THE EVOLVING NATURE OF FINANCIAL REPORTING: DISCLOSURE AND ITS AUDIT IMPLICATIONS – [DRAFT] FEEDBACK STATEMENT

A. Introduction

[1] [[1]] In January 2011, the International Auditing and Assurance Standards Board (IAASB) issued a Discussion Paper, *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications,* to explore the views and perspectives of different stakeholder groups on issues and challenges around financial reporting disclosures. This Feedback Statement summarizes what we have heard.

Why the IAASB Undertook the Project

[2] As financial reporting has evolved to meet the changing needs of users, the role and importance of disclosures in financial reporting has also changed. Appropriate, high quality disclosures have become increasingly important as financial reporting incorporates more fair value information and other estimates involving judgment and complex measurements, and provides more narrative disclosures of some of the risks and characteristics of companies and groups.

[3] In the aftermath of the 2008 financial crisis, the role of auditors in relation to disclosures has been the focus of considerable attention. Questions have been raised about the exercise of professional judgment and skepticism by auditors. Perhaps more fundamentally, attention has been focused on how auditors should apply auditing concepts in obtaining sufficient appropriate audit evidence on disclosures, to support their opinion on the financial statements as a whole. Questions have also surfaced about whether all disclosures are auditable.

[4] At the same time, it was recognized that these are challenges in approaching disclosures not only for auditors, but also for preparers, investors, lenders, creditors, regulators and other users of the financial information.

> ***We are supportive of the Board's efforts to explore a critical component of financial reporting. We believe the Board's Discussion Paper is a useful initiative which comes at a time when the Global Securities Markets are working to emerge from the recent financial crisis and other shocks. –*** *International Organization of Securities Commissions (Regulators and Oversight Bodies)*

[5] Against this backdrop, the IAASB decided to issue the Discussion Paper (DP) to explore these issues, and to assist the IAASB in determining what actions may be appropriate going forward.

[1] [The numbers in square brackets are to facilitate discussion of the Feedback Statement. The paragraph numbers will be removed in the final document.]

History of the Discussion Paper

[6] The impact of evolving disclosures on auditors' responsibilities and practices was first discussed by the IAASB in 2009 and a Working Group was established in 2010. The Discussion Paper issued in January 2011 discussed:

(a) The recent trends in financial reporting and their impact on financial reporting disclosures;

(b) How the International Standards on Auditing (ISAs) currently deal with disclosures; and

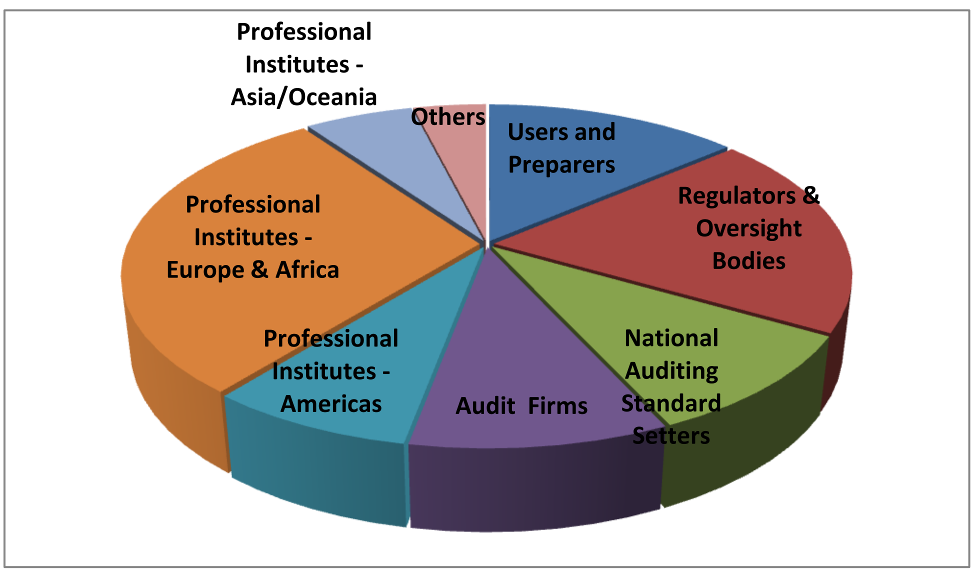
(c) Audit issues in relation to evidence, materiality, misstatements and even auditability itself that the IAASB had identified.

[7] The Discussion Paper included questions tailored for different stakeholder groups, including preparers, investors, lenders and other creditors, regulators and auditors. Respondents were invited to also respond to questions from other stakeholders' lists of questions if they wished to provide their perspective on questions directed to a different stakeholder group.

