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International Auditing and Assurance Standards Board
International Federation of Accountants
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Dear Board Members and Staff:

Grant Thornton International Ltd is pleased to have the opportunity to comment on the Discussion Paper, *The Evolving Nature of Financial Reporting Disclosure and Its Audit Implications*, approved for publication by the International Auditing and Assurance Standards Board (Board or IAASB). We appreciate the IAASB addressing this important subject and respectfully submit our comments and recommendations. Our responses to the Board's request for specific comments follow.

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.

We have frequent discussions with management and those charged with governance about disclosures in entities' financial statements, including whether certain disclosures are immaterial. In evaluating the materiality of disclosures, we consider factors such as:

- The requirements of the applicable financial reporting framework.
- The relevance of the information to the entities' current financial statements.
- The significance of the information in relation to financial statement accounts.
- The extent of subjectivity involved and how it may influence a user.
- Management's evaluation and reasoning, including any potential bias.
- Any duplication of information in other disclosures.

Some entities are reluctant to exclude immaterial disclosures, particularly when regulators have previously raised a question about the specific topic. Management often believes that there is a lower risk associated with including disclosures rather than excluding them. We believe that the risk of extraneous disclosures materially distorting the financial statements to be remote, and therefore, entities will favor retaining existing disclosures that may be considered immaterial.

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

Auditing standards require auditors to identify and assess the risks of material misstatement at the assertion level, which includes disclosures. In particular, the requirements in International Standard on Auditing (ISA) 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, assist the auditor in accomplishing this risk assessment. In our view, most disclosures pertain to the financial statement accounts and transactions addressed by the auditor's risk assessment and further audit procedures that are performed to address those risks.

In addition to these requirements, we consider, among many other factors, the entity's procedures for identifying and developing disclosures and the disclosures requirements related to new accounting pronouncements. We also utilize a disclosure checklist tool. Completion of this disclosure checklist is based on our understanding of the entity and its environment and the completion of other audit procedures. Our policies further require that more experienced personnel review the financial statements and related disclosures for completeness, as well as clarity of the disclosures. In accordance with professional standards, these individuals consider the overall presentation, structure, and content of the financial statements in achieving fair presentation. This involves considering whether the financial statements include the necessary disclosures based on their expectations and understanding of the material underlying transactions and events.

A3) Are there ISA requirements that, in your experience, pose practical challenges in respect of disclosures? Please explain your answer.

An area that can pose practical challenges with respect to disclosures is the concept of materiality. Auditors consider both quantitative and qualitative factors. The assessment of qualitative factors is now common, given the prevalence of objective based disclosure requirements, as discussed in paragraphs 29-33 of the Discussion Paper. For these types of disclosures, auditors need to judge whether the content disclosed materially omits or distorts information relevant to the objectives of the applicable financial reporting framework. Because auditors are required to make this judgment on disclosures individually and in the aggregate, auditors would benefit from additional guidance on this evaluation process, given the subjectivity, complexity, and importance of making these judgments.

Another challenge occurs when the applicable financial reporting framework does not establish documentation expectations with respect to disclosures for preparers. An absence of such expectations creates practical challenges in obtaining sufficient audit evidence. Preparers and auditors would benefit from improved clarity with respect to documentation requirements and expectations.

- 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 unauditably? 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.

There are instances where we have encountered difficulty in obtaining sufficient appropriate audit evidence regarding disclosures. These include, among others:

- Auditing management's plans and other factors to support its assertion that the entity is a going concern.
- Auditing business combinations, particularly the ability to obtain evidence about purchase price allocation.
- Auditing fair value measurements for estimates that have unobservable inputs and involve subjective judgments about methods and assumptions.
- Auditing accruals for legal matters or, more precisely, the lack of an accrual.

If management's consideration of a disclosure can be appropriately supported by evidence and documentation, we do not believe the disclosure would be unauditably. The key words in the question are "If...a disclosure can be appropriately supported..." Those words imply that the support would be appropriate for the auditor. Given this, the auditor should be able to obtain sufficient appropriate audit evidence. There may be situations where a decision is made to provide the information on an unaudited basis, however. For example, in the United States, companies will present quarterly financial information in their footnotes; however, this information is not presented as audited information. This information is auditable, but this form of presentation is used because there is no audit requirement. There may be other situations where the legal or regulatory environment requires disclosures to be included in the footnotes where the auditor cannot get sufficient appropriate audit evidence. This is because the evidence would not be available, criteria do not exist against which the auditor could assess the "fairness" of presentation, or the nature of the information is such that an audit opinion would not be appropriate. These examples, however, do not line up with the premise of the question.

There could also be situations where management has not provided evidence and documentation to support a disclosure where it would be possible for the auditor to obtain sufficient appropriate evidence. For example, in a situation of a legal matter, the auditor could obtain a letter from the entity's counsel that would be sufficient to support the disclosure, even though management did not have such information. Similarly, with respect to fair value, the auditor could obtain third party pricing information about a Level 3 investment that management had not obtained. However, if management does not have this information, we believe that it is inappropriate for the auditor to be the source of the entity's evidence and documentation for its disclosures.

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

These paragraphs are excellent examples that demonstrate the wide range of complexities that an auditor may encounter in practice. An auditor needs to understand the entity's internal controls for developing the information to prepare the necessary disclosures. In addition, the engagement partner must also have the personnel with the right experience level involved with the more complex disclosures as well as those disclosures that require a greater amount of critical thinking and professional judgment. Even with an appropriate high-level understanding, as the Discussion Paper indicates, auditors would benefit from increased clarity as to the nature and extent of the audit evidence needed for some disclosures, such as those that relate to the matters identified in our response to question A4.

- 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?

