

[Draft] Discussion Paper**The Evolving Nature of Financial Reporting: Disclosure and Its
Audit Implications****CONTENTS**

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Preface

Over the past decade, the nature of financial reporting has evolved to meet the changing needs of users. Business and capital markets have become more challenging, with greater complexity in business models, sources of risk and uncertainty, as well as greater sophistication in how risk is managed. This shift reflects an underlying trend toward the provision of information that is relevant to users, even if such information may be more subjective and less reliable.

Financial reporting disclosure requirements and practices have also had to respond to these changes by shifting from simply providing breakdowns of the line items on the face of the financial statement, to providing longer and more detailed disclosures, including disclosures of assumptions, models, alternative measurement bases and sources of estimation uncertainty amongst others. In some ways, disclosures have become the balancing item in the calculus of how to provide credible decision useful information.

In light of these trends in the role and importance of financial statement disclosures, questions have risen about how auditors should apply auditing concepts in obtaining sufficient appropriate audit evidence about financial statement disclosures to support their opinion on the financial statements as a whole.

This Discussion Paper (DP) is designed to help the International Auditing and Assurance Standards Board (IAASB) gain a robust understanding of views and perspectives on issues relevant to the audit of disclosures in a financial statement audit. It explores a number of issues regarding financial statement disclosures and includes a series of consultation questions. The IAASB is aware that challenges in approaching disclosures do not affect just auditors. Preparers, regulators and users also need to consider their approaches to disclosures. Therefore, although, this DP is focused on the implications for auditors, many of the issues are equally as relevant from the perspective of preparers, investors and other stakeholders.

The DP begins with a discussion of recent trends in financial reporting and their impact on financial statement disclosures. It then discusses how the ISAs currently deal with disclosures. The remainder of the DP focuses on audit issues that the IAASB has identified regarding disclosures required by a financial reporting framework.

The IAASB encourages stakeholders, including preparers, investors, auditors, accounting standard-setters and regulators to respond in order to help the IAASB decide whether further standards or guidance in this area is needed.

I. Introduction

Background

1. Over the past decade, the nature of financial reporting has evolved to meet the changing needs of users. Business and capital markets have become more challenging, with greater complexity in business models, sources of risk and uncertainty, as well as greater sophistication in how risk is managed. The financial services sector continues to grow in significance and has spawned new assets classes such as securitizations. Financial reporting has had to keep up with these changes, perhaps most significantly with more frequent use of fair value accounting, which often involves more complex and judgmental measurements. This shift reflects an underlying trend toward the provision of information that is relevant to users, even if such information may be more subjective and less reliable.
2. Financial reporting disclosure requirements and practices have also had to respond to these changes by shifting from simply providing breakdowns of the line items on the face of the financial statement, to providing longer and more detailed disclosures, including disclosures of assumptions, models, alternative measurement bases and sources of estimation uncertainty amongst others. In some ways, disclosures have become the balancing item in the calculus of how to provide credible decision useful information.
3. All of these trends in financial reporting pose challenges not only for preparers who are faced with the need to prepare and support these new disclosures,, but also for investors in trying to discern the importance of the disclosed information when forming decisions based on the financial statements, for accounting standard setters in forming judgments on the disclosures that should be required, and for auditors in determining how auditing standards and underlying concepts, such as materiality, apply to their consideration of disclosures in their audits of financial statements.
4. Under International Standards on Auditing (ISAs), auditors are required to consider disclosures in planning and performing the audit, including identifying and assessing the risks of material misstatement at the assertion level for disclosures. Further, for financial statements prepared in accordance with a fair presentation framework, auditors are required to consider the overall presentation of the financial statements and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
5. Recently, the role of auditors in relation to disclosures has been the focus of considerable attention. One element of this appears to have arisen in the context of the recent financial turmoil, and relates to perceptions regarding the auditor's efforts in relation to disclosures. Some recent reports have suggested that auditors need to use greater professional judgment and skepticism in approaching disclosures. However, it has also raised questions about the particular challenges that arise in obtaining sufficient appropriate audit evidence in relation to some disclosures, and even whether all disclosures are capable of being audited.
6. Against this background, the IAASB decided to issue this DP to raise the full range of views and perspectives on issues relative to disclosures and the approaches of preparers

and auditors. The IAASB encourages responses from all relevant stakeholders including preparers, investors, auditors, accounting standard-setters and regulators.

7. The IAASB believes it is important that all participants in this debate articulate their underlying reasoning to enable a useful discussion. This requires stakeholders to comment on the full range of issues about financial statement disclosures to ensure that others, including the IAASB, have the opportunity to engage with different perspectives.

Scope

8. This DP explores issues in respect of note disclosures required by a financial reporting framework.¹
9. In addition, while ISAs are neutral in respect of financial reporting frameworks, this paper has been prepared using the disclosures required by the International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) as a frame of reference, although the issues raised are equally valid for other financial reporting frameworks.
10. While the DP is written primarily from the perspective of auditors, many of the matters auditors need to consider in auditing disclosures are encountered first by preparers. The ISAs do not impose responsibilities on management, but an audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged their responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework and, where relevant, their fair presentation. Thus, the preparation and presentation of the disclosures in the financial statements, and support for the assertions made in them, rests in the first instance with management.
11. Further, whilst stakeholders may have various views on the auditability of certain disclosures, this paper is prepared on the preliminary assumption that all disclosures required by a financial reporting framework are capable of being covered by the auditor's opinion on the financial statements. However, to respond to these views, paragraphs 97 to 108 examine the auditability of certain disclosures and ask for input from stakeholders.
12. The IAASB has the following projects on its current work program that respond to the complexity in disclosures generally:
 - A project to revise ISA 720² to ensure that the ISA continues to be capable of enhancing the credibility of financial statements through specifying appropriate responsibilities of the auditor relating to the range of other information, specifically the entity's disclosures of information beyond the requirements of the financial

¹ This DP does not discuss the issues about disclosure of the financial statements themselves, that is, the classification and presentation of line items on the face of the financial statements. The DP also does not cover other information in documents containing audited financial statements.

² ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*

reporting framework and financial statements, in documents containing or accompanying the audited financial statements and the auditor's report thereon.

- A project to consider user perceptions about the standard unqualified auditor's report under ISA 700³ as well as considering the wider context of information about auditor reporting from other relevant sources, including auditor reporting models used in countries where the auditor's report reflects a different form and/or content to the ISA 700 report.

Also, representatives of the IAASB meet with representatives of the IASB on a regular basis to discuss recent financial reporting and auditing developments and to provide input on each other's work programs. This is an important opportunity for the IAASB to make comments to the IASB to provide an auditor's perspective on proposed financial reporting requirements.

Small- and Medium-Sized Entities (SMEs) Perspective

13. Disclosures are likely to be more challenging to prepare and audit when the business model and transactions of the entity are complex. As such, the issues regarding the audit of disclosures in this paper will be relevant to entities and their auditors that have complex operations or financing, regardless of their size. Auditors of SMEs are likely to encounter some of these audit issues in respect of disclosures mentioned in this DP, although in some cases, they may be less difficult to overcome.

Public Sector Perspective

14. This DP is also relevant for the public sector as many public sector regulators base their financial reporting frameworks on the International Public Sector Accounting Standards (IPSAS) issued by the International Public Sector Accounting Standards Board (IPSASB) which encourages the disclosure of additional information on key issues such as the entity's outputs, outcomes and compliance with laws and regulations. These additional public sector disclosures may be made in or outside of the financial statements, and may be within the audit mandate.

³ ISA 700, Forming An Opinion and Reporting on Financial Statements,

II. Financial Reporting Disclosure Trends

Increasing Length and Complexity of Financial Statement Disclosures

15. As discussed above, disclosures were once primarily related directly to further explanations of line items on the face of the financial statements. This included, for example, disclosures of accounting policies related to line items and breakdowns of those items into smaller categories for the purposes of enabling a user of the financial statements to understand the movements in balance sheet items. A significant theme of these disclosures was that the majority of them were derived from the accounting system and, as such, raised few specific audit challenges. Auditors would be able to largely address the risks of the financial statements being material misstated due to disclosures via their audit work on the related line items. There were other types of disclosures but the predominant disclosure theme was directly related to the numbers in the financial statements.
16. As financial reporting has grown more complex, financial statements are now more likely to include a variety of disclosures in addition to the traditional disclosure items. The IAASB has identified the following categories of disclosures in current financial statements:
 - Significant accounting policies—description of the accounting policies adopted by the entity relevant in understanding the line items on the face of the financial statements and the basis of the accounting policies of the entity.
 - Components of line items—such as breakdowns of line items into smaller categories, movement analyses or other related information about a line item.
 - Factual information about the entity—such as addresses, names of group entities, composition of share capital and dividend payments.
 - 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 disclosure of material uncertainties in relation to the going concern basis of accounting.
 - Assumptions/models/inputs—includes disclosures of material information relevant to the calculation of items in the financial statements, such as possible ranges of values, discount rates, effective interest rates and growth rates.
 - 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.
 - Descriptions of internal processes, such as risk management policies and practices. An example is the disclosure of the policies and procedures for managing financial instrument risks.
 - 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, for example the requirement to disclose the fair value of reclassified financial assets.