Purpose of this Feedback Statement

[8] This Feedback Statement provides an overview of the key messages from the responses to the questions in the Discussion Paper. The responses were both thoughtful and informative, and the views expressed offered valuable insights relevant not only to the IAASB, but also to accounting standard setters, regulators and other stakeholders. For that reason, the IAASB believes that sharing what was learned will be useful in stimulating further thinking and exploration of this very important topic. It will also provide a basis to begin the process of collaboratively working towards addressing some of the issues raised.

B. High Level Overview of Respondents



[9] The comment period closed on June 1, 2011 with 51 responses received from a broad range of stakeholders (a list of the respondents is provided in Appendix 1). Given the wide-ranging implications of the issues raised in the Discussion Paper, the IAASB was particularly pleased with the broad range of respondents.

[10] It was interesting that in response to a number of questions, there were no discernible differences among stakeholder groups; rather there were diverse views both within, and across, stakeholder groups.

C. What We Learned

[11] Many respondents thought that the ISAs appropriately reflected the necessary risk-based approach to auditing the disclosures. Where shortfalls were noted, which were not characterized in any way as the ISAs being "broken" in relation to disclosures, respondents suggested that to address them there could be additional guidance or other enhancements to the existing standards. In some cases, the areas highlighted were ones the IAASB could further consider as part of its own work strategy. However, for some of the more significant areas, stakeholders believed the issues needed to be addressed in collaboration and cooperation with others.

[12] The following highlights broad messages along similar themes that were observed in the responses received to the Discussion Paper.[2]

Collaboration and Cooperation

[13] Many stakeholders have a role to play in relation to disclosures. Financial reporting standards set the framework for the expected financial statement disclosures. The preparation of financial statements, including disclosures, and support for the assertions made in them rests in the first instance with the preparers (management, with the oversight of those charged with governance). Auditors play an important role in enhancing the credibility of the entity's financial reporting disclosures and the audit process itself can contribute to an improvement in the quality of them. Regulators monitor the financial reporting process, and many respondents recognized that their views and actions may influence judgments and behaviors when preparing and auditing disclosures. There is, therefore, a shared agenda for promoting the quality of financial reporting disclosures.

> ***We agree that the challenges in addressing disclosures does not affect just auditors, but also preparers, investors, regulators and other users of financial statements.*** *– Audit Inspection Unit (UK) (Regulators and Oversight Bodies)*

[14] The majority of respondents expressed the view, some quite strongly, that many of the issues around disclosures could not be solved by the IAASB alone, and that an effective response would require a collaborative approach with other stakeholders. Many respondents specifically mentioned the International Accounting Standards Board (IASB) (and other financial reporting standard setters), but it was also

[2] This Feedback Statement is not intended to provide a complete detailed analysis of all of the comments received, but rather highlights the key common messages.

observed that securities, audit and prudential regulators also need to be involved, and the solutions supported by preparers and investors too. Issues on materiality, in particular, were highlighted as an example of an area where collaboration would be required in order to make effective progress.

[15] Many responses pointed to the need for a disclosure framework. A framework would not only serve to assist accounting standard setters when considering specific disclosure requirements, but would also help to guide judgments made by both preparers and auditors.. In the view of many respondents, today's financial reporting frameworks do not adequately articulate the role and objective of disclosures in the financial statements and the criteria for including them. Others pointed to the inherent tension between the concepts of completeness and relevance, and therefore the need for a common understanding on how to balance them when making judgments about disclosures.

[16] The need for a disclosure framework has already been recognized by various standards setters and other interested groups (who in some cases are working collaboratively):

- The European Financial Reporting Advisory Group (EFRAG) have undertaken a thought leadership project, "Disclosure Framework for the Notes to the Financial Statements", to stimulate debate about the content and form of disclosures with the aim of contributing to improved presentation and relevance of information in the financial report.
- The Financial Accounting Standards Board (FASB) is currently working on a "Disclosures Framework Project" aimed at establishing an overarching framework intended to make financial statement disclosures more effective, coordinated and less redundant[3].
- The Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA) jointly undertook a project for the International Accounting Standards Board (IASB) to review the level of disclosure requirements in existing International Financial Reporting Standards (IFRS) and to recommend deletions or changes to the IFRS disclosure requirements. Their initial findings were presented to the IASB in 2011.
- Further to the inputs received from ICAS and NZICA, the IASB is seeking input on the priority for future phases of their conceptual framework, including developing principles for presentation and disclosure.

[3] The FASB is cooperating with the European Financial Reporting Advisory Group (EFRAG) and other national standard setters working on the similar projects.

