THE EVOLVING NATURE OF FINANCIAL REPORTING: DISCLOSURE AND ITS AUDIT IMPLICATIONS

A discussion paper issued for comment by the International Auditing and Assurance Standards Board

Comments from ACCA
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Executive Summary

ACCA welcomes the opportunity to respond to the discussion paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* issued by the International Auditing and Assurance Standards Board (IAASB). The paper is intended to inform decisions about whether and to what extent additional standards or guidance are needed.

This is an excellent paper that lays bare the potential difficulties arising from the increase in length and complexity of financial statements disclosures and the move towards providing information traditionally seen as outside the boundaries of financial statements.

The paper calls for views from four primary viewpoints (preparers, users, regulators and auditors). By virtue of ACCA's diverse membership and our role as regulators of auditors, our response addresses all these perspectives.

For disclosures, we are generally content with the requirements and guidance for auditors in the existing International Standards on Auditing. Nevertheless, we identify an opportunity for the IAASB to provide information to diminish any gap that arises between user expectation of auditors and what auditors actually do in relation to disclosures.

We also refer to our earlier published research and position papers and reiterate our view that audit needs to be broadened in scope so auditors can better meet legitimate user needs.

General Comments

In this section of our response, we make general comments on the material in the discussion paper.

ACCA welcomes the opportunity to respond to the discussion paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* (the paper) issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). While the issues are more obviously relevant to companies and auditors concerned with the voluminous annual reports now seen on major capital markets, there are, nevertheless, impacts that affect smaller entities.

The discussion paper is thorough in its analysis and has itself done a good job presenting the issues relevant to disclosure. Naturally the IAASB focuses on the role of the auditor but we would caution that disclosure is primarily a matter for preparers and those responsible for determining the applicable financial reporting framework.

The paper correctly identifies significant trends: the 'modernisation' of disclosures in the financial statements, and user interest in disclosures that are arguably not part of the financial statements (or at least that they are not addressed by the financial reporting framework). The overarching question is whether such disclosures are understood by users without an expectation gap? Similarly, is there an appropriate user understanding of the limits of assurance when the subject matter is narrative and unrelated to traditional financial disclosures?

There is clearly value in auditors fulfilling user expectations in relation to disclosures, but that need not take place wholly within their traditional audit mandate as significant aspects could also form the subject matter of related engagements. In our January 2010 policy paper *Audit Policy: Lessons from the Crisis* we said:

> *'Audit needs to be broadened in scope – as well as reporting on historic financial statements, auditors can meet stakeholders' needs better by incorporating into the audit assurance on risk management and*

> *governance arrangements. They should also report on the assumptions underlying the business model as to whether these seem reasonable or optimistic. If the scope of audit is to be expanded, and if auditors are to be given significant new responsibilities, then it is reasonable for law-makers to address the issue of the exposure of auditors to liability.'*

User understanding of the limits of assurance can be related to the concept of reasonable assurance. As the International Standards on Auditing (ISAs) themselves explain, the limitations on an audit are not uniform. Paragraph A51 of ISA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* begins:

> *'In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:*
> *Fraud, particularly fraud involving senior management or collusion. See ISA 240 for further discussion . . . '*

This mechanism to inform users (or at least those users who refer to the standards) could usefully extend to the disclosures for which difficulties are discussed in the paper. Corresponding communication by financial reporting standard setters would also be relevant to developing an appropriate user understanding.

In the next section of this response, we answer the specific questions posed in the exposure draft. The paper calls for views from four primary viewpoints (preparers, users, auditors and regulators). By virtue of ACCA's diverse membership and our role as regulators of auditors, our response addresses all these perspectives.

Should the IAASB have any questions about our response, or require further information, please contact in the first instance:
David York, Head of Auditing Practice, at david.york@accaglobal.com

Matters on which Specific Questions are Asked

In this section of our response we answer the questions posed in the discussion paper. The paper contains questions directed at four viewpoints but several of the questions are similar. As there are more questions for auditors than other viewpoints, we have structured our response primarily as answers to those. We provide cross-references and certain other discussion where necessary for the other viewpoints.

AUDITORS

Question A1
Have you had discussions with entities about whether some of their required disclosures might be considered immaterial? What factors did you take into account? Please explain what difficulties (if any) you have experienced.

