

# Agenda Item 3-B

## Auditing Disclosures - Task Force Analysis of Issues and Related ISA Requirements

The following analysis tentatively sets out the broad issues identified, together with the requirements of each relevant ISA relating to disclosures, and the Task Force's views on identified potential gaps. Commentary on the Task Force's conclusions and views can be found in **Agenda Item 3-A**.

### Planning and Understanding the Entity and Assessing the Risks of Material Misstatement (ISA 300<sup>1</sup> and ISA 315<sup>2</sup>)

Issues Identified in the Responses to the Discussion Paper	ISA Objective: <sup>3</sup> Has the Auditor...	Disclosures Related Requirements in ISA <sup>4</sup>	Potential Gaps <sup>5</sup> in ISA Requirements and Task Force Views
Respondents to the DP had the view that: (a) Auditors do not focus on their planned approach to obtain evidence on disclosures early enough; and (b) Planning, in some cases, does not build in sufficient time for audit procedures on disclosures.	Planned the audit so that the audit will be performed in an effective manner? <sup>6</sup>	<u>ISA 300:</u> The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. <i>No specific reference to disclosures but they would be included implicitly in the requirement.</i> (ISA 300, para 7)	No potential gaps in requirements in ISA 300 have been identified by the Task Force.
Respondents to the DP, particularly auditors, noted that there was insufficient guidance on: (a) Performing risk assessments for note disclosures. In particular, at what level this risk assessment is	Identified and assessed the risks of material misstatement...at the financial statement and	<u>ISA 315:</u> The auditor shall obtain an understanding of...(b) the nature of the entity,... to enable the auditor to understand... <u>disclosures</u> to be expected in the financial statements (ISA 315, para 11)	No potential gaps in requirements in ISA 315 have been identified by the Task Force.

<sup>1</sup> ISA 300, *Planning an Audit of Financial Statements*

<sup>2</sup> ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> The objective of the ISA has been included as it is relevant to assess whether the objectives are being met in light of the issues raised.

<sup>4</sup> For the purposes of this analysis, only requirements relating to auditing disclosures have been included. There may be other requirements in each standard that have not been repeated here as they are not relevant to auditing disclosures. Also, for brevity, the requirements in some cases have been shortened, which has been indicated by "...", however the relevant parts of the requirement have been repeated here. If it is not clear what the actual requirement is, the relevant ISA should be referred to.

<sup>5</sup> The potential gaps identified by the Task Force include areas where potential additions may be useful.

<sup>6</sup> ISA 300, para 4

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<p>performed (i.e., financial statements as a whole or at the individual disclosure level); and</p> <p>(b) How to apply risk assessment procedures to disclosures (such as understanding the control processes around disclosures)</p>	<p>assertion levels... thereby providing a basis for designing and responding to the assessed risks of material misstatement? <sup>7</sup></p>	<p>The auditor shall obtain an understanding of the information system..., relevant to financial reporting, including... (e) the financial reporting process used to prepare the entity's financial statements, including... <u>disclosures</u>...</p> <p>(ISA 315, para 18)</p> <p>The auditor shall obtain an understanding of control activities relevant to the audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks.</p> <p><i>No specific reference to disclosures but they would be included implicitly in the requirement.</i></p> <p>(ISA 315, Para 20)</p> <p>The auditor shall identify and asses the risk of material misstatement at (a) the financial statement level; and (b) the assertion level for... and <u>disclosures</u>, to provide a basis for designing and performing further audit procedures.</p> <p>(ISA 315, para 25)</p> <p>For this purpose, the auditor shall: (a) identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and <u>disclosures</u> in the financial statements;...</p> <p>(ISA 315, para 26)</p>	