> ***We believe that preparer and auditor perceptions of regulators, if not their actions, influence judgments about disclosures.*** *The Association of Chartered Certified Accountants (ACCA) (Professional Institutes – Europe & Africa)*

[17] Comments varied on the role that regulators (including securities, audit and prudential regulators) play in relation to disclosures. Some believed that the behavior of the regulators influence the behavior of both preparers and auditors, and could be inadvertently adding to what a number of commentators perceive as excessive disclosures. Many thought that preparers and auditors would rather include information, regardless of materiality considerations, than be subject to challenge afterwards by the regulators for not including particular disclosures. On the other hand, some noted that regulators could play a valuable role in helping to identify emerging areas of concern or topical interest (such as the disclosures around sovereign debt). Ongoing dialogue and collaboration among regulators, preparers, and auditors in advance of a financial reporting season, were identified as a positive way to promote a common understanding of those disclosures that are likely to be particularly important in the current environment.

> ***It is therefore essential that IAASB's work in this area is coordinated with that of the IASB and not merely run parallel because the cross-over is too close and the issues of materiality for financial reporting and auditing purposes need to be addressed in tandem. –*** *The Institute of Chartered Accountants in England and Wales (Professional Institutes – Europe a& Africa)*

[18] For all of these reasons, the majority of respondents called for the IAASB to engage with accounting standard setters, in particular the IASB and the FASB, and regulators to explore collaborative solutions to many of the key issues that have been raised. Because the issues affect auditors as much as others in the financial reporting supply chain, many emphasized that it is important for the IAASB to be at the table when solutions, such as the development of a disclosure framework, are being addressed.

Materiality

> ***It is our experience that while the concept of materiality is well understood by management, auditors and regulators when considering the accuracy of the primary financial statements, there is considerable uncertainty and variability of approach when this concept is applied to the note disclosures within the financial statements. –*** *The Hundred Group of Finance Directors (Users and Preparers)*

[19] Integral to the topic of disclosures is how the concept of materiality applies to them. Responses across all stakeholder groups raised concerns about the length of disclosures reaching the point where they obscure readers' understanding of the entity's financial position and performance. Several respondents argued that unnecessarily detailed, duplicative or uninformative disclosures can decrease the effectiveness of financial reporting. There was a strong theme in the responses on the need for balance between financial statement disclosures that are necessary, whilst enabling preparers to focus on

disclosures that provide value to users, particularly investors, in understanding "their story". However, some cautioned that potentially valuable information should not be eliminated merely because a disclosure note is considered voluminous.

[20] Many preparers and auditors observed that making judgments about the appropriate amount of information to include in financial statement disclosures is a key challenge. A focus on consistency over relevance, complying with all disclosures requirements related to material financial statement items, and the use of "boilerplate" or generic narratives without appropriate tailoring, were cited as contributing to information being included in disclosures that is arguably not material in the circumstances of the entity. Their omission would not have misled users and greater brevity could have increased the understandability of the financial statements.

> ***Immaterial (and also 'boilerplate") disclosures which do not convey relevant information about the entity, can obscure the essential disclosures in the financial statements which can undermine understandability.***
> *– European Banking Authority (Regulators and Oversight Bodies)*

[21] Several respondents pointed to the extensive use of checklists as a source of the problem of excessive disclosures. However others noted that it is illustrative of how preparers and auditors are unsure of whether it would be acceptable to apply a further materiality "filter" to disclosures identified in accounting standards as relevant to material line items in the financial statements. Consistency with prior periods, and compliance with regulatory and legislative disclosure requirements, regardless of whether a disclosure is considered material or relevant, are other reasons believed to cause superfluous information being presented in financial statements.

[22] In relation to consistency, some respondents believe it is consistency over time that is essential, and that consistency between entities is less important. However, others believed both are important.

> ***A framework would provide important guidance to management, auditors and other stakeholders, including audit committees, in helping them make judgments with respect to the evaluation of materiality of individual disclosures and whether the financial statements as a whole achieve fair presentation.***
> *- KPMG (Audit Firms)*

[23] Importantly, however, there was widespread agreement among respondents that many of the issues relating to materiality are not an area that can be addressed by the IAASB on its own. Materiality is, in the first instance, a financial reporting concept and respondents argued that auditing guidance should not usurp the role of the financial reporting standards[4]. A comprehensive disclosures framework (as discussed in "Collaboration and Cooperation" above), would assist preparers, auditors, regulators and others to better define what is considered

4 In November 2011, European Securities and Markets Authority (ESMA) published a consultation paper, *Consideration of Materiality in Financial Reporting*. In this document, the ESMA questioned whether different wordings between accounting standards and auditing standards lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes.

