

### Auditing Disclosures—Issues and Task Force Recommendations

#### Draft Minutes from the January 2015 IAASB Teleconference<sup>1</sup>

#### Disclosures – Issues and Revised Proposed Requirements in ISA 315 (Revised),<sup>2</sup> ISA 330<sup>3</sup> and ISA 700 (Revised)<sup>4</sup>

The Task Force proposed that, in view of the changes being proposed to emphasize ‘information from accounting records that are outside the general and subsidiary ledgers,’ the phrase should also be included in paragraph 18(c) of ISA 315 (Revised), in relation to accounting records.<sup>5</sup> The Board expressed reservations that as a result of this, the Task Force may have inadvertently scoped in a required understanding of systems and processes that may not be relevant to the audit. For example, it was noted that by including ‘accounting records that are outside the general and subsidiary ledgers’ in paragraph 18(c) the Task Force may have inadvertently increased the auditors’ work effort in areas that are not relevant to the audit. A similar concern was raised regarding the auditors’ responsibility to obtain an understanding of the controls surrounding journal entries. The Task Force was asked to clarify that an understanding of controls over accounting records from outside the general and subsidiary ledgers was limited to understanding controls over journal entries used to capture this information. The Task Force was also asked to further consider the related application material to ensure that there were no unintended consequences as a result of the introduction of a number of examples of information in ‘accounting records outside the general and subsidiary ledgers’.

The IAASB also considered the articulation of the requirements that had been elevated from application material in ISAs 330 and 700 (Revised)<sup>6</sup> in response to the Board’s request at the December 2014 meeting that further consideration be given to the drafting of the requirements. The Task Force was asked to further consider the drafting of these requirements.

A few Board members had concerns with the concept of “all relevant” information being included in the auditor’s evaluation about whether the information presented in the financial statements is relevant, reliable, comparable and understandable.<sup>7</sup> Notwithstanding that this had been included to recognize the completeness of the information in terms of the applicable financial reporting framework, the Task Force agreed to further consider the best way to incorporate the concept of the completeness of the information.

The Task Force also agreed to several editorial changes suggested by Board members.

<sup>1</sup> These draft minutes are still subject to IAASB review and may be subject to further change.

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> ISA 330, *The Auditor’s Responses to Assessed Risks*

<sup>4</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>5</sup> Proposed revisions to ISA 315 (Revised), paragraph 18

<sup>6</sup> In relation to proposed changes in the requirements in ISA 330, Paragraph 24 and ISA 700 (Revised), paragraphs 13(a) and 13(d).

<sup>7</sup> ISA 700 (Revised), paragraph 13(d)

### *Way Forward*

The proposed changes to the ISAs for auditing disclosures, including the proposed revised requirements in ISA 315 (Revised), ISA 330 and ISA 700 (Revised), will be presented for approval at the March 2015 IAASB meeting.

### **Objectives of the IAASB Discussion**

The objective of the IAASB discussion at its March 2015 meeting is:

1. To consider remaining issues and Task Force recommendations, as well as a revised draft of proposed changes to the ISAs relating to auditing disclosures, together with conforming and consequential amendments.
2. To finalize and approve these standards for submission to the Public Interest Oversight Board (PIOB).
3. To consider an updated draft of the Staff Publication, *Auditing Disclosures in a Financial Statement Audit*.

## **Significant Issues and Task Force Recommendations**

### **A. Materiality**

#### *Significant Comments Received on Exposure*

1. A summary of the comments received in response to the changes proposed relating to ISA 320<sup>8</sup> in the Exposure Draft (ED), [\*Proposed Changes to the International Standards on Auditing–Addressing Disclosures in the Audit of Financial Statements\*](#), can be found in [Agenda Item 7-A](#) from the December 2014 IAASB meeting. As a reminder, significant comments from respondents included:<sup>9</sup>
  - The recognition that issues relating to applying the concept of materiality to disclosures cannot be solved by the IAASB alone (as acknowledged by the IAASB in the Explanatory Memorandum to the ED).
  - General support for the changes in application material relating to materiality as proposed in ISA 315 (Revised),<sup>10</sup> but it was emphasized that more guidance is needed on the application of the materiality concept to disclosures, particularly in the planning phase of the audit, as well as in the evaluation of misstatements in disclosures.

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<sup>8</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>9</sup> The names of the respondents are set out in Agenda item 2.

