

**Auditing Disclosures – Issues and Task Force Views**

1. It has been widely acknowledged that many stakeholders have a role in improving financial reporting, including auditors. An overview of the work of others in this area, including the International Accounting Standards Board (IASB), can be found in Appendix 1.
2. The definition of “financial statements” in the IAASB’s *Glossary of Terms*<sup>1</sup> includes the information contained in the related notes. Notwithstanding that there are many references to “financial statements” in the requirements and related application and other explanatory material (“application material”) throughout the ISAs, which are also intended to address the auditor’s work in relation to the notes to the financial statements, the Task Force has the view that it would benefit auditors and enhance their understanding if amendments and enhancements are made to the ISAs in selected areas. Therefore the Task Force has carefully considered those areas where changes would be most impactful and how best to propose changes.
3. The Task Force believes that limited amendments to certain requirements in the ISAs, together with the enhancements to the application material, will improve the ISAs in areas where issues and concerns about auditing disclosures have been raised, and that such changes are responsive to the feedback obtained from the Discussion Paper (DP) (see January 2012 IAASB [Feedback Statement](#)).
4. The Task Force is of the view that the proposed set of changes to the ISAs will drive auditor behavior and improve audit quality with regard to auditing disclosures. The possible amendments should be considered as a package, rather than as isolated changes.
5. At its December 2012 meeting, the IAASB supported an approach whereby limited amendments to the requirements were identified (see Agenda Items [3-A](#) and [3-B](#)). The IAASB also agreed that developing new and revised application material in these and other ISAs would likely assist auditors in applying the principles-based requirements when auditing disclosures.
6. The Task Force acknowledges the concern expressed by some IAASB members about implementing changes to a number of ISAs through this project, in particular because other significant current and planned IAASB projects may also affect a number of ISAs. However, the implementation date for any changes to the ISAs to address auditing disclosures will be determined taking into consideration other IAASB projects that are currently underway or would otherwise be finalized at that time.
7. In proposing changes to the ISAs, including new application material, the Task Force took a holistic view of how disclosures would be considered throughout a financial statement audit. Accordingly, changes are proposed to a number of ISAs to reflect how disclosures could be approached at key stages of the audit.

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<sup>1</sup> In the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*

8. The possible changes to the ISAs are summarized in the table below, with further detail on the Task Force's considerations and views following the table:

Affected ISA	Changes in requirements / application guidance	Summary of possible changes
ISA 210 <sup>2</sup> (Appendix 2)	Application material	To consider making specific reference to information in the notes to the financial statements in the <b>audit engagement letter</b> .
ISA 240 <sup>3</sup> (Appendix 2)	Application material	To emphasize that the <b>engagement team discussions</b> may also include consideration about the risk of material misstatement arising from fraud in the disclosures in the notes to the financial statements.
ISA 260 <sup>4</sup> (Appendix 2)	Application material	To further emphasize <sup>5</sup> the importance of auditing disclosures in the notes to the financial statements as a matter that may be <b>communicated to those charged with governance</b> at the planning stage of the audit.
ISA 300 <sup>6</sup> (Agenda Item 4–B.1)	Application material	To recognize the importance of <b>planning audit procedures</b> at an early stage for disclosures in the notes to the financial statements, particularly in light of the wide range of information that could be included in disclosures, and also to consider information that may be generated by systems outside traditional financial reporting systems. <sup>7</sup>
ISA 315 (Revised) <sup>8</sup> (Agenda Item 4–B.2)	Application material	<p><b>Application material</b></p> <p>To reinforce audit considerations with respect to disclosures when <b>identifying and assessing the risks of a material misstatement</b>, e.g., in the engagement team discussion, and to include consideration of information in disclosures from systems outside of traditional financial reporting systems.</p> <p><b>Assertions</b></p> <p>To revise assertions within Presentation and Disclosure,</p>

<sup>2</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>3</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

<sup>4</sup> ISA 260, *Communication with Those Charged with Governance*

<sup>5</sup> Appendix 2 of ISA 260 notes that matters that may be communicated with those charged with governance include views about the adequacy of disclosures relating to accounting estimates, specific references to sensitive financial statement disclosures and views on the overall consistency, neutrality and clarity of the disclosures in the financial statements.

<sup>6</sup> ISA 300, *Planning an Audit of Financial Statements*

<sup>7</sup> An example would be disclosures generated outside of the general ledger, such as a model developed for a sensitivity analysis.

<sup>8</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Affected ISA	Changes in requirements / application guidance	Summary of possible changes
		including modifying the descriptions and additional explanatory guidance for applying the assertions.
ISA 320 <sup>9</sup> (Agenda Item 4–B.3)	Requirements and application material	<p><b>Requirements</b></p> <p>A new requirement has been added to <b>consider the risk of material misstatements in narrative disclosures</b>, together with related application material.</p> <p><b>Application Material</b></p> <p>Additional examples have been provided about the types of areas in narrative disclosures that could be considered for further auditor work effort.</p>
ISA 330 <sup>10</sup> (Agenda Item 4–B.4)	Application material	To highlight consideration of the expected timing of audit procedures with respect to disclosures when <b>responding to risks of material misstatements</b> , and to update the auditor's considerations of the adequacy of presentation and disclosure to be consistent with changes proposed to the assertions.
ISA 450 <sup>11</sup> (Agenda Item 4–B.5)	Application material	To provide further application material on considerations around <b>aggregating and evaluating misstatements in disclosures</b> , including in narrative disclosures.
ISA 700 <sup>12</sup> (Appendix 2)	Requirements and application material	Clarifying that the auditor's <b>evaluation</b> includes consideration of the requirements of the applicable financial reporting framework and the ISA assertions, with relevant amendments to the related application material.

