DANSKE
REVISORER
FSR*

Ms. Kathleen Healy
Technical Director, IAASB

Submitted via e-mail to:
KathleenHealy@iaasb.org
Posted as comment on:
www.ifac.org

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Dear Ms. Healy,

FSR – danske revisorer
Kronprinsessegade 8
DK - 1306 København K

Telefon +45 3393 9191
fsr@fsr.dk
www.fsr.dk

CVR. 55 09 72 16
Danske Bank
Reg. 9541
Konto nr. 2500102295

Re: FSR – danske revisorer's comments on the IAASB Exposure Draft (ED): "Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements"

FSR – danske revisorer is pleased to provide you with its comments on the IAASB Exposure Draft (ED): "Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements" ("the ED").

Main comments
FSR – danske revisorer welcomes that the ED promotes correspondence with current developments in financial reporting. It is important that all disclosed information is relevant, reliable and presented in a comparable and understandable way.

We commend the IAASB for the effort put in this project. However, in our opinion, the matter dealt with in this ED cannot be solved by the IAASB alone and it is essential for the IAASB to work even closer with other critical stakeholders, such as the IASB, and approach the matter in co-ordinated fashion. Simply observing each other's efforts and dealing with the issue in parallel will not result in a satisfactory outcome.

FSR – danske revisorer agrees with the IAASB's decision not to address disclosures by way of a separate ISA. Although such an approach might emphasise its importance, we believe that disclosures can best be addressed throughout the suite of ISAs. We support the IAASB's view that, in general, most of these amendments are through changes to application guidance. Even though we recognise the valuable work done by the IAASB to date, we have concerns that the project's success will be significantly limited as the two fundamental matters, namely materiality and the use of judgement in estimations, are in our opinion not adequately addressed in this ED.

Overall, we therefore find it problematic to revise ISAs on the subject for the time being. This means that the update is temporary, and it seems a little vague since it raises new and more complex issues. There are no further requirements but only application material.

In connection to the disclosures to audited financial statements, we agree that a proportionate approach must be enabled and highly recommend that this can only be achieved if a robust and comprehensive cost-benefit analysis is undertaken.

Our detailed responses to the questions stated in the ED are set out in the appendix.

Appendix – Comments on specific matters:

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?
In general, some of the suggested guidance is rather evident in nature, and as such harmless but not very helpful. In some ways, though, the temporary character of the suggested guidance leaves matters open for interpretation.

E.g., it seems unclear how the auditor is to focus on irrelevant or excessive disclosures and, in particular, what the consequences would be if such information exists (ISA 700, paragraph 3b). Only a thorough consideration of materiality could address this uncertainty. The suggested guidance in ISA 450, paragraph A13a is not very helpful. Furthermore, for the same reason it is not clear how to accumulate misstatements in disclosures, cf. ISA 450, paragraph 2a.

For some of the suggestions there is a risk that disclosures would seem relatively too important compared to the "hard core" financial statements. This may be an issue by the suggested definition of financial statements (ISA 200, paragraph 13f), cf. below. This risk also exists by paragraphs 12a and 12b on planning activities in ISA 300, since this would imply that two out of three paragraphs under the subheading "The audit plan" would address disclosures. The risk is also present by the paragraph A21a in ISA 240 as a disclosure supplement under the subheading "Discussion among the engagement team", and the paragraphs A128a-A128c in ISA 315 under the subsection on the "Process of identifying risks of material misstatements" (three out of five paragraphs on disclosures).

<u>The Meaning of Disclosures (ISA 200, paragraph 13 (f))</u>
The two following detailed changes to the definition of financial statements are of concern to us:

Addition of: *"… or information incorporated by cross-reference when permitted by applicable financial reporting framework."*

Although we acknowledge that our comments should be framework neutral, it is important to highlight the fact that the proposed text diverges from IAS 1, inclusive of changes proposed thereto in March 2014, which explicitly requires presentation of information on significant accounting policies used. In our opinion, the matters highlighted above do not contribute to enhancing clarity.

Last but not least, the proposed changes should have the purpose to make the meaning of "disclosures"' clear; we do not believe that this is the case. Stepping back, we would question whether defining 'disclosures' is necessarily an exercise that should be part of defining financial statements and the IAASB might not be the right body to define 'disclosures', this might therefore need further considerations in concert with other stakeholders.

Addressing Disclosures early in the Audit (ISAs 210, 260 and 300)
Guidance concerning the importance of disclosures during audit planning and the need to emphasize to management their responsibility to deliver information according to an agreed timetable is helpful and should reinforce the need to integrate the audit of disclosures throughout the audit process, rather than leaving them to the end of the audit process.

Nevertheless, it should be acknowledged that it is not always possible for management to provide the information to be disclosed at an early stage. Also, no matter how well-planned, it is important to duly recognise that unanticipated circumstances often impact and change disclosures as the audit progresses.

The ED emphasises the use of information obtained from systems outside the general ledger. We agree with this and note that this information can even come from systems outside the control of the organisation, but also outside the organisation.

This raises the question as to whether this matter should be more deeply considered. In particular, access to these systems and assessment of their reliability is often not straightforward and, to the extent that included information is non-financial, the auditor has to assess the sufficiency of evidence regarding non-quantitative information, an area where the current ISA suite is not well developed. For example, much of the information related to financial instruments and their measurement does not form part of the general ledger but is part of the risk management system, moving the responsibilities of auditors away from accounting and financial reporting; an area which needs more attention.

