IAASB
International Auditing
and Assurance
Standards Board

545 Fifth Avenue, 14th Floor, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.iaasb.org

FEEDBACK STATEMENT

FEEDBACK STATEMENT

THE EVOLVING NATURE OF FINANCIAL REPORTING: DISCLOSURE AND ITS AUDIT IMPLICATIONS

JANUARY 2012




INTRODUCTION

In January 2011, the International Auditing and Assurance Standards Board (IAASB) issued a Discussion Paper, *The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications*, to explore the views and perspectives of different stakeholder groups on issues and challenges around financial reporting disclosures. The broad range of respondents and thoughtful comments received demonstrate the importance of, and interest in, this initiative. This Feedback Statement summarizes what we have heard.

Why the IAASB Undertook the Initiative

As financial reporting has evolved to meet the changing needs of users, the role and importance of disclosures in financial reporting have also changed. Appropriate, high-quality disclosures have become increasingly important as financial reporting incorporates more fair value information and other estimates involving judgment and complex measurements, and provides more narrative disclosures of some of the risks and characteristics of companies and groups.

In the aftermath of the 2008 financial crisis, the role of auditors in relation to disclosures has been the focus of considerable attention. Questions have been raised about the exercise of professional judgment and skepticism by auditors. Perhaps more fundamentally, attention has been focused on how auditors should apply auditing concepts in obtaining sufficient appropriate audit evidence for disclosures, to support their opinion on the financial statements as a whole. Questions have also surfaced about whether all disclosures are auditable.

At the same time, it was recognized that these are challenges in approaching disclosures not only for auditors, but also for preparers, investors, lenders, creditors, regulators and other users of financial statements.

Against this backdrop, the IAASB decided to issue the Discussion Paper to explore these issues, and to assist the IAASB in determining what actions may be appropriate going forward.

History of the Discussion Paper

The impact of evolving disclosures on auditors' responsibilities and practices was first discussed by the IAASB in 2009 and a Working Group was established in 2010. The Discussion Paper issued in January 2011 discussed:

(a) The recent trends in financial reporting and their impact on financial reporting disclosures;

(b) How the International Standards on Auditing (ISAs) currently deal with disclosures; and

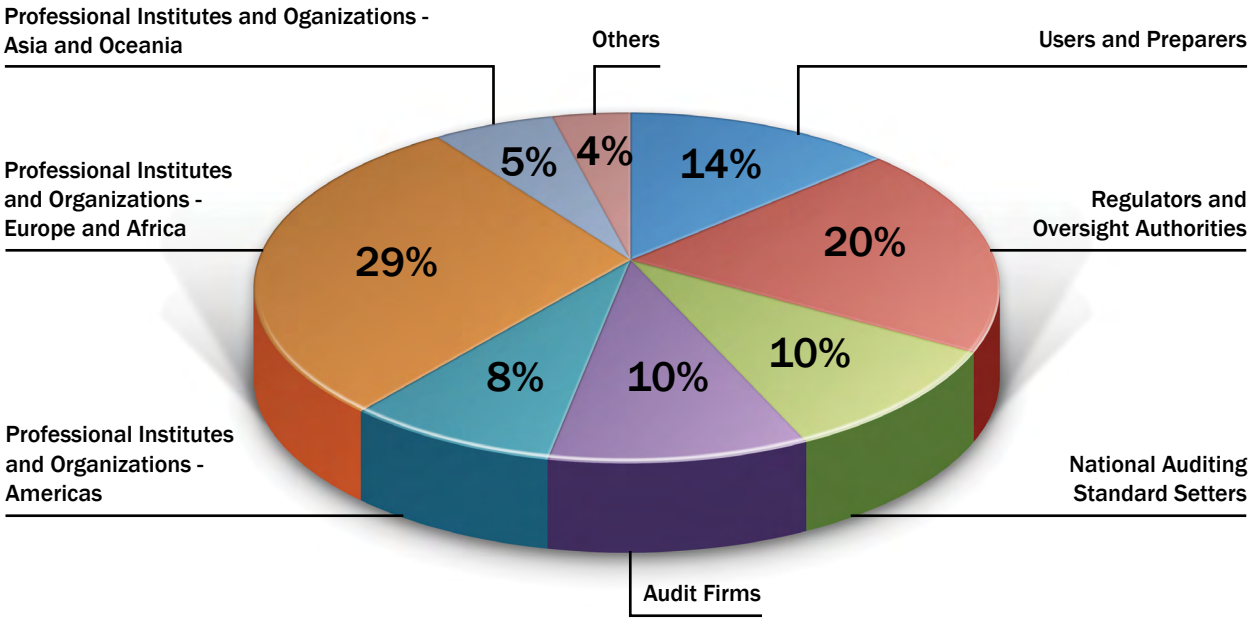
(c) Audit issues in relation to evidence, materiality, misstatements and even auditability itself that the IAASB had identified.