### ISA 210, *Agreeing the Terms of Audit Engagements*

9. ISA 210 had not been initially identified as requiring change as part of this project. However, at the April 2013 IAASB meeting, a Board member suggested that consideration be given to specifically referring to disclosures in the audit engagement letter to remind management of their responsibilities to provide the disclosures to the auditor on a timely basis, and to obtain agreement between the auditor and management as to when they would be prepared. The Task Force agreed, and has included a possible change to ISA 210 in this regard (see **Appendix 2** (ISA 210 mark-up

<sup>9</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>10</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>11</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*

<sup>12</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*

for Auditor Reporting changes, paragraph A23<sup>13</sup> and the example engagement letter in Appendix 2).

#### **ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements***

10. ISA 240 had also not been originally identified as requiring change. The Task Force has considered enhancing ISA 315 (Revised) relating to the application material for the engagement team discussion (see paragraph 18 below). On further reflection it was agreed that making reference in ISA 240 to disclosures in explaining the matters that may be discussed by the engagement team when considering the risk of material misstatement arising from fraud and error to specifically include disclosures would:
  - (i) Be consistent with the proposed change to ISA 315 (Revised); and
  - (ii) Also be helpful to focus the auditors on this element during their engagement team discussions (see **Appendix 2**, ISA 240, paragraph A11).
11. The Task Force also considered whether additional examples in ISA 240, Appendix 2, *Fraud Risk Factors*, would potentially highlight disclosures, but it felt that the list provided was comprehensive and that nothing more should be added.

#### **ISA 260, *Communication with Those Charged with Governance***

12. Discussions at the December 2012 IAASB meeting highlighted that further consideration should be given to including disclosures and the implications on the planned audit approach in the communications with those charged with governance at the planning stage of the audit. This was presented at the April 2013 IAASB meeting (see [Agenda Item 5-B](#)), and no further comments were noted; therefore, no further changes in ISA 260 are proposed beyond those presented at the April 2013 meeting (see **Appendix 2**, paragraph A12).

#### **ISA 300, *Planning an Audit of Financial Statements***

13. The Task Force presented possible changes to ISA 300 at the April 2013 IAASB meeting (see [Agenda Item 5-B](#)). Some Board members had the view that more emphasis should be added in ISA 300, while others had the view that ISA 300 was not the correct place; rather, the additional guidance would be better placed in ISA 315 (Revised).
14. The Task Force discussed whether to include another requirement specifically to emphasize disclosures in ISA 300, but felt that the extant requirements already included this at a principles level,<sup>14</sup> which is how ISA 300 is presented, and that no further changes would be proposed.
15. The Task Force also considered comments from the IAASB in April 2013 on the possible changes presented in the application material to ISA 300, and made various changes to respond to the comments made, including to emphasize that planning early would be beneficial when considering:
  - The wide range of information that may be included in disclosures, and

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<sup>13</sup> Conforming amendments would also need to be made in the illustrative management representation letter in ISA 580, *Written Representations*.

<sup>14</sup> See paragraphs 7 and 8 of ISA 300.

- That the information may be generated by systems outside traditional reporting systems<sup>15</sup> (see **Agenda Item 4-B.1** paragraphs A12a and A12b).

The Task Force has also enhanced the considerations in establishing the overall audit strategy to include disclosures more specifically in the **Appendix** to ISA 300.

**ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment***

*Possible Changes to ISA 315 (Revised) (Excluding the Assertions)* (see **Agenda Item 4-B.2**)

16. No gaps in the requirements were identified in the initial analysis of the responses to the DP (see Agenda Item 3-B from the December 2012 IAASB meeting). The Task Force further explored whether to add to, or amend, the requirements in relation to disclosures, in particular around whether to specifically include information that is generated by systems outside traditional financial reporting systems in paragraph 18 of ISA 315 (Revised). However, the Task Force continued to have the view that, using a principles-based approach, the requirements for planning in relation to disclosures, regardless of where the information is generated, are sufficient, and that any changes to focus the auditor or emphasize work effort should be made in the application material.
17. Changes to the application material were presented to the IAASB at the April 2013 meeting (see [Agenda Item 5-B](#)) to include specific references to disclosures, particularly in relation to understanding the entity and its environment, and aspects of internal control. Comments from the IAASB on this material included that the Task Force should further consider:
  - Emphasizing that there are a wide range of disclosures, some of which contain information that is generated by systems outside traditional financial reporting systems, and for which further audit consideration may need to be given. On further consideration by the Task Force, it was agreed that this would be best placed in ISA 300; and
  - Including material to urge the engagement team to specifically discuss the susceptibility of the financial statements to the risk of material misstatement, whether due to fraud or error, arising from disclosures.
18. Taking into account the IAASB's comments from the April 2013 meeting, and on further analysis of the concerns that had been raised in the responses to the DP, as well as considering what is done in practice, the Task Force had the view that enhancements to the application material would be beneficial as follows:
  - Additional guidance for specifically discussing disclosures during the engagement team discussion (paragraph A21a);
  - Reference to the need to consider disclosures when considering complex transactions and events, and related party transactions (paragraph A30);
  - Emphasizing that disclosures may be considered in connection with financial reporting requirements and controls (paragraphs A31 and A80);
  - Adding guidance for other sources of information outside of traditional financial reporting systems (paragraphs A89 and A89a);

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<sup>15</sup> These additions were made based on feedback from the IAASB at the April 2013 IAASB meeting.