- 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 so as to achieve fair presentation. See further discussion of this trend in paragraphs 29–33.
17. From the categories above it is clear that financial statements are now more likely to include a broad variety of disclosures, some of which may not be derived from the accounting system and may include more forward-looking information, disclosures of estimation uncertainty and models. The complexity of disclosures has also increased to deal with disclosures necessary to faithfully represent new and challenging subject areas such as financial instruments, business combination and off-balance sheet financing.
 18. As a result, the note disclosures in financial statements have increased significantly. One study of Annual Reports in the United Kingdom (U.K.) noted that they grew on average from 26 pages in 1965 to 75 pages in 2004, reflecting increases in both voluntary and mandated disclosures.⁴ Further, a recent Deloitte U.K. publication⁵ indicated that in 1996 the average length of a UK Annual Report was 44 pages, whereas in 2010 it grew to 101 pages. This increasing length and complexity of disclosures has drawn the attention of many parties in the financial reporting supply chain. For example:

Many people point to the increasing length and detail of annual reports – and the regulations that govern them – as evidence that we have a problem. Others are more worried that reports no longer reflect the reality of the underlying businesses, with key messages lost in the clutter of lengthy disclosures and regulatory jargon.⁶
 19. One response by accounting standard-setters to the challenges with disclosures has been efforts to develop a framework for disclosures. Such a framework would assist accounting standard-setters in developing consistent, logical and balanced disclosure requirements. They would also assist preparers in the judgments that need to be made in applying disclosure requirements in practice. Projects have been initiated by the European Financial Reporting Advisory Group,⁷ the Financial Accounting Standards Board in the United States (U.S.) (FASB)⁸ and the Canadian Accounting Standards Board.⁹

⁴ Beattie, V. and Dhanani, A. *Investigating Presentation Change in U.K. Annual Reports*, Journal of Business Communication, Vol 45, 2, (April 2008), pp.181–222)

⁵ *Swimming in Words: Surveying Narrative Reporting in Annual Reports* (London: Deloitte, October 2010)

⁶ *Louder Than Words* (London: Financial Reporting Council, 2009), p. 2

⁷ <http://www.efrag.org/projects/detail.asp?id=169>

⁸ http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156344894

⁹ <http://www.acsbcanada.org/projects/completed-projects/item18119.aspx>

The Blurring of the Boundaries of Financial Reporting

20. There are discussions underway in a number of forums about the boundaries of financial reporting. Some argue that information that is relevant to investors extends beyond the traditional boundaries of financial statements, and there is, at least for some, a growing interest in the concept of integrated corporate reporting¹⁰ across a broader range of performance information.
21. There has already been some blurring of the boundaries of the traditional financial statements. For example, under IFRSs certain mandated disclosures are able to be located outside of the financial statements in a document that is made available on the same terms as the financial statements and at the same time with cross references from the financial statements to that information.¹¹ There are also some jurisdictions that permit cross-references of certain disclosures, such as directors' and executives' compensation disclosures, to documents outside of the financial statements. This blurring of the boundaries may be to avoid duplication of disclosures and to avoid adding to the length of financial statements when disclosures were already being made elsewhere in some cases. Accounting standard-setters have also shown an interest in addressing aspects of corporate reporting beyond the traditional financial statement format, such as the management commentary.¹²

Developments in the Conceptual Framework of Accounting Standards

22. It has been suggested that part of the reason for the increasing length and complexity of financial statements may be that accounting standard-setters have increasingly emphasized the fundamental qualitative characteristic of relevance over reliability. Indeed, the qualitative characteristic of "reliability" that used to be one of the fundamental qualitative characteristics of financial information in the IASB Conceptual Framework for Financial Reporting (The Conceptual Framework) has been replaced by the characteristic of "faithful representation." In September 2010, the IASB issued an update to the Conceptual Framework that included an update on Chapter 3 *Qualitative characteristics of useful financial information*. The updated Chapter 3 includes a hierarchy of qualitative characteristics (see Figure 1 below). Reliability is no longer mentioned. It has been replaced by faithful representation, which requires three sub-characteristics: complete, neutral and free from bias.¹³ Verifiability, which might have

¹⁰ See, for example, the recent launch of the International Integrated Reporting Committee (<http://www.integratedreporting.org/>). Integrated reporting is described as "a framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format—put briefly, in an "integrated" format. The intention is to help with the development of more comprehensive and comprehensible information about an organization's total performance, prospective as well as retrospective, to meet the needs of the emerging, more sustainable, global economic model."

¹¹ IFRS 7.B6

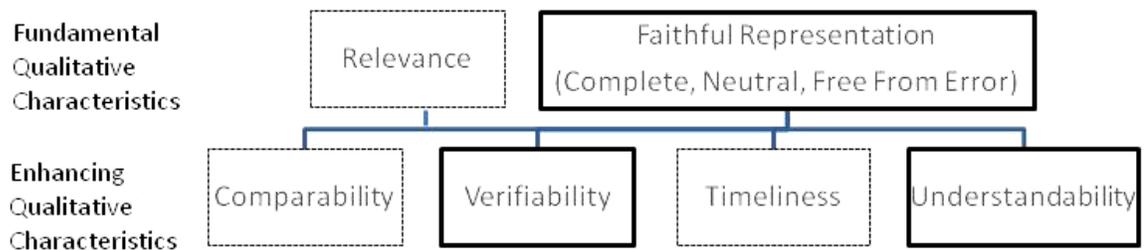
¹² For example, the IASB Exposure Draft ED/2009/6, *Management Commentary*, issued in June 2009, notes that the management commentary is a type of financial reporting, even if it is not included in the financial statements. The IASB has stated that it does not intend to issue a standard on management commentary.

¹³ *The Conceptual Framework for Financial Reporting* (London: IASB, 2010)

been considered as similar to reliability, is identified as an enhancing characteristic. In the revised conceptual framework, although enhancing characteristics are expected to be maximized to the extent possible, they are not sufficient on their own, in that they cannot make financial information useful that is not both relevant and a faithful representation.

23. Given the new emphasis on faithful representation some argue that, in some circumstances, the disclosures about the line item may be at least as important, if not more useful, to users than the number on the face of the financial statements. The disclosures are necessary to inform users about judgments and assumptions made in the measurement of the line item, reasons for the judgments, facts, circumstances and the measurement uncertainty related to that line item. In effect, the disclosures in these cases are being used to achieve balance between the principles of relevance and faithful representation.

Figure 1: Hierarchy of Qualitative Characteristics



24. In QC15, the 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 an appropriate process for developing the estimate.

25. Also important is the enhancing characteristic of verifiability which (QC26):

...helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.

26. There are some who have expressed concern about the fact that less emphasis is being placed on reliability. For example, the Institut Der Wirtschaftsprüfer (IDW) issued a concept paper in 2007 outlining further steps the IASB should take in regard to the conceptual framework. A particular focus of the paper was the need for proper consideration of management's need to have accounting evidence to support their judgments. Amongst other matters they highlight that the move away from reliability in

the conceptual framework may make it difficult for management to assemble appropriate accounting evidence and documentation:

The reliability of accounting processes and evidence, together with its verifiability, may also have a significant impact on the consistency with which IFRSs are applied at an international level.¹⁴

27. Two other aspects of the revised conceptual framework may be particularly relevant when thinking about disclosures. The sub-characteristic of neutrality requires management to ensure that the financial statements are free from bias. This helps to ensure that the financial statements are a neutral depiction of the economic phenomena and are not “slanted, weighted, de-emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably.”¹⁵ This may be particularly relevant when considering how qualitative disclosures are written.
28. The Conceptual Framework also recognizes that financial information is enhanced if it is understandable which is recognized as another of the enhancing qualitative characteristics. The IASB explains:

Classifying, characterizing and presenting information clearly and concisely makes it understandable. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from financial reports might make the information in those financial reports easier to understand. However, those reports would be incomplete and therefore potentially misleading. Financial reports are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyze the information diligently. At times, even well-informed and diligent users may need to seek the aid of an adviser to understand information about complex economic phenomena.¹⁶

The Prevalence of Objective-Based Disclosure Requirements

29. 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.