Discussion is common concerning materiality, but mostly such discussion relates to the degree of analysis of a line item in the financial statements, the impact of uncorrected misstatements and so on. It is relatively rare for there to be disagreement about the inclusion of too many disclosures as the justification for disclosure is frequently the demands placed on the entity by the financial reporting framework.

It is very difficult for an auditor to challenge the inclusion of an immaterial disclosure because clearly, being immaterial, the disclosure can have no acknowledged impact on users. It is only collectively that the inclusion of immaterial disclosures might detract from the information content of the rest of the financial statements. However, for that effect to be itself judged material would require a considerable degree of proof on behalf of the auditor to persuade a client to make adjustments. For example, even if half the disclosures in a set of financial statements were unnecessary, would that necessarily affect users' ability to make appropriate decisions on the basis of the information conveyed? Anecdotally, the impact of such an occurrence would only be to raise user questions as to why all the unimportant disclosures had been included.

We have not encountered any modified audit opinion criticising the financial statements because too many immaterial disclosures have been made. This is not to say that, theoretically, such a circumstance could not occur but in practice the auditor would hope to resolve any potential issues through discussion with the entity.

While it is more likely that a public interest entity will find itself encouraged to make numerous disclosures, there is also an appetite in such entities to achieve balance and clarity in the financial statements. In the SME environment, the management mindset is to prefer minimal disclosures and, given the less complex SME financial reporting framework, auditors are much less likely to encounter obfuscation of the view given by the financial statements due to the level of extraneous detail presented.

Question A2
How do you approach the identification and assessment of the risks of material misstatement in disclosures?

Where the disclosure relates to a line item in the financial statements, the identification and assessment of risk will often be carried out in relation to the line item.

Where the disclosure is not related to a line item, the approach will vary depending on the nature of the disclosure and we are aware of differences in the way auditors carry out this aspect of their work. Audit methodologies may make use of standardised approaches to common circumstances but inevitably professional judgement is necessary to interpret such constraints and adapt to less usual circumstances.

Where disclosures depend on the outputs of related systems the auditor will face a choice between a direct approach and one that relies on assessing and perhaps testing the system. Auditors also have to consider the extent to which overall factors, perhaps relevant to financial systems, are applicable to non-financial systems or processes that may occur on a non-routine basis.

Question A3

Are there ISA requirements that, in your experience, pose practical challenges in respect of disclosures? Please explain your answer.

We do not believe that ISA requirements pose practical challenges in respect of disclosures. The audit of disclosure is in several ways different from the audit of line items (and closely related matters) but, even where such differences might be regarded as challenges, that is not related back to any cause in the ISAs.

Question A4

Have you encountered situations where you experienced difficulty in obtaining sufficient appropriate audit evidence for a disclosure, even though management believed it had appropriate supporting evidence for the disclosure? If management's consideration of a disclosure can be appropriately supported by evidence and documentation, are there factors that could nevertheless make a disclosure unauditable? If management has not provided evidence and documentation in support of a disclosure, do you believe you are able nevertheless to obtain SAAE on the disclosure? Please explain your answer.

Auditors necessarily exercise considerable professional scepticism and may on occasion demand more evidence than anticipated by management. If further evidence is available this issue is quickly resolved. There may on occasion be issues of cost, timing or physical circumstance preventing sufficient evidence from being obtained. Depending on the nature of a proposed disclosure this night result in the auditor suggesting to management that it would be inappropriate to include the disclosure in the financial statements.

For some proposed disclosures, there will not be sufficient evidence to justify their inclusion in the financial statements. Some such disclosures may be better made in accompanying information but some would not be suitable for that. The auditor would seek to resolve all such issues with the preparer. One possible resolution is for the information to be issued but for it to be clearly labelled as unaudited. Even then, the auditor would be careful to ensure that their name is not associated with misleading information.

Question A5
What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

The discussion paper analyses the examples it provides and in general we agree with that analysis. Paragraphs 60 of the analysis refers to the requirement in ISA 501 *Audit evidence – Specific Considerations for Selected Items* concerning segment information. The application material (paragraph A26) recognises the difficulty of doing more on segments because they are smaller than the turnover disclosed and similar thinking, albeit not embodied in application material elsewhere, is undertaken by auditors in relation to many disclosures.

Question A6
Some disclosures include the fair value of a financial statement line item measured on another basis, such as historical cost. In this circumstance, what level of effort do you believe should be applied to the fair value disclosure? Should your effort be the same as if the fair value was on the face of the financial statements?

