

Disclosures—Issues and Working Group Proposals**I. Background of Project**

1. The issue of auditors' responsibilities and practices regarding disclosures has been discussed by the IAASB in December 2009, by the IAASB CAG in March and September 2009 and at the June 2010 IAASB-National Standard Setters meeting. In March 2010 the IAASB agreed the establishment of a working group to explore and catalogue the issues and concerns around the audit of disclosures.
2. Since these discussions, the outreach activities of the IAASB Chairman and Deputy Chair with key stakeholders have further confirmed the importance of the proposed project.
3. The IAASB's work in this area comes at a crucial time. Other bodies have noted the importance of the topic of disclosures, for example:
 - The Financial Stability Board has invited feedback¹ on the risk disclosure recommendations that were made in the April 2008 Financial Stability Forum's *Report on Enhancing Market and Institutional Resilience*.
 - The US PCAOB Standing Advisory Group discussed the audit of disclosures and the need for judgment at its June 2010 meeting².
 - The UK Financial Services Authority and Financial Reporting Council released a joint paper³ which included specific commentary regarding the role of auditors in auditing disclosures.
 - The UK Financial Reporting Council commented⁴ on the increasingly voluminous disclosures in financial statements, and the possible effect of auditors in contributing to that trend, including how materiality is applied in relation to disclosures.
 - Both the European Financial Reporting Advisory Group and the US Financial Accounting Standards Board have projects underway to develop "disclosure frameworks" for the accounting standard setters.

II. Views Expressed About Auditors' Responsibilities Regarding Disclosures

4. The Working Group began by identifying various views or perceptions that have been expressed about issues that ought to be addressed about the auditor's responsibilities

¹ http://www.financialstabilityboard.org/press/pr_100721.pdf

² http://pcaobus.org/News/Events/Pages/07152010_SAGMeeting.aspx

³ *Enhancing the Auditor's Contribution to Prudential Regulation* (London: Financial Services Authority and Financial Reporting Council, June 2010), p.18

⁴ *Louder than Words* (London: Financial Reporting Council, 2009), p.42–45

regarding disclosures. The Working Group has not concluded on the accuracy of these perceptions but believes they need further investigation to determine whether they are valid and, therefore, need to be addressed or whether they are misunderstandings which may call for different actions. For example:

- Despite the ISAs treating the risks of material misstatement at the assertion level for disclosures equivalently to risks of material misstatement at the assertion level for classes of transactions and account balances, some parties have expressed the perception that auditors may not pay the same amount of attention to disclosures as they do to amounts on the face of the financial statements.
- Questions have been raised by some about how misstatements in disclosures are taken into account when evaluating whether the financial statements are free of material misstatement, and whether such misstatements are given the same weighting compared with misstatements related to account balances and classes of transactions.
- Views have been expressed by some that auditors may not be exercising sufficient judgment regarding disclosures in the financial statements. There may be a perception that auditors may not sufficiently challenge management and those charged with governance about whether all disclosures necessary are included in the financial statements. Alternatively, others may have the perception that auditors focus solely on completeness (i.e., use checklists) without applying judgment regarding whether all of those disclosures are necessary in the context of that specific entity.
- Some auditors as well as other stakeholders have raised questions regarding the “auditability” of some of the new disclosure requirements being introduced into financial reporting frameworks. There have also been questions raised in various forums about what constitutes sufficient appropriate audit evidence for some disclosures. Some argue that for such disclosures, auditors’ evidence gathering procedures may focus on process rather than numbers, but others take different views in this respect.
- There are also discussions underway in a number of fora about the boundaries of financial reporting. Some argue that information that is relevant to investors extends beyond the traditional boundaries of financial statements, and there is, at least for some, a growing interest in the concept of integrated corporate reporting⁵ across a broader range of performance information. Already there has been some blurring of the boundaries of the traditional financial statements, with some financial statement disclosures being permitted to be placed outside of the financial statements, and information that had traditionally been placed outside of the financial statements (and beyond the scope of the audit) being placed in the financial statements.

⁵ See, for example, the recent launch of the International Integrated Reporting Committee (<http://www.integratedreporting.org/>)

5. The above does not capture the full nature and range of issues, and the different views already expressed suggest that there is not necessarily consensus on the appropriate direction for the Working Group.
6. Some believe that the focus of the project should be on the auditor's responsibilities regarding the disclosures in the financial statements. This view considers that already there are a significant number of issues to consider regarding disclosures within the financial statements. The Working Group has benefitted from knowledge arising from the IAASB – IASB Liaison activity in this respect.
7. Others consider that the project should cover the issues that arise when the boundaries of the financial statements blur. This could have the effect of extending the scope of the project to consider the auditor's association with disclosures both within and outside the traditional financial statements. The Working Group is aware that certain aspects of this are being considered in the ISA 720 project (i.e., exploring the possibility for an extension of the auditor's "read and consider" responsibilities). In addition, any change in the auditor's responsibilities in respect of disclosures outside the financial statements would have significant implications for the scope of "statutory audits" and would require the engagement of and cooperation of regulators and other parties.