Further, IFRS 7.31 has a similar requirement in respect of the nature and extent of risks arising from financial instruments that the entity is exposed to at the end of the reporting period. IFRS 7.B3 gives some guidance on what level of detail to provide:

An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users

¹⁴ *Additional Issues in Relation to a Conceptual Framework for Financial Reporting* (Düsseldorf: Institut Der Wirtschaftsprüfer, September 2007), p.55

¹⁵ IASB, *Conceptual Framework for Financial Reporting*, paragraph QC 14

¹⁶ IASB, *Conceptual Framework for Financial Reporting*, QC 30–32

of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Further, paragraph 69–71 of IASB ED/2010/6 Revenue From Contracts with Customers requires:

To help users of financial statements understand the amount timing and uncertainty of revenue and cash flows arising from contact with customers, an entity shall disclose qualitative and quantitative information about its contracts with customers and the significant judgments, and changes in judgments made in applying the [draft] IFRS to those contracts...An entity shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements...If the disclosures provided in accordance with this [draft] IFRS and other IFRSs do not meet the objective [above], *an entity shall disclose whatever additional information is necessary to meet that objective.* [Emphasis added]

30. These objective-based disclosure requirements create particular challenges for preparers. They must “stand back” from the financial statements and evaluate whether sufficient disclosures have been made. This is a highly judgmental process and it may be difficult for management to substantiate how they complied with these types of disclosure requirements.
31. Also, these disclosure requirements emphasize providing users with decision-useful information, though this may come at a cost to consistent, comparable information. An entity may reasonably decide to show a disclosure one year to comply with an objective-based disclosure requirement, but may not make the same judgment in a subsequent year. This may cause challenges for users who may look to compare disclosures over time. An entity in a particular industry may also make judgments about the disclosures that are particularly relevant in the circumstances of that entity. However, this may result in entities in the same industry not including the same disclosures. While that fact in and of itself might yield useful information to users, it is at a cost of less comparability and consistency which other users—and regulators—might value more.
32. Whilst not directly commenting on objective-based disclosure requirements, the comments of the FASB¹⁷ on the effect of moving to principles-based financial reporting are useful guidance for all stakeholders in assessing the judgment needed for these types of disclosure requirements:

Preparers and auditors would need to apply professional judgment in more circumstances, while the SEC, investors, creditors and other users of financial information must accept the consequences of applying professional judgments, including some diversity in practice.

¹⁷ *Proposal for a Principles-Based Approach to U.S. Standard Setting* (Norwalk: Financial Accounting Standards Board, October 2002)

33. A response to concerns that the emphasis on judgment comes at the cost of consistency has been calls for the development of a framework for the application of judgment. A judgment framework would be “a set of principles, guidelines or good faith thought process that enable decision-makers to consider a situation holistically and drive more consistent decision-making.”¹⁸ Such a framework could assist preparers, auditors, regulators and investors in understanding how to organize their analysis and what factors should influence judgments.¹⁹

Observations Regarding Disclosure Preparation

34. The IAASB’s outreach activities touch on many parts of the financial reporting supply chain, including preparers, regulators, auditors, investors and standard-setters. Discussions with auditors and preparers have also uncovered some practical realities in relation to the preparation of the disclosures in the financial reporting process that may be relevant as issues regarding the expectations of auditors in relation to disclosures are explored.
35. Most audit firms prepare disclosure checklists or illustrative financial statements at the request of their clients. Many preparers welcome such practice aids because they assist preparers in complying with all the disclosure requirements. However, a counter argument is that the checklists and illustrative examples could be criticized for encouraging unnecessary disclosures, as preparers do not want to omit any required disclosures.
36. Further, in practice, it is common for disclosures, once added to the financial statements, to remain in the financial statements—even if management judges them to be immaterial in future years—and for there to be a reluctance to change the approach to and content of a disclosure once it has been developed (for example, in response to a new accounting standard). While, it may assist trend analyses by users, it can be an impediment to continuous improvement.
37. Another common observation from practitioners is that disclosures are often prepared late in the financial reporting process. This is because the financial statements flow from the accounting system, which is the focus of attention throughout much of the year. Disclosures are usually prepared based on a separate process, and increasingly are derived from IT systems which are not connected to the accounting system, such as risk management systems. Further, detailed disclosures are often not required for preliminary announcements to stock exchanges, and so the pressure to prepare them early is reduced.
38. As a consequence, even where the process for preparing the financial statements themselves is well organized and structured, the process for preparing disclosures is usually less formal and less structured. In order to meet the filing deadline within the short period of time, entities are usually rushing to finish the process, and so there is a disincentive for both preparers and auditors to make any changes to disclosures, including

¹⁸ Barrow, Shirley, *Judgment Sustained* (New York: Deloitte, January 2010)

¹⁹ *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission* (Washington: Securities and Exchange Commission, August 1, 2008), p. 91

deletions of disclosures that might now be considered to be immaterial.²⁰ Of course, the next year's disclosures begin again with the previous year's disclosures, meaning that any inadequate consideration of the materiality of disclosures and the understandability of the financial statements as a whole may not be reexamined in subsequent years.

39. A positive development has been the creation of disclosure committees at some of the larger US listed entities in response to a U.S. SEC recommendation.²¹ The SEC adopted rules regarding disclosure controls and procedures and recommended that entities establish a disclosure committee of officers and senior management to supervise the disclosure process.
40. Another source of practical experiences is the results of interviews conducted by the U.K. FRC, which made the following observations²² regarding the reasons for including immaterial disclosures:
 - Due to time pressures, preparers simply repeat disclosures made in prior years rather than considering whether they are still material
 - Lack of confidence in making the judgment between disclosures that are material and those that are not
 - Just as much work being required to conclude on materiality as to prepare the disclosure
 - Desire to avoid lengthy debates with the auditors
 - Following the leader: if another company makes a disclosure, it can influence others to follow
 - Fear that a missing disclosure will be challenged by regulators.

Consultation Questions

1. Is the discussion of financial reporting disclosure trends a fair reflection of recent developments?
2. Regarding the list of financial reporting disclosure categories in paragraph 20, are there any other disclosures required by IFRS that do not fit into any of the above categories? Please list the disclosures and explain how they might be categorized.
3. Is the description of the practical difficulties in removing disclosures a fair reflection? If not, please explain what could be added.
4. What other aspects of financial reporting disclosure trends have not been addressed?
5. Are there any other comments you wish to make regarding financial reporting disclosure trends?

²⁰ One perspective on this issue comes from a recent report (FRC, *Louder than Words*). The view of the U.K. FRC was that auditing standards, by requiring communication by auditors of detected errors, including omissions of material disclosures, to management, may actually result in an increase in disclosures. This is because management find it time-consuming to debate the materiality of disclosure omissions and so err on the side of including disclosures they consider material.

²¹ SEC Rule 33–8124

²² FRC, *Louder than Words*, p. 42

III. How Do ISAs Currently Deal With Disclosures?

41. ISAs are directed to an audit of financial statements and expressing an opinion on the financial statements as a whole. They recognize the role of disclosures in performing risk assessments and developing responses to assessed risks, gathering and evaluating audit evidence, forming the auditor’s opinion on the financial statements, including (where applicable) their fair presentation, and communicating with users of financial statements, management and those charged with governance. In Appendix A to this DP there is a list of relevant ISAs and a summary of the key requirements that relate to disclosures. In addition to these key requirements, ISAs often refer to “classes of transactions, account balances and disclosures” when describing the auditor’s responsibilities in many areas, indicating that disclosures are treated equivalently to classes of transactions and account balances in the application of many auditing requirements.
42. In addition, the definition of a misstatement treats misstatements in disclosures equivalently to misstatements in classes of transactions or account balances. A misstatement is defined as:²³

A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Where the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor’s judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

43. ISAs are predicated on a risk-based approach, where an auditor obtains an understanding of the entity and its environment and identifies and assesses the risks of material misstatements at the assertion level. Disclosures are a key part of this process. ISAs specify that disclosures have the assertions of:
 - Occurrence and Rights and Obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity;
 - Completeness—all disclosures that should have been included in the financial statements have been included;
 - Classification and Understandability—financial information is appropriately presented and described, and disclosures are clearly expressed; and
 - Accuracy and Valuation—financial and other amounts are disclosed fairly and at appropriate amounts.²⁴

²³ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(i)

²⁴ ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph A111(c)

44. It is worth noting that, while many of the assertions above are also relevant for classes of transactions and account balances, there are some important differences. The explanations of the assertions have been tailored to presentation and disclosure and, also, the assertion of understandability is unique to presentation and disclosure.
45. ISA 320 requires,²⁵ in addition to the auditor determining the materiality for the financial statements as a whole, that if, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures 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 is also expected to determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. ISA 320 describes²⁶ factors that may be relevant in determining if a lower level of materiality is needed for particular disclosures, including whether law, regulation or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, and the remuneration of management and those charged with governance).
46. The ISAs include specific requirements and guidance related to the consideration of particular disclosures in several standards, most notable ISA 540²⁷ and ISA 550²⁸. The IAASB also recently released an exposure draft of IAPS 1000²⁹ which aims to help promote consistency in practice and share good practices in auditing. IAPS 1000 notes the importance of the audit of disclosures regarding complex financial instruments. Appendix A to this DP summarizes these and other ISAs relevant to disclosures.
47. Auditors using ISAs are also required to make a number of judgments about disclosures when considering the overall adequacy of the presentation of, and disclosures in, the financial statements. These include:
- Performing procedures to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework;
 - Evaluate misstatements, including misstatements of disclosures, both individually and in aggregate; and
 - Evaluating whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.