- Providing examples of factors that may affect the identification of risks of material misstatements in disclosures (paragraph A127a); and
- Other areas where the Task Force believed a reference to disclosures in the notes to the financial statements should be added (paragraphs A1 and A26).

*Assertions: Presentation and Disclosure* (see **Agenda Item 4-B.2**)

19. Questions have arisen about whether the assertions for presentation and disclosure explained in paragraph A124 of ISA 315 (Revised) are appropriate and useful when auditing disclosures.
20. At the April 2013 IAASB meeting (see [Agenda Item 5-A](#)), the Task Force presented their initial views, for IAASB consideration, on changes that could be made to the assertions. At that time, the Task Force had mixed views on the way that the possible changes could be made, for example either to:
  - Revise and enhance the descriptions of the assertions as they are currently presented;
  - Separate the assertions into their component parts and revise the description appropriately; or
  - Make fundamental changes to the extant assertions and descriptions.

IAASB Views

21. The IAASB agreed that this was a difficult area to address and supported the Task Force's efforts in considering whether changes were necessary. Different views were also expressed by IAASB members on how to make changes to the extant assertions.
22. Detailed comments from IAASB members included that:
  - (a) Any changes proposed should assist auditors to sensibly and practically apply the assertions for presentation and disclosure.
  - (b) The assertions should be simplified, even if it resulted in a more fundamental change to the assertions. Others had the view that the extant assertions should remain unchanged, but changes made to the explanation of what they represented to make them more relevant and support their use in practice. Another Board member had the view that fundamental changes to the assertions may not significantly enhance audit quality.
  - (c) Consideration should be given to separating presentation from disclosure because they are different by nature—disclosures encompass a much broader set of information. Others had the view that they were closely related and should remain together as one assertion.
  - (d) Further consideration should be given to the wording of the fundamental qualitative characteristics of financial information in the financial reporting standards, as some had the view that the qualitative characteristics were clearer. However, this did not mean re-characterizing the auditing assertions to be the same as the financial reporting qualitative characteristics, because they are used for different purposes.
  - (e) Consideration be given to including the concept of the “stand-back” review, i.e., whether the financial statements achieved fair presentation, or give a true and fair view, into the assertions.

23. It was also noted that the IAASB should continue to work with the IASB in this area as they further reflect on their Conceptual Framework project that is currently underway. However, it should be noted that at this point the IASB has not given any indication that it will be reconsidering the fundamental qualitative characteristics.

#### Task Force Views

24. The Task Force has extensively discussed various options for changes to the assertions, including separating presentation from disclosure, revising the assertions within presentation and disclosure, and revising the descriptions.
25. The auditing standards do not define what either “presentation” or “disclosure” means. The following paragraphs set out the financial reporting interpretation of the meaning of “presentation” and “disclosure”, and how this may differ from the auditing standards’ use of these terms.
26. In the context of financial reporting, the term “presentation” may attract different meanings. IAS 1<sup>16</sup> prescribes “the basis for presentation of general purpose financial statements to ensure comparability...”. Others have the view that “presentation” has a more specific meaning, i.e., the depiction of financial information in words and monetary amounts on the face of the entity’s financial statements.”<sup>17</sup> For the purposes of discussion on their conceptual framework, the IASB uses presentation to mean the disclosure of financial information on the face of the entity’s primary financial statements.
27. In the Task Force’s view, presentation for auditing purposes applies to both the face of the primary financial statements, as well as to the notes. For example, the “presentation” of certain notes, such as segment reporting, may be particularly important to an entity and therefore would require auditor attention. The Task Force does not believe that this difference in interpretation with the financial reporting standards would cause confusion but has added application material (in Agenda Item 4-B.2 paragraph A124a) to make this clear.
28. Financial reporting standards interpret disclosure to have a broader meaning than presentation. “Disclosure is the process of providing relevant financial information about the entity to users. It is the entity’s own facts and circumstances that determine what information is presented in the primary financial statements and what information is disclosed in the notes to the financial statements. The notes disclose relevant information required by the applicable financial reporting framework that is not presented on the face of the primary financial statements.”<sup>18</sup> The Task Force agrees with this view that disclosure applies to both the face of the primary financial statements and the notes to the financial statements, and has therefore agreed that no further guidance in the ISAs is required.

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<sup>16</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

<sup>17</sup> Paragraphs 7.9 to 7.10 of the IASB’s Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*, (IASB Conceptual Framework DP) issued in July 2013. Paragraph 7.14 of the IASB DP defines the term “primary financial statements” to mean the statement of financial position; the statement of profit or loss and OCI (or the statement of profit or loss and the statement of comprehensive income); the statements of changes in equity; and the statement of cash flows.