<sup>10</sup> At the March 2014 IAASB meeting at which the ED was approved, the IAASB considered a proposal for a new requirement to make a preliminary determination of those non-quantitative disclosures for which misstatement thereof reasonably could be expected to influence the economic decisions of users taken on the basis of the financial statements. The Board agreed that the guidance relating to these considerations was better placed in ISA 315 (Revised), and agreed that the guidance more appropriately supported the existing requirements in paragraphs 25–26 of ISA 315 (Revised). Accordingly, the application material previously proposed for ISA 320 was moved to ISA 315 (Revised) application material. The Board also agreed at that time that a new requirement in ISA 320 was not needed.

- A few regulatory respondents, including two Monitoring Group (MG) members, specifically called for a requirement(s) to assist the auditor in determining materiality in the context of disclosures (particularly qualitative disclosures).
2. Respondents raised a number of points regarding the interaction of the work of the IAASB with the work of the accounting standard setters, principally the International Accounting Standards Board (IASB). These comments were primarily in relation to the IAASB's development of further guidance or requirements on the application of the concept of materiality when auditing disclosures relative to expected progress of the IASB's work in that area. In particular:
- The IAASB was encouraged to work more proactively with the IASB towards a more holistic approach to addressing the concerns that have been raised about materiality, and to continue to closely monitor the IASB's materiality project and consider further enhancements accordingly.
  - There were mixed views as to the appropriate timing of further IAASB changes to ISA 320. On the one hand, a call was made by some respondents (including by MG members) for changes to ISA 320 to be made now (many of these respondents also suggested that further changes should be considered at an appropriate time to respond to any revisions to the concept of materiality and other related developments made by the IASB). However, others cautioned that the IAASB should wait until the IASB had concluded its work in relation to the concept of materiality, and other related developments.

Various other comments were also received for which the Task Force proposed amendments in December 2014. (See [Agenda Item 7-A](#) from the December 2014 IAASB meeting papers for discussion about the proposed changes, and [Agenda Item 7-B](#) from that meeting for the proposed changes to the relevant ISAs shown in mark-up).

#### *Proposed Responses to Comments Received*

3. At the December 2014 IAASB meeting, the Task Force explored the possibility of a new requirement for the auditor to make a preliminary determination of the nature of a qualitative misstatement of disclosures that could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole. This included proposed corresponding amendments to relevant paragraphs in ISA 320 and ISA 450.<sup>11</sup>
4. However, on reflection of the nature of the changes being proposed, some Board members had concerns about the significance of the changes, particularly in light of the IASB's intention to further explore this area, with the possibility that further changes would be needed in the near-term once the IASB had progressed its work. Accordingly, the Board agreed not to proceed with the development of changes to the requirements in ISA 320 and instead wait for the IASB to progress its work on materiality, at which time the Board could then consider a more holistic review of ISA 320 (see further discussion on the way forward for materiality in section D of this paper). Notwithstanding this, the Board asked the Task Force to consider whether other changes, such as application material to support the existing requirements, could be developed to address qualitative disclosures, whether this was in ISA 320 or ISA 315 (Revised).