"material" information in relation to disclosures, and would promote a consistent understanding about the application of materiality to disclosures in practice.

[24] There were different views expressed in the responses about the adequacy of the current guidance in the ISAs on materiality. Some respondents indicated that auditors would benefit from additional guidance in specific areas. For example: guidance as to the application of the concept of performance materiality in ISA 320[5] where quantitative amounts in disclosures are substantially larger than financial statement line items; and guidance on how to make materiality judgments in relation to qualitative disclosures, and disclosures not linked to a line item in the financial statement. Others were of the view that the ISAs contain sufficient guidance and that how the concept of materiality applies to disclosures is a matter for financial reporting standard setters to address.

Misstatements

[25] The evaluation of misstatements in disclosures was broadly highlighted as a challenging area. There is a largely accepted view that misstatements in disclosures cannot be accumulated in the same way as quantitative errors in line items in the financial statements. Many agreed that the overriding objective is to evaluate whether the potential misstatement, either individually or when appropriately taken into account with others, could reasonably be expected to influence the decisions of the users of the financial statements. The evaluation of misstatements in disclosures necessarily requires professional judgment to assess their impact on the financial statements as a whole. It was noted by a few respondents that misstatements in disclosures may be indicative of undue management bias, or a trend towards deliberately misleading information, and bring into doubt the fair presentation of the financial statements as a whole.

> ***Qualitative misstatements are obviously less capable of 'accumulation', but the impact of quantitative misstatements from unrelated disclosures may not be additive either. On the other hand, recording them is useful as it helps to evaluate whether the misstatements are indicative of, for example, a trend towards deliberately misleading information. –*** *PWC (Audit Firms)*

[26] Many suggested that additional guidance in the ISAs to assist auditors in applying the auditing concepts for evaluating misstatements to disclosures would be helpful. Both quantitative and qualitative note disclosures were of concern.

[27] On release of the IAASB Discussion Paper, the CFA Institute conducted a survey among its Financial Reporting Survey Panel on certain aspects covered by the Discussion Paper. One of the most interesting findings of this survey was the responses of the survey participants on disclosure matters that they believed would result in a material misstatement. The Discussion Paper had asked for views on attributes of disclosures that could result in a material misstatement, ranging from quantitative errors to omissions to

[5] ISA 320, *Materiality in Planning and Performing an Audit*

more subjective attributes, such as how a particular disclosure was written. The following table shows the results from the CFA survey on this issue:[6]

Question: Which of the following disclosure matters do you believe would result in a material misstatement?	
Omission of a required disclosure	72%
A quantitative error in a disclosure, that, if the same level of quantitative error were made in a line item in the financial statements, would result in a qualified opinion	69%
A quantitative error which is discovered in a subsequent period which would likely have changed a user's opinion as to the value of the enterprise if disclosed appropriately in the previous period	68%
Omission of a disclosure which is not required, but could materially impact a user's opinion as to the value of the enterprise	66%
A disclosure that is poorly worded so that it is not understandable	33%
A disclosure which is not sufficiently disaggregated to convey information which is likely to be decision-useful to investors	32%
The disclosure is accurate, but is obscured by poor presentation	15%
No opinion	1%
None – there are no disclosure matters that would result in a material misstatement	1%

The feedback from the survey in this area is particularly informative given that materiality is a concept based on the information needs of users.

> ***The concept of fair presentation gives a greater focus to the notion of understandability. This implies that all relevant information is adequately presented within the disclosures, regardless of whether or not there are any specifically prescribed disclosure requirements for that information. –*** *International Association of Insurance Supervisors (Regulators and Oversight Bodies)*

Fair Presentation

[28] Many respondents, particularly regulators, agreed there is a need for the auditor to undertake a considered assessment of the audited financial statements as a whole, to assess whether a fair presentation has been achieved. Some respondents noted that this "stand-back" review is, in the first instance, the responsibility of the preparers. For both preparers and auditors, respondents emphasized that this "stand-back" review is more than compliance with the requirements

[6] The Results have been presented here with the permission of the CFA Institute.

of the financial reporting framework and should include consideration of whether the financial statements fairly presents the financial information for users to be able to make informed economic decisions.

[29] This is another area where stakeholders suggested that collaboration among regulators, auditors and preparers is essential to align expectations.