<sup>18</sup> Paragraphs 7.11 to 7.13 of the IASB’s Conceptual Framework DP

29. The Task Force has reflected on the possible changes that could be made to enhance the assertions, and has the view that:

- The category “presentation and disclosure” should not be separated. Notwithstanding that disclosures is a broader concept than presentation, both concepts apply to the primary financial statements as well as to the notes to the financial statements (with a proposed change to make this point in the application material). Separating presentation from disclosure would result in repetition of some assertions within each category, which may be confusing to auditors.
- Changes should be made to the four existing assertions within the presentation and disclosure category<sup>19</sup> to make them more relevant for evolving financial reporting and more understandable and usable. In addition, changes are proposed to the description of each where necessary.
- Adding further application guidance to emphasize that the assertions applying to account balances at the end of the period, and transactions and events during the period, also apply to disclosures directly related to these will reinforce that the audit of the related disclosures is done at the same time as the underlying numbers, and is not a separate exercise (see Agenda Item 4-B.2 paragraph A124b).

See **Agenda Item 4-B.2** (ISA 315 (Revised)) for the revised assertions, and related descriptions (paragraph A124(c)).

30. In revising the assertions about presentation and disclosure, the Task Force has considered the accounting qualitative characteristics, what others have defined as their assertions for presentation and disclosure,<sup>20</sup> and what is being done in practice. The Task Force believes that the proposed changes will satisfy the desire to simplify the assertions, and make them useful and practical for auditors to apply.

### **ISA 320, *Materiality in Planning and Performing and Audit***

31. The Task Force explored possible changes to ISA 320 with the IAASB in April 2013. Concern was expressed by a few IAASB members about the possible changes presented addressing the auditor’s application of materiality, including performance materiality, to qualitative disclosures. Some IAASB members had the view that the issue was the relevance of disclosures rather than applying the concept of materiality. The Task Force re-deliberated and formed the view that an additional requirement to consider narrative disclosures, separate from the auditor’s consideration of quantitative amounts (both in the primary financial statements and the notes), would appropriately focus the auditor on those narrative disclosures and highlight that unique audit effort may be needed. To support the new requirements, the Task Force also added application material to provide examples of the types of factors that the auditor may consider in relation to narrative disclosures (see **Agenda Item 4-B.3** paragraphs 11a and A12a, as well as the clarification in paragraph 10).

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<sup>19</sup> The extant assertions are: Occurrence and rights and obligations; completeness; classification and understandability; and accuracy and valuation.

<sup>20</sup> Other standard setters, such as the US Public Company Accounting Oversight Board (PCAOB), only have one assertion for presentation and disclosure (defining it as “the components of the financial statements are properly classified, described, and disclosed”), and most of the large firms also only have one assertion covering presentation and disclosure.



32. The Task Force also considered whether to add a requirement around documentation for the new requirement relating to narrative disclosures. However, the Task Force is of the view that this is adequately covered in principle by ISA 230.<sup>21</sup>
33. In addition, the Task Force had the view that additional examples, specifically referencing disclosures, may assist auditors in determining whether they may need to focus on certain disclosures where misstatements of lesser amounts than materiality may be relevant to users for making economic decisions (**Agenda Item 4-B.3** paragraph A10). Other changes of a relatively minor nature, further to those discussed in April 2013, are also proposed.

### **ISA 330, *The Auditor's Responses to Assessed Risks***

34. Possible changes to ISA 330 have not yet been discussed with the IAASB.
35. The Task Force continues to have the view that no further changes to the requirements in this standard are required, which is consistent with the view on initial assessment. However, the Task Force believes that additional application material would be useful, including:
- Emphasizing that, when responding to the risk of material misstatement, the auditor considers when the disclosures will be prepared in determining the timing of the work to be performed (see **Agenda Item 4-B.4** paragraph A13a); and
  - Clarifying that the planned work for the evaluation of the overall presentation of the financial statements includes the assertions for presentation and disclosure (see **Agenda Item 4-B.4** paragraph A59).

### **ISA 450, *Evaluation of Misstatements Identified during the Audit***

36. Possible changes to ISA 450 have not yet been discussed with the IAASB.
37. The Task Force considered whether to enhance the requirements for narrative disclosures, to mirror the change proposed to the requirements in ISA 320. On further reflection, the Task Force is of the view that there are sufficient requirements in ISA 450 in relation to disclosures, for both amounts and narrative disclosures, which is consistent with the IAASB's initial views in December 2012 (see **Agenda Item 3-B** from December 2012 IAASB meeting).
38. The Task Force believes that additional application material to support the requirements to aggregate identified misstatements, and evaluate these misstatements, would be beneficial to auditors, as well as be responsive to some of the issues that were raised by respondents to the DP in this area, including:
- Adding examples to the definition of a misstatement for misstatements in disclosures, demonstrating that these also may need to be considered (see **Agenda Item 4-B.5** paragraph A1).
  - Clarifying that misstatements of amounts in disclosures should be aggregated (see **Agenda Item 4-B.5** paragraph A2).
  - Clarifying that consideration still may need to be given to the cumulative effect of narrative disclosures (see **Agenda Item 4-B.5** new paragraphs A3a and A13a).