²⁵ ISA 320, *Materiality in Planning and Performing an Audit*, paragraph 10

²⁶ ISA 320, paragraph A10

²⁷ ISA 540, *Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

²⁸ ISA 550, *Related Parties*

²⁹ Proposed International Auditing Practice Statement (IAPS) 1000, *Special Considerations in Auditing Complex Financial Instruments*

48. One of the characteristics of a fair presentation framework is the ability to add disclosures in order to give a true and fair view. A key requirement of the ISAs is that, when the financial statements are prepared in accordance with a fair presentation framework, the auditor evaluates whether the financial statements achieve fair presentation in view of the overall presentation, structure and content of the financial statements and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.
49. Disclosures are also included in ISA requirements related to communication. Financial statement disclosures are given as an example of matters the auditor may communicate with those charged with governance, particularly in regard to sensitive disclosures and the overall neutrality, consistency and clarity of disclosures. If the financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation then the auditor is required to discuss the matter with management or modify the opinion.
50. When considering the effect of a material misstatement on the auditor's report, the auditor considers whether the effect on the financial statements is pervasive. Pervasive effects include disclosures that are, in the auditor's judgment, fundamental to users' understanding of the financial statements.³⁰ If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor is required to discuss the non-disclosure with those charged with governance, describe in the basis for modification paragraph the nature of the omitted information and, unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

³⁰ ISA 705, paragraph 5(a)

IV. Audit Issues Regarding Disclosures Required by a Financial Reporting Framework

51. The auditor's consideration of an entity's financial statement disclosures in an audit of financial statements raises questions regarding:
- What it means to audit disclosures in the context of an audit of the financial statements as a whole;
 - What constitutes sufficient appropriate audit evidence in relation to different categories of financial statement disclosures; and
 - How to apply materiality to and evaluate misstatements in disclosures.

Within each of these areas there are different perspectives and issues which deserve attention from the IAASB and its stakeholders.

52. Although this DP is based on the premise that all disclosures are capable of being audited, there are perceptions that not all disclosures required by financial reporting frameworks are capable of being audited. The IAASB is aware of two perspectives on what is meant by auditability: (1) whether an auditor can apply procedures to reduce the risk of material misstatement; or (2) whether information is so imprecise that an auditor cannot increase the credibility of the information.
53. This section begins by examining the auditor's opinion on the financial statements as a whole, and then deals with the key questions about what constitutes sufficient, appropriate audit evidence and how to deal with materiality and misstatements in respect of disclosures. Following that is a discussion of the perceptions about the auditability of disclosures.

An Auditor's Opinion on the Financial Statements as a Whole

54. It is important to recognize that the objective of the auditor is not to form an opinion on each individual disclosure in the financial statements, nor on the disclosures separately from the line items to which they relate. ISAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements. Auditors are looking for sufficient appropriate audit evidence to enable them to draw reasonable conclusions on which to base an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.³¹ Therefore, the gathering of sufficient, appropriate audit evidence on classes of transactions, account balance and disclosures is a part of this process and not an end in itself. This may introduce a different perspective on the question of what constitutes sufficient appropriate audit evidence with respect to some disclosures.

³¹ ISA 500, paragraph 4

What Does Sufficient, Appropriate Audit Evidence Mean for Disclosures?

55. ISA 200³² requires an auditor to obtain sufficient appropriate audit evidence (SAAE) to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. Sufficiency is a measure of the quantity of audit evidence and is affected by the auditor's risk assessment and the quality of audit evidence.³³ Appropriateness is a measure of the quality of audit evidence and is influenced by its source and by its nature.³⁴ These principles apply equally to disclosures as they do to items on the face of the financial statements. Professional judgment is key to the auditor's assessment of whether SAAE has been obtained for disclosures and therefore, by necessity, auditors may form varying views on the composition of SAAE for disclosures.
56. The IAASB is aware that stakeholders may not have a common view of what constitutes SAAE in relation to some disclosures. The IAASB has identified two different views on what SAAE means for disclosures:
- The first perspective is that the auditor is trying to obtain evidence to reduce the risk that the information in the disclosure itself is materially misstated to an acceptably low level.
 - The second perspective is that the auditor seeks sufficient appropriate audit evidence about the disclosures as an integral part of the presentation of the related financial statement amount. The auditor's focus is therefore more on whether the disclosure conveys information relevant to the preparation of the related financial statement amount (for example, the model used, the sensitivity analysis performed). That perspective does not abrogate the auditor's responsibilities because the reasonableness of assumptions and methods need to be evaluated in obtaining sufficient appropriate audit evidence regarding the recognition and measurement of the related financial statement amount. However, it does perhaps put the auditor's work effort into the context of what evidence is needed to support the auditor's conclusion on the financial statements as a whole.
57. The distinction between the two perspectives varies depending on the nature of the disclosure being audited. A disclosure which is directly linked to the face of the financial statements, for example a breakdown or fair value of a line item, will have little difference between the two perspectives. On the other hand, a disclosure that is not derived from the accounting system has a more noticeable difference.
58. For example, the IASB proposed the following stress test information in its ED *Financial Instruments: Amortized Cost and Impairment*.
20. If an entity prepares stress testing information for internal risk management purposes it shall disclose that fact and information that enables users of financial statements to understand:
- (a) the implications for the financial position and performance of the entity; and

³² ISA 200, paragraph 18

³³ ISA 500, paragraph A4

³⁴ ISA 500, paragraph A5

(b) the entity's ability to withstand the stress scenario or scenarios.

59. For such a disclosure,³⁵ the difference is:
- Whether the stress test was correctly performed (which would require criteria, such as direction from regulators on the parameters of the entity's stress testing, or other expectations of how such a stress test should be performed) and, therefore, whether the reported outcome of the test is appropriate in the entity's circumstances (that is, whether it was an appropriate stress test). Some have pointed out, however, that the lack of clear criteria that is publicly available or disclosed and nature of subject matter, it may be difficult to audit such disclosures, if this is the interpretation of what is expected; or
 - Whether the disclosure properly explains the process the entity followed in performing the stress test and the outcomes of that test (that is, whether it is an accurate portrayal of the stress testing that was performed).
60. Another disclosure that helps illustrate the difference is a disclosure, such as a risk disclosure, that describes an internal control. Is the auditor expected to ensure that the internal control is operating effectively, or is the focus of the auditor's work on whether the description of the control is accurate? Further, some disclosures relate to explanations of management intent and the interpretation of the evidence for intentions is likely to be subjective and may not be verifiable using external data. Other disclosures are forward-looking and the evidence is likely to be limited to management's own process for determining the disclosure, with limited external evidence to provide confirmation or contradiction.
61. The ISAs acknowledge circumstances when the auditor may obtain evidence by auditing the process management has followed to prepare information. For example, ISA 540 identifies "testing how management made the accounting estimate and the data on which it is based"³⁶ as one of the four methods to obtain evidence in response to a risk of material misstatement in an estimate.
62. However, others are concerned that users of the financial statements may not understand that evidence obtained regarding the process of preparing the financial statement amount would be of a different nature to evidence obtained with respect to other disclosures in the financial statements. Users may not fully understand that while some disclosures can enhance users' understanding of the nature of inherently uncertain financial statement amounts, they cannot make that information more reliable (i.e. disclosures cannot reduce inherent measurement uncertainty), nor will auditing the disclosures make the financial statement amount more reliable. Also, the auditor's responsibility under ISAs is to consider the risks of material misstatement at an assertion level, meaning that the auditor must consider all applicable assertions.

