For the attention of Ms Kathleen Healy
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
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USA

[Submitted via IAASB website]

12 September 2014

Dear Ms Healy

IAASB Exposure Draft - Proposed changes to the International Standards on Auditing (ISAs): Addressing disclosures in the audit of financial statements

We[1] appreciate the opportunity to comment on the IAASB's proposed changes to the ISAs to address disclosures in the audit of financial statements.

Overview of our key messages

We agree that financial statement disclosures are an increasingly important way for preparers to communicate deeper insights about the entity's financial position and financial performance than is possible through the primary financial statements alone. More widespread use of fair value and estimates with greater measurement uncertainty, for example, need to be supported by disclosures that provide insight into the underlying assumptions and valuation models. This trend has increased the importance of the role of disclosures in the fair presentation of financial statements, but at the same time added to the complexity of financial reporting.

As the nature and importance of disclosures have changed, a number of challenging issues have emerged. We welcome the actions being taken by the accounting standard setters to address some of the more complex issues, including:

- How to apply the concept of materiality to, and evaluate misstatements in, different types of disclosures, in particular qualitative information.
- Whether accounting standards disclosure requirements are contributing unnecessarily to undue "clutter" in financial statements, with the risk of inadvertently obscuring key information.

We were pleased to note that the IAASB is contributing to the International Accounting Standards Board's (IASB) initiatives on a disclosure framework and materiality. There is no doubt that many of the most challenging issues are not solely audit issues, and new requirements or application material in auditing standards alone cannot address them. In fact, most are accounting issues first. There is, therefore, a compelling need for all stakeholders of corporate reporting to work together to identify holistic solutions. For this reason, we encourage the IAASB to not just closely follow the IASB's

[1] This response is being filed on behalf of PricewaterhouseCoopers International Limited (PwCIL). References to "PwC", "we" and "our" refer to PwCIL and its global network of member firms, each of which is a separate and independent legal entity.

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developments and activities, but to proactively partner and participate in them so that the final disclosure framework can be applied effectively by both auditors and preparers.

Evaluating the right time for change

All of which leads us to question whether now is the right time to be opening up a suite of ten ISAs to incorporate some new limited application material on disclosures.

We do not question the aims of the proposed changes that the IAASB has put forward, and indeed fully support many of the principles that the changes are trying to address – such as, for example, the need for disclosures to be considered earlier in the audit process. However, we are not convinced that the nature and extent of the changes proposed are sufficiently compelling yet to warrant opening up such a large number of ISAs now. In our view, it would be more effective to make the changes to the ISAs when a more comprehensive change can be made once the larger issues are addressed. There is an inherent administrative time and effort associated with updating methodologies, training and other guidance materials to incorporate changes to the ISAs – these can be significant for smaller firms and jurisdictions requiring translation of the ISAs. Given the limited nature of the proposed changes, these associated costs are likely to exceed the limited benefits that may be gained in practice.

We also worry that there may be a risk that these changes, in adding so many explicit references to disclosures throughout the application guidance to the ISAs as is proposed, could have the unintended consequence of inadvertently over-emphasising this particular financial reporting area at the cost of other aspects that may be equally important but not given explicit mention.

In the event that IAASB proceeds with the proposed changes, we have provided some specific comments on aspects of the changes, by individual ISA, in our response to question 1 in the appendix to this letter.

Alternative ways of achieving short term goals

An alternative that would enable the IAASB to more effectively achieve some of its intended goals in the shorter term would be an International Auditing Practice Note (IAPN). The content of the proposed IAASB Staff Paper is useful because it brings the issues together, with illustrative examples. It is able to reinforce the importance of considering disclosures as part of the audit of the financial statements in a way that cannot be achieved as effectively through changes interspersed across the application material in a number of different ISAs. However, we believe that this material is more in the nature of an IAPN as opposed to a Staff Paper. In our view, this would be an appropriate response to the concerns raised about the need to clarify the expectations of auditors, while achieving the aim of raising awareness and promoting these considerations earlier in the audit process.

In the longer term, once relevant parties in the corporate reporting chain have reached consensus on the more complex issues, targeted and meaningful changes can be made to both the requirements (if deemed necessary) and application material of relevant ISAs to effect practical change.

Effective date

If the Board decides to proceed with these amendments now, we are not convinced that it is necessary for them to be made effective to align with the auditor reporting and ISA 720 revisions. However, an implementation period of 12-15 months seems reasonable.

In conclusion, we are not convinced that the benefits to be gained through the proposed changes are sufficient to offset the costs associated with opening up so many ISAs to make changes largely to application material alone. We believe aspects of the IAASB's intended goals could be better achieved in the short term through issuing an IAPN, based on the content of the proposed Staff Paper. In the longer term, once holistic solutions to some of the more significant issues described in this letter have been identified, more meaningful changes to the ISAs can be made.

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Jamie Shannon, at jamie.shannon@uk.pwc.com or me, at richard.g.sexton@uk.pwc.com.

Yours sincerely,

Richard G. Sexton
Vice Chairman, Global Assurance

Appendix

Request for specific comments

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?**

   - Our overall comments on the appropriateness of the proposed changes are set out in our covering letter. In the event that the IAASB proceeds with the proposed changes, we include below some additional comments on certain changes, by ISA, that we believe need to be addressed:

   ISA 210, ISA 300, ISA 315 & ISA 330

   - We find the many references to "information from systems or processes that are not part of the general ledger system" confusing. The ISAs, generally, focus on the "financial reporting system" – introducing this new terminology adds confusion and, in the absence of clearer guidance as to its intended meaning, we do not find this helpful.