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<sup>21</sup> ISA 230, *Audit Documentation*

- Adding application material on additional auditor considerations around misstatements in disclosures (see **Agenda Item 4-B.5** new paragraph A17a).

## ISA 700

39. Possible changes to ISA 700 relating to disclosures have not yet been discussed with the IAASB.
40. The Task Force considered the requirements of ISA 700, in particular regarding the “stand-back review”, as some respondents to the DP had expressed concern about the assessment of the audited financial statements as a whole. The Task Force is of the view that the requirement in ISA 700<sup>22</sup> is sufficient. However, due to the evolving nature of disclosures, and the growing importance of disclosures, the Task Force has identified possible amendments to the requirement to strengthen the evaluation of the financial statements in view of the requirements of the applicable financial reporting framework with regard to disclosures, including relating this evaluation back to the (proposed) revised assertions. Consistent changes have been made to the application material. (See **Appendix 2** paragraphs 13 and A4).

### Matters for IAASB Consideration

1. The IAASB is asked for its views on the appropriateness of the proposed changes to the ISAs as set forth in **Appendix 2** and **Agenda Items 4-B.1–4-B.5**. Are there any additional changes that, in the IAASB’s view, are necessary to enhance the auditing of disclosures?
2. Do IAASB members agree with the proposed changes to the assertions in ISA 315 (Revised), including the Task Force’s recommendations to continue to link the assertions relating to presentation and disclosure?

### Way Forward

41. The Task Force intends to further refine the proposed changes to the ISAs in light of the IAASB’s feedback on Questions 1 and 2. It envisages that a first read of the Exposure Draft illustrating these changes could be presented to the IAASB as the basis for its next discussion.
42. The Task Force is continuing to consider an appropriate response to concerns raised regarding sufficient appropriate audit evidence, and is deliberating whether the development of material in this respect is practical.

### Educational Guide

43. At this stage, the Task Force has continued to concentrate its efforts on developing possible changes to the ISAs rather than the educational guide for following reasons:
- The educational guide would need to be developed in conjunction with changes to the ISAs; however, since no changes have been made to the ISAs at this point, the guide would need to be based on existing material in the ISAs, which may reduce the usefulness of the guide.
  - There is an expectation for changes to the ISAs – a clear message from the IAASB Consultative Advisory Group (CAG) indicated their preference for changes to the ISAs rather than non-authoritative guidance.

<sup>22</sup> Paragraph 14 of ISA 700 requires the auditor to evaluate whether the financial statements achieve fair presentation.

- Changes to the ISAs will help focus auditors on disclosures and have the greatest impact on audit quality.
44. However, the Task Force believes that the material in this educational guide would be useful to support the existing material in the ISAs and the changes that are being proposed, and is continuing to develop and refine the educational guide.

## Appendix 1

### Summary of Other Developments and Initiatives

1. This Appendix sets out the current status of other developments and initiatives currently in progress relating to disclosures and materiality.

#### International Accounting Standards Board (IASB)

2. In 2012, the IASB restarted its Conceptual Framework project. One of the focus areas in developing the Conceptual Framework is 'Presentation and Disclosure'.
3. The IASB decided to build on the existing Conceptual Framework, updating, improving and filling in gaps rather than fundamentally reconsidering all aspects of the Conceptual Framework. Consequently, the IASB decided not to revisit all chapters of the Conceptual Framework, including those on materiality and the qualitative fundamental characteristics of financial information.
4. The IASB released its Conceptual Framework Discussion Paper (DP), [\*A Review of the Conceptual Framework for Financial Reporting\*](#), in July 2013.
5. The existing Conceptual Framework does not include any guidance on presentation and disclosure. Of relevance to the IAASB's disclosures project, the IASB has included the following in its DP:
  - Financial statements comprise the primary financial statements and the notes to the financial statements. The primary financial statements are:
    - (i) The statement of financial position;
    - (ii) The statement(s) of profit or loss and other comprehensive income (or the statement of profit or loss and the statement of comprehensive income);
    - (iii) The statement of changes in equity; and
    - (iv) The statement of cash flows.
  - The primary financial statements convey summarized information about an entity. They are not complete in themselves and are supported by notes to the financial statements.
  - No primary financial statement has primacy over the other primary statements and they should be looked at together.
  - In order to provide information that is useful to users, classification and aggregation into line items and sub-totals should be based on similar properties (for example, the nature, function or measurement basis of the item).
  - The purpose of the notes to the financial statements is to support the primary financial statements and to provide any additional useful information.
6. In January 2013, the IASB held a discussion forum on the topic of disclosures in financial reporting. The purpose of the forum was to obtain a clearer picture of the "disclosure problem" and to explore ways of addressing the concerns raised, within existing requirements, to improve the quality of disclosures. The forum was attended by 120 people including preparers, auditors, regulators, users and standard-setters and others who have a role to play in improving the quality of disclosures in financial reporting.