The Discussion Paper included questions tailored for different stakeholder groups, including preparers, investors, lenders and other creditors, regulators and auditors. Respondents were invited to also respond to questions from other stakeholders' lists of questions if they wished to provide their perspective on questions directed to a different stakeholder group.

Purpose of this Feedback Statement

This Feedback Statement provides an overview of the key messages from the responses to the questions in the Discussion Paper. The responses were both thoughtful and informative, and the views expressed offered valuable insights relevant not only to the IAASB, but also to accounting standard setters, regulators and other stakeholders. For that reason, the IAASB believes that sharing what we have heard will be useful in stimulating further thinking and exploration of this very important topic. It will also provide a basis to begin the process of collaboratively working towards addressing some of the issues raised.

OVERVIEW OF RESPONDENTS



The comment period closed on June 1, 2011 with *51 responses* received from a broad range of stakeholders (a list of the respondents is provided on page 15). Given the wide-ranging implications of the issues raised in the Discussion Paper, the IAASB was particularly pleased with the broad range of respondents.

It was interesting that, in response to a number of questions, there were no discernible differences among stakeholder groups; rather there were diverse views both within, and across, stakeholder groups.

There were limited responses from small- and medium-sized entities (SMEs). Financial statements for such entities generally do not have lengthy and complex disclosures. Indeed, financial reporting frameworks for such entities often have simplified disclosure requirements. Therefore most of the issues outlined in the Discussion Paper appear not to be faced by preparers and auditors of SMEs.

WHAT WE HEARD

Many respondents thought that the ISAs appropriately reflected the necessary risk-based approach to auditing disclosures. There were, however, some areas, detailed later in this Feedback Statement, where respondents thought that additional guidance or other enhancements to the existing standards would improve practice. In some cases, the areas highlighted were ones the IAASB could further consider as part of its own work program. However, for some of the more significant areas, stakeholders believed the issues needed to be addressed in collaboration and cooperation with others.

The following highlights broad messages along similar themes that were observed in the responses received to the Discussion Paper.[1]

> ***We are supportive of the Board's efforts to explore a critical component of financial reporting. We believe the Board's Discussion Paper is a useful initiative which comes at a time when the Global Securities Markets are working to emerge from the recent financial crisis and other shocks.***
> *International Organization of Securities Commissions (Regulators and Oversight Authorities)*

Collaboration and Cooperation

Many stakeholders have a role to play in relation to disclosures. Financial reporting standards set the framework for the expected financial statement disclosures. The preparation of financial statements, including disclosures, and support for the assertions made in them rests in the first instance with preparers (management, with the oversight of those charged with governance). Auditors play an important role in enhancing the credibility of the entity's financial reporting disclosures and the audit process itself can contribute to an improvement in their quality. Regulators monitor entities' financial reporting and many respondents recognized that their views and actions may influence judgments and behaviors when preparing and auditing disclosures. There is, therefore, a shared agenda for promoting the quality of financial reporting disclosures.

> ***We agree that the challenges in addressing disclosures do not affect just auditors, but also preparers, investors, regulators and other users of financial statements.***
> *Audit Inspection Unit and Auditing Practices Board (UK) (Regulators and Oversight Authorities)*

The majority of respondents expressed the view, some quite strongly, that many of the issues around disclosures could not be solved by the IAASB alone, and that an effective response would require a collaborative approach with other stakeholders. Many respondents specifically mentioned the International Accounting Standards Board (IASB) (and other financial reporting standard setters), but it was also observed that securities, audit and prudential regulators need to be involved, and the solutions supported by preparers and investors. Issues about materiality, in particular, were highlighted as an example of an area where collaboration would be required in order to make effective progress.

Many responses pointed to the need for a disclosure framework. A framework would not only serve to assist accounting standard setters when considering specific disclosure requirements, but would also help to guide judgments made by both preparers and auditors. In the view of many respondents, today's financial reporting frameworks do not adequately articulate the role and objective of disclosures in the financial statements and the criteria for including them. Others pointed to the inherent tension between the concepts of completeness and relevance, and therefore the need for a common understanding on how to balance these issues when making judgments about disclosures.

The need for a disclosure framework has already been recognized by various standard setters and other interested groups (who in some cases are working collaboratively):

- The European Financial Reporting Advisory Group (EFRAG) has undertaken a thought leadership project, "Disclosure Framework for the Notes to the Financial Statements," to stimulate debate about the content and form of disclosures with the aim of contributing to improved presentation and relevance of information in the financial report.
- The US Financial Accounting Standards Board (FASB) is currently working on a "Disclosure Framework Project" aimed at establishing an overarching framework intended to make financial statement disclosures more effective and coordinated and less redundant.[2]
- The Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA) jointly undertook a project for the IASB to review the level of disclosure requirements in existing International Financial Reporting Standards (IFRS) and to recommend deletions or changes to the IFRS disclosure requirements. Their initial findings were presented to the IASB in 2011.
- Further to the inputs received from ICAS and NZICA, the IASB is considering the priority for future phases of their conceptual framework, including developing principles for presentation and disclosure.