³⁵ See IASB ED/2009/12, *Financial Instruments: Amortized Costs and Impairment*.

³⁶ ISA 540, paragraph 13(b)

The Role of Professional Skepticism

63. Closely related to the topic of sufficient, appropriate audit evidence are calls for an examination of the use of professional skepticism. The UK Financial Services Authority (FSA) and Financial Reporting Council stated:

...we stress the importance of auditors applying a high degree of professional skepticism when examining key areas of financial accounting and disclosure which depend critically on management judgment. Both the FSA and the FRC believe auditors need to challenge management more. Arising from its more intensive approach to supervision, the FSA has questioned whether the auditor has always been sufficiently skeptical and has paid adequate attention to indicators of management bias. Although the difference between the FSA's view, what management has done and the auditors have accepted may not be material to whether the financial statements are fairly stated overall, there are concerns that the auditor sometimes portrays a worrying lack of skepticism in relation to these key areas.

64. This may have led to the view expressed by some³⁷ that auditors may not be exercising sufficient judgment regarding disclosures in the financial statements. There is a perception that auditors may not sufficiently challenge management and those charged with governance about whether all disclosures necessary are included in the financial statements. Alternatively, others may have the perception that auditors focus solely on completeness (that is, use checklists) without applying judgment regarding whether all of those disclosures are necessary in the context of that specific entity.

Management's Evidence and Documentation of Disclosures

65. The ISAs are premised on management assuming responsibility (a) for the preparation and fair presentation of the financial statements;³⁸ and, (b) whilst not explicitly stated in the ISAs, management's responsibility to have a sufficient basis to support their disclosures (in effect, evidence).³⁹ Some suggest that management may not always have sufficient support for all disclosures in all circumstances due to the nature of some disclosure requirements, which may make it difficult for the auditor to obtain SAAE.
66. This leads to the question of what is adequate support for management's disclosures, particularly for the newer and more subjective categories of disclosures. This question was addressed by the IDW in a report in 2007 which noted:

When management seeks to support the arguments in its decision-making process to recognize, measure, classify, present or disclose (or not to do so) certain circumstances or events relating to the entity in a certain way, it uses information (evidence) to support the assertions embodied in its arguments. The existence of circumstances or the occurrence of events in relation to an entity generally leave behind evidence about these. Furthermore, the

³⁷ See, for example, Discussion Paper 10/3, *Enhancing the Auditor's Contribution to Prudential Regulation* (London: Financial Services Authority and Financial Reporting Council, June 2010).

³⁸ ISA 200, paragraph A2

³⁹ The IDW paper on the conceptual framework (IDW, *Additional Issues in Relation to a Conceptual Framework for Financial Reporting*, September 2007, paragraph 39) notes "It is management's responsibility to gather evidence to support its accounting decision-making process...Without such evidence, management is not in a position to justify its decision on accounting treatment, and management would therefore be unable to meet its stewardship responsibilities."

formulation of arguments in the decision-making process about the recognition, measurement, classification, presentation and disclosure of such events and circumstances also represent evidence supporting the arguments in that decision-making process.

67. Part of the debate about what is SAAE depends on what is seen to be adequate support for management's disclosures in the evolving areas of disclosures.

Auditor's Work Effort

68. The auditor's work effort with respect to some disclosures is relatively straightforward. Many disclosures are derived from the accounting system and are likely to be audited as a consequence of auditing the items on the face of the financial statements. However, the work effort in respect of some disclosures is less clear.
69. Despite the ISAs treating the risks of material misstatement at the assertion level for disclosures equivalently to risks of material misstatement at the assertion level for classes of transactions and account balances, some parties have expressed the perception that auditors may not pay the same amount of attention to disclosures as they do to amounts on the face of the financial statements. Indeed, accounting standard setters have debated requiring some such disclosures to be placed on the face of the financial statements themselves to ensure the appropriate audit rigor is applied. However, it is not clear whether these perceptions relate to work effort, materiality, sufficiency and appropriateness of audit evidence, evaluation of misstatements or some other matter.
70. Others would argue, however, that auditors are applying a risk-based approach and, as a result, may judge some disclosures as more or less significant than others. This means that auditors may vary their work effort in response to the assessed risks. As such, disclosures with a lower assessed risk may have fewer and less persuasive audit procedures applied. Of course, a disclosure which has been assessed as significant should have more audit procedures applied. The auditor's assessment of risk will change from engagement to engagement so the audit procedures will vary as well.

Audit Evidence for Different Categories of Disclosures

71. To explore these issues more fully, the IAASB considers that it is useful to discuss what comprises SAAE for some categories of disclosures. For a simple disclosure it is generally understood what constitutes SAAE. For example, a Property, Plant and Equipment disclosure is derived mostly from the accounting system that also produced the account balance, and so the audit evidence requirements are similar to those for the account balance and many of the assertions will have been covered by the audit of the account balance.
72. However, for a more complex or subjective disclosure the composition of SAAE is subject to all the uncertainty discussed in the earlier sections of this paper. When an auditor evaluates a sensitivity analysis, for example, it is not clear if the auditor should seek SAAE that the disclosure is an appropriate description of management's approach,

or should seek SAAE that the sensitivity analysis itself is correct. Some national auditing standard-setters have issued guidance on the audit of sensitivity analyses.⁴⁰

73. The IAASB is interested in raising the level of the debate about what constitutes SAAE for different types of disclosures. To this end, Table 1 below gives examples of the sort of questions that can be asked in respect of auditing some categories of disclosures.

Table 1: Audit Evidence Questions for Different Categories of Disclosures

| Category of Disclosure ⁴¹ | Audit Evidence Questions |
|--|--|
| Judgments, assumptions, models, inputs | <p>Does the auditor obtain evidence about the disclosure in the audit of the related financial statement amount and seek evidence that the disclosures of judgments, assumptions or models were those used by management?</p> <p>Alternatively, is the auditor considering the risks of material misstatement of the disclosure, independently of the audit of the account balance or other disclosures?</p> |
| Sources of estimation uncertainty/sensitivity analysis | <p>Is the auditor obtaining SAAE regarding the process that management used to prepare the disclosure, or is the auditor seeking to find SAAE that the information in the disclosure is a faithful representation of the underlying subject matter of the disclosure (in this case, does the auditor also need to evaluate the appropriateness of the criteria)?</p> |
| Descriptions of internal processes, such as risk management descriptions | <p>Is the auditor seeking SAAE that the disclosure is a fair description of the internal process or is the auditor seeking SAAE that the risk management process is sound?</p> |
| Disclosure of fair value for a line item recorded on the balance sheet using a different measurement basis | <p>Is the auditor applying the same level of work effort on the disclosure as would be applied as if the disclosure was instead recorded on the face of the financial statements?</p> |
| Objective-based disclosure requirements | <p>What is SAAE if management determines that no additional disclosures are needed?</p> |

⁴⁰ Institute of Chartered Accountants in England and Wales. “*Interim Guidance: Guidance for Auditing Financial Statement Disclosures made under IFRS 7 (FRS 29) Financial Instruments: Disclosures.*” FSF 03/07, London, (2007)

⁴¹ See paragraph 16.

Consultation Questions

6. What is appropriate support for management’s consideration of disclosures?
7. If management’s consideration of disclosure can be appropriately supported by evidence and documentation, is there any reason why the disclosure could not be audited? Also, if a disclosure is not appropriately evidenced and documented by management, is the auditor able to provide assurance on the disclosure?
8. We have discussed in paragraphs 56–59 the issues about disclosures that are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. One example is the proposed disclosures regarding to stress tests. What do you think constitutes sufficient appropriate audit evidence in respect of the proposed stress test disclosures?
9. As discussed above, some disclosures include the fair value of a line item disclosed on another measurement basis, such as historical cost. In this circumstance, what level of effort should be applied by the auditor on the fair value disclosure? Should it be the same as if it was on the face of the financial statements?
10. Does the shift to faithful representation, instead of reliability, change what users expect of auditors? Please explain your answer.
11. Are there other aspects of sufficient appropriate audit evidence that should be addressed?

How Materiality is Applied to Disclosures, and How Misstatements are Evaluated

Materiality for Disclosures

74. Materiality is a pervasive concept in auditing, and not least in respect of disclosures. ISA 320 Materiality in Planning and Performing an Audit contains several requirements and application material relevant to disclosures.⁴²
75. There are a number of areas relative to the materiality of disclosures that need to be considered. These include whether all disclosures are material and the application of materiality to certain disclosures.

