

Auditing Disclosures – Select Issues and Task Force Views

This Paper comprises the following two Sections:

- **Section I**—Discussion and Task Force views on areas where changes to the ISAs relating to the ‘planning stage’ of the audit in relation to auditing disclosures may be appropriate.
- **Section II**—Discussion and Task Force views on the assertions for presentation and disclosure.

Section I: Potential Changes to the ISAs

Scope and Context of Material Presented for IAASB Discussion in April

1. As explained in Agenda Item 5, for the purposes of the April IAASB meeting the Task Force has selected only the ‘planning stage’ of the audit process for IAASB discussion on potential changes to the ISAs. The remaining stages of the audit process and related ISAs will be considered at a subsequent IAASB meeting.
2. Although the Task Force is presenting potential changes to select ISAs for IAASB discussion, the Task Force’s intention is not to commit the IAASB to either changes to the ISAs or the development of other guidance at this stage. The Task Force acknowledges that the decision on whether changes to the ISAs, and if so their nature and timing, that may ultimately be proposed will need to take into consideration:
 - The nature and extent of all of the potential changes to the ISAs once the full review by the Task Force is complete;
 - IAASB decisions in relation to actions from projects such as ISA Implementation Monitoring, Auditor Reporting and the IAASB’s upcoming Strategy Consultation; and
 - Progress and outcomes on initiatives by the accounting standard setters on this topic area.

Notwithstanding the above, the Task Force would not delay making recommendations for changes to the ISAs if it is felt that such changes are needed on a more timely basis to address a fundamental concern pertinent to the quality of audits.

Specific Areas of Possible New Guidance

3. Potential changes to the ISAs relating to auditing financial statement disclosures identified by the Task Force for the ‘planning stage’ of the audit are presented in **Agenda Item 5-B**. The ISAs addressed are, ISA 300¹, and, in so far as the material therein pertains to audit planning, ISA 315 (Revised),² ISA 320³ and ISA 260⁴.
4. The following provides general and specific explanations in relation to the potential changes identified by the Task Force to the individual ISAs.

¹ ISA 300, *Planning an Audit of Financial Statements*

² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

³ ISA 320, *Materiality in Planning and Performing an Audit*

⁴ ISA 260, *Communication with Those Charged with Governance*

General

5. In relation to all of the proposed changes in connection with audit planning, the IAASB is asked to note that the changes are predominantly in the nature of additional application and explanatory material, as opposed to new or revised ISA requirements. In part, this takes into account the view implicit in the comments of many of the respondents to the IAASB 2011 Discussion Paper (DP), *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications*, that:

- More explanation in the ISAs about the nature of different disclosures, and of the importance of considering these early on in the audit, would be particularly helpful.
- The requirements of the selected ISAs are largely adequate but that additional guidance in applying existing requirements in relation to certain types of disclosures is needed.

(Appendix 1 summarizes matters raised by respondents to the DP and the Task Force's analysis thereof in relation to the ISAs, as presented to the IAASB at its December 2012 meeting.)

ISA 300

6. In relation to ISA 300, the Task Force believes that additional emphasis should be given to disclosures particularly in relation to:

- The section of the ISA addressing the role and timing of planning. In this regard, the Task Force has made more explicit that the understanding of the disclosures required by the financial reporting framework are one of the items to be considered before audit procedures are performed, thereby focusing on disclosures at a very early stage (See **Agenda Item 5-B** page 1); and
- Developing the audit plan. In this regard, the Task Force believes it is important to emphasize disclosures when the auditor is planning the nature, timing and extent of audit procedures to be performed by members of the engagement team. (See **Agenda Item 5-B** pages 1 to 3)

ISA 315 (Revised)⁵

7. In relation to ISA 315 (Revised), the Task Force is of the view that ISA 315 (Revised) has sufficient requirements relating to obtaining an understanding of the entity and its environment and assessing the risk of material misstatement in respect of disclosures. However, the Task Force is suggesting that more guidance be included in relation to matters to consider when the auditor obtains an understanding of the entity and its environment, including about relevant industry, regulatory and other external factors including the applicable financial reporting framework. (See **Agenda Item 5-B**, pages 4 and 5)

8. In addition, the Task Force considered whether modifying ISA 315 (Revised), to include the categories of disclosures as presented in Appendix 2, would be useful to auditors by demonstrating the wide variety of disclosures that may be encompassed in financial statements. The Task Force expressed mixed views on including this Appendix in ISA 315 (Revised), and have therefore not

⁵ With respect to guidance on applying risk assessment procedures the Task Force intends to consider this aspect when considering ISA 330, *The Auditor's Responses to Assessed Risks*.

included this as a potential change to ISA 315 (Revised) in **Agenda Item 5-B**. However, as further material is developed, the Task Force may revisit the decision not to include this as an Appendix.