Audit Evidence

> ***The quality of audit evidence is often the function of the quality of the process management has undertaken to produce the information to be audited. –*** *European Banking Authority (Regulators and Oversight Bodies)*

Auditability

[30] The majority of respondents were of the view that auditability is an issue worthy of further reflection[7] in relation to financial reporting disclosures. Whilst they believed that there are no disclosures presented in financial statements today that are not auditable, some commented that this is in the context of expressing an opinion on the financial statements as a whole. Some respondents suggested the availability of supporting evidence is key. While auditors have the responsibility to obtain sufficient appropriate audit evidence to support their opinion on the audited financial statements, some respondents note that the availability of audit evidence is dependent, at least in part, on the underlying information provided by preparers to support the disclosures.

> ***We believe that if there are questions about the auditability of an item there must also be questions about whether it is appropriate to be included in the accounts because it raises issues of whether the company, and in particular its board, has an appropriate basis for making such a disclosure.*** *– Hermes Equity Ownership Services (Users and Preparers)*

[31] Respondents were generally of the view that if information is not capable of being audited, it should not be within the financial statements. A few were, however, comfortable with such information being left in the financial statements but labeled as unaudited.

> ***If management's consideration of a disclosure… can be appropriately supported by evidence and documentation thereof, then a disclosure… is, by definition, auditable. -*** *Institut der Wirtschaftsprüfer (Professional Institutes – Europe & Africa)*

[32] Respondents acknowledged that the availability, and the nature and extent of audit evidence, will vary on the item being audited. However, this was not seen as an impediment because the auditor is obtaining evidence as a

7 In November 2011, the US Securities and Exchange Commission held a roundtable of financial reporting series. At the roundtable discussion, one of the topics panelists discussed is issues around 'auditability.'

basis for the opinion on the financial statements as a whole, and not separately opining on the disclosures individually. The quality of the audit evidence that can be obtained may be less objective or externally verifiable for some information disclosed than others, but most respondents thought that this was inherent to the nature of the individual disclosures.

[33] A few respondents expressed the view that some information, such as where there are no suitable criteria or that relate to future actions of management, was not "auditable." Many expressed the view that the underlying issue was not inherent "auditability" but rather having a common understanding of the expectations of what preparers need to do to support the assertions they are making in the financial statements.

> ***Even if management's consideration of a disclosure required by the financial reporting framework can be appropriately supported by evidence and documentation, due to the nature of the information, there may be an expectation gap between the stakeholder's expectation regarding the auditors' role for such information and the actual role of the auditor on that information. In such a case, it is "unauditable" for the auditor to meet such stakeholder's expectation" – The*** *Japanese Institute of Certified Public Accountants (Professional Institutes – Asia / Oceania)*

The Concept of Reliability

[34] Many respondents commented on the shift in the IASB Conceptual Framework terminology from "reliability" to "faithful representation". While some respondents identified this as a major change, many indicated they do not believe it has affected views on what is expected of preparers and auditors. A few respondents acknowledged that although they did mean different things, in practice the change is a semantic reflection of the reality of modern business of the move toward fair value and the judgments that are required. Some noted that not all information in disclosures is reliable to the same degree that is some items are by nature less precise (such as disclosures based on subjective estimates, and disclosures that do not directly relate to financial statement line items). The majority of users expressed the view that such disclosures generally do not have, nor are expected to have, the same "reliability" as financial statement line items. However others believed that certain disclosures, or in one case, all, should have the same reliability.

> ***Although we support faithful representation we are not convinced it provides investors the same amount of confidence as reliability. –*** *International Corporate Governance Network (Users and Preparers)*

> ***Members believe that the reliability of disclosures should be at the same level for any type of disclosure. – Ordre des Comptables Agréés du Québec*** *(Professional Institutes – Americas)*

[35] An interesting observation was made that users of the financial statements have different needs, and that the extent to which they expect information in different disclosures to be

"reliable" may vary for their own particular needs. It was also acknowledged that work performed by the auditors is influenced by their assessment of risk and materiality based on their perception of the common information needs of all users. As such, it may not necessarily meet all individual users' particular needs.

Work Effort

[36] Many respondents agreed that the work effort on a fair value that is a disclosure only, and not linked to a line item, should not be less than if the fair value were on the face of the financial statements. Others argued, however, that the work effort would be based on the auditor's assessment of risk and materiality, and would be influenced by their perception of how important the information is to users. Contrasting views were expressed on what information was being audited in certain disclosures.

> ***It is not the role of auditors to assess the effectiveness of those stress tests. In each case, our firm view is that the auditors' role is to assess the accuracy and fullness of the disclosures in describing the procedures. –*** *Hermes Equity Ownership Services (Users and Preparers)*

[37] For example, on the proposed IASB "stress tests" (which, in February 2011, the IASB tentatively decided would not be required in the final standard but is a good illustrative example of the principal), several respondents believed that the focus should be on whether the disclosure properly describes the process actually performed. Several others believe it is the reasonableness of the outcome that is being tested, including auditing the inputs and assumptions. Several more respondents said that both should be tested. The breakdown between the three alternative views was virtually equal among the different categories of respondents.

