

25 September 2014

Ms. Kathleen Healy  
IAASB Technical Director  
International Auditing and Assurance Standards Board  
529 Fifth Avenue, 6th Floor  
New York  
NY 10017

Dear Ms. Healy:

**Exposure Draft, *Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements***

Ernst & Young Global Limited, the central coordinating entity of the Ernst & Young organization, welcomes the opportunity to offer its views on the Exposure Draft, *Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements* (ED), issued by the International Auditing and Assurance Standards Board (IAASB).

We support the IAASB in its project to provide additional guidance for auditors when auditing financial statement disclosures to help establish an appropriate focus on disclosures in the audit, encourage earlier auditor attention on them during the audit process and address the practical challenges arising from the evolving nature of disclosures.

We agree with the IAASB that many of the issues encountered when auditing disclosures cannot be solved by the IAASB alone. In this regard, we continue to stress the importance of the ongoing liaison between the International Accounting Standards Board (IASB) and the IAASB to monitor the implications of proposed changes to financial reporting standards relating to disclosures and to provide input on a timely basis regarding potential “auditability” issues. In addition, we believe the IAASB should continue to monitor the work of national standard setters as well as the initiatives of other parties related to disclosures.

We also support the IAASB’s decision to make enhancements now to improve the effectiveness of the audit of disclosures rather than waiting for action to be taken by other stakeholders, such as regulators and preparers. However, we believe that, in certain aspects, the changes as presently drafted, although helpful, may not be sufficient to result in the change in practice that the IAASB may be anticipating. In section 1, we elaborate further where we believe additional guidance is needed to facilitate the audit of disclosures.

Responses to the specific questions and general matters on which the IAASB is seeking feedback are set out in sections 1 and 2 respectively. Our letter also includes editorial and other suggestions which are set out in section 3.

## 1. Responses to specific matters on which the IAASB is seeking comments

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

Overall, we agree that the proposals in the ED are consistent with the IAASB's assessment that the ISA requirements are sufficient to meet the objectives stated in the standards in relation to disclosures. We believe that the changes proposed by the IAASB, mainly to application material in the ISAs, are an important step toward enhancing the focus of the auditor on disclosures and ensuring disclosures are duly considered in the audit and in particular earlier in the audit process. However, we have identified a few areas that would benefit from further clarification or enhancement to promote effective auditing of financial statement disclosures. Our views on the proposed changes related to the assertions are included in section 1.3.

#### *Disclosures derived from systems or processes that are not part of the general ledger system*

We strongly support the decision to acknowledge and give prominence to disclosures derived from systems and processes that are not part of the general ledger system. These types of disclosures may be challenging to audit because they are often less formal, not subjected to internal control over financial reporting, limited in documentary evidence and subjective in nature. However, we do not believe that the proposed changes in the ED, as presently drafted, are sufficient for the auditor to determine the appropriate audit procedures to perform or to facilitate consistency in the application of those procedures. We understand that the IAASB staff intends to issue a document addressing disclosures in the audit of financial statements. Such a document is useful but we believe that additional practical assistance, such as an International Auditing Practice Note (IAPN), is needed to address the audit of disclosures derived from systems and processes that are not part of the general ledger system and the challenges relating to obtaining sufficient appropriate audit evidence for such disclosures.

As a minimum, the IAPN could address the following:

- Identification and assessment of the risks of material misstatement associated with the nature of the information disclosed and how it is generated
- Whether or not to identify and perform tests of controls relating to such disclosures
- Examples of the nature and extent of procedures to perform and how to modify those procedures depending on the nature of the information disclosed (e.g., narrative disclosures versus quantitative disclosures such as purchase commitments)
- Whether the audit procedures performed are similar to those performed when auditing accounting estimates when the auditor is required to exercise professional judgment (e.g., when the disclosure is subjective in nature)

- The procedures to perform when the nature of the disclosure is not capable of consistent evaluation or measurement against the requirements of the applicable financial reporting framework (for example, narrative information that is subjective in nature and that is measured against general disclosure requirements)
- The procedures to perform to obtain sufficient appropriate audit evidence to support the auditor's conclusion (for example, when the documentary evidence is deemed to be insufficient or inappropriate in itself and the auditor's procedures are limited to inquiries of entity personnel)
- The procedures to perform to assess the reliability of the information when it is internally generated and there is no available information from other sources to corroborate it.

#### *Misstatements in disclosures*

We support the changes proposed to the guidance on the definition of misstatement to expand the possible sources of misstatements and highlight misstatements in disclosures. However, we suggest that the IAASB consider including "incomplete disclosures" and "disclosures that may be misleading when considered in relation to the financial statements as a whole" to further enhance the definition and to help appropriately focus audit procedures.

We believe that the additional guidance proposed to ISA 450 will help to emphasize that the accumulation and evaluation of misstatements include those relating to disclosures and specifically non-quantitative disclosures.

#### **1.2 Are there any specific areas where, in your view, 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?**

##### *Materiality considerations for disclosures*

We agree with the IAASB's decision not to address the issues relating to materiality considerations for disclosures in isolation but rather to consider them in conjunction with other issues in assessing the need for revision of ISA 320, *Materiality in Planning and Performing an Audit*.