9. With respect to internal controls over disclosures, the Task Force is of the view that there is appropriate guidance in ISA 315 (Revised).⁶ Nevertheless, it believes that additional specific references to emphasize disclosures when considering the effect of the control environment, and components of internal control, would be useful. (See **Agenda Item 5-B**, pages 5 and 6)
10. The Task Force is also of the view that further consideration should be given on the assertions for presentation and disclosure that are set forth in ISA 315 (Revised). Section II of this Paper addresses this issue.

ISA 320

11. In relation to ISA 320, the Task Force has identified potential changes to the application and other explanatory material of the ISA to:
 - (a) Provide further guidance on considerations for determining whether qualitative disclosures are material when planning the audit, an area that respondents to the DP had highlighted as needing clarity. (See **Agenda Item 5-B**, pages 8 and 9)
 - (b) Make clear that the concept underlying the definition of performance materiality applies to all types of disclosures, notwithstanding that the definition⁷ in the ISAs addresses quantitative items and therefore refers to “amount or amounts.” Respondents to the DP had expressed concern that it was not clear whether performance materiality applied or not. (See **Agenda Item 5-B**, page 10)

The IAASB is asked to note that the Task Force has not yet contemplated whether changes to the requirements of the ISA are needed. The issues identified for further consideration in ISA 320 to date, and which relate to planning activities only, are relatively uncomplicated and are not anticipated to be significantly influenced by developments occurring by others.

ISA 260

12. An important objective of ISA 260 is to enhance the two-way communication between the auditor and those charged with governance. The Task Force is of the view that it would be beneficial if changes to the applicable financial reporting framework that are relevant and material to the entity (including changes to disclosure requirements), and the implications of these on the planned audit approach, are identified as a matter to be communicated with those charged with governance. (See **Agenda Item 5-B**, page 11)

⁶ In relation to internal control, Application and Other Explanatory Material is presented in paragraphs A49 to A117 of ISA 315 (Revised).

⁷ ISA 320, paragraph 9

Matter for IAASB Consideration

1. The IAASB is asked for its views on the potential changes in the ISAs as set forth in **Agenda Item 5-B**, including the extent to which the IAASB believes they are important in enhancing the application of the existing requirements with respect to auditing disclosures and whether they are adequate for that purpose.

Section II: Assertions about Presentation and Disclosure

13. In the Task Force's view, the assertions about presentation and disclosure should play a key role in driving auditor behavior and enhancing the audit of disclosures. Questions have arisen, however, about whether the assertions, which are included in the application material in ISA 315 (Revised), are wholly appropriate and useful when auditing disclosures. Therefore, the Task Force has considered whether the assertions need to be clarified or otherwise further enhanced.
14. The extant assertions in ISA 315 (Revised)⁸ relating to 'Presentation and Disclosure' are as follows:
 - (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - (ii) Completeness—all disclosures that should have been included in the financial statements have been included.
 - (iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.
 - (iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.
15. In order to determine whether changes to the assertions should be proposed, the Task Force considered:
 - (a) Whether they can be applied to all categories of disclosures, in particular disclosures which are continuing to evolve with changes to the financial reporting standards.
 - (b) Whether they are consistent with the financial reporting qualitative characteristics, or if they are not, do they need to be consistent.

Applying the Assertions to Disclosures

16. The Task Force has tentatively explored the following options regarding the extant assertions for presentation and disclosure:
 - (a) Revising and enhancing the descriptions of the assertions as they are currently presented;
 - (b) Separating the assertions into their component parts and revising the description appropriately;
 - (c) Making a fundamental change to the extant assertions and descriptions; or
 - (d) Not making any changes to the assertions.

⁸ ISA 315 (Revised), paragraph A124(c)

17. In order to explore (a) and (b) above, the Task Force analyzed how the extant assertions relating to presentation and disclosure could apply to a wide range of disclosures (the categories of disclosures used by the Task Force are shown in Appendix 2). In addition, the Task Force has noted that the ISAs do not currently provide guidance on how to apply these assertions to disclosures, and do not explain that every assertion may not apply to all types of disclosures. With regard to (c) above, the Task Force has not yet fully explored this option as it wanted IAASB views before further considering this option.

