

**Meeting:** IAASB Consultative Advisory Group

**Meeting Location:** New York

**Meeting Date:** March 11–12, 2014

## Agenda Item

# H

### Auditing Financial Statement Disclosures

#### Objectives of Agenda Item

1. To provide a report back on proposals of the Representatives on this project as discussed at the September 2013 CAG Meeting.
2. To obtain the Representatives' views on:
  - (i) Proposals for changes to the International Standards on Auditing (ISAs) to address issues raised by respondents to the IAASB's 2011 Discussion Paper (DP), [The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications](#); and
  - (ii) Proposals of the Task Force about the need for further supplemental guidance for auditing disclosures.

#### Project Status and Timeline

3. The Appendix to this paper provides a history of previous discussions with the CAG on this topic including links to the relevant CAG documentation.
4. The following provides a brief summary of the IAASB's activities to date in relation to the topic of auditing financial statement disclosures:
  - (a) January 2011—Release of the IAASB DP.
  - (b) January 2012— Release of the IAASB [Feedback Statement](#) summarizing what was heard in the responses to the DP from stakeholders.
  - (c) September 2012—IAASB approval of a project proposal on the Audit Implications of Disclosures Required by an Applicable Financial Reporting Framework.<sup>1</sup>

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<sup>1</sup> The project proposal stated the following project objectives: (i) To determine whether revisions (in the form of new or revised requirements, or additional application material) to the ISAs with respect to auditing disclosures are required and, if so, develop such revisions; (ii) To consider how such revisions should be presented, for example within the relevant ISAs or in a separate ISA; and (iii) To determine whether other types of non-authoritative guidance, such as an International Auditing Practice Note (IAPN) or Staff Questions and Answers (Staff Q&A) publication should be developed and, if so, develop the content of such a publication. The above objectives are not mutually exclusive, and deliberations on each are intended to inform the overall project.

- (d) December 2012—IAASB deliberation on the Task Force's analysis of potential gaps in the ISAs relative to the issues identified in the responses to the DP as a basis for further Task Force exploration.
  - (e) April, September and December 2013—IAASB views on proposed changes to the ISAs relating to auditing disclosures. At the December 2013 IAASB meeting it was agreed that the proposed changes would be presented at the March 2014 IAASB meeting for approval for public consultation in an exposure draft (ED).
5. At the September 2013 CAG meeting, the CAG was asked for their views on:
- (i) The approach taken by the Task Force to identify gaps or deficiencies in the ISAs;
  - (ii) The IAASB's decision to pursue changes to the ISAs in separate ISAs, rather than developing a new ISA addressing disclosures; and
  - (iii) Proposed changes to specific ISAs, including the requirements in ISA 300<sup>2</sup> and ISA 700,<sup>3</sup> and the application material in ISA 315 (Revised).<sup>4</sup> This included whether there were any additional areas that the Task Force should be considering for change.

Issues and concerns noted by the Representatives, together with the Task Force / IAASB response, can be found in the Report Back in paragraph 9.

6. The IAASB previously agreed that the revisions would be better placed in the individual ISAs, and that the Task Force should not explore developing a separate ISA for auditing disclosures. In September 2013, the CAG also agreed with making the changes in the relevant ISAs, noting that a separate ISA may imply that auditing disclosures is a separate exercise rather than an integral part of the audit.
7. The IAASB generally supported the nature and extent of the Task Force's proposed changes to the ISAs that were discussed by the Board and CAG in September 2013. The Task Force's work since the last CAG meeting has therefore been focused on refining the proposed wording to be included in the ED. However, on further reflection, the proposed changes to the requirements in ISA 700 have been deleted – this is further explained in paragraphs 20(b)(ii) and (iii) below.
8. The IAASB has concentrated its efforts on progressing the changes to the ISAs to an ED as it was agreed by the IAASB that this would more likely drive auditors to focus on disclosures and therefore contribute to an improvement in the quality of financial statement disclosures. Nonetheless, the Task Force has explored whether further supplemental guidance for auditors would be useful, and is putting forth proposals to the IAASB as set out in **Agenda Item H.2**.

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<sup>2</sup> ISA 300, *Planning an Audit of Financial Statements*

<sup>3</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

<sup>4</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

**Report Back on September 2013 CAG Discussion**

9. Below are extracts from the draft minutes of the September 2013 CAG meeting,<sup>5</sup> and an indication of how the project Task Force or IAASB has responded to the Representatives' comments.