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

5. The Task Force has therefore reversed the proposed changes in ISA 320 and ISA 450 as presented in the December 2014 IAASB meeting papers relating to the introduction of a new requirement for the qualitative misstatement of disclosures. However, the Task Force has retained other changes proposed in December 2014 that did not relate to the new requirement but that had been proposed to address other comments from respondents (in particular changing the term “non-quantitative” (in paragraph 6 of ISA 320) to “qualitative” as explained in paragraph 24 below).
6. The Task Force has also reconsidered whether other actions could be undertaken that would address respondents’ comments, where feasible, but that would not prejudice a more holistic review of ISA 320. The Task Force has:
  - (a) Revisited the use of the term “qualitative”—(see discussion in paragraphs 24–25 below)
  - (b) Revisited the proposed changes to paragraph 6 of ISA 320. Although no specific comments were received at the December 2014 Board meeting on this paragraph, the Task Force reconsidered the changes that had been proposed, and, with the exception of the changes considered as explained in paragraph 6(c) below, agreed to not propose further revisions to this paragraph until a more holistic review of ISA 320 is undertaken.
  - (c) Discussed removing the reference to qualitative disclosures in paragraph 6 of ISA 320 so that the ‘consideration of the nature of potential misstatements in disclosures’ referred to in paragraph 6 is not restricted to ‘qualitative’ disclosures only. The Task Force had mixed views on the matter, particularly as the change was proposed in the ED and was supported by respondents. Accordingly, the Task Force has agreed to retain the reference to ‘qualitative’ and seek the Board’s opinion on the matter. However, as respondents to the ED had suggested that additional application guidance would be helpful, and the concept of materiality relating to qualitative disclosures has been introduced, the Task Force has proposed additional application material as further guidance for auditors (see **Agenda Item 2-B**, ISA 320, proposed paragraph A1a). The Task Force believes that guidance relating to the application of the concept of materiality to qualitative disclosures should remain in ISA 320. However, the Task Force has added a footnote reference to the guidance in ISA 315 (Revised) about the interactions of risk and materiality, including examples of qualitative disclosures that may be relevant when assessing the risks of material misstatement (in **Agenda item 2-B**, paragraphs A128a and A128b of ISA 315 (Revised)).
  - (d) Reconsidered what further changes could be made to either ISA 320 or ISA 315 (Revised) to address qualitative disclosures. Recommendations by the Task Force, in addition to the new proposed application material in paragraph A1a (as described above), include:
    - (i) Revising the requirement in ISA 315 (Revised) to remind auditors that when identifying risks of material misstatement, the auditor also needs to consider qualitative disclosures. (See **Agenda Item 2- B**, ISA 315 (Revised), paragraph 26(a)). The extension to the requirement in paragraph 26(a) regarding the auditor’s consideration of qualitative disclosures is supported by application material in ISA 315 (Revised), paragraph A128b.
    - (ii) Revising the requirement in ISA 315 (Revised), paragraph 26(d) by removing the term ‘magnitude’. This paragraph requires the auditor to consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. The Task Force agreed to remove the reference to ‘magnitude’ so that the auditor’s

consideration as to whether the potential misstatement could result in a material misstatement is not restricted to size alone. Further guidance regarding misstatements is set out in ISAs 320 and 450. (See **Agenda Item 2-B**, ISA 315 (Revised), paragraph 26(d)).

- (iii) Postponing the development of further application material in ISA 315 (Revised). On reflection, the Task Force is of a view that the changes that had been made when the ED was finalized (i.e., the addition of the application material in **Agenda Item 2-B**, ISA 315 (Revised), paragraphs A128a and A128b) is sufficient to drive auditor behavior around assessing the risks of material misstatements in qualitative disclosures in the near term. However, the Task Force agrees that further material may be considered necessary when a more holistic review of ISA 320 is undertaken.
- (e) Further considerations about the way forward on materiality can also be found in **Section D** of this paper.

#### **Matters for IAASB Consideration**

1. Taking into account the proposal for moving forward as set out in **Section D** below, does the IAASB agree with the proposed changes to ISA 315 (Revised), paragraphs 26(a) and (d), and ISA 320 as presented in **Agenda Item 2-B**?
2. Does the IAASB agree that the guidance on the auditor's consideration of the nature of potential misstatements in disclosures should be retained in respect of qualitative disclosures only (in relation to ISA 320)?
3. Does the IAASB have the view that any other actions are appropriate at this time relating to materiality?

### **B. Information from Accounting Records that Are Outside the General and Subsidiary Ledgers**

7. In the responses to the Discussion Paper (DP), respondents had highlighted certain areas where the ISAs could be further enhanced, including around auditing disclosures where the information has not been derived from the entity's "financial accounting system".
8. In working through the possible areas for enhancement, the IAASB agreed to include considerations about information "that may be generated by systems and processes outside traditional financial reporting systems". The wording was refined and examples were added to help auditors understand what was intended. The term used in the ED was "information in the financial statements may contain information from systems or processes that are not part of the general ledger system."
9. The majority of respondents to the ED agreed with the introduction of the concept of "information from systems and processes outside the general ledger" but a few respondents to the ED expressed concerns that the term 'general ledger system' is not widely known or might be difficult to understand, or suggested that it could be further clarified. At the December 2014 IAASB meeting, the Board generally agreed with the proposed changes to ISA 315 (Revised) in relation to this issue, including changes to the requirements of paragraph 18 and a proposed re-articulation of the above concept to "information from accounting records that are outside the general and subsidiary ledgers".