> ***We believe that where an entity prepares and discloses stress testing information, there is a presumption by users of the financial statements that the auditor has obtained evidence about the relevance and the appropriate performance of the stress test. –*** *International Corporate Governance Network (Users and Preparers)*

Risk Assessment

[38] The responses were mixed regarding the assessment of risk for disclosures. Responses broadly supported the view that obtaining sufficient appropriate audit evidence starts with a robust assessment of risk. Many responses, including those from auditors, acknowledged that the risk assessment for disclosures, particularly at the assertion level as required by ISA 315[8], is often less formal than for other

> ***The risk assessment 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 –*** *Deloitte (Audit Firms)*

[8] ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*

areas of the audit. Comments were made that evaluation of the entity's internal controls over the disclosures is a critical step in identifying and assessing risks of material misstatements in disclosures. Overall, broad support was given for additional application guidance in the ISAs that emphasizes the importance of separately assessing the risks of material misstatement in disclosures and integrating the audit work on disclosures as part of the overall audit in order to promote best practice in this area.

Views on the ISAs

> ***We believe that the requirements and guidance in ISAs, while there are challenges related to auditing disclosures, are sufficient at this time. We believe it is premature to consider additional requirements or guidance, given the rapidly changing accounting rules. –*** *South African Institute of Chartered Accountants (Professional Institutes – Europe & Africa)*

[39] Many respondents perceive that the ISAs, as currently drafted, tend to deal with disclosures "hand in hand" with related transactions and balances (i.e, the auditor considers the disclosure requirements when auditing the related transactions or balances). Many noted, however, that as disclosures are evolving—becoming more narrative, complex and broad—this approach may need to be reconsidered. Several respondents suggested that many disclosures now need to be separately audited.

> ***…Consideration should be given to whether the ISAs should separately identify the work required to audit disclosures, so that this work can have an appropriate focus. –*** *European Securities and Markets Authority (Regulators and Oversight Bodies)*

[40] Many highlighted specific ISAs where they face challenges in applying them in practice to disclosures—predominantly ISA 320 and ISA 450[9] (which have both been previously discussed), but also ISA 315 with regard to applying more formalized risk assessment procedures to disclosures and ISA 330[10] with regard to obtaining audit evidence for certain disclosures. Suggestions were also made for the development of specialized auditing guidance for specific types of disclosures. For example, given the potential for significantly different views on what constitutes sufficient appropriate audit evidence regarding certain disclosure (such as the disclosure of the stress test discussed above), some respondents said that guidance that defines the nature and extent of audit evidence that is appropriate in the circumstances would be useful.

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9 ISA 450, *Evaluation of Misstatements Identified During the Audit*

10 ISA 330, *The Auditor's Responses to Assessed Risks*

[41] Overall, while respondents thought that there may not be a need for many, if any, new requirements in the existing ISAs to address disclosures, many thought that additional guidance would be useful. Some indicated they thought this might be achieved by adding application material to existing ISAs, others referred to the possibility of non-authoritative guidance to encourage best practice, and others recommended that all requirements for disclosures should be located in a single standard.

Practical Challenges and Useful Advice

> ***A challenge occurs when the applicable financial reporting framework does not establish documentation expectations with respect to disclosures for preparers.** – Grant Thornton (Audit Firms)*

[42] Many preparers and auditors acknowledged that the most challenging aspect of preparing and auditing disclosures is where the information is not derived from the accounting system. Such information includes forward looking statements, descriptions of models used in fair value measurements, risk exposures and other narrative disclosures. Preparers also suggested that another challenge is to comply with the financial reporting standards without "overloading" the financial statements, and keeping them understandable. They said that meeting the needs of *all* users may result in excessive information and work.

[43] Auditors expressed the view that documentary evidence for disclosures could be variable, particularly for those areas noted above. They urged accounting standard setters to take the auditability of the information into account when developing reporting standards, and to consider what preparers are expected to do to support the disclosures they are required to make.

[44] Several respondents also offered useful advice on actions that could be taken by preparers and auditors in practice today. Both preparers and auditors agreed that timely preparation and consideration is key to overcoming some of the challenges: poor quality disclosures, including excessive and immaterial disclosures can arise when disclosures are prepared and audited relatively late in the financial reporting process. In this regard, several respondents noted that the data gathering and preparation process relating to many disclosures is often started late in the overall financial reporting process, and is often less formal and less structured. As a result, there are generally few discussions about the materiality and consistency of the proposed disclosures.