Comments varied on the role that regulators (including securities, audit and prudential regulators) play in relation to disclosures. Some believed that the behavior of the regulators influences the behavior of both preparers and auditors, and could be inadvertently adding to what a number of respondents perceive as excessive disclosures. Many thought that preparers and auditors would rather include information, regardless of materiality considerations, than be subject to challenge afterwards by the regulators for not including particular disclosures. On the other hand, some noted that regulators could play a valuable role in helping to identify emerging areas of concern or topical interest (such as the disclosures around sovereign debt). Ongoing dialogue and collaboration among regulators, preparers, and auditors in advance of a financial reporting season were identified as positive ways to promote a common understanding of those disclosures that are likely to be particularly important in the current environment.

> ***We believe that preparer and auditor perceptions of regulators, if not their actions, influence judgments about disclosures.***
> *The Association of Chartered Certified Accountants (Professional Institutes and Organizations – Europe and Africa)*

> ***It is therefore essential that IAASB's work in this area is coordinated with that of the IASB and not merely run parallel because the cross-over is too close and the issues of materiality for financial reporting and auditing purposes need to be addressed in tandem.***
> *Institute of Chartered Accountants in England and Wales (Professional Institutes and Organizations – Europe and Africa)*

For all of these reasons, the majority of respondents called for the IAASB to engage with accounting standard setters, in particular the IASB and the FASB, and regulators to explore collaborative solutions to many of the key issues that have been raised. Because the issues affect auditors as much as others in the financial reporting supply chain, many emphasized that it is important for the IAASB to be working with the accounting standard setters and others in developing solutions, such as the development of a disclosure framework.

The Concept of Reliability

Many respondents commented on the shift in the IASB Conceptual Framework terminology from "reliability" to "faithful representation." While some respondents identified this as a major change, many indicated they do not believe it has affected views on what is expected of preparers and auditors. A few respondents acknowledged that although they do mean different things, in practice the change is a semantic reflection of the reality of modern business—for example, the move toward fair value and the judgments that are required. Some noted that not all information in disclosures is reliable to the same degree; that is, some items are by nature less precise (such as disclosures based on subjective estimates, and disclosures that do not directly relate to financial statement line items). The majority of users expressed the view that such disclosures generally do not have, nor are they expected to have, the same "reliability" as financial statement line items. However, others believed that certain disclosures, or in one case all disclosures, should have the same reliability.

> ***Although we support faithful representation we are not convinced it provides investors the same amount of confidence as reliability.***
> *International Corporate Governance Network (Users and Preparers)*

> ***Members believe that the reliability of disclosures should be at the same level for any type of disclosure.***
> *Ordre des Comptables Agréés du Québec (Professional Institutes and Organizations – Americas)*

The observation was made that users of financial statements have different needs, and that the extent to which they expect information in different disclosures to be "reliable" may vary for their own particular needs. It was also acknowledged that work performed by the auditors is influenced by their assessment of risk and materiality based on their perception of the common information needs of all users. As such, it may not necessarily meet all individual users' particular needs.

Materiality

Integral to the topic of disclosures is how the concept of materiality applies. Responses across all stakeholder groups raised concerns about the length of disclosures reaching the point where they obscure readers' understanding of the entity's financial position and performance. Several respondents argued that unnecessarily detailed, duplicative or uninformative disclosures can decrease the effectiveness of financial reporting. There was a strong theme in the responses on the need for balance between financial statement disclosures that are necessary, while also enabling preparers to tailor their disclosures to their particular circumstances. However, some cautioned that potentially valuable information should not be eliminated merely because a disclosure note is considered voluminous.

> ***It is our experience that, while the concept of materiality is well understood by management, auditors and regulators when considering the accuracy of the primary financial statements, there is considerable uncertainty and variability of approach when this concept is applied to the note disclosures within the financial statements.***
> *The Hundred Group of Finance Directors (Users and Preparers)*

> ***Immaterial (and also 'boilerplate') disclosures, which do not convey relevant information about the entity can obscure the essential disclosures in the financial statements which can undermine understandability.***
> *European Banking Authority (Regulators and Oversight Authorities)*

Many preparers and auditors observed that making judgments about the appropriate amount of information to include in financial statement disclosures is a key challenge. A focus on consistency over relevance, complying with all disclosure requirements related to material financial statement items, and the use of "boilerplate" or generic narratives without appropriate tailoring, were cited as contributing to information being included in disclosures that is arguably not material in the circumstances of the entity. These respondents thought their omission would not have misled users and greater brevity could have increased the understandability of the financial statements.

