

Disclosures—Issues**Background**

1. The IAASB recognized in December 2009 that the topic of disclosures, and the implications of recent trends in financial reporting on auditors' responsibilities and practices, should be further considered. A Disclosures Working Group (WG) was established to explore and catalogue the issues and challenges around disclosures, including the audit implications.
2. In January 2011 the IAASB issued a Discussion Paper (DP), *The Evolving Nature of Financial Reporting: Disclosures and its Audit Implications*. The DP discussed:
 - (a) Recent trends in financial reporting and their impact on financial reporting;
 - (b) How the International Standards on Auditing (ISAs) currently deal with disclosures; and
 - (c) Audit issues in relation to evidence, materiality, misstatements and auditability that the IAASB had identified regarding disclosures.
3. The DP included questions tailored for different stakeholder groups, including preparers, investors, lenders and other creditors, regulators, and auditors. However, respondents, including those not part of any of the key stakeholder groups, were invited to respond to any of the questions if they wished to provide their perspective.
4. Responses to the DP were received from fifty-one stakeholders. The broad range of respondents and the thoughtful comments received demonstrated the importance of this initiative. In January 2012 the IAASB released a Feedback Statement to summarize what was heard from respondents.
5. At its March 2012 meeting, the IAASB approved its Strategy and Work Program, 2012—2014, which includes a proposed new project on a new ISA or guidance on auditing financial statement disclosures. As noted in the Strategy and Work Program, debates are being held in a number of major jurisdictions about lessons for audit from the global financial crisis and what more can be done to enhance the role of auditors in safeguarding financial stability. Accordingly, the IAASB would explore the need to clarify auditors' responsibilities regarding financial reporting disclosures, including consideration of whether standard-setting is the most appropriate action.
6. Recognizing the importance of staying close to developments in financial reporting disclosures, the IAASB will also monitor relevant developments pertaining to disclosures, and provide input and work collaboratively, as appropriate, through its ongoing liaison initiatives with key stakeholders such as the International Accounting Standards Board (IASB) and others actively engaging in work in this area.

Matters for Discussion

7. At this stage, the Disclosures WG is of the view that there is sufficient support to warrant the development of a project proposal in this area for the IAASB's consideration. Further, input from recent discussions at the April 2012 IAASB-National Standard Setters (NSS) Liaison meeting, as well as from the IAASB Consultative Advisory Group (CAG) Working Group on Disclosures, have

also reconfirmed the importance of the IAASB addressing audit issues relating to financial reporting disclosures.

8. The responses to the DP identified a number of areas where further guidance, at a minimum, would be helpful. The Disclosures WG is in process of considering the nature and scope of a project on disclosures, including the specific issues to be addressed and anticipated form of the output from a project. A Project Proposal is anticipated to be presented at the September 2012 IAASB meeting, subject to Steering Committee approval.
9. This Paper identifies two matters on which the IAASB's initial views are sought. This Paper does not identify all matters that the Disclosures WG anticipates will need to be covered in a project proposal. Further, this request for input from the Board is not intended to prejudge the Board's consideration of whether to approve a project.

A. The Way Forward – Materiality

10. The majority of respondents to the DP expressed the view that many of the issues around disclosures could not be solved by the IAASB alone. Rather, an effective response would require collaboration and cooperation with other stakeholders, particularly the accounting standard setters; securities, audit and prudential regulators; and preparers and investors.
11. Some of the more significant areas where respondents to the DP believed the issues needed to be addressed in collaboration and cooperation with others included:
 - Materiality and a Financial Reporting Disclosures Framework—many respondents noted that the concept of materiality was a financial reporting concept first, and that a comprehensive disclosure framework would greatly assist with some of the issues identified relating to materiality;
 - Auditability—the availability of audit evidence is dependent, at least in part, on the underlying information provided by preparers; however, financial reporting frameworks often do not set out what preparers are expected to do, or the documentation they are expected to maintain, to support the assertions they make in disclosures; and
 - Excessive disclosures—it was noted that an extensive use of checklists exacerbated this problem as preparers and auditors were unsure on how to apply materiality to financial reporting disclosures.
12. With regard to the current ISAs, many respondents (including preparers and auditors) to the DP also observed that making judgments about the appropriate amount of information to include in the financial reporting disclosures is a key challenge. Respondents indicated that auditors would benefit from additional guidance in specific areas such as:
 - Determining materiality for quantitative amounts in disclosures, including how to apply materiality to individual disclosures in the context of the financial statements as a whole;
 - Applying the concepts of materiality to qualitative disclosures and disclosures not linked to a line item in the financial statements; and
 - Evaluating the materiality of misstatements identified in disclosures.
13. The need for a disclosures framework, which would likely include guidance on materiality for disclosures, has been recognized by some accounting standard setters. Others have recognized

materiality as an issue and have commenced initiatives to address some of the concerns and problems. Some of those who have commenced projects or initiatives on the development of a disclosures framework, or other initiatives to address concerns in financial reporting disclosures, include:

- Financial Accounting Standards Board (FASB)(US)—it is expected that they will release an Invitation to Comment with views on addressing the effectiveness of disclosures in the summer of 2012.
- European Securities and Markets Authority (ESMA)—released a consultation paper¹ on materiality in November 2011, with a comment period until 29 February 2012. Forty six responses were received.
- European Financial Reporting Advisory Group (EFRAG)—have undertaken a thought leadership project “Disclosures Framework for Notes to the Financial Statements.”
- Financial Stability Board—has facilitated the formation of a private-sector Enhanced Disclosures Task Force (FSB EDTF) to develop principles for financial institutions for enhanced disclosures on current market conditions and risk, including improving comparability of such disclosures, and to identify leading practice risk disclosures.

Others, such as the IASB, have commenced the consultative process to determine whether to pursue a project in this area. The IASB’s process includes inputs from a joint project to review the level of disclosure requirements in the current International Financial Reporting Standards (IFRSs) by the Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA). They have also signaled that they will be hosting a public forum to assess strategies for improving the quality of financial reporting disclosures, but within the existing disclosure requirements.

14. The development of robust disclosure principles, which can be applied when both preparing and auditing disclosures, is expected to help address some of the more significant concerns that have been raised in respect of materiality. The nature, scope and content of the disclosures framework projects or initiatives is still being determined, and the outcomes and impact of these projects or initiatives will not be known for some time.
15. Notwithstanding the above, the Disclosures WG is of the preliminary view that the auditing aspects of materiality should be identified and included as part of the project proposal on disclosures. The focus of effort, in particular, would be on the areas where the IAASB can itself work to address the concerns raised (e.g., aggregation of qualitative misstatements), regardless of the status of projects by various accounting standard setters and others on a disclosures framework or similar initiatives.
16. The main advantage of this approach is that the IAASB would be actively formulating views and position on whether, and if so how, to enhance practice in this area on a timely basis. While the IAASB may only be capable of addressing some, and not all, of the relevant issues, the IAASB would not be subject to the timing and uncertainty of the outputs from others. Further, a review of the existing guidance in the ISAs regarding disclosures now may also further inform whether there are related areas where changes may also be appropriate. Should changes arise in the future

¹ ESMA Consultation Paper, *Considerations of Materiality in Financial Reporting*

because of the work efforts of the accounting standard setters or others, they could be addressed at that time.

17. On the other hand, it is recognized that there are benefits to working in tandem with others towards a single, coordinated solution in the international context.

Matters for IAASB Consideration

1. The IAASB is asked whether the Disclosures WG should:
 - (a) Continue to consider and deliberate the concerns and issues raised on materiality and evaluation of misstatements to the extent that they would affect the IAASB pronouncements only, regardless of the status of projects by various accounting standard setters on a disclosures framework or similar initiatives; or
 - (b) Delay any further work relating to materiality and evaluation of misstatements pending the finalization of the work of the accounting standard setters and others in this area. The IAASB would then recommence its work to determine what further actions are necessary in the auditing pronouncements to deal with any issues or concerns raised about materiality and evaluation of misstatements which have not been addressed.
 - If this option is preferred, the IAASB is asked whether a staff document or practice note might be a viable alternative in the interim, taking into account that it may be several years before the accounting standard setters have finalized their deliberations in this area.

B. The Way Forward – Approach to Changes to the ISAs

18. With regard to the ISAs, many respondents had the view that they appropriately reflected the necessary risk-based approach to auditing disclosures. However, there were some areas where respondents believed additional guidance or enhancements to the existing standards would improve practice.
19. The specific areas highlighted included, in relation to disclosures:
- Aspects of applying materiality (as discussed above).
 - More formalization around assessing risks of material misstatement and responding to those risks.
 - Specific areas where it has been noted that there were significantly different views on what would constitute sufficient appropriate evidence.²
 - Accumulating and evaluating misstatements.
20. Based on the presumption that the IAASB determines that a standard setting project is necessary, the initial decision on how to incorporate the changes into the ISAs will need to be made. There are three courses of action that the Disclosures WG currently has under consideration (under each