There is a general perception that the inclusion of a matter as a line item signals a higher significant than if it were a disclosure. This is primarily because any change in the value of a line item will ordinarily affect the results or financial position of the reporting entity. Any misstatement in a noted disclosure on another valuation basis would affect user perceptions but would only be as significant if a considerable body of users invariably use the data in their own calculations concerning the financial circumstances of the reporting entity. Having said that, the effort undertaken by the auditor on a fair valuation is likely to be similar whether that valuation is presented as a line-item or in a noted disclosure.

Question A7

What is your expectation regarding the need for disclosures not specifically required by the financial reporting framework, but which some users may believe are relevant to the fair presentation of the financial statements? Examples may include non-compliance with a critical law, even though there is no quantitatively material effect, or the fact that the entity does not have a material holding of a particular asset class, such as sovereign debt, which may be of particular interest in the current economic environment.

Compliance with law and with relevant financial reporting standards will generally achieve a fair presentation but what is a fair presentation will change over time and additional disclosures may be necessary to reach a fair presentation.

Sometimes the need for a new disclosure is identified widely, for example by the regulator, or a standard setter's urgent issues mechanism, or by the occurrence of a highly significant event such as the global credit crisis or a natural disaster. In such cases, preparers and auditors may reach consensus over materiality in a relatively easy fashion. Other circumstances, (the question refers to sovereign debt) may be of limited general, but considerable specific, user interest. Preparers and auditors have to remain alert and sensitive to such issues. There is perhaps a role for standard setters to issue a general or specific industry advisory publication, as has occurred to some extent over the going concern question following the credit crisis.

Question A8
In light of the discussion in paragraphs 79–87, what do you believe is the appropriate way of applying materiality to disclosures? Do you believe there is sufficient guidance in the ISAs?

We believe that there is an appropriate way of applying materiality to disclosures but, because of the diversity of disclosures, it is not easy to generalise other than to say that applied materiality is the preparer's and auditor's anticipation of what will be material to users in the particular circumstances.

To a large extent, in financial reporting, the standard setter acts as the representative of stakeholders in determining what, in general, is material. However, as materiality must be determined individually for each report of an entity, the requirements of standards can only act as a persuasive indication rather than an absolute rule.

For auditors, the paper rightly points out the need to consider how materiality determines the audit work in relation to particular matters. As we explained in our general comments earlier in this response, an expectation gap may arise because auditors need to use a general level of materiality when carrying out testing of account balances and transaction flows but, for certain disclosures, users may anticipate a more precise approach.

In general, we believe that the ISAs provide sufficient guidance for auditors. In the main, ISAs leave the detailed methodology of the audit to the professional judgement of the auditor concerned and we would be reluctant to see more prescription unless there was good evidence of actual need. However, earlier in this response we suggest that any expectation gap could be narrowed by including in ISAs information to provide users with a further explanation concerning the limitations of the audit.

Question A9
What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosure:
- *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.*

Any material misstatement of a disclosure has necessarily to be material in the context of a financial statement as a whole. When the disclosure is related directly or indirectly to a financial statement line item, that linkage can be utilised to gauge the significance of the disclosure to users and the potential impact of the misstatement. Where there is no such linkage, the auditor must necessarily depend on professional judgement as to whether the misstatement would be material to users either in isolation or in conjunction with other misstatements (both qualitative and quantitative).

Because of the foregoing, we are unable to provide concrete examples of what would constitute a material misstatement for the above categories of disclosure.

In general, misstatements that are likely to be significant would have some of the following characteristics:
- incorrect information disclosed (this is a wide category and includes not only factual errors but, for example, choosing a particular model to use and report when it is not the most appropriate model)
- unreliable information, such as might arise from immature systems, reported with confidence
- imprecise information conveyed as certain
- disclosure exhibits management bias (eg reporting only the good news)
- disclosure contradicts information elsewhere in the financial statements
- important disclosure omitted
- presenting disclosures without also presenting linked disclosures necessary for a complete understanding

Question A10
Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute sufficient appropriate audit evidence for such a disclosure? What do you believe would constitute a misstatement of such a disclosure?

We would expect to develop an understanding of the disclosure, assess the risk of material misstatement and appropriately test the occurrence of matters disclosed, including the controls put in place to mitigate risk. We would not test the effectiveness of a control but would remain alert to, for example, indications of its failure.

A misstatement of such a disclosure would involve a significant factual inaccuracy that altered the user's view of the adequacy of policies and procedures.