Representatives' Comments	Task Force/IAASB Response
<b>APPROACH TO IDENTIFY GAPS OR DEFICIENCIES IN THE ISAs</b>	
<p>Speaking on behalf of the Disclosures CAG WG, Mr. Waldron noted that they agreed with the approach taken to identify possible deficiencies in the ISAs, but did not believe it was clear whether all the issues and concerns that had been raised by respondents to the Discussion Paper had been addressed, in particular in relation to obtaining sufficient appropriate evidence when auditing disclosures. He also suggested that consideration be given to highlighting that the auditor's level of experience may be relevant in certain areas, such as when considering whether items are "clearly trivial".</p>	<p>Point taken into account.</p> <p>Mr. Archambault responded that not all the issues and concerns had been addressed by proposed changes to the requirements, but rather to the Application and Other Explanatory Material. In addition, he noted that the Task Force was still considering changes, if any, to the ISAs relating to obtaining sufficient appropriate audit evidence for disclosures. He noted the Task Force's initial concern that it may be difficult to summarize considerations relating to obtaining evidence within ISA 500<sup>6</sup> in light of the diverse types of disclosures as well as the confusion between what is meant by "disclosures," in particular as compared to "other information." On balance, Mr. Archambault noted the Task Force had added reference to "the related notes" to expand upon those requirements addressing the financial statements in certain limited areas where the Task Force was of the view that the additional emphasis would enhance auditor performance.</p> <p>Further explanation about IAASB actions to respond to issues raised in the DP can be found in the "Matters for CAG Consideration" section of this paper.</p>
<p>Mr. Waldron and Ms. Blomme agreed with the IAASB's decision to keep the proposed changes in the relevant ISAs, and not to develop a new ISA on auditing disclosures, as doing so may incorrectly imply that auditing disclosures is a separate exercise at the end of the audit, rather than an integral part of the audit.</p>	<p>Support noted.</p> <p>The IAASB also previously agreed that the revisions would be better placed in the individual ISAs, and that the Task Force should not explore developing a separate ISA for auditing disclosures.</p>

<sup>5</sup> The September 2013 minutes will be approved at the March 2014 IAASB CAG meeting.

<sup>6</sup> ISA 500, *Audit Evidence*

Representatives' Comments	Task Force/IAASB Response
<p>Ms. Blomme agreed with the Task Force's plan to develop educational material to supplement any changes to be made to the ISAs. She suggested such material would be particularly useful in light of differences in disclosure requirements between financial reporting frameworks, as it could further assist auditors when identifying and assessing the risks of material misstatement and applying professional judgment in auditing disclosures.</p>	<p>Support noted.</p> <p>Mr. Archambault explained that the Task Force was in the process of developing an educational guide, and would need to determine the status and authority of such material. Further discussion on the IAASB's efforts to develop educational supplemental guidance can be found in <b>Agenda Item H.2.</b></p>
<p>PROPOSED CHANGES TO ISA 320<sup>7</sup></p>	
<p>Mr. Waldron supported the need for changes to ISA 320 relating to narrative disclosures, but questioned whether the new proposed requirement should be stronger than requiring the auditor "to consider" these disclosures, suggesting the use of "assess" may be more appropriate. Mr. Dalkin agreed, and added that the IAASB should further reflect on the use of "to consider" or "consideration given to" throughout the ISAs.</p>	<p>Point accepted.</p> <p>The IAASB deliberated whether to continue to use "consider", but decided that the work effort relating to this would be unclear, and have therefore rearticulated this to "the auditor shall make a preliminary determination." The Task Force believes this is the appropriate wording in the context of ISA 320.</p> <p><b>See Agenda Item H.1, Section G, paragraph 11a.</b></p>
<p>Mr. Waldron suggested it was not necessary in proposed paragraph A12a of ISA 320 to refer to the disclosure of "relevant" information about related parties and related party transactions.</p>	<p>Point accepted.</p> <p>Mr. Archambault noted the Task Force also had mixed views on whether the use of "relevant" was necessary in this context, and has removed this in the context of related parties and related party transactions.</p> <p><b>See Agenda Item H.1, Section G, paragraph A12a.</b></p>
<p>Mr. Hansen expressed the view that as the footnotes are often not prepared until very late in the reporting process, the proposed changes may result in the auditors performing too much work on certain disclosures that may not be material.</p>	<p>Point taken into account.</p> <p>Mr. Archambault agreed that the footnotes are often prepared very late, but added that some of the proposed changes to the ISAs were designed to encourage an earlier focus during the audit on the footnotes and the process to prepare them. He also added that the Task Force would continue to consider the timing of the preparation of the note disclosures. <i>(see further discussion in</i></p>

<sup>7</sup> ISA 320, *Materiality in Planning and Performing an Audit*

Representatives' Comments	Task Force/IAASB Response
	<i>"Matters for CAG Consideration" section of this paper on how these issues have been addressed.)</i>
<b>PROPOSED CHANGES TO ISA 700</b>	
<p>Mr. Fukushima noted that significant concern had been raised about excessive disclosures in the financial statements, in particular that not all of the information presented was necessarily relevant to users, notwithstanding that the financial statements were in compliance with the applicable financial reporting framework. He added that a contributing factor to this was the auditor's use of disclosure checklists, with additional disclosures being added that may, in some cases, not be relevant to investor's understanding of the financial statements or may be immaterial. In his opinion, the proposed changes in ISA 700 were not sufficient to change the mindset of auditors towards questioning whether certain disclosures were necessary.</p>	<p>Point noted.</p> <p>Mr. Archambault acknowledged the concerns about excessive disclosures and the use of checklists in evaluating disclosures compared with the need for disclosures to be complete. He noted that, not only the work of the IAASB, but also the work of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), had a role to play in addressing this concern, but highlighted that auditors also have a responsibility to audit the disclosures that management have presented in the financial statements.</p> <p>Additional application material has been proposed to ISA 700 in support of the requirement for the auditor to evaluate whether the information presented in the financial statements is relevant, reliable, comparable, and understandable. This guidance focuses on whether the information is classified, characterized and presented in a clear and concise manner but does not omit relevant information; and the disclosures do not undermine the overall presentation of the financial statements by including information that is not relevant or in a manner that may obscure a proper understanding of the matters disclosed.</p> <p><b>See Agenda Item H.1, Section J, paragraph A3b.</b></p>
<p>Mr. Waldron noted investors are finding it difficult to evaluate differences in recognition and measurement under different financial reporting frameworks where such frameworks do not converge. As a result, investors are most concerned with the quality of disclosures to help them understand such differences, which should not be obscured by the quantity of disclosures.</p>	<p>Point noted.</p> <p>See note above regarding the changes made to ISA 700 regarding understandability of the financial statements.</p> <p>In addition, application material has been added to focus auditors on potential assets and liabilities and whether these have been adequately disclosed so that users can understand their</p>