Several respondents pointed to the extensive use of checklists as a source of the problem of excessive disclosures. However, others noted that it is illustrative of how preparers and auditors are unsure of whether it would be acceptable to apply a further materiality "filter" to disclosures identified in accounting standards as relevant to material line items in the financial statements.

Consistency with prior periods, and compliance with regulatory and legislative disclosure requirements, regardless of whether a disclosure is considered material or relevant, are other reasons believed to cause superfluous information being presented in financial statements. Some respondents believe it is consistency over time that is essential, and that consistency between entities is less important. However, others believed both are important.

Importantly, however, there was widespread agreement among respondents that many of the issues relating to materiality cannot be addressed by the IAASB on its own. Materiality is, in the first instance, a financial reporting concept and respondents argued that auditing guidance should not usurp the role of the financial reporting standards.[3] A comprehensive disclosure framework (as discussed in "Collaboration and Cooperation" on page 5), would assist preparers, auditors, regulators and others to better define what is considered "material" information in relation to disclosures, and would promote a consistent understanding about the application of materiality to disclosures in practice.

> ***A framework would provide important guidance to management, auditors and other stakeholders, including audit committees, in helping them make judgments with respect to the evaluation of materiality of individual disclosures and whether the financial statements as a whole achieve fair presentation.***
> *KPMG IFRG Limited (Audit Firms)*

There were different views expressed in the responses about the adequacy of the current guidance in the ISAs on materiality. Some respondents indicated that auditors would benefit from additional guidance in specific areas, for example, guidance as to the application of the concept of performance materiality in ISA 320[4] where quantitative amounts in disclosures are substantially larger than financial statement line items; and guidance on how to make materiality judgments in relation to qualitative disclosures, and disclosures not linked to a line item in the financial statements. Others were of the view that the ISAs contain sufficient guidance and that applying the concept of materiality to disclosures is a matter for financial reporting standard setters to address.

Misstatements

The evaluation of misstatements in disclosures was broadly highlighted as a challenging area. There is a largely accepted view that misstatements in disclosures cannot be accumulated in the same way as quantitative errors in line items in the financial statements. Many agreed that the overriding objective is to evaluate whether the potential misstatement, either individually or when appropriately taken into account with others, could reasonably be expected to influence the decisions of the users of the financial statements. The evaluation of misstatements in disclosures, including when and how they should be aggregated, necessarily requires professional judgment to assess their impact on the financial statements as a whole. It was noted by a few respondents that misstatements in disclosures may be indicative of possible management bias, or a trend towards deliberately misleading information, and bring into doubt the fair presentation of the financial statements as a whole.

> ***Qualitative misstatements are obviously less capable of 'accumulation', but the impact of quantitative misstatements from unrelated disclosures may not be additive either. On the other hand, recording them is useful as it helps to evaluate whether the misstatements are indicative of, for example, a trend towards deliberately misleading information.***
> *PricewaterhouseCoopers (Audit Firms)*

Many suggested that additional guidance in ISA 450 [5] to assist auditors in applying the auditing concepts for evaluating misstatements to disclosures would be helpful. Both quantitative and qualitative note disclosures were of concern.

On release of the IAASB Discussion Paper, the CFA Institute conducted a survey among its Financial Reporting Survey Panel on certain aspects covered by the Discussion Paper. One of the most interesting findings of this survey was the responses of the survey participants on disclosure matters that they believed would result in a material misstatement. The Discussion Paper had asked for views on attributes of disclosures that could result in a material misstatement, ranging from quantitative errors to omissions to more subjective attributes, such as how a particular disclosure was written. The following table shows the results from the CFA survey on this issue: [6]

Question: Which of the following disclosure matters do you believe would result in a material misstatement?

Omission of a required disclosure	**72%**
A quantitative error in a disclosure, that, if the same level of quantitative error were made in a line item in the financial statements, would result in a qualified opinion	**69%**
A quantitative error which is discovered in a subsequent period which would likely have changed a user's opinion as to the value of the enterprise if disclosed appropriately in the previous period	**68%**
Omission of a disclosure which is not required, but could materially impact a user's opinion as to the value of the enterprise	**66%**
A disclosure that is poorly worded so that it is not understandable	**33%**
A disclosure which is not sufficiently disaggregated to convey information which is likely to be decision-useful to investors	**32%**
The disclosure is accurate, but is obscured by poor presentation	**15%**
No opinion	**1%**
None – there are no disclosure matters that would result in a material misstatement	**1%**

Given that materiality is a concept based on the information needs of users, this feedback offers some interesting avenues to further explore. For example, the results seem to suggest that objective or quantitative aspects of disclosures are more important to users than subjective or qualitative considerations. The results also suggest that users expect preparers and auditors to go beyond the specific disclosure requirements of the applicable financial reporting framework and consider if there are other disclosures that could impact their opinion or decisions.

