Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements

Comments from ACCA to the International Auditing and Assurance Standards Board

9 September 2014

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

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ACCA welcomes the opportunity to comment on the proposals issued by the International Auditing and Assurance Standards Board (the IAASB). The ACCA Global Forum for Audit and Assurance has considered the matters raised and the views of its members are represented in the following.

OVERALL COMMENTS

In our response to the earlier discussion, paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* we made the overall comment that: '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 coupled this comment with a caution that: '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.'

We note that the IAASB has undertaken active liaison and outreach, for example contributing to related initiatives of the International Accounting Standards Board (IASB), such as its work on disclosure frameworks and materiality. We encourage other participants in the financial reporting supply chain to engage and assist in clarifying user expectations of auditors when auditing financial statement disclosures.

While we accept the IAASB's assertion (in the ED) that the proposed changes 'assist auditors in addressing the practical challenges arising from the evolving nature of disclosures', we believe that they do not do enough to address the above expectations gap. That would instead require a wide-ranging technical project examining the nature of reasonable assurance and the sufficiency of audit evidence.

We suggest that the presentation of the proposed changes should acknowledge the different cost/benefit circumstances of listed companies and SMEs.

In relation to the detailed proposals, as explained in more detail in our specific comments below, we agree with guiding auditors to address disclosures early in the audit and on the difficulties in obtaining sufficient appropriate evidence. We do not agree with changing the definition of 'financial statements' or with integrating the disclosures assertions with assertions generally.

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SPECIFIC COMMENTS

In this section of our response, we answer the three questions set out in the *Request for Comments* section of the Exposure Draft document.

Question 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?

Clarifying the meaning of disclosures

We have no problems with the current definition of financial statements in ISA 200 and are not convinced that there is a need for any change. Such a change should in any case be made only if there is an overwhelming need, as the definition is fundamental to auditing and any change to it would involve considerable implementation costs.

Indeed, the change actually proposed seems to us to go far beyond mere emphasis on disclosures; for example, changing 'economic obligations', into 'claims against the entity'.

Within the proposed definition, we do not agree with de-emphasising the notes and omitting the fact that the notes ordinarily comprise a summary of significant accounting policies and other explanatory information. We feel that the extant definition gives a necessary emphasis to the accounting policies.

We do not agree with the inclusion, in the definition of financial statements, of a sentence stating what disclosures comprise. The IAASB sees this as necessary to make it clear that 'where the term "financial statements" is used in the ISAs' . . . 'this is intended to include all disclosures subject to audit and that such disclosures may be found in the related notes, on the face of the financial statements, or incorporated by cross-reference as allowable by some financial reporting frameworks.'

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To achieve appropriate emphasis, it would be better to define disclosures separately. We do not underestimate the difficulty of this given that the accepted usage in financial reporting admits to two interpretations. The word 'disclosures' is often interpreted as meaning material presented in the notes to the financial statements. Consequently, it would be unusual to refer to an item in a particular financial statement as a 'disclosure'. However, others extend the term to include explanatory or descriptive information in a financial statement (but perhaps not 'line item' amounts or their classification or presentation).

The definition should accord with the existing usage in auditing standards, such as:

- disclosures are contrasted with 'classes of transactions' and 'account balances'
- audit evidence is related to 'the amounts and disclosures in the financial statements'
- misstatement involves 'a difference between the amount, classification, presentation, or disclosure of a reported financial statement item'

Guiding auditors to address audit considerations relating to disclosures early in the audit

We agree with the objective of encouraging the consideration of disclosures early in the audit. We note the IAASB's view that the existing requirements are sufficient to meet the objectives stated in the ISAs in relation to this so that the proposals relate to further guidance.

Identifying and assessing and responding to risks of material misstatement – disclosure considerations

We discuss these proposed changes in the order in which they are addressed in the *Explanatory Memorandum*.

Assertions

We do not agree with integrating the assertions relating to disclosures rather than keeping them separate. For further discussion of this, see our answer to question 3 below.

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Sources of information for disclosures, and sufficient appropriate audit evidence
Where sufficient appropriate audit evidence is available, we believe that the ISAs drive appropriate audit evidence gathering

We agree that there is a legitimate concern relating to the sufficiency of appropriate audit evidence in relation to some disclosures. However, proposed changes to ISAs to emphasise the fact that some disclosures now include information from systems and processes that are not part of the general ledger system is only part of the solution. We observe that in the ISAs it is rare to use the term 'general ledger system'; instead, ISAs typically refer to 'information systems' and such systems also support disclosures.

The recognition and measurement of disclosures is a matter for financial reporting standard setters, but the criteria applied may be less rigorous than for items in the financial statements that result from the general ledger system. Such circumstances can present difficulties for auditors in obtaining and judging the sufficiency of evidence.

We do not believe that it is possible for the current project on disclosures to fully address these user concerns. That would instead require a wide-ranging technical project examining the nature of reasonable assurance and the sufficiency of audit evidence.

Materiality for non-qualitative disclosures and evaluating misstatements in disclosures
The judgement of materiality will always be a professional judgement, albeit one where the methodology employed by many firms involves mathematical accumulations and combinations of errors.

We believe that the tendency for audit firms to concentrate on the easy aggregation of quantitative errors is inevitable. However, once the auditor has knowledge of the qualitative errors then they are taken into account in the professional judgement concerning whether a material misstatement exists; so there is less need for mechanical aggregation.

If the IAASB wishes to change auditor behaviour in this area, we suggest that education and training is the way to achieve that.

Evaluating the presentation of the financial statements
Accounting policies – we have commented earlier on changes that would de-emphasise the accounting policies. We find this incomparable with a proposal to introduce changes to emphasise the consideration of adequate disclosure of accounting policies.

