‘balanced’ and ‘reasonable’ as potentially confusing with:

(i) ‘reasonable assurance’ as defined in the IAASB assurance framework, and

(ii) ‘balanced’ in the Financial Reporting Council’s (FRC) ‘fair, balanced and understandable’ requirement for annual reports in the UK.

The term ‘representationally faithful’ was suggested by one respondent.

A significant number of respondents believed that the ‘fair, balanced and understandable’ expression required by the FRC in the UK in relation to annual reports was preferable and advocated waiting to see how this requirement developed in the UK before proposing any changes.

(vii) Do you agree with the proposed substitution of the word ‘significant’ for the word ‘material, to draw a clear distinction between what should be included in the management commentary from the familiar reference to material information which is specific to information presented in the financial statements?

Do you have any alternative suggestions for a term that would be an appropriate substitute for ‘material’ in relation to information that would be considered important in the management commentary?

**RESPONSE**

A number of respondents did not agree with the substitution of the word ‘significant’ for the word ‘material’. However, some respondents recognised the limitations of using the term ‘material’ when opining upon management commentary given its more familiar association with the financial statements and acknowledged that an alternative term might be required.

One suggested alternative term was ‘fundamental’.

(viii) What level of additional costs would you expect to be incurred by the auditor in providing assurance on management commentary?

**RESPONSE**

The cost issue seemed to cause a divide amongst the respondents. Respondents from the audit firms had concerns about the potentially significant cost implications of such work. Some ventured that this type of assurance engagement would increase the amount of work required by between 20% and 30%.

However, a few of the investors did not see the potential additional costs as an issue.

(ix) Is the benefit to users from this new opinion likely to exceed the cost of this additional work?

**RESPONSE**

The cost v benefit issue also caused a lot of debate. The importance of being able to demonstrate and, if possible, quantify the costs versus the benefits of such assurance was raised frequently.
### BALANCED AND REASONABLE CONSULTATION QUESTIONS AND RESPONSES (Cont.)

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<tr>
<th>QUESTION</th>
<th>RESPONSE</th>
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<tr>
<td>(x) Do you believe that auditors would be willing to express a positive opinion on management commentary, in particular over future-oriented information, which relies so heavily on their professional judgement?</td>
<td>As stated in response to question (i), there was general support and willingness among auditors for the provision of assurance of this nature. One of the audit firms suggested that some future-oriented information may not be objectively verifiable and expressed concern that some useful information might be omitted by management on the basis that it could not be assured. In response, they suggested a move towards assurance over specific individual elements of the front-half, based on user demand. A small number of respondents saw future-oriented information as an issue when providing positive assurance on the front-half but acknowledged that some form of caveat might be able to address their concerns.</td>
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<tr>
<td>Do you believe that some form of caveat or disclaimer within the assurance opinion would be necessary to enable auditors to provide a positive opinion on a narrative report encapsulating future-oriented information?</td>
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<tr>
<td>(xi) Do you believe that auditors are the most appropriate and suitably qualified professionals to undertake an assurance engagement on the management commentary? Do you believe that there is likely to be any conflict of interest or perceived threat to auditor independence if the statutory audit and this type of assurance engagement are undertaken by the same audit firm?</td>
<td>A number of respondents questioned whether auditors had the necessary skills and ability to undertake this type of work, recognising that greater expertise and reliance on subject experts and specialists might be required. No conflict of interest or independence issue was highlighted.</td>
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<td>(xii) Do you envisage resistance from management/those charged with governance, from disclosing information relating to an entity’s business model due to concerns over the confidential and sensitive nature of this information?</td>
<td>This was not seen as a significant issue by many respondents in recognition that quoted companies in the UK are now required to disclose more information on their business activities.</td>
</tr>
<tr>
<td>(xiii) Have we identified the appropriate additional procedures in section 2.2 which an auditor would need to undertake to give a ‘balanced and reasonable’ opinion on the narrative section of the annual report?</td>
<td>There was overall agreement on the appropriateness of the additional procedures listed, although one of the firms suggested some additional steps.</td>
</tr>
<tr>
<td>(xiv) Do you agree that the content listed in section 2.2 is the most relevant and appropriate to be considered when undertaking this type of assurance engagement?</td>
<td>There was overall agreement on the relevance and appropriateness of the materials listed with some additional suggestions made by one of the firms.</td>
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<td>(xv) Do you believe that the proposed modifications to the assurance report in Step 9 of section 2.2 and the flowchart within Appendix 1 are adequate and provide a clear means for determining the nature of the opinion to be expressed?</td>
<td>Many respondents supported the proposed modifications in the assurance report and the suggested flowchart, subject to concerns over the use of the term ‘significant’ instead of ‘material’. However, some respondents suggested that professional judgement is not a substitute for sufficient appropriate evidence and that this option should be deleted from the flowchart.</td>
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### Balanced and Reasonable Consultation Questions and Responses (Cont.)