[45] Suggestions for useful proactive ways that auditors may be able to address this issue included: initiating earlier in the audit process discussions and enquiries of management including discussions on the surrounding processes and controls; and placing more emphasis on disclosures throughout the audit. Devoting sufficient time on this increasingly important area was recognized by many respondents as being key to improving the quality of disclosures.

> ***The issues around disclosures are not isolated to audit implications. They are closely related, and an integral part, of the ongoing debates on corporate reporting and auditor reporting.** – Hong Kong Institute of Certified Public Accountants (National Auditing Standards Setters)*

Beyond Disclosures

[46] The Discussion Paper was issued to explore issues related to disclosures. The responses received have extended, in some cases, beyond the ambit of disclosures and have included throughout comments on related subjects. Although various questions within the Discussion Paper were targeted at issues and challenges around auditing disclosures, it appears that, in many ways, the challenges are not specifically related to disclosures but rather the audit of the underlying numbers in the financial statement line items.

[47] For example, ISA 540[11] addresses the auditor's responsibilities for the audit of accounting estimates, including fair values, and their related disclosures. Many respondents focused on challenges and issues in the audit of accounting estimates and fair values themselves rather than specifically to the audit of the related disclosures. For example, many discussed the practical issues around challenging management's assumptions and judgments that is the audit issues pertain more to the audit of the fair value or accounting estimate than to the related disclosures.

[48] There is a perception by some that certain disclosures that may be challenging to audit, such as forward looking information, should not reside within the financial statements. Rather, the relevant information should be included as other information presented with the audited financial statements. If so, they would nevertheless be subject to the requirements of ISA 720.[12] A few others have suggested that an opinion under ISAE 3000[13], or another applicable assurance standard, might be able to be given on that information and would be more appropriate than the fair presentation opinion on the financial statements. Others noted that certain information that is currently outside of the financial statements could usefully be brought into the auditors' report. For example, in Australia the detailed Remuneration Report does not form part of the financial statements but is opined separately within the auditors' report.

[49] Concern has been expressed by several respondents as to the requirements in ISA 705[14] for the auditor to include in the audit report material disclosures required to be made but which have been omitted. Various views were expressed on the relationship of the auditor's report and disclosures, particularly around what should be reported on, some of which has been discussed above.

[50] Several comments were received on the use of professional skepticism when auditing disclosures. Some have questioned the extent to which skepticism was in fact being applied by some auditors while others agreed that professional skepticism should be reinforced. This includes challenging the materiality level used by the preparer and robustly challenging management's assertions regarding the financial statements. Views have been expressed that to encourage clear and skeptical thinking, auditors should be

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[11] ISA 540, *Auditing Accounting Estimates, including Fair Value Accounting Estimates, and Related Disclosures*

[12] ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing audited Financial Statements*

[13] ISAE 3000, *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

[14] ISA 705, *Modifications to the Opinion in the Independent Auditor's Report,* Para 18

***The IAASB needs to strengthen the requirements with respect to auditing disclosures to promote greater application of professional skepticism and a thinking, risk-based approach to auditing disclosures which will improve the quality of the disclosures provided to financial statement users. –** Canadian Public Accountability Board (Regulators and Oversight Bodies)*

guided to use more experienced staff to document audit evidence for the rationale for key judgments and decisions, and to challenge management to disclose fully how figures and valuations have been derived.

[51] Separately from the Discussion Paper consultation, other stakeholders have also recognized the importance of disclosures and have called upon the IAASB to address related issues. For example, the Financial Stability Board (FSB) released a report[15] in which it has "recommended that the IAASB review the need for further guidance on the level of assurance provided by external auditors on risk disclosures…." both those within the financial statements and those outside.

D. The Way Forward

[52] Financial reporting disclosures are an important component of public reporting to investors. Users should have access to full and fair disclosures in order to be able to make better informed investment decisions. The IAASB has identified three initial steps in further progressing the valuable start made with the Discussion Paper and this Feedback Statement.

[53] Firstly, the IAASB firmly believes that cooperation and collaboration are key to advancing on many of the issues identified. The feedback received will serve as a valuable basis for upcoming and forward outreach activities of the IAASB with many relevant stakeholders, including standard setters and others actively engaged in this area. Views and perspectives on this area will be further explored, and awareness will be raised for many of the issues identified, as the IAASB continues its active liaison and outreach with the many stakeholders involved, pursuing the objective of continuous improvement.