Representatives' Comments	Task Force/IAASB Response
	effect on the financial statements <b>See Agenda Item H.1, Section J, paragraph A4</b>
Mr. Hansen questioned whether consideration had been given to information included in disclosures that is not generated by the "traditional accounting system". In addition, he expressed concern that auditors should not automatically rely on information in disclosures derived from the general ledger or accounting system.	Point accepted. Mr. Archambault responded that changes had been proposed to the application material in certain relevant ISAs, in particular ISA 315, but added that the Task Force would consider the most appropriate words to emphasize that auditors need to look at all sources of information. <i>See further discussion in "Matters for CAG Consideration" section of this paper on how this issue has been addressed.</i>
Messrs. Bluhm, Hines and Waldron noted that some of the proposed changes may require more guidance as they could be interpreted in different ways and additional guidance may help auditors more clearly understand what the work effort should be. In particular, Mr. Hines suggested the use of the phrase "information presented and disclosed is appropriately classified" may be confusing.	Points taken into account. Task Force considerations about further supplemental guidance can be found in <b>Agenda Item H.2.</b> The phrase "information presented and disclosed is appropriately classified" has been deleted, and the underlying concepts relating to "presentation" are now included in ISA 315 (Revised). <b>See Agenda Item H.1, Section F, paragraph A124.</b>
<b>PROPOSED CHANGES TO THE ASSERTIONS IN ISA 315</b>	
Mr. Waldron supported changes to the assertions, including the development of additional guidance on how to apply them.	Support noted. Further changes have been made to respond to IAASB concerns, see further explanation in "Matters for CAG Consideration" section of this paper. <b>See also Agenda Item H.1, Section F, paragraph A124.</b>
Mr. Dalkin queried whether further guidance could be developed to explain the assertion "classification and aggregation" to address circumstances in which disaggregation of amounts would be more appropriate.	Point taken into account. The assertion for "presentation" has now been reinstated to the assertions and, within this assertion, consideration about "appropriate aggregation and disaggregation" has been explained. <b>See Agenda Item H.1, Section F, paragraph A124.</b>

Representatives' Comments	Task Force/IAASB Response
	Specific examples about circumstances in which disaggregation would be more appropriate has not been included in the ISA, but will form part of the IAASB's considerations about further supplemental guidance. <b>See Agenda Item H.2.</b>
Mr. Thompson expressed concern about changing the assertions for presentation and disclosure without consideration of whether the other assertions about classes of transactions and events for the period under audit, and account balances at period end, also needed to change.	Point noted. The scope of any project to revise ISA 315, including the assertions, will form part of the IAASB's considerations at the time of a new project to revise this standard, as contemplated in its Work Program 2015–2016 ( <b>see Agenda Item J.1</b> ). A fuller revision of the assertions is beyond the scope of this project, and there is no immediate need identified for this revision. However, the Task Force's proposals now integrate the assertions for presentation and disclosure with those for classes of transactions and events, and account balances. <b>See Agenda Item H.1, Section F, paragraph A124.</b>
Mr. Baumann inquired whether the description of "accuracy" was correct, in particular the use of "where appropriate reasonably measured." He suggested consideration be given to replacing this with "appropriately measured" or "where applicable reasonably measured".	Point accepted. The assertion for "accuracy" has been revised accordingly. <b>See Agenda Item H.1, Section F, paragraph A124.</b>
<b>OTHER POTENTIAL CHANGES TO APPLICATION MATERIAL IN THE ISAS</b>	
Mr. Hansen supported the changes in ISA 320 and ISA 450 <sup>8</sup> relating to narrative disclosures. He also inquired whether something could be included to address the issue where entities are including "promotional" information (for example in start-up entities) in the notes to the financial statements, which in his view is not appropriate in the financial statements.	Point noted. Mr. Archambault explained that it would be difficult for auditors to have responsibility for requesting the removal of disclosures unless they were considered a material misstatement of the financial statements. However, he added that changes had been proposed to encourage auditors to further consider whether certain disclosures presented are obscuring relevant information. In addition, he highlighted that a few