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<th>QUESTION</th>
<th>RESPONSE</th>
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| (xvi) Do you consider that the two conditions listed in Step 9 of Section 2.2 for the expression of a clean opinion will cover each of the following three possible scenarios?  
• Where sufficient appropriate evidence is available for the expression of a clean opinion; or  
• Where sufficient appropriate evidence is available to provide a degree of assurance but, in addition, the application of professional judgement will be required to gain sufficient assurance to express a clean opinion; or  
• Where there is a lack of, or no, sufficient appropriate evidence and therefore a clean opinion relies completely on the application of the auditor’s professional judgement. | A number of respondents highlighted that, per the current IAASB assurance framework, it is not permissible to issue a clean opinion which relies heavily on the exercise of judgement, in the absence of sufficient, appropriate evidence. |
| (xvii) Do you envisage any barriers to the implementation of a ‘balanced and reasonable’ opinion? For example, do you believe that the current liability regime for auditors in your jurisdiction is flexible enough to assign different levels of liability to the different types of engagement? | The liability issue was identified as a potential issue which would need to be addressed.  
The subjective nature of some of the material in the front-half was cited as a barrier to the auditor providing positive assurance.  
A few respondents highlighted that cost and a lack of investor demand may also act as barriers. |
| (xviii) Are the practical considerations included in section 3 helpful when assessing how a positive opinion can be provided over the specific disclosures within the management commentary? | The majority of those who responded specifically to this question commented that these were helpful. However, one audit firm did not agree with the categorisation of some of the subject headings.  
The same firm believes that certain information in the front-half is unassurable. |
| (xix) Do you believe that such engagements should be of a voluntary nature or should steps be taken to mandate engagements of this nature? | The general consensus among respondents was that these engagements should be voluntary until sufficient guidance is developed. |
| (xx) Do you agree that the assurance report in which a ‘balanced and reasonable’ opinion is expressed over the management commentary should be a completely separate assurance report from the auditor’s report expressing a ‘true and fair’ opinion on the financial statements? | There was no overall consensus on this issue, but a number of respondents believed that the most sensible solution was to include this as a separate report to highlight that a different level of assurance is being provided to that in the independent auditor’s report on the financial statements. |
**BALANCED AND REASONABLE CONSULTATION QUESTIONS AND RESPONSES (Cont.)**

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<td>(xxi) Looking ahead, do you envisage a time when assurance of a ‘balanced and reasonable’ nature might be expressed over the whole of the annual report? This may of course make the expression of a ‘true and fair’ opinion redundant?</td>
<td>This question resulted in a split of opinion amongst the respondents. One respondent did not envisage that it would be appropriate to provide a ‘balanced and reasonable’ opinion over the financial statements as this implied a less robust process than the provision of a true and fair view. Another respondent acknowledged that, if the Integrated Reporting, (IR), initiative gained momentum, this might be entirely possible.</td>
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<td>(xxii) Do you have any other comments?</td>
<td>The risk of boilerplate / dumbing down of the key messages was raised by a number of respondents, mainly representing investors with a few similar messages coming from some of the audit firms. Concern was expressed by one respondent that some of the current innovative reporting styles adopted by management in the front-half of the annual report may be stifled by the requirement to obtain external assurance, as some of this information is considered unassurable.</td>
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APPENDIX 3  STEERING GROUP PARTICIPANTS

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