EXPOSURE DRAFT: PROPOSED CHANGES TO THE INTERNATIONAL STANDARDS ON AUDITING (ISAs)

ADDRESSING DISCLOSURES IN THE AUDIT OF FINANCIAL STATEMENTS

RESPONSE FROM ICAS TO THE IAASB

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Background

ICAS welcomes the opportunity to comment on the IAASB's Exposure Draft on Proposed Changes to the International Standards on Auditing (ISAs): Addressing Disclosures in the Audit of Financial Statements.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General comments

We welcome the proposed changes to the ISAs which are aimed at enhancing the focus and attention given to the audit of disclosures at an earlier stage of the audit process. We believe that by entering into a dialogue on the subject of disclosures with management at an earlier stage, for example the planning stage, the auditor will encourage management themselves to consider the disclosures in the financial statements earlier in the preparation process.

We have, however, noted some specific comments and concerns relating to some of the references and terminology used in the revised ISAs and details of these are covered in our responses to the specific matters below.

Furthermore, we would encourage the inclusion of additional guidance and reference material in the revised ISAs which addresses the proportional application of the revised disclosures and requirements for audits of SMEs where the disclosures tend to be less complex and less contentious.

Finally, we welcome the recognition by the IAASB that the financial reporting regime directly impacts upon the audit of disclosures and welcome the contribution that the IAASB has made to the International Accounting Standards Board's (IASB) related initiatives on disclosures. This collaboration between the two standard setters should enhance the consistency of the approach to the audit of disclosures.

Our comments on the specific matters in the consultation document are as follows:

Question 1
Whether the proposed changes to the ISAs are appropriate and sufficient for the purposes of enhancing the focus of the auditor on disclosures and, thereby, will further support proper application of current requirements in the ISAs?

Response to question 1
In our view, the proposed changes to the ISAs go some way towards the purpose of enhancing the focus of the auditor on disclosures throughout the audit process, to further support the proper application of current requirements in the ISAs.

Question 2
Are there any specific areas where additional enhancement to either the requirements or guidance of the ISAs would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit?

Response to question 2
In order to make the proposed changes more appropriate for the purposes of the effective audit of disclosures, we would request that consideration be given to our suggested additional enhancements as follows:

a. There is some inconsistency in the proposed amendments to the standards with regard to the references used to describe the disclosures. For example, amended ISAs 210 (*Agreeing the terms of audit engagements) and 240 (The Auditor's Responsibilities Relating to a Fraud in an Audit of Financial Statements)* refer to the 'financial statements, including disclosures', yet in the example of an engagement letter in Appendix 1 to ISA 210, reference is still made to the 'primary statements and the notes to the financial statements including the significant accounting policies'. Should the latter not also refer to the 'financial statements, including disclosures' to be consistent with the amended ISAs?

b. Many of the revised standards now make reference to the consideration of new or revised disclosures arising from changes in the entity's circumstances or in the applicable financial reporting framework. However, it is also equally important for auditors to consider the removal of out of date and superfluous disclosures which, although recorded in previous years, are no longer relevant. Although this might be implied by the use of the phrase 'relevant and understandable' in relation to the presentation assertion, a more explicit statement could be included to this effect. The move towards a reporting framework which removed irrelevant disclosures and resulted in financial statements that focused upon what is important to users was a prime objective in the 2011 joint NZICA / ICAS publication: '*Losing the Excess Baggage': http://icas.org.uk/excessbaggage/.* This publication proposed the removal of unnecessary detail from the financial statements thereby enhancing their usefulness and enabling clearer communication and improved reporting. As a result, the financial reporting and audit processes would become more efficient as less time would be spent preparing and reading numerous, detailed disclosures that have become irrelevant and meaningless.

c. Within the proposed amendments to ISA 320, although paragraph 6 acknowledges the relevance of qualitative disclosures when considering the risk of material misstatement, much of the remainder of the revised standard uses terminology which is more closely associated with quantitative materiality. For example, references are made to 'materiality level or levels' (paragraph 10) and 'amounts' (paragraph A10) which are less appropriate and relevant when used in relation to qualitative disclosures. Perhaps the term 'indicators of material misstatement' could be inserted into the last sentence of paragraph 10 of ISA 320 so that it would read: 'the auditor shall also determine indicators of material misstatement and the materiality level or levels…..' to describe how materiality might be determined in relation to such qualitative disclosures.

Furthermore, we believe that the additional guidance in the revised standards is not sufficient to enable auditors to determine when aggregated qualitative misstatements become material. We believe that greater guidance would be useful in this respect.

Question 3
Whether the proposed changes to the assertions will help appropriately integrate the work on disclosures with the audit work on the underlying amounts, thereby promoting an earlier and more effective audit of disclosure?

Response to question 3
The proposed changes should encourage auditors to consider disclosures at an earlier stage in the audit of the financial statements, integrating this work with the audit work on the classes of transactions and events and account balances. As a result, the effectiveness of the audit of disclosures should be improved by helping to ensure that sufficient time is devoted during the audit process to the audit of disclosures.

General matters:

SME Application
We would welcome some guidance on the proportionate application of the updated ISAs for the audit of SMEs, many of whose financial statements and disclosures tend to be less complex and subject to fewer assumptions and management judgement, and this should be reflected in the revised guidance. This issue is also important for SMPs who serve many of these entities, and the additional costs of compliance may outweigh the benefits achieved.

Additionally, in some jurisdictions, smaller entities are entitled to produce financial statements that include fewer disclosures and this entitlement should also be reflected in the revised standard.

Effective date of implementation
We believe that it is generally sensible to try to align the implementation dates for the various revisions to the auditing standards so as to avoid an unnecessary staggered and burdensome implementation process. However, in this case, the revisions to the ISAs are not directly related to the auditor reporting project and therefore it is questionable as to whether it would be beneficial to align the implementation dates for the two projects. It would be more sensible to align the IAASB’s implementation date in relation to the disclosures project with that of the IASB’s Disclosure Initiative on proposed amendments to IAS1.