<sup>8</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*

Representatives' Comments	Task Force/IAASB Response
	members of the IAASB and Staff are participating in a working group set up by the IASB, which also includes representatives from the International Organization of Securities Commissions (IOSCO), to further consider materiality as it relates to disclosures, and whether further guidance in this area may be needed.
Ms. Blomme expressed the view that it is important for auditors to set the expectation that management will provide evidence in support of financial statement disclosures and that this should be done at the planning stage of the audit. She suggested consideration should be given to specifically including this expectation in ISA 210. <sup>9</sup>	<p>Point accepted.</p> <p>Mr. Archambault agreed.</p> <p>The Task Force noted that management's responsibility for providing information beyond disclosures is already covered by paragraph A11 of ISA 210 – "the auditor has a reasonable expectation of obtaining the information necessary for the audit." However, this does not emphasize that this should include information from systems or processes that are not part of the general ledger system. Accordingly, the Task Force has proposed amending paragraph A11 to highlight that some of the information may also be contained in systems or processes that are not part of the general ledger system, with a corresponding change in paragraph A23. This change should assist auditors in understanding the changing sources of information for, but not limited to, disclosures.</p> <p><b>See Agenda Item H.1, Section B, paragraphs A11 and A23.</b></p>

**Matters for CAG Consideration**

10. The Representatives are asked to note the Report Back above and to respond to the Matters for CAG Consideration: set out below in relation to the proposed changes to the ISAs; and set out in **Agenda Item H.2** in relation to further supplemental guidance for auditing disclosures.
11. The discussion on these topics will focus on:
  - (i) The proposed changes to the ISAs – How the proposed changes in the ISAs are responsive to the issues and concerns raised in response to the IAASB's DP, as explained in paragraphs

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<sup>9</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

12–26 below (which includes references to the relevant proposed changes to the ISAs as set out in **Agenda Item H.1**), and the “Matters for CAG Consideration” included therein.

- (ii) The supplemental guidance for auditing disclosures – the matters set out in **Agenda item H.2** and the additional “Matter for CAG Consideration” included in that agenda item.

*Proposed Changes to the ISAs—Addressing the Issues Identified from the Responses to the Discussion Paper*

- 12. Throughout the development of the proposed changes to the ISAs, the Task Force has been mindful of the issues and concerns raised in response to the IAASB’s DP.
- 13. As discussed with the IAASB in December 2012 (and with the CAG in September 2013), respondents to the DP had raised the concern that auditors do not focus on their planned approach to obtain evidence on disclosures early enough and, in some cases, the audit plan does not build in sufficient time for audit procedures on disclosures.
- 14. The following sets out the issues identified in the DP, together with an explanation of IAASB and Task Force action to respond to the key issues identified.
  - A. Planning Phase of the Audit
  - 15. The Task Force is of the view that the package of proposed changes to ISA 300, ISA 315 (Revised) and ISA 320, together with other supplementary changes identified,<sup>10</sup> appropriately respond to the issues that were raised in the DP relating to the planning phase of the audit. The following sets out the proposed changes corresponding to the issues that have been raised:

**(a) Issue raised: Auditors need to focus on disclosures early in the audit process.**

- (i) Addition of **paragraph A12b in ISA 300** (**Section E in Agenda Item H.1**)—Highlights that attention at an early stage in the audit is beneficial and provides examples of matters the auditor may identify early so that adequate consideration can be given when *planning the audit*.
- (ii) Expanding matters that may be discussed during the *engagement team discussion*, which is often held early during the audit process and provides an opportunity for engagement team members to think together about areas of possible misstatement. **Paragraph A21a in ISA 315 (Revised)** (**Section F in Agenda Item H.1**) focuses the auditor on disclosure-related issues during the engagement team discussion. Changes are also proposed to **paragraph A11 in ISA 240**<sup>11</sup> (**Section C in Agenda Item H.1**) to specifically reference discussion about disclosures when the engagement team discusses the risks of material misstatement due to fraud.
- (iii) Highlighting to auditors, in a footnote in the engagement letter, that there may be matters to be explicitly included in the *engagement letter* relating to the financial

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<sup>10</sup> As part of the deliberations, the Task Force also identified changes to other key standards that are an integral part of the audit process.

<sup>11</sup> ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

statements and disclosures (see **paragraph A23 in ISA 210** and the illustrative audit engagement letter) (**Section B in Agenda Item H.1**) This is intended to help focus management on disclosures early in the audit process.

- (iv) Including relevant and significant changes in the financial reporting framework that may affect disclosures in the *matters that are communicated with those charged with governance* during the discussion of the planned scope and timing of the audit (see **paragraph A13 in ISA 260**<sup>12</sup>) (**Section D in Agenda Item H.1**).

**(b) Issue raised: Insufficient focus by auditors on disclosures that may contain information from systems or processes that are not part of the general ledger system.**

- (i) As disclosures continue to evolve, an increasing amount of the information supporting disclosures is not obtained from the general ledger system. To focus auditors on other “sources” of information, the Task Force has added **paragraph A12a in ISA 300** (**Section E in Agenda Item H.1**) and **paragraph A89a in ISA 315 (Revised)** (**Section F in Agenda Item H.1**) (which provides examples of these other kinds of systems or processes that may generate the information to be audited). The Task Force has further clarified what these systems or processes are, as concern had been raised by some IAASB members, the IAASB CAG and the IFAC Small and Medium Practices (SMP) Committee on the material presented at the September 2013 meeting.

Paragraph 18 in ISA 315 (Revised) clearly sets out that the auditor needs to obtain an understanding of “the information system, including the relevant business processes, relevant to financial reporting, including...”. In the Task Force’s view, this would incorporate the systems or processes used to generate disclosures, but the Task Force felt that the changes as described above will help focus auditors on these other sources of information.