Task Force Views

18. In considering the appropriateness of the assertions for presentation and disclosure, including their relevant descriptions, the Task Force agreed that certain changes would be beneficial to make them more suitable to present-day disclosures. However, the Task Force expressed mixed views on the options in paragraph 15.
19. By revising and enhancing the descriptions, and supplementing the application and other explanatory material with further considerations and explanations regarding applying the assertions to disclosures, the change would be less substantial. However, this would still need to be done in the confines of the extant assertions with the resulting changes perhaps not being as comprehensive as needed.
20. A more fundamental change to the assertions could make them more relevant by allowing for changes to be made to the assertions themselves so that they more appropriately define and describe the wide range of disclosures, and there may be the opportunity to align the audit process with what the preparer is required to consider under the financial reporting standards.

Financial Reporting Qualitative Characteristics

21. As part of the consideration of the assertions in ISA 315 (Revised), the Task Force also considered the qualitative characteristics of useful financial information as set out in the International Accounting Standards Board's (IASB) *Conceptual Framework* of financial reporting standards. The qualitative characteristics are important as they underlie the financial information that is being audited. Questions have arisen on whether they would also be applicable when considering assertions in the auditing standards such that the auditing assertions are consistent with the qualitative characteristics.
22. In 2010, the IASB published revisions to part of its conceptual framework, *Conceptual Framework for Financial Reporting* (The IASB's *Conceptual Framework* that incorporates the revisions in 2010 is referred to as "Framework 2010" hereafter).⁹ Framework 2010 identifies two fundamental characteristics of useful financial information: 'relevance' and 'faithful representation'. Framework 2010 states that "faithful representation requires that financial information be complete, neutral and free from error, although perfection is seldom, if ever, achievable."¹⁰ Comparability, verifiability, timeliness and understandability are identified as enhancing qualitative characteristics. However,

⁹ In this paper, the IASB's Conceptual Framework is referenced, but similar considerations would apply to other financial reporting frameworks where applicable.

¹⁰ Framework 2010, paragraph QC12

Framework 2010 acknowledges that information may not possess all of the enhancing characteristics, but that the information may still be useful.

23. Framework 2010 explains that ‘relevant information’ has “predictive value, confirmatory value, or both, and is therefore capable of making a difference to decisions by users such as investors, lenders and other creditors.¹¹ Financial information has predictive value if it can be used as input to processes used to predict future outcomes.¹² It has confirmatory value if it provides feedback about previous predictions”.¹³
24. Framework 2010 also explains that the financial report represents economic phenomena in words and numbers, and that to be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent¹⁴ the phenomena that it purports to explain.

The Interaction of the IASB’s Fundamental Characteristics of Useful Information and the IAASB’s Disclosures Assertions

25. As part of its considerations on whether to change the auditing assertions to be consistent with the accounting qualitative characteristics, the following table sets out the IASB’s fundamental characteristics of useful information with, where applicable, the IAASB’s assertions for presentation and disclosure in ISA 315 (Revised):

IASB’s Qualitative Characteristics from Framework 2010	Description of IASB’s Qualitative Characteristics	IAASB Assertion Relating to Disclosures ¹⁵
<i>Fundamental Characteristics of Useful Information:</i>		
Relevant	Relevant financial information is capable of making a difference to users. Financial information is capable of making a difference in decisions if it has predictive value, confirmative value, or both. ¹⁶	None

¹¹ Framework 2010 , paragraphs QC 6-7

¹² Framework 2010, paragraph QC8

¹³ Framework 2010, paragraph QC9

¹⁴ In paragraph QC15, the IASB Conceptual Framework states: “Faithful representation does not mean accurate in all respects. Free from error means there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying the appropriate process for developing the estimate”.

¹⁵ Description from ISA 315 (Revised), paragraph A124(c)

¹⁶ Framework 2010, paragraphs QC 6-7

IASB's Qualitative Characteristics from Framework 2010	Description of IASB's Qualitative Characteristics	IAASB Assertion Relating to Disclosures ¹⁵
Faithful representation:		
<ul style="list-style-type: none"> Complete 	A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations. ¹⁷	Completeness (all disclosures that should have been included in the financial statements have been included)
<ul style="list-style-type: none"> Neutral 	A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasized, de-emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably by users. ¹⁸	<ul style="list-style-type: none"> Occurrence and rights and obligations (disclosed events, transactions, and other matters have occurred and pertain to the entity) Accuracy and valuation (financial and other information are disclosed fairly and at appropriate amounts) Classification and understandability (financial information is appropriately presented and described, and disclosures are clearly expressed)
<ul style="list-style-type: none"> Free from error 	Free from error means that there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects. ¹⁹	