Fair Presentation

Many respondents, particularly regulators, commented explicitly that there is a need for the auditor to undertake a considered assessment of the audited financial statements as a whole, to assess whether fair presentation has been achieved. Some respondents noted that this "stand-back" review is, in the first instance, the responsibility of the preparers. For both preparers and auditors, respondents emphasized that this "stand-back" review is more than compliance with the requirements of the financial reporting framework and should include consideration of whether the financial statements fairly presents the financial information for users to be able to make informed economic decisions.

This is another area where stakeholders suggested that collaboration among regulators, auditors and preparers is essential to align expectations.

> ***…the concept of fair presentation gives a greater focus to the notion of understandability. This implies that all relevant information is adequately presented within the disclosures, regardless of whether or not there are any specifically prescribed disclosure requirements for that information.***
> *International Association of Insurance Supervisors (Regulators and Oversight Authorities)*

Audit Evidence

Auditability

The majority of respondents were of the view that auditability is an issue worthy of further reflection [7] in relation to financial reporting disclosures. While many believed that there are no disclosures presented in financial statements today that are not auditable, some commented that this is in the context of expressing an opinion on the financial statements as a whole.

> ***The quality of audit evidence is often the function of the quality of the process management has undertaken to produce the information to be audited.***
> *European Banking Authority (Regulators and Oversight Authorities)*

Many respondents expressed the view that the underlying issue was not inherent "auditability" but rather having a common understanding of the expectations of what support preparers need to have for the assertions they are making in the financial statements. While auditors have the responsibility to obtain sufficient appropriate audit evidence to support their opinion on the audited financial statements, some respondents noted that the availability of audit evidence is dependent, at least in part, on the underlying information provided by preparers to support the disclosures. Financial reporting frameworks, however, often do not set out what preparers are expected to do to be able to support assertions made in the disclosures they make, or establish documentation requirements for what is needed in an entity's books and records. Given the importance of supporting documentation to the auditability of financial statement disclosures, this is an area where further dialogue and collaboration with accounting standard setters is essential.

> ***If management's consideration of a disclosure… can be appropriately supported by evidence and documentation thereof, then a disclosure… is, by definition, auditable.***
> *Institut der Wirtschaftsprüfer (Professional Institutes and Organizations – Europe and Africa)*

> ***We believe that if there are questions about the auditability of an item there must also be questions about whether it is appropriate to be included in the accounts because it raises issues of whether the company, and in particular its board, has an appropriate basis for making such a disclosure.***
> *Hermes Equity Ownership Services (Users and Preparers)*

Respondents were generally of the view that if information is not capable of being audited, it should not be within the financial statements. A few were, however, comfortable with such information being left in the financial statements but labeled as unaudited.

Respondents acknowledged that the availability, and the nature and extent, of audit evidence, will vary on the item being audited. However, this was not seen as an impediment because the auditor is obtaining evidence as a basis for the opinion on the financial statements as a whole, and not separately opining on the disclosures individually. The quality of the audit evidence that can be obtained may be less objective or externally verifiable for some information disclosed than others, but most respondents thought that this was inherent to the nature of the individual disclosures.

A few respondents expressed the view that some information, such as where there are no suitable criteria or it relates to future actions of management, was not "auditable."

> ***Even if management's consideration of a disclosure required by the financial reporting framework can be appropriately supported by evidence and documentation, due to the nature of the information, there may be an expectation gap between the stakeholder's expectation regarding the auditor's role for such information and the actual role of the auditor on that information. In such a case, it is "unauditable" for the auditor to meet such stakeholder's expectation.***
> *The Japanese Institute of Certified Public Accountants (Professional Institutes and Organizations – Asia and Oceania)*

Work Effort

Many respondents agreed that the work effort on a fair value accounting estimate that is a disclosure only, and not linked to a line item, should be the same as the work effort on a fair value presented in the primary financial statements. Others argued, however, that the work effort would vary based on the auditor's assessment of risk and materiality, and would be influenced by their perception of how important the information is to users.

> ***We believe that where an entity prepares and discloses stress testing information, there is a presumption by users of the financial statements that the auditor has obtained evidence about the relevance and the appropriate performance of the stress test.***
> *International Corporate Governance Network (Users and Preparers)*

> ***It is not the auditor's role to assess the effectiveness of those stress tests. In each case, our firm view is that the auditor's role is to assess the accuracy and fullness of the disclosures in describing the procedures.***
> *Hermes Equity Ownership Services (Users and Preparers)*

Contrasting views were expressed on the necessary work effort with regard to certain disclosures. For example, on the proposed IASB "stress tests" (which, in February 2011, the IASB tentatively decided would not be required in the final standard *Financial Instruments: Amortised Cost and Impairment* but is a good illustrative example of the principle), several respondents believed that the focus should be on whether the disclosure properly describes the process the entity followed and the factual outcome of it. Several others, however, argued that the auditor should also evaluate and test the reasonableness of the test performed, including verification of whether the inputs and assumptions are reasonable. Several more respondents said that both should be tested. Some observed that, if the auditor is expected to probe beyond testing that the disclosure is a factual description, robust criteria would need to be established regarding how entities are expected to perform such tests. The breakdown between the three alternative views was virtually equal among the different categories of respondents.

