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June 10, 2011

Mr. James Gunn
Technical Director, International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Dear Mr. Gunn:

We appreciate this opportunity to comment on the discussion paper, *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* (the "discussion paper"), as developed by the International Auditing and Assurance Standards Board ("IAASB").

We commend the IAASB for taking on such a wide-reaching project to collect insights and perspectives from multiple stakeholders. The information that will be collected as a result of this discussion paper will be exceptionally valuable to not only the IAASB, but also to regulators and accountancy boards around the world. We look forward to reviewing the results of this ambitious project.

Questions for Auditors Included in the IAASB Consultation Paper on Disclosures

Section II–Financial Reporting Disclosure Trends

Section II of the discussion paper explores the recent trends in financial reporting disclosures, and the practical experiences of preparers and auditors.

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.

Discussions do arise occasionally about the immateriality of disclosures, but in the vast majority of cases, entities have the mindset that if a disclosure is required by GAAP, then they will include it in the financial statements, regardless of materiality.

Section III–How Do ISAs Currently Deal with Disclosures?

Section III describes the key requirements and guidance for auditors in dealing with disclosures.

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

Within our audit methodology, the approach to the identification and assessment of the risks of material misstatement in disclosures is the same as for other financial statement items (material classes of transaction and account balances), as is required by the ISAs. However, the risk assessment process for disclosures that are associated with amounts on the face of the financial statements is generally more formal and more structured than the risk assessment process for other disclosures, for example, disclosures on the process to develop an estimate and its inherent uncertainty.

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

No, there are no ISA requirements that pose practical challenges in respect of disclosures.

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

Section IV discusses the implications of disclosures required by accounting standards. In particular, it explores the challenges in providing evidence to support some disclosures (paragraphs 59–78) and discusses the assessment of materiality and misstatements (paragraphs 79–101).

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.

Yes, there is usually difficulty in obtaining sufficient appropriate audit evidence for "forward looking" information or for disclosures which are based primarily on management judgment. The reasoning behind management's judgments is not always carefully documented by management, which can be problematic for the auditor in obtaining sufficient appropriate audit evidence about those judgments. We still believe these types of disclosures are auditable, but not to the same degree of precision as other items in the disclosures or amounts in the financial statements.

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

As noted in the answer to question A4, one of the key issues related to gathering audit evidence is the ability to have access to specific documentation regarding management's judgments. Management should follow a sound process within a judgment framework, and document the reasons behind any judgments they make. This will allow auditors to have access to better audit evidence on which to challenge management's judgments.

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?

The level of effort for auditing disclosure information should be the same as auditing items on the face of the financial statements. However, the concept of materiality and sampling do factor into the audit procedures performed (i.e., similar to a financial statement line item, every disclosure may not necessarily be audited to a 100% precision level).

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.

Due to the high level of judgment about what disclosures ARE necessary to achieve fair presentation (in the absence of requirements by the financial reporting framework), in practice, it can be very difficult for both preparers and auditors to make a decision regarding the level of disclosures which are needed for the financial statements to not be misleading

As noted in the answer to question A1, many entities approach disclosures with a "compliance mindset"; that is, if it is required, it is included otherwise not included. Because of this, there is an increased risk that disclosures that are needed to prevent the financial statements from being misleading may not be included.

Regardless, the auditor should consider what disclosures are necessary to prevent the financial statements from being misleading, whether the disclosures are specifically required by the financial reporting framework or not.

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?

As with risk assessment procedures and further audit procedures, for disclosures that are quantitative in nature (for example, the detail of the Property, Plant and Equipment account), we believe that materiality is applied to disclosures in the same way that it is applied to classes of transactions and account balances. For other disclosures that are more qualitative in nature, the auditor applies his or her professional judgment in assessing whether the disclosure may be misleading to users of the financial statements. We do believe that there is sufficient guidance in the ISAs regarding the application of materiality to disclosures; however, we acknowledge that it might be implemented in various ways by different audit firms.

Specifically relating to the example in paragraph 84 (where the disclosure of the maximum credit risk for a bank is likely to be a number larger than the gross assets of the bank), we do not believe that a disclosure exceeding performance materiality is necessarily always material, as qualitative factors in addition to quantitative factors are taken into consideration when identifying material disclosures, in addition to material classes of transactions and material account balances.

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;***
  When the auditor does not believe the reasoning behind management's judgments is appropriate.

- ***Assumptions/models/inputs;***
  A difference of view between the auditor and management does not necessarily result in a material misstatement, but if the assumptions/models/inputs were not plausible or reasonable, then a disclosure may reach the level of being materiality misstated.

- ***Sources of estimation uncertainty/sensitivity analysis disclosures;***
  If the auditor believes that the disclosures were "cherry-picked" to only provide positive information.

- ***Descriptions of internal processes;***
  If the description is not complete enough to be meaningful or omits important aspects that may not present a positive picture. Additionally, if the description is vague and can be interpreted in significantly different ways.

- ***Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and***
  If the disclosure does not include the entity's method of determining fair value, including significant assumptions used.

  In some circumstances, materiality used to assess the disclosure of the fair value amount may be different than the materiality used to evaluate the financial statements as a whole. For example, when disclosing the fair value of pension assets in the footnotes, an auditor may consider materiality in relation to the pension assets, as opposed to the materiality of the financial statements as a whole.

- ***Objective-based disclosure requirements.***
  If the disclosure was quantitatively or qualitatively material.

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?

The auditor would need to determine whether the description in the disclosure accurately reflected the design of the policies and procedures, and then test to see if those policies and procedures have been implemented (design and implementation testing). If the description of the policies and procedures was not complete enough to be meaningful, then the disclosure may be misstated. Additionally, if the disclosure indicated that there was a control in place to mitigate a risk, when in fact, our testing indicated that such control was not operational, this would constitute a misstatement of such disclosure.

(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?

We would expect that the procedures outlined in paragraph 66b would be followed, as users would expect more extensive auditing procedures. This is similar to our answer for Q10(a).

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?

It is possible to accumulate misstatements of disclosures, regardless of whether they are quantitative, qualitative, judgmental in nature, or a description of a process. We can evaluate them in the aggregate for the same disclosure area (for example, we can aggregate all disclosure deficiencies related to a particular footnote). However, it is not appropriate to aggregate all disclosure deficiencies across different and unrelated areas.

In evaluating misstatements in disclosures, the auditor should consider the number of misstatements and their nature in determining whether the issues should be reported to management or to those charged with governance.

Prior year disclosure misstatements would identify areas where the auditor would place more scrutiny in evaluating disclosures in the current year.

Section V–Questions about Auditability

Section V considers auditability of disclosures, and the implications of the IASB's concept of ―verifiability‖ on the auditability of disclosures.

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

We believe it is rare that a disclosure is unauditable. If management has evidence to support a disclosure factually and/or through sound reasoning, the disclosure is auditable. However, if the disclosures are primarily based on management judgments and the auditor can't determine the basis for those judgments or the disclosure is simply a statement of opinion, then in some circumstances they may be unauditable.

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?

In order to determine whether the financial statements achieve fair presentation, the auditor "stands back" and evaluates the financial statements taken as a whole, beyond mere compliance with the applicable financial reporting framework, and determines whether the financial statements and related disclosures provide the information users need to make appropriate financial decisions.

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?

We believe it would be imprudent for an auditor to not consider how the financial reporting regulators will enforce financial reporting requirements. These considerations do influence all parts of the audit, not just how the auditor may approach auditing disclosures.

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact Jens Simonsen, Managing Director of Global Audit Services at + 1 212 492 3689.

Very truly yours,

Jens Simonsen

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