



*European Federation of Accountants and Auditors for SMEs*

International Auditing and Assurance Standards Board (“IAASB”)  
529 5th Avenue, 6th Floor  
New York, New York 10017  
United States of America  
Attn. IAASB Technical Director  
Brussels, 11 September 2014

Dear Ms Healey

**Comment on IAASB Exposure Draft - Proposed Changes to the International Standards on Auditing (ISAs) Addressing Disclosures in the Audit of Financial Statements**

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to small and medium-sized entities (“SMEs”) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs.

EFAA appreciates the opportunity to comment on the IAASB Exposure Draft (“ED”) - Proposed Changes to the International Standards on Auditing (ISAs) - Addressing Disclosures in the Audit of Financial Statements.

**General Remarks**

- Definition of financial statements and proposed change to ISA 200

We do not support the proposed change to the definition of “financial statements”. Our detailed comments in respect of this are included in our response to question 1.

- Cost benefit analysis and disproportionate impact on SMEs

As an overarching comment, we believe the project has not been appropriately evaluated and that a thorough cost benefit analysis should have been performed. Accepting that certain stakeholders have raised concerns over the audit of disclosures, and this issue is important because disclosures form a fundamental part of financial statements, we are not convinced that the proposals in the ED, which predominantly require amendment to explanatory material, suitably address the needs of a range of stakeholders.

As we stated in our response to the IAASB Discussion Paper<sup>1</sup>, SME financial statements do not have the lengthy and complex disclosures on which that discussion paper dwelled. While audit issues pertaining to disclosures may arise, any measures to increase the quality of the audit of disclosures by SMEs will most likely have only limited impact on users.

The cost of implementing the changes that the ED proposes will affect all audits but the anticipated benefits will only be significant in the audit of larger entities.

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1 The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications



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We appreciate and support the IAASB's drive for increasing quality and we do not want to discourage the IAASB in this task but, in this instance, we cannot support the changes to the ten ISAs that the ED proposes. This is because we are not convinced that there is a fully justified rationale for making these changes and we believe that SMEs will be disproportionately affected.

- Alternative approaches

In the consultation on the IAASB's Proposed Work Program for 2015–2016 respondents were asked whether there were alternative approaches that would enhance the IAASB's ability to address calls from stakeholders in light of the constraints of available resources and the need for due process to be applied in the development or revision of standards.

In further consideration of this question, we would favour addressing concerns over the quality of audit of disclosures, not through changes to standards but by education, training and building upon the IAASB staff paper already issued. Whilst we are unsupportive of the direction that the ED is taking, we do not wish the analysis done to date to go to waste. As a minimum, the changes proposed to individual ISAs within the ED could be postponed and then implemented at some future date when those ISAs are open for re-exposure.

- Assertions

We do not support the proposal to combine the assertions for disclosures with all other general assertions. Our comments in respect of this are included in our response to question 3.

### **Request for Specific Comments**

Our responses to the specific questions raised are set out below.

- 1. Whether, in your view, the proposed changes to the ISAs are appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and, thereby, will further support the proper application of current requirements in the ISAs?**

Because the proposed changes encompass amendments to several ISAs we comment on the significant matters (as outlined in the ED) below.

#### **Clarifying the Meaning of Disclosures: Proposed Change to ISA 200**

Whilst we agree with the IAASB that disclosures are a fundamental part of financial statements we do not agree that the definition of financial statements needs to be changed as outlined in the ED. Nor do we agree that the definition proposed is an improvement on the current definition.

The proposed change in paragraph 13(f) of ISA 200 replaces the term "related notes" with that of "disclosures". We think the phrase "related notes" is already well understood.

In addition we accept the IAASB's assertion that the audit of financial statements should include disclosures and that "Disclosures comprise explanatory or descriptive information on the face of the financial statements, information in the related notes, or information incorporated by cross-reference when permitted by the applicable financial reporting framework". However, we do not believe that this sentence should form part of the definition because we think that this is less clear and less concise than the extant definition. We would also favour retention



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of the linkage to “significant accounting policies” because we believe that this is helpful in giving context to the notes.

The introduction of the phrase “claims against the entity” in replacement of “obligations” does not seem to be born out of the work performed as part of the disclosures project and the change has not been satisfactorily justified in the ED. Whilst we acknowledge that this is a term often used in IFRS<sup>2</sup> we do not believe that the proposed change is required.

In summary we believe that changes to this definition, which we acknowledge is fundamental to auditing, should be driven only by an overwhelming need for change. In the absence of this, we think it likely that the costs of making this change (translation and implementation) will outweigh any benefits. The importance of disclosures in financial reporting is well understood but we are not convinced that the change in this definition will have a net positive impact on the audit of disclosures. We are also of the view that this change has not been sufficiently justified.