- (ii) In **paragraph A11 in ISA 210** (**Section B in Agenda Item H.1**), further reference is made to these other systems or processes in relation to the auditor having a “reasonable expectation of obtaining the information necessary for the audit.”

**(c) Issue raised: The audit plan does not build in sufficient time for audit procedures on disclosures.**

- (i) Application material on specific consideration of the timing for audit procedures for those disclosures that are not audited with the underlying numbers has been added to **paragraph A14 in ISA 330**<sup>13</sup> (**Section H in Agenda Item H.1**).

**(d) Issue raised: The ISAs are not clear on how to apply materiality to disclosures, particularly non-quantitative disclosures.**

- (i) Addition of a new requirement in **paragraph 11a in ISA 320**<sup>14</sup> (**Section G in Agenda Item H.1**) for the auditor to make a “preliminary determination” of those non-

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<sup>12</sup> ISA 260, *Communication with Those Charged with Governance*

<sup>13</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

quantitative disclosures that may be material, with the intention of distinguishing considerations about non-quantitative disclosures from disclosures of amounts for which determined materiality (i.e., an amount) will apply. Related application material has been added in **paragraph A12a** to provide examples of when non-quantitative disclosures may be considered “material”, as well as to provide guidance about how to make the preliminary determination.

- (ii) At the December 2013 IAASB meeting, it had been noted that ISA 320 was the standard that requires materiality to be determined but that the concept is operationalized in ISA 315 (Revised). A few IAASB members had the view that distinguishing materiality for non-quantitative disclosures may be better placed in ISA 315. The Task Force re-deliberated where best to position the proposed change and agreed that doing so in ISA 320 has value, in that it encourages the auditor to start reflecting on the types of matters that may be material from a non-quantitative perspective earlier in the audit process. The Task Force acknowledges that the determination of misstatements in non-quantitative disclosures is usually done in the context of the financial statements as a whole, which is usually towards the end of the audit, but still believes that it is beneficial for the auditor to start considering this earlier in the audit. The Task Force also believes that the sub-heading preceding the new requirement clearly delineated non-quantitative disclosures from the determination of materiality amounts.

**(e) Issue raised: Insufficient guidance on performing risk assessments on disclosures**

- (i) Respondents to the DP had noted that there was insufficient guidance on performing risk assessments on disclosures, in particular to address at what level the risk assessments should be carried out (i.e., at the financial statement level or individual disclosure level). Notwithstanding that no gaps in the requirements<sup>15</sup> have been identified by the Task Force relating to these required risk assessments, the Task Force had the view that further consideration about the appropriateness of the assertions, which drive the auditor’s risk assessment, may be helpful to auditors, promote consistency in their application and further promote auditor focus on disclosures during the planning stage of the audit.
- (ii) Since the end of 2012, the Task Force has been exploring changes to the assertions for presentation and disclosure, in particular considering whether they are appropriate and useful when auditing disclosures, with mixed responses on its proposals. However, both the Task Force and the IAASB are of the view that any changes to the assertions

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<sup>14</sup> The proposed changes to ISA 320 are not expected to be affected by the work of the IASB in this area. The IASB does not intend to change their definition of materiality, but is in the process of developing the scope of a project on materiality project, which is expected to be presented to the IASB in March 2014 for its consideration. It is intended that this project will look at how materiality is applied in practice in International Financial Reporting Standards (IFRSs) and consider whether further guidance is needed. The changes being proposed here are not expected to be affected by the proposed IASB changes, but the Task Force will continue to monitor the progress of these changes.

<sup>15</sup> ISA 315 (Revised), paragraphs 25(a) and (b)

would only be beneficial to auditors if they are made more straightforward and appropriate, and consider the evolving types of disclosures that are being reflected in financial reports.

- (iii) The Task Force considered not making any changes to the assertions or postponing any changes to the assertions until a project for a more fundamental revision of ISA 315 was undertaken, such as that which is included in the proposed future strategy for the period 2015–2019.<sup>16</sup> However, taking into account the various approaches that have been explored, and the comments received from both the IAASB and the CAG, and in order to achieve the objective of enhancing the usefulness of the assertions, the Task Force determined a more substantive change to the assertions is appropriate. The IAASB supported this view at its December 2013 meeting.
- (iv) The Task Force continues to have the view that appropriate changes to the assertions, as well as the other changes to the ISAs that are being proposed, would be more likely to drive auditors to focus on disclosures and therefore contribute to an improvement in the quality of financial statement disclosures. In addition, the Task Force also has the view that a more substantive revision of ISA 315 will not likely occur in the near term and, thus, changes in this area through the Disclosures project would contribute to improving practice in this area on a more timely basis.
- (v) Changes to the assertions, set out in **paragraphs A124–A125a in ISA 315 (Revised)** (*Section F in Agenda Item H.1*), include:

- i. Deleting the Separate Assertion for “Presentation and Disclosure”

The responses to the DP noted that it was not clear how to apply this assertion to disclosures in the notes to the financial statements. Empirical evidence also indicates that other standard setters and a number of firms do not use the separate assertions within “presentation and disclosure,” but rather have one assertion for presentation and disclosure. The IAASB considered this option, but agreed that one assertion would not be as useful in explaining the details of what should be considered when auditing disclosures. Therefore, to effect the changes below the assertion has been deleted and the concepts therein “redistributed”.

