



ICGN

International Corporate Governance Network

By web submission: www.iasb.org

James Gunn, Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

09 June 2011

Dear Mr. Gunn,

Re: The Evolving Nature of Financial reporting: Disclosure and Its Audit Implications

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of over 500 institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of U.S. \$12 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through its Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the Accounting and Auditing Practices Committee (A&A Practices Committee) is to address and comment on accounting and auditing practices from an international investor and shareowner perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world.
http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

Thank you for the opportunity to comment on the discussion paper (DP) on the Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications. We agree the discussion paper highlights the need for robust disclosures in a complex business and capital markets environment, which necessitates greater sophistication in how risk is managed. As global investors, the integrity of financial reporting in conjunction with disclosures is critical to obtaining needed information for our investments.

Under the International Standards on Auditing (ISAs), auditors are required to address disclosures in planning and performing the audit, management's assessment of internal controls, including identifying and assessing the risks of material misstatement at the assertion level for disclosures. Investors rely on the work of auditors in their assessment of whether financial statements are prepared in accordance with a fair presentation framework, and whether the financial statements, including the related notes, represent the underlying transactions and events in a

manner that achieves fair presentation. Recently, ICGN has responded to requests for comments regarding whether auditors need to use greater professional judgment and scepticism in their work. In a letter to the Financial Reporting Council (FRC) on 5 November 2010 ICGN supported the proposal that audit partners and audit staff should document how they demonstrated/applied professional scepticism; how they have challenged management's judgment and how the audit partner is satisfied that scepticism has been part of the attitude of the audit team's work.

ICGN believes 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 and ultimately with the Board of Directors. Board members have a fiduciary responsibility to their shareowners and are ultimately responsible for the fair presentation of financial statements which investors utilize to decide where to allocate their capital.

Issues regarding the auditing of disclosures are particularly relevant to entities that have complex operations or financing, regardless of their size. In keeping with the principles of good governance and sound business practices, we do not support exemptions for small and medium sized entities in following an established reporting framework. Two recent studies published in American Accounting Association journals provide explain the potential adverse implications of such exemptions. (see <http://aaahq.org/newsroom.cfm>, 12/2/10, "Exempting small firms from audit mandates may be mistake, 2 studies suggest")


ICGN maintains that relevant information to investors extends beyond the traditional boundaries of financial statements and support integrated reporting across a broader range of performance information. We value the very definite purpose of bringing together the financial statements with the key non-financial information. We hope that Management Commentary will gain prompt acceptance globally as we see great merit in its use as an anchor document for any integrated reporting framework. ICGN recommends that companies provide explanation of the link between financial and non-financial key performance indicators (KPIs) to a company's business model, strategy and performance. We support the current work of the International Integrated Reporting Council (IIRC) in developing this link and framework.

ICGN believes it is critical for the IAASB to work closely with accounting standard setters, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to ensure the auditability of information reported in accordance with accounting standards. We believe a closer relationship would benefit both accounting and auditing standards. We also recommend the relationship be strengthened through the IAASB's ongoing discussions with the Public Company Accounting Oversight Board (PCAOB) as well as the International Organization of Securities Commissions (IOSCO).


Our additional comments in response to the detailed questions for investors are in the attached appendix. Thank you for the opportunity to express our views on the evolving nature of financial reporting disclosures.

If you would like to discuss any of these points, please do not hesitate to contact Carl Rosen, our Executive Director, at +44 207 612 7098 or carl.rosen@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,



Christy Wood
Chairman of the ICGN Board of Governors



Lou Moret
Co-Chair, ICGN Accounting and
Auditing Practices Committee



Elizabeth Murrall
Co-Chair, ICGN Accounting and
Auditing Practices Committee

Cc: Martin Bauman, Chief Auditor and Director of Professional
Standards - PCAOB
ICGN Board Members
ICGN A&A Practices Committee

**Appendix -Consultation Questions for Investors:****Section II–Financial Reporting Disclosure Trends**

11) 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?