10. However, some reservations have been expressed by a few Board members and some Task Force members about the potential unintended consequences of the revisions to ISA 315 (Revised), paragraphs 18 and A89a that were presented to the Board at the December IAASB meeting and for the January 2015 IAASB teleconference. In particular, reservations were expressed about the expression “financial statements may contain information from accounting records that are outside the general and subsidiary ledgers”, and that the examples given focused on aspects of the information system from which such information was derived, rather than on the nature of the information that was derived from outside the general and subsidiary ledgers. In light of the Board’s discussion during the January 2015 IAASB teleconference, the Task Force agreed to give further consideration to this matter.
11. The primary concerns in adding this new material have been that it may:
- Signify that records of the type referred to in the examples (that contain information generated, processed or recorded by the audited entity in systems and processes that are outside the general or subsidiary ledgers) are deemed to fall within the definition of ‘accounting records’, when that was not the intent when the definition was established; and,
  - Consequently signify that some or all of the ISA requirements to perform risk assessment procedures and further audit procedures to obtain sufficient audit evidence apply to aspects of these systems that are, or may not be, relevant to the audit, even though those requirements would not otherwise have applied to those aspects of the systems.

For example, including information from an entity’s tax returns and records as an example within ISA 315 (Revised) may have the unintended consequence of requiring the auditor to obtain an understanding of the systems and related control activities for producing the tax returns and records in areas that may not be relevant to the audit.

#### *Task Force Reconsideration*

12. The Task Force has reconsidered the proposals in this area. In general, the Task Force continues to believe that the initial intent of focusing auditors on sources of information outside the general and subsidiary ledgers, from which many disclosures in the financial statements are sourced (especially those that have been identified as more difficult for the auditor to address), is an important enhancement to the ISAs.
13. A Staff-prepared analysis about the audit process, including where issues might arise from the proposed changes, was extensively debated by the Task Force. Areas covered by the analysis that were subject to such debate included:
- The auditor’s understanding of internal controls<sup>12</sup> relevant to the audit, as required by paragraph 12 of ISA 315 (Revised) and the interaction of the requirements in paragraph 18 with the requirement in paragraph 12 in ISA 315 (Revised).

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<sup>12</sup> Internal control is divided into the following five components, for purposes of the ISAs: (a) The control environment; (b) The entity’s risk assessment process; (c) The information system, including the related business processes, relevant to financial reporting, and communication; and (d) Control activities

- The auditor’s understanding of the information system, including the related business processes, relevant to financial reporting, as required by paragraph 18 of ISA 315 (Revised), including its related application material.
  - The related requirements in respect of audit evidence, as the revised phrase was linked to “accounting records”, which is defined in ISA 500.<sup>13</sup>
14. The Task Force agreed that there are boundaries to the understanding required to be obtained by the auditor in accordance with the requirements of ISA 315 (Revised), paragraphs 12 and 18 – at least in terms of what the auditor judges, as applicable, to be ‘relevant to the audit’ and/or ‘relevant to financial reporting’. The Task Force notes that those boundaries of the auditor’s judgment can be seen to have been addressed to some extent as it relates to ‘the information system relevant to financial reporting’, given that the sub-paragraphs of ISA 315 (Revised), paragraph 18 indicate areas that are required to be included in applying the requirement in that paragraph. However, the Task Force had mixed views about how far, if at all, these boundaries would extend beyond the general and subsidiary ledgers and indeed beyond the accounting records more generally. The Task Force did agree (with some exceptions as noted in relation to the fourth bullet point below):
- The auditor’s consideration about what comprises the accounting records, that are relevant to financial reporting, is a matter of judgment based on the circumstances of the engagement.
  - The auditor’s consideration about what internal controls are relevant to the audit is a matter of professional judgment.
  - The nature and extent of risk assessment procedures in relation to the information in financial statements from outside the general and subsidiary ledgers, including the auditors’ required understanding of internal controls, is also a matter of the auditor’s judgment.
  - That it is important to maintain the emphasis that when auditing disclosures the auditor should consider information in the financial statements obtained from outside the general and subsidiary ledgers when: understanding internal controls relevant to the audit, identifying and assessing the risks of material misstatement, and responding to those risks. Two members of the Task Force, whilst otherwise agreeing with the content of this bullet point, did not agree with the inclusion of the words “understanding internal controls” in this part of the analysis. This was not because they believed it is necessarily wrong; but rather, it was because they believe that this phrase (which they believe is open to a very broad range of interpretation) is at the heart of their concerns about the boundaries described above and requires further discussion. The Task Force (including these two members) acknowledges that there is a need for a more thorough and transparent discussion about those boundaries, perhaps during any wider review of ISA 315 in the future or when the IAASB undertakes the development of guidance on obtaining sufficient appropriate audit evidence when auditing disclosures (see paragraphs 43–45).