- ii. Combining the Assertions for “Presentation” and “Disclosures” with Those for Classes of Transactions and Events, and Account Balances

The IAASB is of the view that this change helps to advocate the audit of related disclosures concurrently with the underlying classes of transactions and events, or account balances. In proposing this change, the IAASB has ensured that all of

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<sup>16</sup> The planned revision of ISA 315 (Revised) has been included as a possible action for future Work Programs in the IAASB’s Proposed Consultation Paper, *Work Program for 2015–2016* (see **Agenda Item J.1**). Subject to comments on consultation, other priorities of the IAASB, and approval by the IAASB of the scope of any project to revise ISA 315, any decision to postpone revision of the assertions for presentation and disclosure may pre-judge the scope of any future project.

the assertions in the extant standard under “presentation and disclosure” are still captured. This change will also correspond more appropriately to the underlying requirement in paragraph 25(b) in ISA 315 (Revised), which states:

The auditor shall identify and assess the risk of material misstatement at... the assertion level for classes of transactions, account balances and disclosures...

- iii. Adding Application Material for the Appropriate Assertions to Consider with Respect to Those Disclosures that Are Not Directly Related to Classes of Transactions and Events, or Account Balances

The IAASB is of the view that this change will assist auditors in understanding that they need to consider the same assertions with respect to disclosures, notwithstanding that they do not directly relate to recorded transactions and events, or account balances. However, the proposed guidance makes clear that not every assertion would necessarily apply.

16. At the September 2013 IAASB meeting, concern was raised that the term “disclosure” was used in different contexts and may therefore be confusing. In extant ISAs, the term is used as an “assertion”, and also to mean the presentation in the financial statements of information required by the applicable financial reporting framework. By incorporating disclosures in the assertions for classes of transactions and events, and account balances, and not as a separate assertion, the confusion may be obviated. The meaning attributed to “disclosures” would therefore be items of information included in the financial statements as required by an applicable financial reporting framework.
17. In addition to the changes to the assertions as explained above, the IAASB believes it would also be beneficial to revise the definition of “financial statements” in **paragraph 13(f) in ISA 200**<sup>17</sup> (*Section A in Agenda Item H.1*), to make clear that disclosures are included in the definition, and to improve consistency of the use of the terms “disclosures” and “notes to the financial statements.” The proposed amendments also included making clear what is included in the “term” disclosures, including that under some financial reporting frameworks disclosures may be found outside of the financial statements but included by cross-reference.<sup>18</sup>

#### **Matters for CAG Consideration**

1. Do Representatives agree that the proposed changes adequately address the issues and concerns raised relating to disclosures for the planning phase of the audit? Are there any other changes in the ISAs that the Task Force should consider to address the planning phase of the audit?

<sup>17</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>18</sup> For example, IFRS 7, *Financial Instruments: Disclosures*, paragraph B6, states that the “disclosure requirements...shall either be given in the financial statements or incorporated by cross-reference to the financial statements in some other statement...”

2. Do Representatives agree that combining the assertions for presentation and disclosure will drive auditor behavior to focus on audit procedures for disclosures when auditing classes of transactions and account balances?

B. Presentation of the Financial Statements and Evaluating Misstatements

18. Respondents to the DP expressed a view that there is insufficient guidance on what constitutes a material misstatement in disclosures for both qualitative and quantitative information, as well as in relation to accumulating misstatements in note disclosures (particularly those that are expressed in non-monetary terms), including how to combine these misstatements with misstatements arising from accounts and balances disclosed on the face of the financial statements.
19. The respondents also suggested that the ISAs do not provide a useful basis for identifying and eliminating excessive disclosures; and also that there is insufficient guidance to support the requirement in paragraph 14 of ISA 700 to consider whether management's compliance with specific requirements of the accounting framework provide sufficient information for the financial statements to be presented fairly. It was also noted that this has become increasingly challenging as the accounting standards incorporate more objective-based disclosure requirements,<sup>19</sup> in particular whether the entity's disclosures are complete.
20. The following sets out the applicable changes to address the issues that have been raised:

**(a) Issue raised: Insufficient guidance for misstatements in non-quantitative disclosures, including aggregation of such misstatements**

The IAASB supported enhancements to the application material in ISA 450, including:

- (i) Further examples of misstatements to emphasize misstatements may also occur in disclosures (**paragraph A1 in ISA 450**) (*Section I in Agenda Item H.1*);
- (ii) Highlighting that misstatements in non-quantitative disclosures cannot be accumulated in the same way as misstatements in amounts (**paragraph A2a in ISA 450**) (*Section I in Agenda Item H.1*), but nevertheless need to be collected and considered for their effect on the financial statements as a whole (**paragraph A13a in ISA 450**) (*Section I in Agenda Item H.1*); and
- (iii) Guidance for the auditor to consider that individual misstatements in disclosures, although not material collectively, could be indicative of misleading trends (**paragraph A17a in ISA 450**) (*Section I in Agenda Item H.1*).

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<sup>19</sup> One of the themes of recent financial reporting standard-setting activities has been the increased use of "objective-based" disclosure requirements in addition to specific disclosure requirements. For example, IFRS 7, paragraph 7, states "An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance".