<sup>7</sup> ISA 315, para 3

**Materiality (ISA 320)<sup>8</sup>**

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>Respondents to the DP had the view that:</p> <p>(a) There is a lack of clear guidance on how to apply materiality to disclosures, including the application of 'performance materiality'.</p> <p>(b) There is insufficient guidance on applying the concept 'clearly trivial' to disclosures, particularly qualitative and narrative disclosures.</p> <p>(c) It is difficult to apply materiality principles to narrative disclosures / ISAs should clarify the difference in the determination of materiality for quantitative disclosures compared to what is required for qualitative disclosures.</p> <p>(d) There is not sufficient guidance on how materiality is to be applied when quantitative amounts are substantially larger than any financial statement line item (e.g., notional amounts for derivatives).</p> <p>(e) There is insufficient guidance on the relationship between estimation uncertainty and materiality assessment, particularly where measurement</p>	<p>Applied the concept of materiality appropriately in planning and performing the audit?<sup>9</sup></p>	<p>When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or <u>disclosures</u> for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or <u>disclosures</u>.</p> <p>(ISA 320 para 10)</p> <p>The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or <u>disclosures</u>) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially</p> <p>(ISA 320, para 12)</p> <p>If the auditor concludes that a lower materiality...(and if applicable, materiality level or</p>	<p>The Task Force has identified the following potential gaps in ISA 320:</p> <ul style="list-style-type: none"> <li>Paragraph 10 of ISA 320 refers to amounts, with limited references to narrative or qualitative types of disclosures. As a result at the planning stage identification of material misstatements that are not numerical is causing difficulty in applying ISA 320.</li> <li>Performance materiality – it is not clear if, and how, performance materiality applies to disclosures.</li> </ul>

<sup>8</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>9</sup> ISA 320, para 4

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>uncertainty is greater than materiality.</p> <p>(f) The impact of components on group materiality for disclosures can be challenging in large group audits.</p>		<p>levels for particular classes of transactions, account balances or <u>disclosures</u>) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality...</p> <p>(ISA 320, para 13)</p> <p>The auditor shall include in the audit documentation the following amounts and factors considered in their determination:... (b) if applicable, the materiality level or levels for particular classes of transactions, account balances or <u>disclosures</u>; ...</p> <p>(ISA 320, Para 14)</p>	

**Planning Procedures to Respond to Assessed Risks of Material Misstatement (ISA 330)<sup>10</sup>**

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>Respondents to the DP had the view that there is insufficient guidance on how to apply professional judgment to determine the nature and extent of work on qualitative and objective-based<sup>11</sup> disclosures arising from the unique characteristics of those types of disclosures, e.g.,:</p>	<p>Obtained sufficient appropriate audit evidence regarding the assessed risks of material</p>	<p>In designing further audit procedures to be performed, the auditor shall (a) consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and <u>disclosure</u>, including: (i) the likelihood of material misstatement due to the particular characteristic of</p>	<p>No potential gaps in requirements in ISA 330 have been identified by the Task Force.</p>

<sup>10</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>11</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 7.7 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".

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>(a) Disclosures based on information that is not generated by the accounting system.</p> <p>(b) Disclosures including estimation uncertainty and sensitivity analyses.</p> <p>(c) Disclosure of fair value of an amount recorded on the balance sheet using a different measurement basis.</p> <p>(d) Overarching objective-based disclosure requirements.</p>	<p>misstatement, through designing and implementing appropriate responses to those risks?</p>	<p>the relevant class of transactions, account balance, or <u>disclosure</u>...</p> <p>(ISA 330, para 7)</p> <p>Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material ... <u>disclosure</u>.</p> <p>(ISA 330, para 18)</p> <p>The auditor shall perform audit procedures to evaluate whether the overall presentation of the financial statements, including the related <u>disclosures</u>, is in accordance with the applicable financial reporting framework.</p> <p>(ISA 330, para 24)</p>	

**Obtaining Sufficient Appropriate Audit Evidence (ISA 500<sup>12</sup> and ISA 501<sup>13</sup>)**

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>Respondents to the DP had the view:</p> <p>(a) That there is insufficient guidance on what constitutes sufficient appropriate evidence in relation to different categories of note disclosures, including management judgments,</p>	<p>Designed and performed audit procedures in such a way so as to be able to draw reasonable conclusions on</p>	<p><u>ISA 500</u>:</p> <p>The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.</p> <p><i>No specific reference to disclosures but they would</i></p>	<p>No potential gaps in requirements in ISA 500 have been identified by the Task Force.</p> <p>A potential gap in ISA 501 has been identified</p>

<sup>12</sup> ISA 500, *Audit Evidence*

<sup>13</sup> ISA 501, *Audit Evidence—Specific Considerations for Selected Items*