7. The key messages from the Disclosures Forum can be found in the IASB's [Feedback Statement](#). The Task Force Chair attended this forum (as a panelist), together with another member of the Task Force.
8. Resulting from the forum, the IASB have identified some specific actions to deliver tangible improvements to disclosures in financial reporting:<sup>23</sup>
  - Short-term actions including:
    - (i) Clarifying in IAS 1<sup>24</sup> that the materiality principle does not only mean that material items should be included, but also that it can be better to exclude non-material disclosures.
    - (ii) Clarifying that a materiality assessment applies to the whole of the financial statements, including the notes. Therefore if an item is not material, it does not need to be disclosed anywhere at all in the financial statements.
    - (iii) Clarifying that if a standard is relevant to the financial statements, it does not automatically follow that every disclosure requirements in that standard will provide material information. Instead, each disclosure will have to be judged individually for materiality.
    - (iv) Removal of language in IAS 1 that has been interpreted as prescribing the order of the notes to the financial statements.
    - (v) Making sure that IAS 1 allows flexibility about where they disclose accounting policies in the financial statements. Important accounting policies should be given greater prominence in financial statements.
    - (vi) Further consider the creation of either general application guidance or educational material on materiality, in a joint initiative with the IAASB and IOSCO.
    - (vii) Using less prescriptive wordings for disclosure requirements when developing new standards. Instead, the focus will be on disclosure objectives and examples of disclosures to meet the objectives.
  - Medium-term actions:
    - (i) Commence a research project to undertake a more fundamental review of IAS 1, IAS 7<sup>25</sup> and IAS 8.<sup>26</sup> To revisit some of the work already done in the IASB's Financial Statement Presentation project. The goal will be to replace those standards, in essence creating a new disclosure framework.
    - (ii) Undertaking a general review of disclosure requirements in existing standards.

### **Financial Accounting Standards Board (FASB)**

9. The FASB issued a [Disclosure Framework Invitation to Comment](#) in 2012 with a comment period that ended on November 16, 2012. Eighty-four comment letters were received. The Staff of the

<sup>23</sup> Summary of actions as outlined in Hans Hoogervorst's speech "[Breaking the Boilerplate](#)" on June 27, 2013 in Amsterdam

<sup>24</sup> International Accounting Standard (IAS) 1, *Presentation of Financial Statements*

<sup>25</sup> IAS 7, *Statement of Cash Flows*

<sup>26</sup> IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

FASB analyzed the comment letters and provided a summary to Board members on May 7, 2013. In June 2013, the FASB separated the entity's decision process from the Board's (FASB) decision process to make clear that they are two separate issues and will be the subject of separate exposure drafts.

### European Financial Reporting Advisory Group (EFRAG)

10. In April 2013, EFRAG, together with the French Autorité des normes Comptables (ANC) and the UK Financial Reporting Council (FRC), published a feedback statement to their July 2012 Discussion paper "Towards a Disclosures Framework for the Notes". Major findings noted included:
  - Respondents to the DP were in agreement that immediate action is needed to address the quality of disclosures in financial statements.
  - It was agreed that the disclosure burden is a shared responsibility and standard setters need to work with others (including regulators and auditors) to improve disclosures.
  - Defining the purpose of the notes was an important step to identify what was relevant information.
  - There was a general call for simplifying the disclosure requirements.
  - Respondents to the DP agreed that guidance would be helpful to improve the application of materiality.
  - There was support for more communication and a shift away from mere compliance,
11. Also in April 2013, EFRAG, jointly with the ANC, The Accounting Standards Committee of Germany (ASCG), the Organismo Italiano di Contabilità (OIC) and the FRC, published three bulletins on prudence, reliability of financial information and uncertainty.
12. The publication of these bulletins is to stimulate debate within Europe, and keep European constituents informed, as the IASB develops its Conceptual Framework. Views on questions in each bulletin were requested by July 5, 2013.

### UK Financial Reporting Council

13. In June 2013 the UK Financial Reporting Council (FRC) issued a [Feedback Statement](#) on its Discussion Paper *Thinking About Disclosures in a Broader Context* (DP), which was released in October 2012. The DP set out a roadmap for a disclosure framework to encourage more relevant financial reporting including beyond the confines of the financial statements. The responses to the DP indicated broad support for a disclosure framework and for the content of the paper.

### UK Financial Reporting Lab<sup>27</sup>

14. In May 2013, the FRC's Financial Reporting Lab (the Lab) called for listed companies and investors/analysts to participate in a project on approaches to disclosing accounting policy information that is considered to be most effective. The project will also explore the ordering of the footnotes to the financial statements.

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<sup>27</sup> The FRC launched its Financial Reporting Lab with the aim of improving effectiveness of corporate reporting in the UK. The Lab provides a collaborative environment for companies, investors and analysts to discuss innovative reporting solutions that better meet the needs of both communities.

15. The aim of the project is to provide insight from the corporate and investment communities on effective approaches to reporting, both the content and style of presenting information.

#### **CFA Institute**

16. The CFA Institute published a report in July 2013 on [Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust and Volume](#), that sets out how investors view the effectiveness of current financial statement disclosures and how they can be enhanced, including in the area of materiality.

#### **ESMA**

17. In November 2011, the European Securities and Markets Authority (ESMA) issued a Consultation paper entitled *Considerations of Materiality in Financial reporting* (CP) with the objective of contributing to the consistent application of the concept of materiality in financial reporting. In August 2012, ESMA published a *Summary of Responses* to the CP. Given the responses to the CP, ESMA hosted a public roundtable on materiality in financial reporting in October 2012, and released a Feedback Statement that sets out their responses to the issues arising from the consultation process.