Risk Assessment

The responses were mixed regarding the assessment of risk for disclosures. Responses broadly supported the view that obtaining sufficient appropriate audit evidence starts with a robust assessment of risk. Many responses, including those from auditors, acknowledged that the risk assessment for disclosures, particularly at the assertion level as required by ISA 315,[8] is often less formal than for other areas of the audit. Comments were made that evaluation of the entity's internal control over the disclosures is a critical step in identifying and assessing risks of material misstatements for disclosures. Overall, broad support was given for additional application guidance in the ISAs that emphasizes the importance of separately assessing the risks of material misstatement for disclosures and integrating the audit work on disclosures as part of the overall audit in order to promote best practice in this area.

> ***The risk assessment for disclosures that are associated with amounts on the face of the financial statements is generally more formal and more structured than the risk assessment process for other disclosures.***
> *Deloitte Touche Tohmatsu Limited (Audit Firms)*

Views on the ISAs

Some respondents noted that auditors tend to consider the current ISA disclosure requirements as part of auditing the related transactions or balances, although audit work on disclosures is often, in practice, done at the end of the audit process rather than at the same time as assessing the risks and planning responses to risks of material misstatement in the related line items. Many noted, however, that as disclosures are evolving—becoming more narrative, complex and broad—this approach may need to be reconsidered.

> ***We believe that the requirements and guidance in ISAs, while there are challenges related to auditing disclosures, are sufficient at this time. We believe it is premature to consider additional requirements or guidance, given the rapidly changing accounting rules.***
> *South African Institute of Chartered Accountants (Professional Institutes and Organizations – Europe and Africa)*

Many highlighted specific ISAs where they face challenges in applying them in practice to disclosures—predominantly ISA 320 and ISA 450 (which have both been previously discussed), but also ISA 315 with regard to applying more formalized risk assessment procedures to disclosures and ISA 330[9] with regard to obtaining audit evidence for certain disclosures. Suggestions were also made for the development of specialized auditing guidance for specific types of disclosures. For example, given the potential for significantly different views on what constitutes sufficient appropriate audit evidence regarding certain disclosures (such as the disclosure of the stress test discussed on page 10), some respondents said that guidance that defines the nature and extent of audit evidence that is appropriate in the circumstances would be useful.

> ***…Consideration should be given to whether the ISAs should separately identify the work required to audit disclosures, so that this work can have an appropriate focus.***
> *European Securities and Markets Authority (Regulators and Oversight Authorites)*

Overall, while respondents thought that there may not be a need for many new requirements in the existing ISAs to address disclosures, many thought that additional guidance would be useful. Some indicated they thought this might be achieved by adding application material to existing ISAs, others referred to the possibility of non-authoritative guidance to encourage best practice, and others recommended that all requirements for disclosures should be located in a single standard.

Practical Challenges and Useful Advice

Many preparers and auditors acknowledged that the most challenging aspect of preparing and auditing disclosures is where the information is not derived from the accounting system. Such information includes forward looking statements, descriptions of models used in fair value measurements, risk exposures and other narrative disclosures. Preparers also suggested that another challenge is to comply with the financial reporting standards without "overloading" the financial statements, and keeping them understandable. They said that meeting the needs of all users may result in excessive information and work.

> ***A challenge occurs when the applicable financial reporting framework does not establish documentation expectations with respect to disclosures for preparers.***
> *Grant Thornton International (Audit Firms)*

Auditors expressed the view that documentary evidence for disclosures could be variable, particularly for those areas noted above. They urged accounting standard setters to take the auditability of the information into account when developing financial reporting standards, and to consider what preparers are expected to do to support the disclosures they are required to make.

Several comments were received on the use of professional skepticism when auditing disclosures. Some have questioned the extent to which skepticism was in fact being applied by some auditors, for example, whether auditors challenge the materiality judgments used by the preparer in relation to disclosures or robustly challenge management's assertions underlying the disclosures. Views have been expressed that, to encourage clear and skeptical thinking, auditors should be guided to use more experienced staff to document audit evidence used as the rationale for key judgments and decisions, and to challenge management to disclose fully how figures and valuations have been derived.