Are All Disclosures Material?

76. One view is that accounting standard-setters have applied a materiality “filter” in setting the accounting requirements and have judged them to be “material” if the related line item is “material.” As such, the holders of this view would argue that all disclosures required by a financial reporting framework are material. Under this view of materiality, an auditor must ensure that each and every disclosure appears in accordance with the financial reporting framework as all disclosures are material if the related financial statement item is material, or if the disclosure is otherwise required by the framework. A useful example is the disclosure

⁴² For example, when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities.

related to share-based payments—these may be extensive even if the particular share-based payment is quite quantitatively small. This prompts the question of whether the preparer and the auditor are able to further filter out the least important disclosures in the context of the entity to enhance the readability of the financial statements, even if they are ostensibly required by the financial reporting framework.

77. It is also important to note that the IASB also makes the point that specific disclosure requirements need not be complied with if the information is not material.⁴³
78. However, a recent report⁴⁴ included comment on the perception that preparers and auditors have had challenges in applying the materiality concept to disclosures and that this may have increased the volume of disclosures. This is because both preparers and auditors are keen to ensure that the financial statements include all required disclosures. One of the effects the report cites is that management may believe that it is easier to include the requested disclosure rather than try to prove to the auditor that the disclosure is immaterial. However, it is acknowledged that voluminous disclosures can arise for other reasons, e.g. the nature and complexity of an entity's operations. Further, lengthy and complex disclosures may be necessary in many instances to fully inform users of financial statements of the key aspects of the entity's financial position, performance and cash flows.
79. Another materiality issue concerns how to apply planning and performance materiality against quantitative disclosures of financial instruments, in particular. For example, disclosure of the nominal contract amounts of derivatives or maximum credit risk for a bank is likely to be a number larger than the gross assets of the bank. If the auditor uses the same materiality for these disclosures as that used for account balances then it could be argued that the auditor would need to perform extensive audit procedures as a result. Some believe that this has the effect of reducing the risk of material misstatement of the underlying information to a lower level than would be normally required in a reasonable assurance engagement.
80. In contrast, applying materiality to qualitative disclosures poses very different challenges. Materiality for qualitative disclosures is based on the guiding principle that “misstatement, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of financial statements.”⁴⁵ A key consideration is likely to be finding a balance between competing demands such as understandability of disclosures, excessively length of financial statements, consistency and comparability. Auditors need to consider whether the assertion of “understandability” has been met in respect of these disclosures which is a subjective judgment, leading to disagreements with management that may be difficult to resolve. Preparers and auditors also need to weigh the competing demands for consistent

⁴³ See Appendix A.

⁴⁴ U.K. FRC, 2009, *Louder than Words*, p. 45

⁴⁵ ISA 320, paragraph 2. See also the *Conceptual Framework for Financial Reporting* (IASB, paragraph QC11) which states “Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity.”

and comparable information, including whether materiality is applied to determine only misstatements, or also to remove disclosures that are immaterial.

81. A further challenge in this area is how to deal with immaterial disclosures. IFRS 7, for example, suggests that an entity can decide how much detail to provide, how much emphasis it places on that information and how it aggregates information to display the overall picture. IFRS 7 goes on to note the need to strike a balance between overburdening financial statements with excessive detail that may not assist users and obscuring important information as a result of too much aggregation. This requires entities and auditors to exercise judgment in determining how much disclosure to provide and how it should be presented. Regulators also play a role in how such requirements should be interpreted. If entities determine that in their particular circumstances, certain of the disclosures are not relevant, or that a higher level of aggregation is sufficient, the comparability and consistency between entities that regulators value may be lost. Some regulators have also made the point that if an entity fails to include a disclosure, a user cannot tell if the failure to include that disclosure is attributable to a valid judgment, or an omission due to fraud or error.
82. This has resulted in disagreements where entities have tried to remove what they believed was excessively detailed information that got in the way of the users being able to understand the story of the entity's financial position, performance and cash flows but others disagreed and argued for more consistent disclosure with previous periods.

Types of Misstatements of Disclosure

83. Misstatements in respect of disclosures can be as important to users as misstatements of items on the face of the financial statements. For example, in the recent financial turmoil, users placed heavy emphasis on the maturity analysis of liabilities to ascertain the difficulty the entity may have in rolling over debt facilities. A misstatement in this disclosure could affect users' decisions to hold debt or equity in that company, extend finance or take another economic action.
84. Misstatements of disclosures may be different to misstatements on the face of the financial statements. They vary from those that are easy to detect and discuss with management through to those that are highly subjective. For example:
 - A line item, such as Property, Plant and Equipment may not have part or all of the required disclosures.
 - A disclosure may contain a factual mistake, such as an incorrect number, or may disclose an assumption or accounting policy that was not the one used.
 - A disclosure may be biased, such that the disclosure does not reflect a neutral perspective.
 - A disclosure may be poorly worded or confusing, such that the auditor is concerned about the understandability and fair presentation of the financial statements as a whole.

- Key information may be disclosed, but its order in the entity’s overall disclosures may obfuscate its importance to a proper understanding of the entity’s financial position, financial performance or cash flows

Evaluating Misstatements of Disclosures

85. Under ISA 450, the evaluation of misstatements of disclosures is governed by the same requirements and guidance that applies to classes of transactions and account balances. Questions have been raised by some about how misstatements in disclosures are taken into account when evaluating whether the financial statements are free of material misstatement, and whether such misstatements are given the same weighting compared with misstatements related to account balances and classes of transactions.
86. Determining whether a misstatement in a disclosure is a material misstatement is relatively easy to determine for some disclosures, as they are directly derived for a line item on the face of the financial statements which provides a suitable reference point. For example, an error in disclosing the correct discount rate used can be evaluated by determining the effect the misstated discount rate would have on the line item. Equally, where a disclosure contains the fair value of a line item shown on the face of the financial statements on an amortized cost basis, the auditor can recalculate key ratios using the fair value.
87. However, it is not entirely clear how misstatements in relation to some disclosures should be evaluated, particularly when they relate to more qualitative or subjective judgments. For example, at what point does a narrative description become so biased that it would affect a decision of a user based on the financial statements as a whole?
88. In addition, for quantitative misstatements of account balances and classes of transactions, the auditor considers whether a misstatement individually, or in aggregate with other misstatements, materially misstates the financial statements. The effect of aggregation can be determined by analyzing the effect that all identified misstatements would have on, for example, net assets, profit before taxes, or other important ratios. It is less clear, however, whether misstatements in disclosures can be accumulated in the same way that other misstatements are, and whether this might differ for the different types of disclosures. For these types of disclosures, it may be easier to consider the effect of the misstatements on the fair presentation of the financial statements as a whole.
89. Usually, in accordance with ISA 450, misstatements are evaluated by considering the size and nature of the misstatements and the circumstances of their occurrence together with the effect of uncorrected misstatements from prior periods.⁴⁶ This is often focused on determining if the misstatements affect key ratios, earnings targets or contractual covenants. However, in the case of qualitative misstatements this is not an appropriate focus as they have no effect on ratios, targets or covenants. ISAs provide some further guidance and suggest the circumstances that may affect the consideration of a misstatement, including disclosure misstatements. However, the important test of reviewing ratios, targets and covenants is still not relevant and these other considerations may not be sufficient to give the auditor a sound basis to evaluate qualitative misstatements. There may be advantage in

⁴⁶ See Appendix A for a further summary of how ISAs treat disclosure misstatements.

developing further guidance on the types of factors that auditors might take into account when evaluating qualitative disclosures, and determining the impact of an omission or other misstatement of that disclosure. This is not a uniquely “audit issue,” as such guidance would also have relevance to preparers in providing a frame of reference on how to prepare disclosures. Accounting standard setters working on disclosure frameworks will be grappling with similar issues.

The Meaning of “True and Fair” or “Presents Fairly” in the Context of Disclosures

90. Another aspect of the identification of possible misstatements which may be particularly relevant is whether the financial statements achieve fair presentation, particularly in judging possible omissions. Many financial reporting frameworks feature a requirement for financial statements to be “true and fair” or “present fairly.”⁴⁷ The concept of “presents fairly” implies a need for the financial statements to do more than just comply with a checklist of accounting requirements and disclosures, but rather aim for overall transparency of the financial position, performance and cash flows of the entity. ISA 200 defines a fair presentation framework to be one that:

...requires compliance with the requirements of the framework and: (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

91. In essence, the concerns about fair presentation show two different perspectives: those that are concerned that “presents fairly” only means compliance with the financial reporting framework and those that are concerned about the fair presentation and understandability of the financial statements as a whole.