Task Force Views

26. The Task Force is of the view that the assertions are used for a different purpose than the qualitative characteristics of the accounting standard setters. However, additional guidance could be considered on the interaction of the IAASB assertions with the qualitative characteristics of the underlying financial information.
27. To progress the discussion, as a starting point, the Task Force has taken the approach of building on the extant assertions, and has made some tentative modifications and enhancements to the descriptions of the extant assertions as set out in Appendix 3. The illustration of this approach will assist the Task Force as it considers whether such changes will achieve the objective of making the

¹⁷ Framework 2010, paragraph QC 13

¹⁸ Framework 2010, paragraph QC14

¹⁹ Framework 2010, paragraph QC15

assertions more relevant or whether more fundamental changes to the assertions for presentation and disclosure should be developed.

Matters for IAASB Consideration

2. The IAASB is asked whether it agrees that further consideration should be given to changing the assertions for presentation and disclosure?
3. If the IAASB believes that this is an area for further consideration, should the Task Force continue to explore modifications to the existing assertions (along the lines of Appendix 3), or should consideration be given to more fundamental changes to the extant assertions for presentation and disclosure?
4. The IAASB is asked whether they agree with the views of the Task Force in relation to the financial reporting standards qualitative characteristics in paragraph 26 above?
5. With respect to the planning aspects of the ISAs that have been considered by the Task Force, are there additional changes that, in the IAASB's view, are necessary?

Appendix 1

Issues Identified from the Responses to the Discussion Paper and Task Force Views on Potential Gaps

1. **As a reminder**, the Task Force had identified the following issues for further consideration from the responses to the Discussion Paper in December 2012:²⁰

(a) **ISA 300:** The respondents had the view that:

- Auditors do not focus their planned approach to obtain evidence on disclosures early enough; and
- Planning, in some cases, does not build in sufficient time for audit procedures on disclosures.

Task Force Views:²¹ No potential gaps in the requirements of ISA 300 were identified by the Task Force. However, there was the view that consideration may be given to providing additional guidance in the Application and Other Explanatory Material related to helping drive the auditor to establish appropriate focus on auditing disclosures earlier in the planning process.

(b) **ISA 315 (Revised):** Respondents to the DP, particularly auditors, noted that there was insufficient guidance on:

- Performing risk assessments for note disclosures. In particular, at what level this risk assessment is performed (i.e., financial statements as a whole or at the individual disclosure level); and
- How to apply risk assessment procedures to disclosures.⁵

Task Force Views: No potential gaps in the requirements of ISA 315 (Revised) were identified by the Task Force. Areas identified where further guidance may be considered, included:

- (a) Adding a definition for disclosures, which would further explain their nature and make clear that they encompass a wide variety of disclosures, for example, disclosures that are a further numerical breakdown of amounts in the primary financial statements, and disclosures that are narrative and that are not related to specific amounts in the primary financial statements.
- (b) Clarifying the assertions relating to presentation and disclosure in paragraph A124(c)²² in light of the evolving nature of disclosures, particularly the increase in narrative and objective based disclosures. This may more clearly emphasize the nature and

²⁰ The Discussion paper (DP), [The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications](#), was released by the IAASB in early 2011 to further explore trends in financial reporting and their impact on auditing disclosures in a financial statement audit, followed by an overview of the responses of the responses to the questions in the DP in the [Feedback Statement](#) in January 2012.

²¹ From [Agenda Item 3-A](#) (December 2012 IAASB Meeting)

²² See considerations on assertions later in this paper.

characteristics of disclosures rather than being the same as those for the primary financial statements. This may also assist auditors with understanding their responsibilities when auditing disclosures.

- (c) Adding further guidance incorporating examples of risk assessment procedures for different types of disclosures, and understanding control processes around disclosures and when it is appropriate to test those controls.
- (c) **ISA 320:** Respondents to the DP noted the following in relation to materiality (it should be noted that the first two have been considered in the deliberations on planning to date, however the rest of the issues detailed below are still to be considered by the Task Force):
- There is a lack of clear guidance on how to apply materiality to disclosures, including the application of 'performance materiality'.
 - 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.
 - There is insufficient guidance on applying the concept 'clearly trivial' to disclosures, particularly qualitative and narrative disclosures.
 - 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).
 - There is insufficient guidance on the relationship between estimation uncertainty and materiality assessment, particularly where measurement uncertainty is greater than materiality.
 - The impact of components on group materiality for disclosures can be challenging in large group audits.