## Appendix 2

### ISA 210, *Agreeing the Terms of Audit Engagements*

*(Extracts from ISA 210 MARK-UP as revised for Auditor Reporting changes – changes for Disclosures highlighted in green)*

#### Agreement on Audit Engagement Terms

10. Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (Ref: Para. A22–A25) **[NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]**
- (a) The objective and scope of the audit of the financial statements;
  - (b) The responsibilities of the auditor;
  - (c) The responsibilities of management;
  - (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
  - (e) Reference to the expected form and content of any reports to be issued by the auditor, including, if the auditor is not required to communicate key audit matters but intends to do so, a statement that the auditor intends to communicate key audit matters; and (Ref: Para. A23a)
  - (f) Aa statement that there may be circumstances in which a report may differ from its expected form and content.

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#### Agreement on Audit Engagement Terms

*Audit Engagement Letter or Other Form of Written Agreement*<sup>28</sup> (Ref: Para. 10–11)

#### Form and Content of the Audit Engagement Letter

- A23. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on ISA 200.<sup>29</sup> Paragraphs 6(b) and 12 of this ISA deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:
- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, ISAs, and ethical and other pronouncements of professional bodies to which the auditor adheres.
  - The form of any other communication of results of the audit engagement.

<sup>28</sup> In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

<sup>29</sup> ISA 200, paragraphs 3–9



- The requirement for the auditor to communicate key audit matters in the auditor's report in accordance with proposed ISA 701.<sup>30</sup>
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team.
- The expectation that management will provide written representations (see also paragraph A13).
- The expectation that management will provide supporting evidence for the notes to the financial statements, including for those disclosures from systems outside traditional financial reporting systems.
- The agreement of management to make available to the auditor draft financial statements, including the related notes to the financial statements, and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

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## Appendix 1

### Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Financial Reporting Standards. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this ISA. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring audits (see paragraph 13 of this ISA). It may be appropriate to seek legal advice that any proposed letter is suitable.

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<sup>30</sup> Proposed ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

To the appropriate representative of management or those charged with governance of ABC Company.<sup>31</sup>

*[The objective and scope of the audit]*

You<sup>32</sup> have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

~~Our audit will be conducted with the~~ The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our expressing an opinion on the financial statements. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISAs) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

*[The responsibilities of the auditor]*

We will conduct our audit in accordance with ~~International Standards on Auditing (ISAs).~~ Those standards require that we comply with ethical requirements, and As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the planning and performing of the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit also involves ~~We also:~~

- ~~performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of~~ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- ~~In making our risk assessments, we~~ Obtain an understanding of ~~consider~~ internal control relevant to the entity's preparation of the financial statements audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>33</sup> However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.

<sup>31</sup> The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see paragraph A21.

<sup>32</sup> Throughout this letter, references to “you,” “we,” “us,” “management,” “those charged with governance” and “auditor” would be used or amended as appropriate in the circumstances.

<sup>33</sup> This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

- ~~An audit also includes evaluating~~ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management, ~~as well as~~
- ~~evaluating~~ Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with ISAs.

*[The responsibilities of management and identification of the applicable financial reporting framework (for purposes of this example it is assumed that the auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 6(b) of this ISA are therefore used).]*

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]<sup>34</sup> acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards;<sup>35</sup>
- (b) For such internal control as [management] determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
- (c) To provide us with:
  - (i) Access to all information of which [management] is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - (ii) Evidence to support the notes to the financial statements, including for those disclosures from systems outside traditional financial reporting systems.
  - (iii) Additional information that we may request from [management] for the purpose of the audit; and
  - (iv) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

*[Other relevant information]*

*[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]*

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<sup>34</sup> Use terminology as appropriate in the circumstances.

<sup>35</sup> Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards"

*[Reporting]*

*[Insert appropriate reference to the expected form and content of the auditor's report, including where applicable the intent of an auditor of financial statements of an entity other than a listed entity to communicate key audit matters if not otherwise required to do so. This section may also include reference to the auditor's required reporting responsibilities in relation to going concern, other information and key audit matters.]*

The form and content of our report may need to be amended in the light of our audit findings.

*Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.*

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

.....

Name and Title

Date

## **ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements***

*(Extracts from extant ISA 240 – changes for Disclosures highlighted in green)*

### **Discussion among the Engagement Team**

15. ISA 315 requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.<sup>36</sup> This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A10–A11) **[NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]**

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### **Discussion among the Engagement Team (Ref: Para. 15)**

- A10. Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team:
- Provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.

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<sup>36</sup> ISA 315, paragraph 10

- Enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- Permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention.

A11. The discussion may include such matters as:

- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements, including the related notes to the financial statements, may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees which have come to the attention of the engagement team.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements, including the related notes to the financial statements, to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.

## ISA 260, *Communication with Those Charged with Governance*

(Extracts from ISA 260 MARK-UP as revised for Auditor Reporting changes – changes for Disclosures highlighted in green)

### Matters to Be Communicated

*The Auditor's Responsibilities in Relation to the Financial Statement Audit*

14. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that: **[NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]**

- (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
- (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A9–A10)

*Planned Scope and Timing of the Audit*

15. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: Para. A11–A15) **[NO CHANGE PROPOSED TO THE REQUIREMENT FOR DISCLOSURES]**

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*Planned Scope and Timing of the Audit* (Ref: Para. 15)

A11. Communication regarding the planned scope and timing of the audit may:

- (a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures; and
- (b) Assist the auditor to understand better the entity and its environment.