² For example, although not currently required under the existing IFRSs, respondents to the DP noted significant different views as to what constitutes sufficient appropriate audit evidence for the stress test information.

course of action, enhancements to the requirements and/or explanatory and application material would be made as considered necessary):

- (a) Develop a new, separate standard dedicated to auditing disclosures. This new standard would reposition all requirements and guidance that already exist in other ISAs into a new ISA in a coherent and logical way.
- (b) Maintain the existing structure of the ISAs' requirements and related explanatory material, i.e., spread through the suite of standards, including in subject specific standards (such as ISA 550)³.
- (c) Develop a new standard, which incorporates both a discussion of the conceptual issues around auditing disclosures (such as materiality and misstatements, risk identification and assessment, and the nature and sources of audit evidence) and only key overarching requirements applicable to auditing disclosures (i.e., repositioning some, but not all, the relevant requirements and guidance out of individual standards into the new standard (e.g., topic specific standards such as ISA 580⁴ would still maintain references to written representation on disclosures)).

Appendix A includes a preliminary list of the standards expected to be affected by a standard setting project on auditing disclosures. The amount of change made to these standards will depend on the way the changes are made and the additional requirements and/or guidance considered necessary to address the concerns and issues raised (i.e., some will be affected more than others).

21. Each of the alternatives in paragraph 20 above has advantages and disadvantages. These are discussed below, and will be further considered when determining the appropriate way forward.
22. Some would have the view that a separate standard including all references to disclosures would provide the appropriate emphasis to the audit of disclosures that many respondents to the DP had noted was needed. Other advantages of one standard include:
 - Repositioning the material relating to auditing disclosures into one standard would facilitate the understanding of all actions required when auditing disclosures.
 - It may assist with identification of areas where additional requirements and/or explanatory materials are needed.
 - It is easier to establish specific requirements in context, in contrast to adding specific requirements into a broad standard (such as ISA 315).⁵
23. Others would view a separate standard as creating additional issues. For example, isolating disclosures as a separate component of the audit may result in them being audited in a distinct manner, rather than as an integral part of the audit. Other advantages to maintaining the requirements in the existing standards, and adding or enhancing where needed, include:
 - Eliminating the possibility of unnecessary duplication and/or redundancy.

³ ISA 550, *Related Parties*

⁴ ISA 580, *Written Representations*

⁵ ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*

- Not losing the iterative nature of the audit.
 - Allowing for more application of judgment, as a separate standard may be perceived by some as being more prescriptive.
 - Less confusion about the stages of the audit.
24. The third option noted in paragraph 20 (option (c)) – a ‘hybrid’ approach of incorporating both a discussion of conceptual matters and key auditing requirements in a separate standard – would help focus the auditors on the broad concepts relevant to auditing disclosures, with some of the advantages mentioned in paragraphs 22 and 23 above also being applicable. However, from a practical aspect, it would result in the requirements and guidance for auditing disclosures largely continuing to be spread throughout the ISAs.
25. The Working Group has mixed views on the alternatives in paragraph 20, with a slight preference for either 20(b) or 20(c), and would like further views from the IAASB.

Matters for IAASB Consideration

2. The IAASB is asked to share:
- (a) Their initial thinking on their preferred approach in relation to the alternatives in paragraph 20;
 - (b) Whether they have identified any other implications of each of the alternatives, including any additional advantages or disadvantages not mentioned above, which the Disclosures WG should further consider; and
3. The IAASB is asked whether there are other factors they believe the Disclosures WG should consider when exploring recommendations for the way forward.

APPENDIX A

PRELIMINARY LIST OF ISAs WHICH MAY BE AFFECTED BY A PROJECT ON AUDITING DISCLOSURES

The following highlights the ISAs which may be affected by a project on auditing disclosures. The amount of change in each standard will vary, depending on the way the changes are going to be incorporated into the ISAs, and the changes, enhancements or additions, if any, that are considered necessary for each standard.

ISA	Name
230	Audit Documentation
240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
300	Planning and Audit of Financial Statements
315	Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and its Environment
320	Materiality in Planning and performing an Audit
330	The Auditor's Responses to Assessed Risks
450	Evaluation of Misstatements Identified during the Audit
500	Audit Evidence
501	Audit Evidence – Specific Considerations for Selected Items
540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
550	Related Parties
580	Written Representations
600	Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
700	Forming and Opinion and Reporting on Financial Statements