92. The recent European Commission Green Paper illustrates the first perspective:

Current practice would seem to indicate that the “reasonable assurance” referred to above is less targeted at ensuring that the financial statements give a true and fair view and more geared to ensuring that the financial statements are prepared in accordance with the applicable financial reporting framework.⁴⁸

93. The second perspective has been expressed by some regulators such as the U.K. FSA and FRC, for example:

In some areas, the accounting standards may not specify disclosures and in such circumstances the auditor needs to evaluate whether additional disclosures may be necessary to give a true and fair view. This means it is necessary for the auditor to challenge management’s accounting estimates and the appropriateness of their disclosures.⁴⁹

⁴⁷ From here on, the term “presents fairly” will be used to cover both “true and fair” and “presents fairly.”

⁴⁸ European Commission, *Audit Policy: Lessons from the Crisis*, p. 6

⁴⁹ Financial Services Authority and Financial Reporting Council, Discussion Paper 10/3, *Enhancing the Auditor’s Contribution to Prudential Regulation*, paragraph 3.13

We suspect some firms may believe it is rarely necessary to provide disclosures that go beyond the specific detailed disclosure requirements.⁵⁰

Although it is ultimately management’s responsibility to provide appropriate disclosures for their entity, it is the auditor’s responsibility to challenge management when it believes the disclosures are inappropriate. Therefore, the preparers and auditors of financial statements need to ‘stand back’ and ask themselves whether the financial statements contain all the information needed. Only if management and auditors play their role to the full can we be confident about the quality of the disclosures provided.⁵¹

94. A further aspect of “presents fairly” is about the broader issues of understandability, prominence and presentation of key disclosures in the context of the financial statements as a whole. Some would like auditors to give greater focus to the understandability of the financial statements which may include the extent to which they “tell the story” of the entity’s financial position, performance and cash flows.
95. One possible factor in assessing “presents fairly” is the prominence of key disclosures. It may be argued by some that key disclosures should be easy to find and early in the notes to the financial statements, rather than towards the back of the financial statements. To a degree, this may be already happening in practice as often happens, for example, with going concern disclosures that are usually given prominence at the start of the notes to the financial statements.
96. ISA 700, paragraph 13(e) states that “the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.” Also, ISA 450⁵², paragraph A16 states:

The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement...Is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users’ understanding of the financial position, financial performance or cash flows of the entity.
97. A key question to be explored is whether expectations in this regard can be reasonably met, recognizing that the adequacy of the disclosures is likely to be judged in hindsight once events have unfolded.

⁵⁰ Financial Services Authority and Financial Reporting Council, Discussion Paper 10/3, *Enhancing the Auditor’s Contribution to Prudential Regulation*, paragraph 3.23

⁵¹ Financial Services Authority and Financial Reporting Council, Discussion Paper 10/3, *Enhancing the Auditor’s Contribution to Prudential Regulation*, paragraph 3.25

⁵² ISA 450, *Evaluation of Misstatements Identified During the Audit* paragraph

Consultation Questions

12. Do you believe that some material line items from the face of the financial statements can have immaterial disclosures which are able to be removed to enhance the understandability of the financial statements? Please provide examples and your reasoning for why they are immaterial in the context.
13. In light of the discussion in paragraphs 77–84, what is the appropriate way of applying materiality? Do you believe there is sufficient guidance in the ISAs?
14. What do you believe represents a material misstatement of a disclosure? Please describe what you believe a material misstatement would look like for the following categories of disclosure:
 - Significant accounting policies;
 - Components of line items;
 - Factual information about the entity;
 - Judgments and reasons;
 - Assumptions/models/inputs;
 - Sources of estimation uncertainty/sensitivity analysis disclosures;
 - Descriptions of internal processes;
 - Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and
 - Objective-based disclosure requirements.
15. What are the characteristics of understandability that an auditor might consider?
16. How should an auditor approach the evaluation of both qualitative and quantitative misstatements in forming an opinion?
17. Given the difficulties in assessing fair presentation mentioned in paragraphs 91–98, how could judgments in respect of fair presentation be scrutinized in a consistent and rigorous manner?
18. Are there any additional comments you would like to make on the topic of materiality and misstatements for disclosures?

Questions About Auditability

98. The IAASB is aware of two perspectives on what is meant by auditability. The first perspective is that information may be unauditably if there are no procedures that an auditor can reasonably apply to reduce the risk of material misstatement. This might be because the criteria are inadequate, the supporting evidence is lacking or some other reason.
99. The second perspective is that information is unauditably where the information is so imprecise that an auditor cannot increase the credibility of the information. For example,

a required disclosure may relate to a purely subjective judgment such that the auditor has no criteria to challenge management’s judgment.

100. The IASB’s concept of verifiability was discussed earlier in this paper, though it is useful to contrast this with auditability. The IASB Conceptual Framework describes the relationship between verifiability and disclosures in the following manner.⁵³

It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

101. Therefore, it is clear that information which may not be “verifiable” should have increased disclosures, that is, that disclosures are an output of the process. This can be contrasted with both of the perspectives on “auditability” which are concerned with the auditability of the disclosure itself.
102. Central to the question of auditability of disclosures is the question of management’s supporting evidence for their disclosures. If management has appropriate supporting evidence for their judgments and decisions, then it is likely that the disclosure should be capable of being audited. As such, a key question in relation to auditability of disclosures is to extent to which management has documented appropriate supporting evidence.
103. A further challenge with respect to auditability is the question of whether the audit process can reduce measurement uncertainty of an inherently uncertain financial statement amount. Under IFRS, disclosures are often more extensive when measurement uncertainty is high, and it is difficult to see how the audit process could lead to the reduction of measurement.
104. As mentioned earlier, this DP is based on the premise that all disclosures are auditable, and the main question is what constitutes sufficient, appropriate audit evidence. However, there are perceptions that not all disclosures required by financial reporting frameworks may be auditable. In particular, these concerns relate to two areas: can users rely on these disclosures in the same manner as for line items on the face of the financial statements and what does “audited” mean when dealing with subjective statements such as descriptions or sensitivity analyses?
105. Some believe that some categories of disclosures are so difficult to audit that there may be an expectations gap between what the auditor can actually achieve, what users of financial statements believe auditors do in a financial statement audit, and, as noted earlier in the paper, the description in the auditor’s report. For these people, it is more appropriate that some disclosures are excluded from the auditor’s mandate.
106. Others have a different view, pointing out that auditors have managed to find agreement on consistent and appropriate ways of auditing challenging subject matters previously. For example, prior to the full integration of fair value information in financial reporting, some argued that fair values were not capable of being audited, particularly those fair

⁵³ IASB, *Conceptual Framework for Financial Reporting*, QC 28

values that were based on unobservable inputs. The holders of this view believe that auditing should continue to evolve with the financial reporting framework by finding agreement on the composition of SAAE in respect of these types of disclosures.

107. Some of these perceptions are specific to certain jurisdictions. For example, pro forma disclosures on business combinations are scoped out of the audit mandate in Japan, because, although they are presented in the notes of the financial statements, they present events that have not occurred and it is thought that sufficient appropriate audit evidence cannot be obtained. In other jurisdictions, such information⁵⁴ is considered to be within the scope of the financial statement audit and covered by the auditor's opinion on the financial statements. In those jurisdictions, it is argued that, although the pro forma information is of a different nature than other information in the financial statements, it is compiled from historical information and the fact that it is "pro forma" information and the basis for its compilation can be fully described in the note. Another example is the U.S., where it is preferred that forward-looking statements are placed outside of the financial statements, where they can then be subject to "safe harbor" provisions. Other examples of disclosures that some argue are not capable of being "audited" are models such as Value at Risk and disclosures of judgments. The IASB Basis for Conclusions on IFRS 7 acknowledges that there was significant concern expressed by respondents about the difficulties and costs in auditing the risk disclosures required by that standard. The IASB noted:

Respondents raised concerns that the disclosures of sensitivity analysis in particular should not be part of the financial statements. Respondents stated that sensitivity analysis cannot be prepared with the degree of reliability expected of information in the financial statements, and that the subjectivity in the sensitivity analysis and the hypothetical alternative values could undermine the credibility of the fair values recognized in the financial statements.⁵⁵

108. As discussed above, the recent publication of the Conceptual Framework includes "verifiability" as one of the enhancing qualitative characteristics of financial information. Verifiability "means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement that a particular depiction is a faithful representation."⁵⁶ This enhancing characteristic acknowledges⁵⁷ that some explanations and forward-looking financial information may not be verifiable, and, therefore, further disclosure of the assumptions, methods of compiling the information and other facts and circumstances would be needed to help users decide if they wish to use the information. Thus, it is the complete story told by the line item and related disclosure that is being audited, including the portrayal of the inherent measurement uncertainty. Clarity on the auditor's focus and basis for judging what constitutes SAAE in this context would, perhaps, help reconcile the two views.