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Presentation of the proposed changes
The thinking behind the proposed method seems to be a choice between a separate ISA addressing disclosures or changes to several ISAs. Arguing from a belief that a holistic and integrated view on auditing disclosures should be adopted, the IAASB concluded that the proposed changes should be made to several ISAs.

Two further reasons are advanced for this approach. Firstly, that a separate ISA would exacerbate concerns of repetition within ISAs and secondly, that it might imply auditing disclosures was a separate exercise.

While these may be valid standpoints to adopt, they do not amount to an argument in favour of the proposed presentation through changes to several ISAs. A missing step in the logic is whether change to ISAs (whether by introducing a new one or amending several) is actually needed. For that, there must be consideration as to whether the cost of changes is justified by the anticipated benefit.

The motivation behind the changes appears to be calls from investors in listed companies, where disclosures have proliferated, for more relevant auditor involvement.

Many hold the view that 'an audit is an audit' and, as such, they value consistent standards applied proportionately. However, the impending issue of ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* has resulted in a watershed. It is no longer viable for the IAASB to carry out broad-brush appraisals of the cost and benefit of new standards; instead, it must look at the different cost and benefit comparisons for listed companies and other audited entities. In the same way that many jurisdictions vary the financial reporting and indeed auditing requirements by size of entity, the IAASB now has to properly justify the application of any measure to non-listed companies as well as to those that are listed.

For listed companies, with voluminous disclosures, changes to ISAs would meet investors' needs, whether such changes were implemented in several ISAs or one. The advantage of using just one ISA would be that it allowed the requirements to be confined to listed companies (if that was considered appropriate).

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For non-listed companies[1] we believe that the cost of the changes would outweigh any benefits and accordingly, for audits of such entities, a staff guidance paper would be preferable to changes to ISAs. Reference could be made to, and indeed voluntary adoption could be undertaken of, an ISA on disclosures for listed companies. As well as being used voluntarily, such an ISA could also act as authoritative guidance in a way that a simple staff paper cannot.

Conforming amendments ISA 800 series and other.
We note and agree with the intention of the IAASB to include any conforming amendments in the planned exposure draft for the ISA 800 series.

Question 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?

We have carried out a detailed review of the proposed changes. In the context of changes that would apply to several ISAs, we do not suggest additional enhancement to either the requirements or guidance.

Question 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 do not agree with integrating the assertions relating to disclosures rather than keeping them separate. Indeed, given that the whole reason for changing standards is to increase the focus on disclosures, it seems perverse to do away with separate consideration of assertions for them. We do not believe that combining the assertions would provide any encouragement for the auditor to consider disclosures and undertake related audit procedures earlier.

We are further concerned that the change is being proposed to a fundamental part of the audit merely in order to change emphasis in an area where the IAASB states that the existing requirements are satisfactory. It is almost inevitable that any changes made to the assertions at this stage will not only be costly for all auditors (especially those who use the standards directly) but are likely to be technically deficient – because the assertions need to be reconsidered as a whole, together with other fundamental aspects of the audit and standard-setting.

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[1] Although we contrast listed companies with non-listed companies, we recognise that jurisdictions could extend the mandatory scope to suit national circumstances.

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We note that the IAASB does not propose a more wide-reaching project on the assertions at this stage. We think it inadequate that the only evidence advanced in support of this is the absence of comment on problems in response to an open question in the ISA implementation monitoring project.

We note that the IAASB has considered and rejected aligning the assertions with the accounting standard setters' fundamental characteristics of financial information. It may well be that, in the long term, this should be a preferred approach. The fact that it is not being done, suggests that the existing treatment of assertions is acceptable, rather than that there is a need to make adjustments for aspects relating only to disclosures.

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GENERAL MATTERS

In this section of our response, we address the four general matters identified in the section *Request for Comments* of the Exposure Draft document.

(a) *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.

(b) *Developing Nations* – Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment on the proposed changes to the ISAs, in particular, on any foreseeable difficulties in applying these in a developing nation environment.

(c) *Translations* – Recognizing that many respondents may intend to translate the final changes to the ISAs for adoption in their own environments, the IAASB welcomes comments on potential translation issues respondents may note in reviewing the proposed changes to the ISAs.

(d) *Effective Date* – Recognizing that the proposed changes to the ISAs affect some of the same ISAs as other IAASB projects currently being finalized, the IAASB believes that to the extent possible, the effective date should be aligned with these other projects, namely the IAASB's Auditor Reporting project and the project to revise ISA 720. Accordingly, the IAASB believes that an appropriate effective date for the standard would be 12–15 months after issuance of the final standards, but may be longer or shorter to align with the effective date of the revisions arising from the auditor reporting and ISA 720 projects. Earlier application would be permitted. The IAASB welcomes comment on whether this would provide a sufficient period to support effective implementation of the changes to the ISAs.

ACCA has developed this response following an internal due process involving preparers and users, those in developing nations, and those who will use the ISAs in translation. This input, such as from our Global Forum for Audit and Assurance, has informed the whole of this response. However, in relation to (a) to (d) above we would particularly highlight the following matters.

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Small- and medium-sized entities

As we have set out earlier in our response, we believe that the costs of the changes will disproportionately affect the audits of small and medium-sized entities, which do not have either the extended disclosures typical of listed companies nor any equivalent interest from investors in the quality of their audit.

Effective date

The proposal to align the effective date with that of the IAASB's Auditor Reporting project and the project to revise ISA 720 is initially attractive as implementation costs and actions for both would coincide.

However, the proposed changes in relation to disclosures would affect the whole audit process, so to judge whether there is sufficient time allowed for translation and implementation the focus should be on when affected periods commence, rather than when reports are issued.

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