We believe that the effort to audit a fair value disclosure is the same as the effort to audit the fair value of a financial statement line item in the context of the auditor's procedures on the financial statements as a whole. In most cases, the procedures to audit the disclosure are intertwined with the procedures to audit the related financial statement line item based on the auditor's risk assessments.

- 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.

Management is responsible for the preparation and fair presentation of the financial statements, including the related disclosures. To fulfill this responsibility, management must consider whether additional disclosures would be necessary for a fair presentation, even when the applicable financial reporting framework does not require such disclosures. In addition, to meet the fair presentation objectives, management must determine whether matters that may be quantitatively immaterial are qualitatively material to users of the financial statements and therefore, require disclosure.

On the other hand, management should not be expected to provide disclosures about specific matters that do not even exist for the entity. Of course, management may decide to voluntarily provide such information. It should be noted, however, that management has means other than the financial statements to disclose particular matters, which may

provide more timely disclosure than that provided by the financial reporting process. These alternate means are frequently used in practice.

- 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?

Auditors would benefit from additional guidance on applying qualitative materiality to disclosures. We believe that this process involves determining whether the content disclosed materially omits or distorts information relevant to the objectives of the applicable financial reporting framework. Auditors would also benefit from additional guidance on determining whether individually immaterial omissions or distortions aggregate to a material misstatement.

- 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:

Our response to question A8 reflects our view as to what would represent a material misstatement of a disclosure. Omissions are self explanatory. Distortions would include lack of clarity, lack of understandability, presence of errors, and bias.

The following are examples of items that may constitute a material misstatement for the various categories presented and are not intended to be comprehensive. Also, each of these is premised on the fact that the misstatement would influence the economic decisions of users.

- **Judgments and reasons;**
Misstatements of facts; lack of understandability; comments which are not supported.
- **Assumptions/models/inputs;**
Misstatements of amounts, descriptions, or facts; biased amounts to achieve particular results.
- **Sources of estimation uncertainty/sensitivity analysis disclosures;**
Similar to the preceding item.
- **Descriptions of internal processes;**
Description of a process that cannot accomplish what is presented.

- Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and

Misstatements of amounts, descriptions, or facts; biased amounts to achieve particular results.

- Objective-based disclosure requirements.

Failure to provide additional disclosures when the specific disclosures required by an accounting standard do not provide users with sufficient information to understand the matter covered by the disclosure or its impact on the entity's financial position and performance.

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?

Determining what constitutes sufficient appropriate audit evidence is dependent on the specifics of the audited entity. However, among others, some procedures to perform or consider performing would be assessing the risk that such a disclosure could be materially misstated, obtaining documentation of the policies, procedures, and controls that are represented as being in place, reviewing the entity's tests that their processes and controls achieved the desired results, testing the controls, and determining whether the entity uses a specialist to assess the investment risks the entity might encounter. Our response to question A9 provides information on what may constitute a misstatement of this type of disclosure.

- (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 that the criteria for performing the stress tests would be established by regulators so that there is appropriate guidance for management and consistency among entities. If adopted, auditors would need to understand the objective of these disclosures and the criteria that was used to develop the disclosures. The specifics of this information would then be used to determine the specific procedures that would be performed. We believe that users would expect auditors to obtain, and therefore auditors should obtain, the evidence suggested in paragraph 66(b) versus only obtaining the evidence suggested in paragraph 66(a).

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 qualitative or judgmental disclosures? How do prior year's disclosure misstatements affect the evaluation of the current year's financial statements?

Quantitative misstatements are accumulated and considered in light of quantitative materiality thresholds that have been initially established. The qualitative aspects of these misstatements are also considered. Disclosure misstatements (including disclosures that are missing, or where the auditor believes the disclosures need revision) are also accumulated. In addition, the misstatements of disclosures from prior periods, if still relevant to the current period, are considered. This information is discussed with management and those charged with governance. Clearly, this is an area that involves qualitative considerations and significant judgment. Thus, the most experienced personnel on the engagement will review the misstatements and consider whether individually, or in the aggregate, revisions must be made to achieve fair presentation.

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

The nature of the item being disclosed, such as certain forward looking information or statements about related party transactions, may be such that evidence would not be available to support the entity's disclosure, if the disclosure is presented as factual. Also, criteria may not exist against which the auditor could assess the "fairness" of the presentation, or the nature of the information is such that an audit opinion would not be appropriate.

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?

The assessment of an auditor's judgment in respect of the fair presentation of the financial statements will depend on the specific facts of an engagement. Certain factors that we believe should be considered in such an assessment include whether the auditor complied with a high quality set of auditing and quality control standards and, in doing so, exercised appropriate due care and professional skepticism, whether the auditor considered appropriate facts, assumptions, and alternative views available at the time of the audit, and whether the auditor appropriately documented the judgments made and the basis for those judgments.

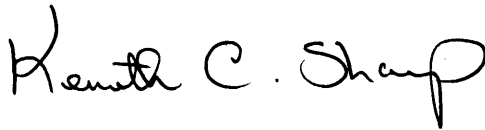
A14) Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach their audits, including how they may approach disclosures. What is your view?

We believe that financial reporting regulators, primarily audit regulators, influence how auditors approach their audits and how they approach auditing disclosures. Auditing

financial statements and the related disclosures requires the use of significant professional judgment. There are instances, however, where regulators, through regulatory inspections or otherwise, establish requirements that go beyond the requirements of the auditing standards and beyond what, in the auditor's professional judgment at the time of the audit, was necessary to obtain sufficient appropriate audit evidence. While independent regulatory oversight, including inspections, is critically important to continuously improving the quality of audits, greater guidance is needed to improve the assessment of auditor judgments.

We would be pleased to discuss our letter with you. Please contact me at (704) 632-6781 if you have any questions.

Sincerely,



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