ICGN does not believe the reliability of disclosures is currently the same as that of line items on the face of the financial statements. We believe there are specific disclosures that should have the same degree of reliability and degree of audit assessment as line items.

12) 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 auditors' effort on the fair value disclosure be the same as if the fair value was on the face of the financial statements?

Users are also interested in knowing to what extent the alternative measure provides relevant and significant information. Where, for example, fair values are provided these need to be conveyed with the same degree of assurance as if they were in the primary statements. However, if market values are unreliable or unobtainable, the user needs to be so alerted to avoid undue significance being placed on them.

13) 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.

ICGN believes that some disclosures may become immaterial to the company when in the past they were material. We believe companies should be diligent in ensuring disclosures are still necessary and provide value to investors. However, we also do believe that there are certain disclosures, although immaterial are necessary to understand the overall approach of a transaction or the overall activity of an entity.

14) 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?

Consistency in disclosures is helpful in understanding the overall trends at a company as well as in making comparisons to peers or the industry overall. Though, disclosures need to be meaningful as opposed to simply ensuring consistency.

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.*

ICGN believes that reliability should have remained in the IASB's Conceptual Framework. Although we support faithful representation we are not convinced it provides investors the same amount of confidence as reliability.

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:*

(6a) *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?*

ICGN believes there may be a misstatement if policies and procedures have dramatically changed and this is not accurately reflected in the disclosures. We understand this may not necessarily result in a restatement but believe such an inaccurate disclosure may mislead investors in their analysis of the risks and how the company is mitigating these risks.

(6b) *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?*

ICGN believes there should be guidelines where depending on the industry the auditor may in fact need to obtain evidence as to whether the stress test was appropriately performed. Financial institutions are an example where it may be critical for auditors to perform this type of testing. It may be important for shareowners to determine whether the benefits of this type of testing are value-added.

Again, if changes occurred where stress testing was not accurately presented then we do believe this is an example of a misstatement.

17) 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:

We have answered this question from the perspective of what we believe the auditor should cover.

- Judgments and reasons accurately reflect management's and the Board's approach. The auditor should assess whether these judgments are reasonable and the methodology approached in a sound manner.
- Assumptions/models/inputs –as above. Though ICGN believes the auditors may need to perform sensitivity analysis in verifying and understanding inputs and assumptions used.
- Sources of estimation uncertainty/sensitivity analysis disclosures. ICGN believes that auditors should use their professional judgment to assess whether management's and the Board's approach to estimation and sensitivity analysis was reasonable.
- Descriptions of internal processes. ICGN believes that auditors need to assess internal processes and controls to develop their audit plan and assessment. We believe internal controls need to be tested and assessed.
- Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis. ICGN believes that auditors need to approach these types of disclosures as a line item on the face of the financials. It is critical to investors that auditors are able to provide a reasonable viewpoint on the valuation, whether fair value or at amortised cost.
- Objective-based disclosure requirements. ICGN supports auditors arriving at their own conclusions based on specific testing and review of management's and the Board's judgment on these type of disclosures.

18) 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?

ICGN does not support disclosures that are not audited being included in the financial statements but should be outside the audited financial statements as it may mislead investors in completing their analysis and understanding of the auditor's work.

Other comments on Section IV: Materiality

Materiality is an important consideration. However, it is also important that disclosures whether material or not provide investors a reasonable understanding of the current position of the company, identifying future risks and how management and the Board are mitigating these. Defining materiality based on quantitative measures is helpful

but there are specific transactions and understanding management's and the Board's philosophy and approach is necessary to provide a complete picture of the company's overall well being, strategy and approach. It is important to stress that materiality is not only a quantitative measurement, but which might potentially influence reasonable decision making by users. Currently, more and more focus is placed on disclosures, on strategy, risk, sustainability, and corporate governance (to name a few). A true and fair representation of these items is of key importance – and hence would be material by definition for users.