     We also find proposed application material paragraph A89a in ISA 315 unclear as to what expectations are being placed on auditors with respect to information obtained from such systems as those listed – what audit procedures are expected of auditors to determine that the information sourced from those systems is reliable?

     We believe that this change, across the ISAs, raises a fundamental question about what constitutes sufficient appropriate audit evidence for different types of disclosures – an issue not addressed by the proposed changes in the Exposure Draft.

     For example, with respect to a valuation report prepared by an independent expert, it is unclear what message the application material is trying to convey – is it implying that such reports and the work of the expert needs to be audited?

     As another example, if the disclosure relates to the existence of an operational control, what is the extent of evidence the auditor needs to obtain in relation to that disclosure – establish whether the control exists and that the description is factually accurate; or that the control has been implemented; or that it is operating effectively? What is reasonable to expect given the role of that disclosure in the context of the financial statements as a whole?

   ISA 315

   - The matters listed in proposed new application paragraph A21a, in considering the requirements of the applicable financial reporting framework, appear to be equally relevant to considering transactions and balances. Therefore, in this instance we find the explicit focus on disclosures to be out of context.
   - The proposed change to paragraph A30, in respect of related parties, risks being read as inconsistent with ISA 550. The consideration of related parties in ISA 550 is not limited to the requirements of the applicable financial reporting framework.
   - We question whether the term "measured", used in the Accuracy assertion in paragraph A124, is appropriate. We suggest "recorded" may be more appropriate.

- We are unclear as to the purpose of the specific list of disclosures included in paragraph A128c. Is this list intended to represent disclosures that are considered to represent a higher risk of material misstatement? As paragraph A128a highlights, all disclosures need to be considered. Therefore without any additional context this list seems to lack purpose. The flow of paragraphs A128b into A128c could also lead a reader to interpret the list as being examples of non-qualitative disclosures, which clearly many are not.
- With regard to the penultimate bullet added to Appendix 2, we do not consider that "omission" can be described as an "event or condition" that may indicate the existence of risks of material misstatement. An omission (if material) would be a material misstatement – it is neither an event nor condition.

ISA 320

- We believe the additional examples that have been incorporated into the guidance in paragraph A10 are inappropriate. We see no reason why a sensitivity analysis for fair value accounting estimates should be audited to a lower level of materiality than the line item to which it relates or how this would be applied in practice. Similarly, we believe the inclusion of "disclosures about segments" implies that the auditor may need to do more work on segmental disclosures, which may be perceived as conflicting with the guidance in ISA 501 paragraph A26 that *"the auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis"*.

ISA 450

- We find the additions to paragraph A1a to lack clarity and may result in confusion around understanding of the concepts that are being included. With regards to proposed A1e and A1f, we have concerns about the scope of these changes vis-à-vis consideration of the requirements of the applicable financial reporting framework. In particular we find A1f to be an inappropriate extension of the 'stand-back' requirement in ISA 700 for the auditor to assess whether the financial statements as a whole achieve fair presentation. The stand-back was not designed in the context of addressing individual misstatements in disclosures which is the implication by adding this into ISA 450. Furthermore, when combined, as here, with the concept of 'omissions' in disclosures this is even more problematic. It is not reasonable to expect that individual auditors can unilaterally bring about reporting changes on matters that appropriately require discussion and debate through standard setting due process to forge consensus on what disclosure the applicable financial reporting framework should require.
- We do not consider the proposed addition of paragraph A17a, second bullet, to be appropriate or fully understand the objective of this application paragraph. A 'trend' is simply that – we are not convinced that misstatements in disclosures can be 'indicative of a trend'. At a certain point in time, duplicative or uninformative disclosures may lead an auditor to conclude that the financial statements as a whole were misleading – however, that is entirely judgemental in the absence of clear guidance under the applicable financial reporting framework. Clearly, financial statements are misstated if they omit material disclosures. But it would be very difficult to make it workable that information can only be included in the financial statements if material. In our response to the IASB Exposure

Draft *Disclosure Initiative (Proposed Amendments to IAS 1)* we have stated our view that, in respect of the proposed clarification that an entity need not provide a specific disclosure required by IFRS if the information is not material, the IASB should be explicit that it is acceptable to include disclosures required by IFRS, even if those disclosures might not be material. We also suggested that the IASB be explicit that the clarifications do not change the current definition of materiality or how materiality is assessed, and that materiality should not be applied differently to disclosures.

ISA 700

- In our view, the changes proposed to paragraph A4 go beyond what is reasonable and are akin to setting additional accounting standard requirements. We do not understand what basis an auditor would apply to determine whether information was 'relevant and specific to the circumstances of the entity'. In addition, with respect to the first two bullets that have been added, we do not understand what these are trying to achieve. Specifically:
  - what is meant by "the nature and extent of...assets and liabilities....that do not meet the criteria for recognition...(or derecognition)"?; and
  - what disclosures were in mind relating to "the nature and extent of risks of material misstatement arising from transactions and events"?

  In paragraph A4b, we do not understand the reference to "evolving financial reporting framework requirements".

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?**
   - See response to question 1 above.

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?**
   - Subject to our one observation above, we believe the changes to the assertions are acceptable. Integrating consideration of disclosures alongside the consideration of the transactions and balances to which they relate seems sensible.