[54] Secondly, the IAASB will consider proposals and deliberate on the commencement of standard setting or other related activities in early 2012, in response to the comments that have been received. The first consideration for the IAASB will be whether standard setting is the most appropriate action, and if not, what other actions may need to be undertaken to address the issues that have been raised. The IAASB's [draft] *Strategy and Work Program 2012-2014* already incorporates some such activities, and deliberation by the Working Group and the IAASB as to the nature and timing of any future actions needed is in the commencement phase.

[15] The report *Thematic Review on Risk Disclosure Practices* is available on the FSB website

[55] Lastly, the IAASB recognizes that comments received on this Discussion Paper may help inform the Board's deliberations on its projects for Auditor Reporting[16] and the revision of ISA 720.[17] They may also assist the IAASB in determining whether there is a need for a broader enhancement of ISA 540 to ensure that the standard continues to support robust, high-quality audit work in the area of accounting estimates, including fair values.

16 See [December IAASB meeting agenda]

17 See [ISA 720 project history]

APPENDIX 1

List of Respondents to the Discussion Paper

The summary has been prepared highlighting what the IAASB have learned from the responses to the Discussion Paper. If readers wish to read the full responses they can be found on the IAASB website.

No	Abbrev.	Respondent
Users and Preparers (7)		
1	HEOS	Hermes Equity Ownership Services
2	100 Group	The Hundred Group of Finance Directors
3	HoTARAC	Australian Department of Treasury and Finance
4	HQ	Hydro–Québec
5	IACVA	International Association of Consultants, Valuators and Analysts
6	ICGN	International Corporate Governance Network
7	QCA	The Quoted Companies Alliance
Regulators and Oversight Bodies (10)		
8	AOB	Audit Oversight Board–Securities Commission Malaysia
9	AIU	Audit Inspection Unit and Auditing Practices Board (UK)[18]
10	CPAB	Canadian Public Accountability Board
11	EBA	European Banking Authority
12	ESMA	European Securities and Markets Authority
13	FAOA	Federal Audit Oversight Authority of Switzerland
14	SEHKL	The Stock Exchange of Hong Kong Limited
15	IAIS	International Association of Insurance Supervisors
16	IOSCO	International Organization of Securities Commissions
17	IRBA	Independent Regulatory Board for Auditors (South Africa)
National Auditing Standard Setters (5)		
18	AICPA	American Institute of Certified Public Accountants
19	AuASB	Australian Auditing and Assurance Standards Board
20	HKICPA	Hong Kong Institute of Certified Public Accountants

[18] For the purpose of this table only, the joint response letter from the AIU and AIU (UK) has been listed once only in the "Regulators and Oversight Authorities" category.

21	AASB-MIA	Auditing and Assurance Standards Board of the Malaysian Institute of Accountants
22	NZICA	New Zealand Institute of Chartered Accountants–Professional Standards Board
Audit Firms (5)		
23	DTT	Deloitte Touche Tohmatsu Limited
24	EYG	Ernst & Young Global
25	GT	Grant Thornton International
26	KPMG	KPMG IFRG Limited
27	PwC	Pricewaterhouse Coopers
Professional Institutes–Americas (4)		
28	FICPA	Florida Institute of Certified Public Accountants
29	IMCP	Instituto Mexicano de Contadores Públicos
30	NYSSCPA	New York State Society of Certified Public Accountants
31	OCAQ	Ordre des comptables agréés du Québec
Professional Institutes–Europe & Africa (15)		
32	ACCA	The Association of Chartered Certified Accountants
33	AIA	The Association of International Accountants
34	ASSIREVI	Associazione Italiana Revisori Contabili
35	CNCC–CSOEC	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts–Comptables
36	CNDCEC	Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili
37	EFAA	European Federation of Accountants and Auditors for SMEs
38	FAR	Institute for the Accountancy Profession in Sweden
39	FEE	Federation of European Accountants
40	FSR	Danske Revisorer (Danish Institute of Professional Accountants)
41	ICAEW	The Institute of Chartered Accountants in England and Wales
42	ICAS	The Institute of Chartered Accountants of Scotland
43	ICJCE	Instituto de Censores Jurados de Cuentas de España
44	IDW	Institut der Wirtschaftsprüfer
45	NBA	Nederlandse Beroepsorganisatie van Accountants

46	SAICA	The South African Institute of Chartered Accountants
Professional Institutes–Asia / Oceania (3)		
47	AAP	Australian Accounting Profession (CPA Australia, The Institute of Chartered Accountants in Australia, Institute of Public Accountants)
48	ICAP	The Institute of Chartered Accountants of Pakistan
49	JICPA	The Japanese Institute of Certified Public Accountants
Individuals and others (2)		
50	FI	Felicitas T Irungu
51	JM	Dr. Joseph S. Maresca, CPA, CISA