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?

We would expect to develop an understanding of the stress test disclosure, assess the risk of material misstatement and appropriately test the occurrence of matters disclosed. We would not, ordinarily, assess the effectiveness of the process or the validity of its outcome; we would, however, remain alert for any indications of problems in that regard.

A misstatement of a stress testing disclosure would involve reporting that testing took place when it did not and vice versa. We also believe that a disclosure would be misstated if adequate stress testing was portrayed as inadequate and vice versa.

Please also see our answer to question I6.

Question A11
How do you evaluate both qualitative and quantitative misstatements in forming an opinion on the financial statements as a whole? Is it possible to accumulate misstatements of disclosures, particularly when they relate to of this response qualitative or judgmental disclosures? How do prior years' disclosure misstatements affect the evaluation of the current year's financial statements?

If misstatements identified during the audit remain uncorrected, ISA 450 *Evaluation of Misstatements Identified during the Audit* (ISA 450) requires the auditor to evaluate their effect, if any, on the financial statements.

For quantitative misstatements the methodologies are well developed and typically involve summing the effects of individual misstatements, including any identified relating to prior periods, to determine the collective impact on relevant significant classes of transactions, account balances or disclosures and the financial statements as a whole (for example the impact on the reported profit or loss).

Some disclosures that might be considered to be qualitative may be reduced to quantitative misstatements and nevertheless accumulated. For example, where the auditor disagrees with management judgements relating to a range of possible outcomes or there is a misclassification between line items.

While the requirements of ISA 450 apply equally to qualitative misstatements it is less easy, and we suspect less common, for them to be allocated to any relevant significant classes of transactions or account balances, and as a consequence, they are considered judgementally in isolation and collectively in relation to the financial statements overall.

Such an evaluation would pose considerable difficulties if many qualitative misstatements were identified, for example at component level in a group. By their nature, however, they reside in the financial statements themselves and are likely, therefore, to be few so that it is possible for one person, such as the engagement partner, to form an overall picture.

Question A12
What are the characteristics of disclosures that, in your view, would not be auditable?

Prima facie, a disclosure would not be auditable if there was insufficient audit evidence available. Disclosures where this may be a problem are generally those that are unrelated to line items in the financial statements; instead being qualitative statements, especially those referencing the future. It may be that, in some instances, evidence would be available if the auditor had almost unlimited resources but there may still be difficulties in finding suitable criteria against which to evaluate the disclosure.

If disclosures with these characteristics were nevertheless desired by users, a mechanism would have to be found to signal that they were not audited. Depending on their nature, such matters might be better presented outside the financial statements. Please also see our answer to question I8 in the investors section of this response.

Question A13
What criteria do you believe should be used to assess an auditor's judgment in respect of the fair presentation of the financial statements as a whole?

An auditor makes a judgement in respect of the fair presentation of the financial statements as a whole in the light of the knowledge obtained from the audit process, including the assessment of the audit evidence, to determine whether a material misstatement exists. In the absence of apparent material misstatement, there is nevertheless a need for the auditor to undertake a considered assessment of the financial statements as a whole to ensure that they accord with the intention of the financial reporting framework. This is an inherently difficult process for which a range of approaches exist depending not only on the particular methodology of an auditor but also on the size and complexity of the audited entity. The importance of this process is recognized in the ISAs through the inclusion of requirements in ISA 700 *Forming an Opinion and Reporting on Financial Statements* (ISA 700). Paragraph 13 of that standard sets out effectively a list of components of the process and hence these will be common to all appropriate methodologies.

The validity of the auditor's judgement will be assessed against criteria of whether the methodology is applied in compliance with ISA 700 and, more importantly, that other auditors would likely concur with the auditor's conclusion. Where an engagement quality control reviewer is concerned with the audit, that person's evaluation is required to involve review of the financial statements and proposed auditor's report (paragraph 20(b) of ISA 210 *Quality Control for an Audit of Financial Statements*). Thus the judgement of, say the engagement partner, is tested in this manner before the issue of the auditor's report.

Question A14
Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach their audits, including how they may approach disclosures. What is your view?

We believe that preparer and auditor perceptions of regulators, if not their actions, influence judgements about disclosures. This gives rise to a ‘safety first’ mentality that anticipates regulator challenge if certain disclosures are omitted. In our experience, it is highly unusual for a financial reporting regulator to challenge the inclusion of immaterial disclosures as, by their nature, such disclosures ordinarily do not have any adverse impact on users.