⁵⁴ IFRS 3 *Business Combinations*, paragraph B64(q)(ii)

⁵⁵ IFRS 7, *Basis for Conclusions*, paragraph BC.44

⁵⁶ IASB, *Conceptual Framework for Financial Reporting*, QC 26

⁵⁷ IASB, *Conceptual Framework for Financial Reporting*, QC 28

109. The IAASB notes that “verifiability” is not necessarily the same as auditability, yet the recognition that not all disclosures are verifiable creates uncertainty about what auditors are presently doing with such disclosures and the appropriate response to unverifiable information.

Consultation Questions

19. This paper has explored auditability and the concept of sufficient appropriate audit evidence. In light of that discussion, are there disclosures that you believe cannot be audited? Please explain your reasoning and provide examples.
20. If some disclosures required by the financial reporting framework are unaudited, what are the implications for the auditor’s report and the presentation of the financial statements?
21. What other disclosure issues do you believe should be brought to the IAASB’s attention?

Appendix A

Pertinent IAASB Requirements and Guidance on Disclosures

This appendix is a brief summary of the pertinent ISA requirements and guidance that are relevant to this DP. It does not include all requirements and guidance on the topic of disclosures, nor is reading this a substitute for reading the ISAs.

ISA Requirements and Guidance

ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

1. ISA 200 includes the definition of a fair presentation framework, which may acknowledge explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework (paragraph 13(a)(i)).
2. ISA 200 also includes the definitions of:
 - Misstatement, which puts the misstatement of a disclosure on equal footing with the misstatement of an amount, classification, or presentation (paragraph 13(i)); and
 - Inherent and control risks, which put the risk/susceptibility of misstatement of an assertion about a disclosure on equal footing with the risk/susceptibility of misstatement of an assertion about a class of transaction or account balance (paragraph 13(n)). It does this also in discussing inherent risk in paragraph A38.

ISA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

3. Paragraph 25 places the same obligation on an auditor to identify the risk of material misstatement in disclosures as with classes of transactions and account balances:

The auditor shall identify and assess the risks of material misstatement at:

- (a) the financial statement level; and (Ref: Para. A105–A108)
- (b) the assertion level for classes of transactions, account balances, and disclosures, (Ref: Para. A109–A113)

to provide a basis for designing and performing further audit procedures.

4. Paragraph A111 deals with the use of assertions and notes that assertions cover the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures. Paragraph A111 offers a way of categorizing assertions and includes:

- (c) *Assertions about presentation and disclosure:*

Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.

Completeness—all disclosures that should have been included in the financial statements have been included.

Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.

Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

ISA 320, Materiality in Planning and Performing an Audit

5. Paragraph A10 gives the following examples of factors that may indicate the existence of one or more particular classes of transactions, account balances or disclosures 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:
- Whether law, regulation or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, and the remuneration of management and those charged with governance).
 - The key disclosures in relation to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company).
 - Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, a newly acquired business).

ISA 450, Evaluation of Misstatements Identified during the Audit

6. Paragraph A1 specifies an omission of an amount or disclosure as one of four circumstances that may result in misstatements.
7. Paragraph A15 notes that determining whether a classification misstatement is material involves the evaluation of qualitative considerations
8. Paragraph A16 includes, as one example of circumstances that may affect the evaluation of a misstatement, the extent to which it is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users' understanding of the financial position, financial performance or cash flows of the entity.

ISA 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, And Related Disclosures

9. As its name implies, in this ISAs disclosures are treated quite explicitly throughout. This is demonstrated by the objective (paragraph 6), which is to obtain sufficient appropriate audit evidence about whether:
- (a) *accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and*
 - (b) *related disclosures in the financial statements are adequate, in the context of the applicable financial reporting framework.*

10. As well as being integrated into other sections, there are two requirements specifically aimed at disclosures:
 19. *The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework.*
 20. *For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable*

ISA 550, *Related Parties*

11. ISA 550 feature many requirements and application paragraphs regarding disclosures. For example, the objective⁵⁸ includes:

The objectives of the auditor are...

- (b) ...where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.
12. Further, the standard establishes requirements for the audit of related party disclosures throughout the standard such as:
 - Paragraph 23 “...the auditor shall...inspect the underlying contracts or agreements, if any, and evaluate whether ...the transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.”
 - Paragraph A46 “Evaluating the related party disclosures in the context of the disclosure requirements of the applicable financial reporting framework means considering whether the facts and circumstances of the entity’s related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if: (a) The business rationale and the effects of the transactions on the financial statements are unclear or misstated; or (b) Key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.”
13. The ISA also includes a specific requirement in paragraph 24 for the auditor to obtain sufficient appropriate audit evidence about any assertion made by management in the financial statements to the fact that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction. The related application material discusses the type of support management may have for the assertion, the types of procedures that might be performed, and the practical difficulties that may limit the auditor’s ability to obtain sufficient appropriate audit evidence.

⁵⁸ See, also, paragraph 25.

ISA 700, Forming and Opinion and Reporting on Financial Statements

14. ISA 700 includes the same definition of a fair presentation framework as does ISA 200. As noted above, a fair presentation framework under this definition may acknowledge explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework (paragraph 7). This is picked up in paragraphs 13(e) and 14, which build upon ISA 330 paragraph 24, and require the auditor to evaluate whether the financial statements provide adequate disclosure (paragraph 13(e)) and to consider the overall presentation and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation (paragraph 14).
15. ISA 700 also includes material regarding disclosures for special cases where the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation without additional disclosure, and even then may not achieve fair presentation (paragraphs 7, 18 and A11)
16. Paragraph 31 requires the audit report to state that an audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.

ISA 705, Modifications to the Opinion in the Independent Auditor's Report

17. In setting requirements for the form and content of the auditor's report when the opinion is modified, ISA 705 reminds the auditor that according to ISA 450 a material misstatement of the financial statements may arise in relation to the appropriateness or adequacy of disclosures (paragraph A3(c)), and provides the following guidance about situations in which the inappropriateness or inadequacy of disclosures may result in a material misstatements:
 - The financial statements do not include all of the disclosures required by the applicable financial reporting framework;
 - The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or
 - The financial statements do not provide the disclosures necessary to achieve fair presentation.
 - Paragraph 19(c) requires the auditor's report to include the omitted disclosures unless prohibited by law or regulation, and provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

Proposed Guidance contained in Proposed IAPS 1000, *Special Considerations in Auditing Complex Financial Instruments*

Proposed IAPS 1000 was issued for comment in October 2010, with comments requested by February 11, 2011. Even though the proposed IAPS has not been issued, it is illustrative on how disclosures may be approached by an auditor in the context of complex financial instruments.

The IAASB is proposing changes to the Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance, and Related Service (the Preface) at the same time as proposed IAPS 1000. It is proposed that the Preface state at paragraph 22:

International Auditing Practice Statements (IAPSs) are issued to provide ~~interpretive guidance and~~ practical assistance to ~~auditors professional accountants~~ in implementing ISAs and to promote good practice. IAPSs do not impose additional requirements on auditors beyond those included in the ISAs, nor do they change the auditor's responsibility to comply with the requirements of all ISAs relevant to the audit. Auditors should determine whether any IAPS is relevant to the circumstances of the audit and, if so, obtain an understanding of its content.

1. Proposed IAPS 1000 notes that financial instrument disclosures are intended to enable users of the financial statements to make meaningful assessments of the effects of the entity's financial instrument activities, including the risks and uncertainties associated with these complex financial instruments. Accordingly, disclosures are of equal importance to the amounts recorded in the financial statements relating to financial instrument activities (paragraph 105).
2. Guidance is given on the following areas (paragraph 107):
 - The financial risks and exposures inherent in complex financial instruments cannot always be effectively captured in a balance sheet and profit and loss account.
 - The information required to do this may come from systems outside traditional financial reporting systems, such as risk data.
 - Consideration as to whether the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved and, accordingly, the financial statements may not achieve fair presentation.
 - Whether the disclosures are complete and understandable, for example, all relevant information may be included in the financial statements (or accompanying reports) but it may be insufficiently drawn together to enable users of the financial statements to obtain an understanding of the position or there may not be enough qualitative disclosure to give context to the amounts recorded in the financial statements.

Appendix B

List of Key References

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