**(b) Issue raised: Insufficient guidance on evaluating the overall presentation of the financial statements (including disclosures)**

- (i) The IAASB also reflected on the evaluation of the financial statements when forming an opinion on the financial statements.<sup>20</sup> At its September 2013 meeting, the IAASB explored changing the requirements to align with the revised assertions, as this may be a reasonable conclusion on the work that had been planned and performed. However, a few IAASB members were of the view that this changed the character of the evaluation and urged the Task Force to further consider whether doing so was necessary. The IAASB also suggested that further consideration be given to developing more guidance to help auditors understand the work effort that is required to support these evaluations.
- (ii) The Task Force continued to reflect on the requirements for evaluating the financial statements (including the disclosures) in both paragraphs 13 and 14 of ISA 700 (the “stand back” review) and proposed not to change the requirements at the December 2013 IAASB meeting. On balance, the IAASB agreed with the view that no changes are necessary to the requirements in either paragraph, as they are sufficiently robust. These paragraphs state, in part:

ISA 700, para 13:

In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:

...

- (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and (Ref: Para. A4)
- (iii) The Task Force is no longer proposing changes to paragraph 13(d), as this is still consistent with what the preparers of the financial statements are required to comply with in International Accounting Standard (IAS) 1.<sup>21</sup> Notwithstanding other accounting frameworks may not contain the same requirement, the principles, in the Task Force’s view, are thorough, and should therefore be maintained.

ISA 700, para 14:

When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12–13

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<sup>20</sup> ISA 700, paragraphs 13–14

<sup>21</sup> IAS 1, *Presentation of Financial Statements*, paragraph 17(b) states “a fair presentation also requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information”. The IASB intends to undertake a long term project on the revision of IAS 1, but as the timing and scope of that project is not known at this time, it is assumed that this requirement will remain in the accounting standards in the medium-term.

shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of:

- (a) The overall presentation, structure and content of the financial statements; and
  - (b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
- (iv) Notwithstanding that changes are not being proposed to the requirements, the Task Force is of the view that additional application material to further guide auditors when carrying out the evaluation in terms of the applicable financial reporting framework is appropriate. Therefore additional application material has been included in relation to the auditor's work effort when:
- i. Determining whether the accounting policies have been adequately disclosed in the financial statements (**paragraph A3a in ISA 700**) (*Section J in Agenda Item H.1*);
  - ii. Evaluating the relevance, reliability, comparability and understandability of the financial statements (**paragraph A3b in ISA 700**) (*Section J in Agenda Item H.1*); and
  - iii. Considering the adequacy disclosures to provide information to users about material transactions and events (**paragraph A3c in ISA 700**) (*Section J in Agenda Item H.1*).
- (v) The Task Force has also added guidance to support the "fair presentation" evaluation in ISA 700, paragraph 14, including clarifying that fair presentation may include disclosures that are not necessarily required by the financial reporting framework, and providing the auditor with additional actions that may be considered as part of this evaluation (**paragraphs A4a–A4c in ISA 700**) (*Section J in Agenda Item H.1*).

21. The Task Force believes that the changes that are being proposed would be responsive to the comments from the IAASB, CAG, IFAC SMP Committee and others.

**Matter for CAG Consideration**

3. Do Representatives agree with the proposed changes to address the issues and concerns raised relating to the auditor's evaluation of misstatements and the presentation of the financial statements? Are there any other changes in the ISAs that the Task Force should consider to address these topics?

C. Sufficient Appropriate Audit Evidence for Disclosures

22. The issues raised in response to the DP in relation to sufficient appropriate audit evidence for disclosures largely related to the nature of evidence that can be gathered for certain types of disclosures. Specifically, respondents highlighted particular challenges in obtaining evidence about non-quantitative (including narrative) disclosures. In addition, evolving financial reporting

requirements for disclosures, such as the disclosure of forward-looking information, management intentions and sensitivity analyses, have also been identified as challenging to audit, partly because of the availability of underlying evidence.

23. Some of the proposed changes in the ED impact the gathering of audit evidence. The proposed change in ISA 210 highlights to management the need for early preparation of the draft financial statements and the expectation that management will provide information necessary for the audit, in particular for those disclosures containing information from systems or processes that are not part of the general ledger system. In addition, various changes have been made in the application material addressing the planning stage of the audit (including in ISA 300 and ISA 315 (Revised)) for the auditor to focus on disclosures containing information from systems or processes that are not part of the general ledger system.
24. In its gap-analysis performed on the ISAs in relation to the issues and concerns raised in the responses to the DP,<sup>22</sup> the Task Force was of the view that enhancement to the requirements of ISA 500, which broadly address information to be used as audit evidence, are not necessary. Rather, there appears to be an underlying practical issue of applying these requirements to the types of disclosures mentioned in paragraph 22. While additional guidance and considerations around gathering audit evidence for different types of disclosures could assist auditors in applying the requirements of ISA 500, the Task Force believes that the wide variety of disclosures and the detail of information that could be found in disclosures would make this additional guidance impractical for inclusion in an ISA.
25. In addition, some of the issues and concerns relating to sufficient appropriate audit evidence are not solely limited to disclosures, but also may be applicable to the audit of the underlying amounts recognized in the financial statements. Concerns have been raised in other IAASB projects, such as the recently completed ISA Implementation Monitoring project, about whether auditors are obtaining sufficient appropriate evidence in certain areas, some of which are consistent with the concerns raised in the responses to the DP. These concerns about sufficient appropriate audit evidence that apply to more than the scope of the Disclosures project will be considered by the IAASB as it finalizes its future *Strategy 2015–2019 and Work Program 2015–2016* later in 2014.