III. Proposed Way Forward

8. The Working Group believes that it is critical to obtain further information and perspectives on audit practice and priorities in this area in a form of Discussion Paper (DP) before proceeding to a project proposal. The need to seek further information in some circumstances before preparing a proposal has been recognized in IAASB projects in the past, such as the revisions of ISRE 2400⁶ and ISAE 3420.⁷ The implications of a poorly scoped project proposal (e.g., in relation to the expectations that may arise) will be difficult to rectify in the course of the project.
9. In addition, as noted above, preliminary input from different stakeholders indicate a broad range of views that seem, in some cases, to be divergent, if not contradictory. There is a need to explore those views and perceptions further to ensure they, and the underlying reasoning, are fully understood. Further, the Working Group is aware that there are debates underway in various fora⁸ on related issues and believes that a DP that is able to articulate the issues from an audit perspective could usefully contribute to those debates. For all of these reasons, the Working Group is of the view that developing a DP is an appropriate first step in the project.

⁶ ISRE 2400, *Engagements to Review Financial Statements*

⁷ ISAE 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*

⁸ See, for example, the organizations mentioned in paragraph 3

10. The objectives of the proposed DP would be:
 - To validate the issues identified by the Working Group and to seek feedback on those issues with the goal of assisting the Working Group in formulating a clear, targeted project plan; and
 - To provide a platform for the IAASB to participate in future discussions and international debate about the future of financial reporting relative to disclosures.
11. The DP would give the Working Group the additional range of views needed to focus the Project Proposal on the key issues. In the view of the Working Group, the issuance of a DP would not delay the eventual output of the project as, in the event that a project proposal was drafted immediately, the first steps of the project plan would include consultation. It is expected that the DP will be useful in obtaining input from many stakeholders such as auditors, preparers, users of financial statements, regulators, analysts and others.

Timeline

12. If the IAASB agrees with this approach, the Working Group would develop the DP for consideration at the December 2010 meeting with a view to releasing it following that meeting. The Working Group believes it is important to move swiftly to the DP, as it will assist the IAASB in engaging with others on the audit implications of disclosures at a critical time when key stakeholders are also considering the topic. Based on the feedback received to the DP, it is expected that the Working Group could present the project proposal to the IAASB in either June or September 2011.

Matter for IAASB Consideration

Does the IAASB support the development of a DP in moving forward on the project?
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IV. Proposed Discussion Paper

13. The Working Group has prepared an outline of the proposed DP which is included in the Appendix.

Scope

14. The DP will canvas a range of views and perspectives to ensure that the final project proposal is focused on the right issues and is achievable within the IAASB's remit and resources.

Views from Other Bodies

15. The DP would also highlight the recent reports and perspectives of other bodies such as the Financial Stability Board, the IASB, FEE and various national regulators and oversight bodies. This gives the opportunity for respondents to inform the IAASB's project by reflecting on the audit issues implicit in the work of these other bodies as well as the opinions expressed on the adequacy of the auditors work in respect of disclosures. This section will analyze the perceptions of other bodies relative to the audit of disclosures.

Current ISA Requirements and Guidance on Disclosures

16. The DP would include a summary of the current ISA requirements and guidance on disclosures. It will also include commentary on the relationship with other relevant IAASB projects, such as those on ISA 720.

Major Areas Seeking Input

17. This aspect of the DP would identify the areas to which opinions are sought from the range of stakeholders, such as preparers, securities regulators, audit inspectors, stock exchange operators, prudential regulators, analysts, auditors and users.

Matter for IAASB Consideration

The IAASB is asked for its views on the major areas that the DP should cover.

Appendix

Outline of Proposed Discussion Paper

1. Introduction—A brief discussion of the evolving nature of financial reporting and the expansion of disclosure requirements and a statement of the audit challenges regarding disclosures
2. Views from Other Bodies—A short analysis of major reports issued by other bodies and any work in progress which touches on the audit issues around disclosures. This section will include an analysis of perceptions regarding the impact of the evolving nature of financial reporting on preparers' and auditor's approaches to information presented in financial statements and those provided in the notes. This section will direct readers to a short "reading list" of key publications in an appendix.
3. Current ISA Requirements and Guidance on Disclosures—This section highlights the extant ISA requirements and guidance, as well as current projects of the IAASB that impact on the audit of disclosures.
4. Major Areas Seeking Input—The section captures the various issues that have been identified regarding the audit of disclosure. This section aims to express the broad range of views on these issues, the reasons for those views and the audit implications arising from them.

What disclosures should be audited? For example:

- The implications of the blurring of boundaries around financial reporting disclosures, such that some disclosures are permitted to be located outside the financial statements.
- The implications that arise from disclosures (whether currently required by financial reporting frameworks, or being contemplated), that may inherently be difficult to audit or for which it is unclear what would constitute sufficient appropriate audit evidence.

What judgments need to be made regarding the disclosures that should be included in the financial statements? For example:

- The completeness of disclosures to achieve fair presentation, including the assessment of materiality of disclosures.
- The auditor's responsibility to evaluate the adequacy of disclosures in light of both the requirements of the applicable financial reporting framework and the intended users.⁹

What constitutes sufficient, appropriate audit evidence to support disclosures? For example:

- Management's responsibility to have support for their disclosures.
- The auditor's work effort in respect of different types of disclosures, including what is considered to be relevant and reliable evidence in relation to them.

⁹ ISA 700, *Forming an Opinion and Reporting on Financial Statements*, paragraph 13(e)

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- How disclosure misstatements are evaluated in conjunction with misstatements of items presented on the face of financial statements, and how materiality is applied in evaluating the misstatement of disclosures.
- Responses to the risk of management bias in the selection and presentation of disclosures, such that the financial statements do not achieve fair presentation.