The **Task Force had identified gaps** in the requirements as follows:

- (i) 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.
- (ii) Performance materiality – it is not clear if, and how, performance materiality applies to disclosures.

Appendix 2

Evolving Categories of Disclosures

The following are examples of the types of disclosures that may be included in the financial statements, and are indicative of the types of disclosures that have evolved from recent financial reporting requirements. The list is not intended to be exhaustive, and may change over time as new financial reporting disclosures are required:

- (a) **Significant accounting policies**—descriptions of the accounting policies adopted by the entity relevant to understanding the line items on the face of the financial statements and the basis of the accounting policies of the entity.
- (b) **Components of line items**—such as breakdowns of line items into smaller categories, movement analyses or other related information about a line item.
- (c) **Factual information about the entity**—such as addresses, names of group entities, composition of share capital and dividend payments.
- (d) **Judgments and reasons**—judgments made in the process of applying accounting policies and management decisions and reasons for the policies/decisions selected/made. Examples include criteria developed by the entity to distinguish investment properties from owner occupied properties and from property held for sale in the ordinary course of business, and disclosures around why an entity's ownership interest does not constitute control in respect of an investee where more than half of its voting rights, or potential voting rights are owned directly or indirectly.
- (e) **Assumptions/models/inputs**—includes disclosures of material information relevant to the calculation of items in the financial statements, such as possible ranges of values, and forward looking information to the extent that it is used for amounts recognized in the balance sheet such as for impairment testing, including discount rates, effective interest rates and growth rates.
- (f) **Sources of estimation uncertainty/sensitivity analysis disclosures**—these are disclosures to enable users to understand the underlying measurement variability of an item in the financial statements. An example is value at risk disclosures or other types of sensitivity analyses.
- (g) **Material uncertainties in relation to the going concern basis of accounting**—information about material uncertainties related to events or conditions that may cast doubt upon the entity's ability to continue as a going concern.
- (h) **Related party disclosures**—Descriptions of related party relationships and amounts of transactions, including key management compensation.
- (i) **Pro forma financial information**—disclosures are required, under some accounting frameworks, relating to business combinations which have occurred after the balance sheet date but before the financial statements are issued.
- (j) **Descriptions of internal processes**—disclosures such as risk management policies and practices. An example is the disclosure of the policies and procedures for managing financial instrument risks.

- (k) **Disclosure of the fair value of an amount recorded on the balance sheet using a different measurement basis**—such as a requirement to disclose fair values for items measured using another measurement basis such as historical cost or amortized cost.
- (l) **Objective-based disclosure requirements**—these are overarching requirements that set out the objectives of the disclosures to be provided rather than require specific disclosures. Thus, preparers are expected to provide additional disclosures when compliance with the specific disclosure requirements in a standard will be insufficient for users to be able to understand the impact of particular transactions, other events and conditions on the entity’s financial position and performance.

Appendix 3

Potential Changes to the Assertions for Presentation and Disclosure

Potential changes to the assertions are shown in marked text below.

The Use of Assertions²³

A123. In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures.

A124. Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms:

- (a)
- (b)
- (c) Assertions about presentation and disclosure:
 - (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - (ii) Completeness—all disclosures that should have been included in the financial statements have been included.
 - (iii) Classification and understandability—~~financial-relevant~~ information is appropriately presented and described, and ~~disclosures are~~descriptions and related information have been clearly expressed.
 - (iv) Accuracy and valuation—financial ~~and other~~ information ~~are~~is disclosed ~~fairly and~~ at appropriate amounts, and descriptions, analyses and other related information is disclosed appropriately.

A125. The auditor may use the assertions as described above or may express them differently provided all aspects described above have been covered. For example, the auditor may choose to combine the assertions about transactions and events with the assertions about account balances, or with assertions about presentation and disclosure.

A125.1. As the information in disclosures can be wide ranging, each assertion about presentation and disclosure does not necessarily apply to every disclosure. For example, classification may not be relevant to factual disclosures about the entity.

A125.2. Other considerations about assertions relating to presentation and disclosure may include:

- o Applying knowledge gained through understanding the entity and its environment to– assess the completeness of objective-based disclosures;
- o Whether the audit of related transactions or account balances, where relevant, covers the same assertions; and

²³ Extract from ISA 315 (Revised), paragraphs A123-A125

- o Identifying those disclosures that relate to information, financial or otherwise, that are not generated by the accounting system and that are relevant to understanding account balances or transactions.