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>assumptions and estimation uncertainty.</p> <p>(b) That more guidance is required for assessing sufficiency and appropriateness of audit evidence with respect to disclosures, particularly narrative disclosures.</p> <p>(c) That more guidance is required for determining the appropriate level of audit work required on accounting estimates or other items that are disclosures but not recognized in the financial statements</p> <p>(d) That areas where difficulty has been experienced in obtaining sufficient appropriate audit evidence include going concern, especially around management plans and intentions and factors to mitigate going concern issues.</p>	<p>which to base the auditor's conclusions?<sup>14</sup></p>	<p><i>be implicitly included.</i></p> <p>(ISA 500, para 6)</p> <p><u>ISA 501:</u></p> <p><i>Litigation and Claims</i></p> <p>Written representations – The auditor shall request management... to provide written representations that all known actual or possible litigation and claims whose effects should be considered.... have been <u>disclosed</u> to the auditor and accounted for and <u>disclosed</u> in accordance with the applicable financial reporting framework.</p> <p>(ISA 501, para 12)</p> <p><i>Segment Information</i></p> <p>The auditor shall obtain sufficient appropriate evidence regarding the presentation and <u>disclosure</u> of segment information in accordance with the applicable financial reporting framework...</p> <p>(ISA 501, para 13)</p>	<p>by the Task Force relating to sufficient appropriate evidence in relation to different types of note disclosures.</p>

<sup>14</sup> ISA 500, para 4

**Evaluating Misstatements (ISA 450)<sup>15</sup>**

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>Respondents to the DP had the view that there is insufficient guidance on:</p> <ul style="list-style-type: none"> <li>(a) What constitutes a material misstatement in disclosures for both qualitative and quantitative information; and</li> <li>(b) Accumulating misstatements in note disclosures (particularly those that are expressed in non-monetary terms) and combining with misstatements from the primary financial statements.</li> </ul>	<p>Evaluated the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements?<sup>16</sup></p>	<p>If... management has examined a class of transactions, account balance or <u>disclosure</u> and corrected misstatements that were detected, the auditor shall perform additional procedures to determine whether misstatements remain.</p> <p>(ISA 450, para 7)</p> <p>The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:</p> <ul style="list-style-type: none"> <li>(a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or <u>disclosures</u> and the financial statements as a whole, and the particular circumstances of their occurrence; and</li> <li>(b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or <u>disclosures</u>, and the financial statements as a whole.</li> </ul> <p>(ISA 450 para 11)</p>	<p>No potential gaps in requirements in ISA 450 have been identified by the Task Force.</p>

<sup>15</sup> ISA 450, *Evaluation of Misstatements Identified During the Audit*

<sup>16</sup> ISA 450, paragraph 3

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
		<p>The auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor’s report, unless prohibited by law or regulation. ...</p> <p>(ISA 450, para 12)</p> <p>The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or <u>disclosures</u>, and the financial statements as a whole.</p> <p>(ISA 450, para 13)</p>	

**Evaluation of Evidence and Forming an Opinion (ISA 700)<sup>17</sup>**

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>Respondents to the DP had the view that:</p> <p>(a) Principles of fair presentation, as currently practiced; do not provide a useful basis for identifying and eliminating excessive disclosures; and</p> <p>(b) There is insufficient guidance on the requirement to consider whether</p>	<p>Formed an opinion on the financial statements based on evaluation of the conclusions drawn from the</p>	<p>The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework.</p> <p><i>No specific reference to disclosures but they would be included implicitly in the requirement.</i></p> <p>(ISA 700, paragraph 12)</p>	<p>A potential gap has been identified by the Task Force relating to the stand back review in ISA 700. Notwithstanding that paragraph 14(b) refers to “related notes”, the references to</p>

<sup>17</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

Issues Identified in the Responses to the Discussion Paper	ISA Objective: Has the Auditor...	Disclosures Related Requirements in ISA	Potential Gaps in ISA Requirements and Task Force Views
<p>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, in particular whether these are complete.</p>	<p>audit evidence obtained?<sup>18</sup></p>	<p>In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework: ...</p> <p>(e) The financial statements provide adequate <u>disclosures</u> to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and...</p> <p>(ISA 700, para 13)</p> <p>When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required... 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:</p> <p>(a) The overall presentation, structure and content of the financial statements; and</p> <p>(b) Whether the financial statements, including the <u>related notes</u>, represent the underlying transactions and events in a manner that achieves fair presentation.</p> <p>(ISA 700, para 14)</p>	<p>"transactions and events" may not be enough with respect to the evolving types of disclosures.</p>

<sup>18</sup> ISA 700, paragraph 6(a)