> ***The IAASB needs to strengthen the requirements with respect to auditing disclosures to promote greater application of professional skepticism and a thinking, risk-based approach to auditing disclosures which will improve the quality of the disclosures provided to financial statement users.***
> *Canadian Public Accountability Board (Regulators and Oversight Authorities)*

Several respondents also offered useful advice on actions that could be taken now by preparers and auditors in practice. Both preparers and auditors agreed that timely preparation and consideration of disclosures are key to overcoming some of the challenges. Poor quality disclosures, including excessive and immaterial disclosures, can arise when disclosures are prepared and audited relatively late in the financial reporting process. In this regard, several respondents noted that the data gathering and preparation process relating to many disclosures is often started late in the overall financial reporting process, and is often less formal and less structured. As a result, there are generally few discussions about the materiality and consistency of the proposed disclosures.

Suggestions for useful proactive ways that auditors may be able to address this issue included initiating earlier in the audit process discussions and inquiries of management, including discussions on the surrounding processes and controls, and placing more emphasis on disclosures throughout the audit. Devoting sufficient time on this increasingly important area was recognized by many respondents as being key to improving the quality of disclosures.

> ***The issues around disclosures are not isolated to audit implications. They are closely related, and an integral part, of the ongoing debates on corporate reporting and auditor reporting.***
> *Hong Kong Institute of Certified Public Accountants (National Auditing Standard Setters)*

Beyond Disclosures

The Discussion Paper was released to explore issues related to disclosures. The responses received have extended, in some cases, beyond the ambit of disclosures and many have included comments on related subjects. Although various questions within the Discussion Paper were targeted at issues and challenges around auditing disclosures, it appears that, in many ways, the challenges are not specifically related to disclosures but rather the audit of the underlying numbers in the financial statement line items.

For example, ISA 540[10] addresses the auditor's responsibilities for the audit of accounting estimates, including fair values, and their related disclosures. Many respondents focused on challenges and issues in the audit of accounting estimates and fair values themselves rather than specifically on the audit of the related disclosures. For example, many discussed the practical issues around challenging management's assumptions and judgments; therefore it seems that the audit issues pertain more to the audit of the fair value or accounting estimate than to the related disclosures.

There is a perception by some that certain disclosures that may be challenging to audit, such as forward looking information, should not reside within the financial statements. Rather, the relevant information should be included as "other information" presented with the audited financial statements. If they were presented in this way, they would nevertheless be subject to the requirements of ISA 720.[11] A few others have suggested that an opinion under ISAE 3000,[12] or another applicable assurance standard, might be able to be given on that information and would be more appropriate than the fair presentation opinion on the financial statements. Others noted that certain information that is currently outside of the financial statements could usefully be brought into the auditor's report. For example, in Australia the detailed Remuneration Report does not form part of the financial statements but is opined on separately within the auditor's report.

Concern has been expressed by several respondents as to the requirement in ISA 705[13] for the auditor to include in the auditor's report material disclosures required to be made but which have been omitted. Various views were expressed on the relationship of the auditor's report and disclosures, particularly around what should be reported on, some of which has been discussed above.

Separately from the Discussion Paper consultation, other stakeholders have also recognized the importance of disclosures and have called upon the IAASB to address related issues. For example, the Financial Stability Board (FSB) released a report[14] in which it has "recommended that the IAASB review the need for further guidance on the level of assurance provided by external auditors on risk disclosures ..." both within the financial statements and outside.

THE WAY FORWARD

Financial reporting disclosures are an important component of public reporting to investors. Users should have access to full and fair disclosures in order to be able to make better informed investment decisions. The IAASB has identified the following initial steps in further progressing the valuable start made with the Discussion Paper and this Feedback Statement.

First, the IAASB firmly believes that collaboration and cooperation are key to advancing many of the issues identified. These include the application of the concept of materiality to disclosures, the identification and evaluation of misstatements, and the expectations regarding the support and documentation preparers need given the importance of that evidence to the inherent auditability of disclosures. Many of these issues may be addressed in the disclosure frameworks on the agenda of accounting standard setters. The feedback received will, therefore, serve as a valuable basis for the IAASB's upcoming collaborative activities with many relevant stakeholders, including standard setters and others actively engaged in this area. Views and perspectives on this area will be further explored, and awareness will be raised for many of the issues identified, as the IAASB continues its active liaison and outreach with the many stakeholders involved, pursuing the objective of continuous improvement.

The IAASB will also deliberate on the issues that should be addressed in IAASB standard-setting or other related activities in 2012, in response to the comments that have been received. These include, for example, issues such as the nature and extent of audit evidence needed for certain types of disclosures; how auditors might better identify and respond to risks of material misstatements in disclosures; and considerations in evaluating the impact of disclosures on the fair presentation of the financial statements. The first consideration for the IAASB will be whether standard setting is the most appropriate action and, if not, what other actions may need to be undertaken to address the issues that have been raised.

Lastly, the IAASB recognizes that comments received on this Discussion Paper may help inform the Board's deliberations on its projects for Auditor Reporting [15] and the revision of ISA 720. [16] The IAASB's future work program may include a project on ISA 540 to ensure that the standard continues to support robust, high-quality audit work in the area of accounting estimates, including fair values. Disclosures are likely to be an important element in any future project on ISA 540.