Where a financial reporting regulator does take action to make its views known, these will normally be highly influential in circumstances where preparers and auditors have to determine the right course of action in relation to a particular disclosure or issue.

PREPARERS

Question P1
What have been the most significant challenges you have experienced in preparing disclosures?

We do not offer examples from specific reporting entities. We note, however, the analysis in the paper concerning the increasing length and complexity of financial statement disclosures, in particular the categorisation of disclosures set out in paragraph 16. The categories progress from those where there are few challenges (for example, components of line items) to categories that pose much more difficulty because of the necessary degree of professional judgement (for example, objectives-based disclosure requirements). Practical challenges arise when requirements change, as it may be necessary to put in place policies and procedures in relation to a disclosure as well as considering, for the first time, the nature of the disclosure itself.

Question P2
Have you included a disclosure in your financial statements to comply with a specific disclosure requirement, even though you believed the disclosure was immaterial? What factors led you to this decision? What practical difficulties exist when deciding to omit a disclosure that you consider to be immaterial?

We do not offer examples from specific reporting entities. We agree, however, with the analysis in the paper of the reasons for including immaterial disclosures (paragraph 41). Where the financial statements are of a public interest entity we see evidence of a growing investor appetite for disclosure coupled with developments in the financial reporting framework that increase the quantum and complexity of disclosures. Although materiality must necessarily be specific to the reporting entity, the financial reporting standard setter to a large extent represents the collective views of stakeholders. This has resulted in reporting entities generally not feeling the need to test materiality decisions through stakeholder engagement (as would be normal for sustainability reporting). That is not to say that some such engagement does not take place, but there is generally no formal process. Accordingly, if a disclosure is required by an International Financial Reporting Standard (IFRS) there is pressure to assume it to be material in the context of the financial statement as a whole even though it may be individually immaterial in the specific circumstances.

Question P3
Have you experienced requests from auditors for evidence to support your disclosures that you find difficult to satisfy? If so, please explain the context.

Please see our answer to question A4.

Question P4
Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:
(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What evidence or support do you believe you need to have as a basis for the assertions you make in the financial statements on such disclosures?
(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). In preparing financial statements, what, in your view, would be sufficient evidence for you to support your stress test disclosure? What do you believe would constitute a misstatement of a stress test disclosure?

Please see our answer to question A10.

Question P5
What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosures:
- *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.*

Please see our answer to question A9.

INVESTORS

Question I1
In general, do you believe that the reliability of disclosures is at the same level as that of the line items on the face of the financial statements? Do you believe that different types of disclosures in audited financial statements can or should have different levels of reliability? Please explain your answer.

The auditor reports on the truth and fairness of the financial statements on an overall basis. We do not interpret this as meaning that all disclosures within those financial statements are reliable to the same degree. Some items are by their nature less precise and on these the auditor can only form a view on the acceptability of the disclosure within a range of possible values. Similar considerations apply to qualitative disclosures not related to financial statements line items.

The notes exist to provide further information relevant to an understanding of the primarily financial statements, and while the auditor would be expected to check their consistency, we accept that there may be insufficient work done to form a view on, for example the allocation between two different subcategories. Because an audit is carried out to a particular fee, it is not feasible to audit everything separately. We would nevertheless expect the auditor to perform sufficient procedures to be capable of concluding on certain matters that must necessarily be viewed in isolation because of their nature. For example, remuneration of, and transactions with, directors may indicate problems with the governance of the company, rather than being immediately relevant to the results and financial position.

Please also see our answer to question A6.

Question I2
In the particular circumstance when a financial statement line item is measured on one basis, such as amortized cost, but the disclosure includes the fair value of the line item, should the auditor's effort on the fair value disclosure be the same as if the fair value was on the face of the financial statements? Please explain your answer.

We would expect the auditor to exert more effort on the financial statement line item, on the basis that the noted disclosure is not equally important. However, we would not expect there to be too much difference between the effort applied to a fair value irrespective of whether it was a line or noted item.

Please also see our answer to question A6.

Question I3
Have you encountered a disclosure which you believe was immaterial, and could have been removed to enhance the understandability of the financial statements? Please provide examples and your reasoning for why you believed they were immaterial in the context.

Please see our answer to question A1.

Question I4
Do you believe that consistency in disclosures is important (either over time for the same entity, or between entities in the same industry), even if achieving this aim may result in extensive disclosures that may not, in the context of a particular entity, be material to that entity in the current period?