#### **Matters for CAG Consideration**

4. Do Representatives agree with the Task Force's view that enhancements to ISA 500 to address obtaining sufficient appropriate audit evidence are not necessary and would rather be more appropriately addressed in supplemental guidance on auditing disclosures? If not, what specific matters should be addressed in requirements or application material in ISA 500?
5. Representatives are also asked invited to raise any other comments they believe may be relevant to the IAASB as it seeks to finalize its proposal changes to the ISAs for exposure.

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<sup>22</sup> See [Agenda Item 3-B](#), and relevant discussion in [Agenda Item 3-A](#), from the IAASB December 2012 meeting.

### **Supplemental Guidance on Auditing Disclosures**

26. **Agenda Item H.2** sets out the proposed direction and discussion on the supplemental guidance. The IAASB will deliberate about whether it agrees with the approach to supplemental guidance, or if an alternative approach would be appropriate.

### **IAASB Interaction with the IAASB CAG**

27. The substantive issues being raised on this project for the purposes of the March 2014 IAASB meeting are included in both this paper and **Agenda Item H.2**.

### **Material Presented – IAASB CAG PAPERS**

Agenda Item H.1	Auditing Disclosures – Proposed Changes to the ISAs
Agenda Item H.2	Auditing Disclosures – Issues and Task Force Views on the Need for Further Supplemental Guidance

**Project History**

**Project: Disclosures**

**Summary**

	<b>CAG Meeting</b>	<b>IAASB Meeting</b>
Project Commencement		March 2010
Development of Discussion Paper and Feedback Statement	March 2011	September 2010 December 2010 December 2011
Project proposal	March 2012 September 2012	June 2012 September 2012
Development of Proposed International pronouncement (up to Exposure)	April 2013 September 2013 March 2014	December 2012 April 2013 December 2013 March 2014

**CAG Discussions: Detailed References**

<b>Project Commencement</b>	<p><u>March 2011</u></p> <p>See IAASB CAG meeting material: (in Agenda Items N of the following):  <a href="http://www.ifac.org/sites/default/files/meetings/files/5978_0.pdf">http://www.ifac.org/sites/default/files/meetings/files/5978_0.pdf</a></p> <p>See CAG meeting minutes:  <a href="http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemA-Final_March_2011_Public_Minutes_APPROVED-v1-03.pdf">http://www.ifac.org/sites/default/files/meetings/files/20110912-IAASBCAG-AgendaItemA-Final_March_2011_Public_Minutes_APPROVED-v1-03.pdf</a></p> <p><u>March 2012</u></p> <p>See IAASB CAG Report Back meeting material: (in Agenda Item E.5 of the following):  <a href="http://www.ifac.org/sites/default/files/meetings/files/20120306-IAASBCAG-AgendaItem_E5-Disclosures.pdf">http://www.ifac.org/sites/default/files/meetings/files/20120306-IAASBCAG-AgendaItem_E5-Disclosures.pdf</a></p> <p><u>September 2012</u></p> <p>See IAASB CAG meeting material: (in Agenda Items E and E-1 of the following):  <a href="http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_E-Disclosures_Draft_Project_Proposal-Cover%20Sheet.pdf">http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-Agenda_Item_E-Disclosures_Draft_Project_Proposal-Cover%20Sheet.pdf</a>  <a href="http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-">http://www.ifac.org/sites/default/files/meetings/files/20120911-IAASBCAG-</a></p>
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	<p>Agenda_Item_E1-Disclosures_Draft_Project_Proposal.pdf</p> <p>See CAG meeting minutes: <a href="http://www.ifac.org/sites/default/files/meetings/files/20130408-IAASB-CAG-Agenda_Item_A-Public_Minutes-final.pdf">http://www.ifac.org/sites/default/files/meetings/files/20130408-IAASB-CAG-Agenda_Item_A-Public_Minutes-final.pdf</a></p> <p><u>April 2013</u></p> <p>See IAASB CAG Report Back meeting material: (in Agenda Item E.2 of the following): <a href="http://www.ifac.org/sites/default/files/meetings/files/CAG-Agenda_Item_E-2_Disclosures-Reportback-final.pdf">http://www.ifac.org/sites/default/files/meetings/files/CAG-Agenda_Item_E-2_Disclosures-Reportback-final.pdf</a></p> <p><u>September 2013</u></p> <p>See IAASB CAG meeting material: (in Agenda Item I of the following): <a href="http://www.ifac.org/sites/default/files/meetings/files/20130909-IAASB-CAG-Agenda_Item_I-Disclosures-Final.pdf">http://www.ifac.org/sites/default/files/meetings/files/20130909-IAASB-CAG-Agenda_Item_I-Disclosures-Final.pdf</a></p> <p>See CAG meeting minutes (in Agenda Item I of the following):</p> <p>See draft minutes included as Agenda Item A of the March 2014 CAG Meeting materials.</p> <p>See report back on September 2013 CAG meeting:</p> <p>See paragraph 9 of this paper.</p>
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