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Nederlandse
Beroepsorganisatie
van Accountants

NBA

Dear Mr. Gunn,

The NBA appreciates the opportunity to comment on IAASB Discussion Paper "The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications". We welcome this initiative. Please find enclosed our comments below.

Section II–Financial Reporting Disclosure Trends

A1) Have you had discussions with entities about whether some of their required disclosures might be considered immaterial? What factors did you take into account? Please explain what difficulties (if any) you have experienced.

As NBA is a professional accountancy body, we are not able to answer this question in a straightforward way. However, we believe that auditors should consider the materiality of a disclosure; whether or not it is immaterial for the financial statements as a whole and therefore it does not have to be audited. It is not always clear when a disclosure is material. More guidance how to determine materiality for (specific) disclosures would be useful.

Other comments

We recommend the IAASB presenting the issues from this discussion paper to the IASB and to discuss how the issues could be dealt with in a coordinated way.

Section III-How Do ISAs Currently Deal with Disclosures

A2) How do you approach the identification and assessment of the risks of material misstatement in disclosures?

In practice there does not seem to be much difference with the risk assessment of the financial statements. The risk assessment defines the audit procedures to be performed, i.e. if the risk is considered to be low, less audit procedures need to be performed.
In our opinion, a disclosure (a note) should also be considered in itself (separately from the financial statements) because its materiality is not necessarily related to the materiality of an item in the financial statements.

A3) Are there ISA requirements that, in your experience, pose practical challenges in respect of disclosures? Please explain your answer.

ISA 705 paragraph 19 (c) requires the auditor to include the omitted disclosures. In the Netherlands, there is a controversy on disclosing the remuneration of the management and supervisory boards which is required by local law. The NBA developed a practice statement that confirms that auditors should act in accordance with ISA 705. Nevertheless, some companies feel that it is not up to the auditor to disclose in the auditor's report information that is missing in the notes to the financial statements.

Section IV Audit Issues Regarding Disclosures Required by a Financial Reporting Framework

A4) Have you encountered situations where you experienced difficulty in obtaining sufficient appropriate audit evidence for a disclosure, even though management believed it had appropriate supporting evidence for the disclosure? If management's consideration of a disclosure can be appropriately supported by evidence and documentation, are there factors that could nevertheless make a disclosure unauditable? If management has not provided evidence and documentation in support of a disclosure, do you believe you are able nevertheless to obtain SAAE on the disclosure? Please explain your answer.

As professional accountancy body, we have not directly encountered the situations described above. However, especially with respect to certain qualitative information it can be difficult to find sufficient and appropriate audit evidence, although management believes to have provided supporting evidence. In order to obtain audit evidence, different audit procedures might be needed. Audit evidence might come from sources outside the company's accounting system or outside the company. Professional judgment plays an important role to determine whether sufficient and appropriate audit evidence has been obtained and what the consequences are if this is not the case

A5) What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

The examples given in paragraph 60 are becoming more difficult to audit as less audit evidence will be available in ascending order. It should be clear what audit evidence is necessary, how this can be obtained and what the auditor should do if this audit evidence is not available. Disclosures are evolving and so should the criteria to review and evaluate this kind of information. Guidance in this area per category would be helpful. There are large differences between the various categories with regard to audit procedures, audit evidence and consequences for the auditor's report in case of lacking audit evidence. An example would be disclosures on internal control and management intentions where the auditor could only give some comfort that they are not inconsistent with other information. The ISAs need to allow for audit of the variety of disclosures and recognize that the audit procedures will be different depending on the characteristics of the disclosure.

A6) Some disclosures include the fair value of a financial statement line item measured on another basis, such as historical cost. In this circumstance, what level of effort do you believe should be applied to the fair value disclosure? Should your effort be the same as if the fair value was on the face of the financial statements?

In theory, the effort of obtaining audit evidence should be the same regardless of whether the fair value is stated on the face of the financial statements or in the notes. In practice however, the level of materiality could be applied differently depending on whether it is stated on the face of the financial statements or in the notes. Auditors have the perception that users focus more on the numbers provided on face of the financial statements. It could be useful to analyze whether this perception by auditors is in fact appropriate.

A7) What is your expectation regarding the need for disclosures not specifically required by the financial reporting framework, but which some users may believe are relevant to the *fair presentation of the financial statements? Examples may include non-compliance with a critical law, even though there is no quantitatively material effect, or the fact that the entity does not have a material holding of a particular asset class, such as sovereign debt, which may be of particular interest in the current economic environment.*

If the disclosure is relevant and does have a material effect on the financial statements and the fair presentation thereof, the disclosure should be included in the financial statements regardless whether it is specifically required by the reporting framework or not. The reporting entity has to keep in mind though that in case of general purpose financial statements the objective of fair presentation is leading and not the information need of some users. The financial statements and disclosures are focused on the general needs of users. If entities are responding to the various needs of multiple stakeholders, this would reduce the readability of financial statements.

A8) In light of the discussion in paragraphs 79–87, what do you believe is the appropriate way of applying materiality to disclosures? Do you believe there is sufficient guidance in the ISAs?