Yes; it is important to be able to form a view on the financial trajectory of a company and also its performance compared to its competitors. We accept that this might result in more disclosures than necessary in a particular company at a particular time, but we do not think that this is a significant factor compared to the general proliferation of disclosure requirements.

Question 15
Does the shift in the IASB Conceptual Framework away from reliability and towards faithful representation change what you expect of preparers and auditors? Please explain your answer.

Because their effect on financial statements is indirect, changes in the framework do not affect our expectations of preparers and auditors.

Question 16
Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute a misstatement of such a disclosure?

A misstatement of such a disclosure would nvolve a significant factual inaccuracy that altered the user's view of the adequacy of policies and procedures. We would not expect the auditor to check the effectiveness of a control merely because its existence is reported.

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect an auditor to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?

We note that the discussion paper suggests two views on what audit evidence is needed. The auditor must necessarily obtain evidence about the factual accuracy of the disclosure. We do not expect the auditor to carry out a formal assessment against suitable criteria as to whether the outputs of the testing are properly arrived at. However, neither would we expect the auditor to ignore such factors because otherwise there is a risk of being associated with misleading information. A company could commission assurance on the stress testing itself, if it felt that assurance was warranted.

A misstatement of a stress testing disclosure would involve reporting that testing took place when it did not and vice versa. We also believe that a disclosure would be misstated if adequate stress testing was portrayed as inadequate and vice versa. Degrees of veracity of disclosure are unlikely to affect a user's view as much.

Question I7
What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosures:
- *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.*

Please see our answer to question A9.

Question I8
If there were certain disclosures that were determined to be incapable of being audited, would you want them to be included in the financial statements and labelled "unaudited" or would you prefer that they be placed outside of the audited financial statements?

Either approach would be acceptable.

REGULATORS

ACCA regulates the conduct of its members and registered firms engaged in public practice. We do not address directly the matters that would be relevant to, for example a capital markets regulator concerned with the quality of financial statements.

Question R1
Have you encountered a disclosure which you believe was immaterial, and could have been removed to enhance the understandability of the financial statements? Please provide examples, your reasoning for why you believed they were immaterial in the context and why you believed they were not omitted.

Many financial statements with which our regulated firms and members become associated include disclosures that are individually immaterial but we would not ordinarily challenge their inclusion, especially for SMEs. In our experience disclosures required either by standard or law are invariably valuable even if just to confirm that they are nil in the circumstances.

Please also see our answer to question A1.

Question R2
Do you believe the ISAs provide sufficient requirements and guidance in respect of disclosures? Please explain your answer.

Yes; although difficulties encountered when supervising auditors do not ordinarily lend themselves to analysis back to any lack of requirements or guidance in ISAs in respect of disclosures. We would have regard to the financial statement reporting requirement (such as in an IFRS) when assessing members' or firms' behaviours.

Please also see our answer to question A8.

Question R3
What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

Please see our answer to question A5.

Question R4
Some disclosures include the fair value of a financial statement line item measured on another basis, such as historical cost. In this circumstance, what level of effort do you expect an auditor to apply on the fair value disclosure? Should the auditor's effort be the same as if the fair value was on the face of the financial statements?

Please see our answer to question A6.

Question R5
Does the shift in the IASB Conceptual Framework away from reliability and towards faithful representation change what you expect of preparers and auditors? Please explain your answer.

Please see our answer to question I5.

Question R6
What is your expectation regarding the need for disclosures not specifically required by the financial reporting framework, but which some users may believe are relevant to the fair presentation of the financial statements? Examples may include non-compliance with a critical law, even though there is no quantitatively material effect, or the fact that the entity does not have a material holding of a particular asset class, such as sovereign debt, which may be of particular interest in the current economic environment.

Please see our answer to question A7.

Question R7

What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosure:

- *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.*

Please see our answer to question A9.

Question R8

Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) *Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute sufficient appropriate audit evidence for such a disclosure? What do you believe would constitute a misstatement of such a disclosure?*

(b) *The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect an auditor to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?*

Please see our answer to question A10.

Question R9

Are there disclosures which, in your view, are not capable of being audited? Please explain your reasoning.

Please see our answer to question A12.

Question R10
What criteria do you believe should be used to assess an auditor's judgment in respect of the fair presentation of the financial statements as a whole?

Please see our answer to question A13.

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