ABOUT THE IAASB

The IAASB (www.iaasb.org) develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants.

KEY CONTACTS

Prof. Arnold Schilder, IAASB Chairman (arnoldschilder@iaasb.org)

Jim Sylph, IFAC Executive Director, Professional Standards and External Relations (jimsylph@ifac.org)

James Gunn, IAASB Technical Director (jamesgunn@iaasb.org)

Beverley Bahlmann, IAASB Technical Manager (beverleybahlmann@iaasb.org)

LIST OF RESPONDENTS TO THE DISCUSSION PAPER

The summary has been prepared highlighting what the IAASB have learned from the responses to the Discussion Paper. If readers wish to read the full responses they can be found on the IAASB website.

Users and Preparers
The Australian Heads of Treasuries Accounting and Reporting Advisory Committee
Hermes Equity Ownership Services
The Hundred Group of Finance Directors
Hydro–Québec
International Association of Consultants, Valuators and Analysts
International Corporate Governance Network
The Quoted Companies Alliance
Regulators and Oversight Authorities
Audit Inspection Unit and Auditing Practices Board (UK)*
Audit Oversight Board–Securities Commission Malaysia
Canadian Public Accountability Board
European Banking Authority
European Securities and Markets Authority
Federal Audit Oversight Authority of Switzerland
Independent Regulatory Board for Auditors (South Africa)
International Association of Insurance Supervisors
International Organization of Securities Commissions
The Stock Exchange of Hong Kong Limited
National Auditing Standard Setters
Auditing Standards Board of the American Institute of Certified Public Accountants
Auditing and Assurance Standards Board of the Malaysian Institute of Accountants
Australian Auditing and Assurance Standards Board
Hong Kong Institute of Certified Public Accountants
New Zealand Institute of Chartered Accountants–Professional Standards Board
Audit Firms
Deloitte Touche Tohmatsu Limited
Ernst & Young Global
Grant Thornton International
KPMG IFRG Limited
PricewaterhouseCoopers

* For the purpose of this table only, the joint response letter from the Audit Inspection Unit and Auditing Practices Board (UK) has been listed once only in the "Regulators and Oversight Authorities" category.

Professional Institutes and Organizations–Americas
Florida Institute of Certified Public Accountants
Instituto Mexicano de Contadores Públicos
New York State Society of Certified Public Accountants
Ordre des Comptables Agréés du Québec
Professional Institutes and Organizations–Europe and Africa
The Association of Chartered Certified Accountants
The Association of International Accountants
Associazione Italiana Revisori Contabili
Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts–Comptables
Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili
Danske Revisorer (Danish Institute of Professional Accountants)
European Federation of Accountants and Auditors for SMEs
FAR (Institute for the Accountancy Profession in Sweden)
Fédération des Experts Comptables Européens
Institute of Chartered Accountants in England and Wales
The Institute of Chartered Accountants of Scotland
Institut der Wirtschaftsprüfer
Instituto de Censores Jurados de Cuentas de España
Nederlandse Beroepsorganisatie van Accountants
The South African Institute of Chartered Accountants
Professional Institutes and Organizations–Asia and Oceania
Australian Accounting Profession (CPA Australia, The Institute of Chartered Accountants in Australia, Institute of Public Accountants)
The Institute of Chartered Accountants of Pakistan
The Japanese Institute of Certified Public Accountants
Others
Felicitas T. Irungu
Dr. Joseph S. Maresca, CPA, CISA

ENDNOTES

1. This Feedback Statement is not intended to provide a complete detailed analysis of all of the comments received, but rather highlights the key common messages.
2. The FASB is cooperating with EFRAG and other national standard setters working on similar projects.
3. In November 2011, the European Securities and Markets Authority (ESMA) published a consultation paper, Consideration of Materiality in Financial Reporting. In this document, ESMA questioned whether different wordings between accounting standards and auditing standards lead to a different assessment of materiality for auditing purposes than that used for financial reporting purposes.
4. ISA 320, *Materiality in Planning and Performing an Audit*
5. ISA 450, *Evaluation of Misstatements Identified during the Audit*
6. The results have been presented here with the permission of the CFA Institute.
7. In November 2011, the US Securities and Exchange Commission held a roundtable of financial reporting series. At the roundtable discussion, one of the topics panelists discussed was issues around "auditability."
8. ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*
9. ISA 330, *The Auditor's Responses to Assessed Risks*
10. ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
11. ISA 720, *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*
12. ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*
13. ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*, para. 18
14. The report, *Thematic Review on Risk Disclosure Practices*, is available on the FSB website.
15. See *Auditor Reporting project history*.
16. See *ISA 720 project history*.




IFAC International Federation of Accountants