The application of materiality depends on the following:
a. disclosures related to items on the face of the financial statements and of importance to the financial statements as a whole: low tolerance level and maximum audit evidence
b. quantitative disclosures not related to items on the face of the financial statements, but high possible exposure/impact: higher tolerance level and less audit evidence than under a
c. qualitative disclosures not related to items on the face of the financial statements: minimum audit evidence; a qualitative assessment/evaluation should take place.

Perhaps some more guidance could be given in the ISAs specifically related to disclosures based on the categories and the examples specified in paragraphs 60-70. E.g. how to deal with information coming from sources outside the company's accounting system or outside the company and how to deal with qualitative information.

A9) What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosure:

Judgments and reasons;

- Biased information or information that is contradictory with other financial information.

Assumptions/models/inputs;

- Inputs that are contradictory with market data (if available), models where the validation results/back testing results of former periods are deviating materially.
- If own audit models are used to compare the results and the results are deviating materially from the models used by the entity.
- Also material misstatements can arise as a result of inadequacies found in the process of using the models (e.g. only front office information used instead of risk management and/or back office information in the case of financial instruments).
- If assumptions are not realistic material misstatements can arise.

Sources of estimation uncertainty/sensitivity analysis disclosures;

- If assumptions are not realistic and/or there are inadequacies in the process, material misstatements can arise.

Descriptions of internal processes;

- Unreasonable deviations from the actual situation.

Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and

- If only the fair value in the disclosure as such is considered (and not compared to the line item): deviations above a certain percentage, depending upon the degree of subjectivity with which the fair value is determined.

Objective-based disclosure requirements.

- Deviations from realistic assumptions and inadequacies in the process of establishing objective-based disclosures.
- Lacking of this kind of relevant disclosures that are required to achieve a fair presentation.

A10) Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute sufficient appropriate audit evidence for such a disclosure? What do you believe would constitute a misstatement of such a disclosure?

There are no specific standards for the audit of risk disclosures and a general framework is lacking. The auditor might test some specific issues (he should be clear about this in his communication) e.g. model review. A misstatement would be if a risk disclosure does not give a fair presentation of the actual situation (see also the answer to question 9).

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?

Evaluate the reasonableness and realistic character of assumptions and methods. A misstatement would be if there are inadequacies in the process or if the scenario's do not seem to be appropriate.

A11) How do you evaluate both qualitative and quantitative misstatements in forming an opinion on the financial statements as a whole? Is it possible to accumulate misstatements of disclosures, particularly when they relate to qualitative or judgmental disclosures? How do prior year's disclosure misstatements affect the evaluation of the current year's financial statements?

Generally, it is easier to evaluate quantitative misstatements. It is difficult to accumulate qualitative misstatements. We wonder what will be the effect if several disclosures which are not material if considered separately but material if considered together. Prior year's disclosure misstatements should be considered in the evaluation of the current year's financial statements.

Other comments
We question whether all disclosures should be audited (see answer to question A1). Furthermore, the auditor should be clear about his involvement in specific disclosures. We have been informed that the ESMA (European Securities and Markets Authority) will issue a paper on materiality later this year.

Section V-Questions about Auditability

A12) What are the characteristics of disclosures that, in your view, would not be auditable?

Characteristics would be that there are no suitable criteria to review or evaluate the disclosure. Furthermore, if supporting evidence is lacking, the disclosure would be not auditable. If disclosures are not auditable and considered material, the auditor should be clear about this in the auditor's report.

A13) What criteria do you believe should be used to assess an auditor's judgment in respect of the fair presentation of the financial statements as a whole?

- Substance over form: that the financial statements represent faithfully the economics of the transactions presented in them.
- Decision usefulness: that the information presented is relevant and faithfully represented. The fundamental qualitative characteristics of relevance and faithful representation for financial statements as described in the IASB Conceptual Framework are important for the auditor as well. They determine the quality of the auditor's judgment.

A14) Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach their audits, including how they may approach disclosures. What is your view?

Indeed we believe that the manner in which a financial reporting regulator enforces financial reporting requirements influences the audit approach regarding disclosures. If the regulators pay more attention to disclosures, the auditors will also do this. This might lead to including immaterial disclosures in the notes to the financial statements.

Other remarks
In the Netherlands, as a result of the financial crisis the politicians have stated that the auditors and the regulator – separately from the standard setter - should ensure that the financial statements including the disclosures are comprehensible and give a fair presentation.

Furthermore, in the Netherlands in a recent court decision the enterprise chamber has stated that non-material disclosures do not have to be included in the financial statements. There is still a debate with the regulator about this subject. The regulator requires that all disclosures relating to material items in the financial statements are included.

Closing remarks

We trust to have informed you sufficiently. If you have any questions, please do not hesitate to contact Karin van Hulsen (k.vanhulsen@nba.nl.).

Yours sincerely,

NBA[1]
Dutch Ethics & Assurance Standards Board

SIGNED BY:

Prof. dr. Peter W.A. Eimers RA
Chairman

[1] The Dutch Professional Accountancy Association (Dutch acronym: NBA) is an alliance between NIVRA and NOvAA.