#### Guiding Auditors to Address Audit Considerations Relating to Disclosures Early in the Audit: Proposed Changes to ISAs 210, 260, 300

We accept that timely preparation and consideration of disclosures should be a key part of planning an effective audit and agree with the objective of the IAASB in this regard.

We note that the IAASB concluded that the ISAs are sufficient to meet the objectives stated within them. The changes proposed are therefore to be made to guidance and explanatory material. We see no real benefit to making these changes to the ISAs at this time because we are concerned that the costs of making these changes will outweigh the benefits.

We would be supportive of these changes being noted for future reference and then being dealt with at the time that the ISAs in question are being re-exposed.

#### Identifying, Assessing and Responding to Risks of Material Misstatement - Disclosure Considerations: Proposed Changes to ISAs 240, 315, 320 and 330

- Assertions

Please refer to our response to question 3.

- Sources of information

It is well understood that the general ledger system does not give rise to all disclosures and all estimates and calculations and that disclosures are frequently based on information provided elsewhere. Whether this needs to be stated so explicitly to include more reference to the general ledger is questionable. To that end we do not support the introduction and the emphasis of this term.

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<sup>2</sup> IFRS, International Financial Reporting Standards



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- Materiality for non-qualitative disclosures

We are mindful that the IAASB will review the matter of materiality at some future point noting that certain challenges with the practical application of ISA 320 have been observed as part of the ISA implementation project.

We believe that in practice the judgement of materiality would include non-quantitative disclosures and that any judgement will be taken by the auditor in the light of all other qualitative errors and misstatements. We also consider training and education to be a necessary ingredient to any resulting improvement in this area.

#### Clarifying and Elaborating Expectations of Auditor when Evaluating Misstatements and Forming an Opinion: Proposed Changes to ISAs 450 and 700

We note that the IAASB concluded that the ISAs are sufficient to meet the objectives stated within them. The changes proposed are to be made, therefore, to guidance and explanatory material. We see no real benefit to making these changes to the ISAs at this time because we are concerned that the costs of making these changes will outweigh the benefits.

We would be supportive of these changes being noted for future reference and then being dealt with at the time that the ISAs in question are being re-exposed.

#### Related Considerations

We note that the IAASB deliberated about whether it should introduce one new ISA that would deal with disclosures or amend several ISAs. Ultimately the IAASB chose the latter option because of concerns over repetition and whether a stand-alone ISA might send the message that the audit of disclosures could be considered to be a separate exercise instead of being an integral part of the audit.

This raises an interesting discussion. This is because ISA 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, is a separate ISA that gives the issue of fraud prominence throughout the audit. Moreover, proposed ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report, effectively opens the door to the concept that a separate ISA that is mandatory only for listed companies could give prominence throughout the audit to addressing their lengthy and complex disclosures. This approach, in which an ISA on disclosures is issued that is mandatory only for the audits of listed companies, would match the costs of the changes proposed in this ED more directly to the benefits and the specific concerns of stakeholders. The disproportionate impact on SME audits that the proposed revision of the ISAs in this ED is likely to have would not then result.

In addition, were a separate ISA on disclosures to be introduced that appropriately targeted the issue of disclosures for listed entities it could always be used voluntarily (as ISA 701 is able to be used). It could, alternatively, provide authoritative guidance.



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**2. Are there any specific areas where, in your view, additional enhancement to either the requirements or guidance of the ISAs would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit?**

None of which we are aware.

**3. Whether, in your view, the proposed changes to the assertions will help appropriately integrate the work on disclosures with the audit work on the underlying amounts, thereby promoting an earlier and more effective audit of disclosures?**

We note that the IAASB proposes to integrate the relevant assertions for disclosures within other assertions. This proposed action seems contrary to the overall IAASB strategy to raise the profile of disclosures in general. We do not believe that the changes as proposed will have any significant impact on the promotion of an earlier and more effective audit of disclosures. In the absence of any significant benefit and acknowledging that the costs of implementation will likely be significant, we do not support the proposed changes to assertions.

**Other matters on which the IAASB is also seeking comments**

*Preparers (including Small- and Medium-Sized Entities (SMEs)) and Other Users — The IAASB invites comments on the proposed changes to the ISAs particularly with respect to the practical impacts, if any, of the proposed changes to the ISAs.*

We appreciate the issues faced by the IAASB in dealing with this matter and we are alert to the concerns raised by some stakeholders.

We are aware of the challenges faced more commonly by listed and public interest entities and stakeholders of these entities because of the ever increasing and ever changing nature of disclosures in this area. That said, the changes proposed will impact every audited entity. The costs of implementation will likely be significant. The benefits, if any, across all entities are less certain. In the section entitled “general remarks” we observed that SME financial statements do not often have lengthy and complex disclosures. Because of that, SMEs will be disproportionately affected as the costs of implementing the proposals in the ED will significantly outweigh any benefits arising.

I trust that the above is clear but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Bodo Richardt  
*President*

Marie Lang  
*Technical Director*