Risk of Material Misstatement (ISAs 240, 315, 320 and 330)
We welcome the emphasis placed upon consistency, understandability and auditability of disclosures. As referred to above, IAS 1 is currently also being revised and in our opinion the matter should be approached in a more holistic fashion. The project of the IAASB will not necessarily lead to a satisfactory solution by tackling the audit of disclosures in isolation. Whilst acknowledging that auditors are part of the supply chain and have their part of the responsibility to guard against opaqueness and clutter of the disclosures, we reiterate that disclosure is first and foremost an issue of financial reporting - which of course impacts the audit.

Evaluating Misstatement and Forming an Opinion (ISAs 450 and 700)
This is a critical area and, although the proposed changes introduce further guidance in this area, we do not believe that the proposed changes are sufficient, further development is needed. In practice, it is particularly problematic to determine when the aggregated misstatement in non-quantitative information becomes material and what material and immaterial means for this type of information. Whilst we appreciate that this process needs to include a high level of judgement, further guidance in this area would be appreciated.

The wording, especially the usage of "misleading" information in the new wording included in ISA 700, is not consistent with the amendments to other ISAs and we suggest it be changed to "not fairly presented".

We are concerned that the changes in themselves are not going to be sufficient to make a real change concerning the quality of disclosures in financial reporting. Indeed, as the IAASB acknowledges, this issue needs to be addressed by all participants: preparers, auditors, accounting and auditing standard setters, and regulators. In light of this, we would have liked to have seen a more coordinated approach between participants. As indicated as part of our main comments, there is a need for a more holistic approach to solve these issues, while taking into consideration a cost-benefit analysis. We also note that some additions to the Application Material are written in a language which is of a level of sophistication that might make it difficult to understand and might create issues upon translation of the ISAs (an issue which in the EU will become very important again very soon).

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?
It seems obvious that materiality and evaluation/aggregation of misstatements, and audit evidence are the key areas to regulate. This should be a first step before revising the different ISA's.

It is a fact that over the recent past, disclosures have not just become more voluminous, but the nature of them has also changed: there are more non-quantitative disclosures in the financial statements than there was a decade ago.

Two fundamental difficulties that this raises for both preparers and auditors are with regards to materiality and the evaluation of misstatements. We believe that the proposed changes to the ISAs do little to help auditors in these areas. Although the IAASB notes a few examples in A128c of ISA 315, the changes do not actually provide a clear framework for the auditor to use for his/her materiality judgement.

As stated in our response to question 1, more guidance would be welcome in connection to the evaluation of the misstatement of non-quantitative information. Additional guidance should also be provided for situations where the auditor is unable to obtain sufficient evidence on the information disclosed by management which is not directly linked to the financial statements.

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 the restructuring of assertions and combining assertions for presentation and disclosure, as included in ISA 315, may help the auditor to integrate the work on disclosures into the audit work at an earlier stage. It is important that the auditor ensures that sufficient time is devoted to the audit of disclosures. Enhanced significance assigned to the aspect of presentation of the information could positively influence the understandability of disclosures.
Since we believe that the disclosures directly linked to a line item on the face of the financial statements should be considered with the same attention as the line item itself, we agree with the integration of 'related disclosures' directly to the description of individual assertions in the financial statements.

We also welcome the IAASB's further guidance on disclosures not directly related to items recorded in the financial statements. However, in itself, we do not believe that this is an adequate response to the expectation gap between auditors and users in this regard, more clarity should be provided, especially on matters such as materiality and evaluation/aggregation of misstatements.

In addition to the request for specific comments above, the IAASB is also seeking comments on the general matters set out below:

(a) Preparers (including Small- and Medium-Sized Entities (SMEs)) and Other Users —The IAASB invites comments on the proposed changes to the ISAs particularly with respect to the practical impacts, if any, of the proposed changes to the ISAs.
It should be acknowledged that not only the SME, but also the SMP perspective, is important in relation to this subject matter. Although not exclusively, SMPs have more of their client portfolio involved with SMEs and entities with less complex disclosures.

Particularly, for those SMPs who design their methodology directly from the auditing standards, the changes may result in additional work and administrative burden without substantial added value. It is highly recommended that the work of the IAASB is subject to a cost-benefit analysis in order to enable proportionality for SMPs.

(b) Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites

respondents from these nations to comment on the proposed changes to the ISAs, in particular, on any foreseeable difficulties in applying these in a developing nation environment.

(c) Translations—Recognizing that many respondents may intend to translate the final changes to the ISAs for adoption in their own environments, the IAASB welcomes comments on potential translation issues respondents may note in reviewing the proposed changes to the ISAs.

The proposals included in the ED open ten different ISAs, which would result for organisations adopting the ISAs in retranslation of ten ISAs. It represents a significant time and cost effort. One can wonder whether changes in guidance are worth such an investment and therefore, not only from a general, but also from a translation perspective, it is imperative that the IAASB performs a cost-benefit analysis of the proposals made. In this respect, it is noted that a Staff Paper, in which the audit of disclosures is highlighted, is much easier to deal with from a logistical and translation-cost perspective.

Effective date – 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.

Although we acknowledge that alignment with other new and revised ISAs can be beneficial, we are not convinced that the changes connected to disclosures are fully 'reporting driven' and therefore do not support the alignment in this particular case. We believe the effective date of this ED could be later than for those ISAs included in the auditor reporting project.

Yours sincerely

Lars Kiertzner	Lisbeth Kjersgaard
Chief Consultant	Chief Consultant
State Authorized Public Accountant	State Authorized Public Accountant