A11a. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.\*

A12. Matters communicated may include: ^

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error.

\* When the final standard is issued, this paragraph will become paragraph A12 and all subsequent paragraphs will be renumbered accordingly.

^ Conforming amendments to this paragraph also were proposed in the Exposure Draft, Proposed ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. The IAASB will consider feedback from that consultation in determining whether such changes continue to be appropriate as it finalizes both proposed ISA 260 (Revised) and proposed ISA 720 (Revised).

- Assessed risks of material misstatement other than identified significant risks that are anticipated to have the greatest effect on the overall audit strategy or on the audit plan, including on the efforts of the engagement team.
- The auditor's approach to internal control relevant to the audit.
- The application of the concept of materiality in the context of an audit.<sup>37</sup>
- The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor's expert.<sup>38</sup>
- Relevant and material changes to the applicable financial reporting framework, including those related to the notes to the financial statements, and the implications of the changes on the planned approach.

## ISA 700, *Forming an Opinion and Reporting on Financial Statements*

(Extracts from ISA 700 as revised for Auditor Reporting changes – changes for Disclosures highlighted in green)

### Requirements

#### Forming an Opinion on the Financial Statements

10. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.<sup>39,40</sup>
11. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:
  - (a) The auditor's conclusion, in accordance with ISA 330, whether sufficient appropriate audit evidence has been obtained;<sup>41</sup>
  - (b) The auditor's conclusion, in accordance with ISA 450, whether uncorrected misstatements are material, individually or in aggregate;<sup>42</sup> and
  - (c) The evaluations required by paragraphs 12–15.
12. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A1–A3)

<sup>37</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>38</sup> See ISA 620, *Using the Work of an Auditor's Expert*.

<sup>39</sup> ISA 200, paragraph 11

<sup>40</sup> Paragraphs 24–25 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

<sup>41</sup> ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 26

<sup>42</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11

13. In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:
- (a) The financial statements adequately disclose the significant accounting policies selected and applied;
  - (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
  - ~~(b)(c)~~ The financial reporting requirements have been met, and that the information presented and disclosed is appropriately classified and aggregated, complete, understandable and accurate.
  - ~~(c)(d)~~ The accounting estimates made by management are reasonable;  
The information presented in the financial statements is relevant, reliable, comparable, and understandable;
  - ~~(d)(e)~~ The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions, and events and other relevant matters on the information conveyed in the financial statements; and (Ref: Para. A4)
  - ~~(e)(f)~~ The terminology used in the financial statements, including the title of each financial statement, is appropriate.
14. When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12–13 shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of:
- (a) The overall presentation, structure and content of the financial statements; and
  - (b) Whether the financial statements, including the related notes, represent the underlying transactions, and events and other relevant matters in a manner that achieves fair presentation.
15. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A5–A10)

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## Application and Other Explanatory Material

### Qualitative Aspects of the Entity's Accounting Practices (Ref: Para. 12)

- A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
- A2. Proposed ISA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.<sup>43</sup> In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of

<sup>43</sup> Proposed ISA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2



neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's attention during the audit (for example, correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
- Possible management bias in the making of accounting estimates.

A3. ISA 540 addresses possible management bias in making accounting estimates.<sup>44</sup> Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

#### **Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements** (Ref: Para. 13(e))

A4. It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, financial performance and cash flows, together with related notes providing essential additional information needed to understand the amounts presented in the primary financial statements. In such circumstances, the auditor evaluates whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions, and events and other relevant matters on the entity's financial position, financial performance and cash flows.

#### **Description of the Applicable Financial Reporting Framework** (Ref: Para. 15)

- A5. As explained in ISA 200, the preparation of the financial statements by management and, where appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.<sup>45</sup> That description is important because it advises users of the financial statements of the framework on which the financial statements are based.
- A6. A description that the financial statements are prepared in accordance with a particular applicable financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.
- A7. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, "the financial statements are in substantial compliance with International Financial Reporting Standards") is not an adequate description of that framework as it may mislead users of the financial statements.

#### *Reference to More than One Financial Reporting Framework*

A8. In some cases, the financial statements may represent that they are prepared in accordance with two financial reporting frameworks (for example, the national framework and International Financial Reporting Standards). This may be because management is required, or has chosen, to prepare

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<sup>44</sup> ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21

<sup>45</sup> ISA 200, paragraphs A2–A3

the financial statements in accordance with both frameworks, in which case both are applicable financial reporting frameworks. Such description is appropriate only if the financial statements comply with each of the frameworks individually. To be regarded as being prepared in accordance with both frameworks, the financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements. In practice, simultaneous compliance is unlikely unless the jurisdiction has adopted the other framework (for example, International Financial Reporting Standards) as its own national framework, or has eliminated all barriers to compliance with it.

- A9. Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework, are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.
- A10. The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework (for example, financial statements prepared in accordance with the national framework that also describe the extent to which they comply with International Financial Reporting Standards). Such description is supplementary financial information and, as discussed in paragraph [4749](#), is considered an integral part of the financial statements and, accordingly, is covered by the auditor's opinion.