Materiality is important in determining the work effort related to disclosures and whether the financial statement disclosures are free of material misstatement. We are of the view that additional guidance that addresses the application of materiality to disclosures is necessary to achieve the goal of effective auditing of disclosures. Such guidance should include the application of materiality to quantitative disclosures that are not related to line items in the financial statements and to non-quantitative disclosures as these pose practical challenges in the audit. We therefore support a revision of ISA 320 to address the issues encountered in applying the standard in practice, including those related to disclosures. As the concept of materiality is discussed in International Financial Reporting Standards in the context of the preparation and presentation of financial statements and provides a frame of reference to the auditor in determining materiality for the audit, we believe the IAASB should consider working with the IASB, and other parties as appropriate, in revising ISA 320.

**1.3 Whether, in your view, 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 disclosures?**

We agree that incorporating the relevant assertions relating to disclosures into those relating to transactions and events and account balances emphasizes that auditing disclosures is an integral part of the audit rather than a separate exercise. However, as the descriptions of the assertions remain mostly the same, we question whether the auditor would necessarily be encouraged to consider disclosures and undertake related audit procedures earlier in the audit.

We agree with updating the description of the presentation assertion to be consistent with the evaluation of the presentation of the financial statements undertaken at the end of the audit. However, we believe that further enhancement is needed to completely describe the presentation assertion. In our view, presentation is more than the appropriate aggregation and disaggregation of transactions, events, account balances and related disclosures, and also includes classification. Our proposed wording changes to address our concern are as follows:

A124. (a) (iv) Presentation—transactions and events are appropriately aggregated or disaggregated, ~~and clearly described~~ and appropriately classified, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

We suggest removing the classification assertion in paragraph A124. (a) (vi) to avoid duplication with the change we are proposing above to A 124. (a) (iv).

A124. (b) (v) Presentation—~~account balances~~ assets, liabilities, and equity interests are appropriately aggregated or disaggregated, ~~and clearly described~~, and appropriately classified, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

As noted above, we suggest changing “account balances” to “assets, liabilities, and equity interests” in paragraph A124. (b) (v) to be consistent with the terminology used in the other assertions for account balances.

We support the decision to include the concept of the relevance of disclosures into the assertion descriptions as this aligns with ISA 700. In addition, we believe this is an important step in addressing the common issue of ‘disclosure overload’ that preparers and users of financial statements currently encounter and would promote a more effective audit of disclosures.

## 2. Responses to general matters on which the IAASB is seeking comments

**2.1 Effective Date—Recognizing that the proposed changes to the ISAs affect some of the same ISAs as other IAASB projects currently being finalized, the IAASB believes that to the extent possible, the effective date should be aligned with these other projects, namely the IAASB’s Auditor Reporting project and the project to revise ISA 720. Accordingly, the IAASB believes that an appropriate effective date for the standard would be 12–15 months after issuance of the final standards, but may be longer or shorter to align with the effective date of the revisions arising from the auditor reporting and ISA 720 projects. Earlier application would be permitted. The IAASB welcomes comment on whether this would provide a sufficient period to support effective implementation of the changes to the ISAs.**

We are supportive of the alignment of the effective date of the proposed revisions in the ED with proposed ISA 720 (Revised) and the revisions to the standards resulting from the Auditor Reporting Project.

## 3. Editorial and other suggestions

ISA Reference	Observation
Several (e.g., 210. A11.; 300. A12a.)	The expression “general ledger system” is not commonly used in the ISAs. It appears to be a subset of the information system relevant to financial reporting, as described in ISA 315, paragraph A 81. For greater clarity, we suggest that “general ledger system” be defined in ISA 315.
Several (e.g., 240. A11.; 315. A1.)	We suggest being consistent throughout all the ISAs by using the same term(s) when referencing disclosures to avoid potential misinterpretation or an implication that there is a difference in the meaning. As presently drafted, the term “disclosures” is used in some instances while “related disclosures” is used in other instances.  For example, in ISA 240. A11 “... how and where they believe the entity’s financial statements, <u>including disclosures</u> , may be susceptible to ...” whereas in ISA 315. A1 “Identifying areas <u>of the financial statements (including related disclosures)</u> .....
315. A21a.	For greater clarity, we suggest the following addition to the paragraph: “ As part of the discussion among the engagement team <u>about the susceptibility of the entity’s financial statements to material misstatement</u> , consideration ...”
315. A89a.	We suggest removing “Information in” in the first sentence as follows: “ <del>Information in</del> The financial statements may contain information from systems or processes that are not part of the general ledger system.”
315. A128b.	We suggest defining the term “non-quantitative disclosures” in the Glossary of Terms to avoid any potential confusion or questions as to whether (and/or how) ‘non-quantitative’ differs from ‘qualitative’ or ‘narrative’ disclosures.
700. A4	The second sentence is very long. For greater clarity, we suggest splitting

ISA Reference	Observation
700. A4b.	<p>this into two or more sentences.</p> <p>We suggest replacing the word ‘knowledge’ with ‘understanding’ to align with the terminology used in the ISAs as follows: “...based on the auditor’s <del>knowledge</del> <u>understanding</u> of the entity and the audit evidence obtained during the audit.”</p>

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We would be pleased to discuss our comments with members of the IAASB or its staff. If you wish to do so, please contact Karen M. Golz, Global Vice Chair, Global Professional Practice ([karen.golz@eyg.ey.com](mailto:karen.golz@eyg.ey.com)).

Yours sincerely,

*Ernst + Young Global Limited*