#### *Proposals for Moving Forward*

15. As noted above, the majority of respondents to the ED agreed with the introduction of the concept of “information from systems and processes outside the general ledger” into the guidance in the ISAs though some questioned the expression used. Also as noted above, the Task Force agreed that this

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<sup>13</sup> ISA 500, *Audit Evidence*

concept should continue to be included in the ISAs, but now using the expression ‘information obtained from [within or] outside the general and subsidiary ledgers’ (including the words in square brackets when appropriate in the circumstances).

16. The Task Force explored various alternatives to help address some of the reservations that have been expressed about the potential unintended consequences of the positioning of that expression in ISA 315 (Revised), paragraph 18, including the consequences of the proposed ‘link’ between that phrase and the term ‘accounting records’, and how this is dealt with in ISA 315 (Revised), paragraph A89a. The Task Force agreed that, in proposing changes to ISA 315 (Revised), paragraphs 18 and A89a, the intent should not be to interpret the boundaries of the auditor’s understanding to be obtained in applying the requirements in ISA 315 (Revised), paragraphs 12 and 18 and, in consequence, the auditor’s work effort in identifying and assessing the risks of material misstatement and responding to those risks.
17. With respect to ISA 315 (Revised), paragraph A89a, the Task Force proposes simplifying the introductory text to clarify that the financial statements may contain information obtained from outside the general and subsidiary ledgers (without interpreting the boundaries of the auditor’s understanding of the information system relating to this information), and clarifying the language used in the examples given so that they describe relevant information that has been disclosed in the financial statements that has been obtained from outside the general or subsidiary ledgers. (See revisions in ISA 315 (Revised), paragraph A89a and conforming amendments, as relevant, to ISA 315 (Revised), paragraph A99(a), and ISA 330, paragraphs 20, 30 and A13). The Task Force believes that this approach is preferable to describing in this paragraph aspects of the systems or processes used to develop such information, which might be seen as interpreting the boundaries discussed above by suggesting that all aspects of those systems would be relevant to financial reporting, or otherwise relevant to the audit.
18. With respect to ISA 315 (Revised), paragraph 18, the Task Force agreed to present for consideration by the IAASB the proposal that was supported by a majority of Task Force members, to introduce the emphasis on such information in the introductory text of this requirement. The proposal seeks to do so by clarifying that the understanding the auditor is required to obtain includes an understanding of the information system relevant to information disclosed in the financial statements, whether such information was obtained from within or outside of the general and subsidiary. Under this proposal, the revisions in ISA 315 (Revised), paragraphs 18 (c) and (e), that were presented in the agenda papers for the January 2015 IAASB teleconference, would unnecessarily duplicate what is in the introductory text and have been removed.
19. Two Task Force members are not supportive of the proposed change to the introduction to ISA 315 (Revised), paragraph 18. Alternatives proposed by these two Task Force members included either not making any change to the extant introduction to, or revising the wording of selected sub paragraphs of, paragraph 18. These Task Force members expressed the concern that the revised introduction would, in their view, be open to the interpretation that the auditor needs to understand the full preparation of all of the information that ultimately gets into the financial reporting systems from the initial inception of the information (e.g., the complete actuarial valuation process or the complete tax preparation process). At a minimum, they believe that it would introduce ambiguity about how far an auditor should go in obtaining an understanding of the information system relevant to financial reporting. At worst, they believe that it would embed an expectation that an auditor needs to fully understand all systems that produce information. These Task Force members believe that

the revised words would add to, rather than solve, the existing confusion that they believe the auditor faces in making judgments as to the boundaries of the understanding they are required to obtain under the extant requirement of paragraph 18.

20. Other members of the Task Force took the view that the proposed revision to the introductory text (addressing information disclosed in the financial statements whether obtained from within or outside of the general and subsidiary ledgers in the context of obtaining an understanding of the “information system ... relevant to financial reporting”) only emphasizes such information in applying the extant requirement in ISA 315 (Revised), paragraph 18. Accordingly, they were not concerned that the revision would be seen as interpreting the boundaries. They believe that the requirement in paragraph 18 (both with and without the proposed revision) limits the necessary understanding to what is relevant to financial reporting more generally but also when obtaining the required understanding in the areas required to be included in doing so that are specified in sub-paragraphs 18 (a)–(f). They also believe that the requirement in ISA 315 (Revised), paragraph 12 similarly limits the understanding of internal control required to be obtained to what is relevant to the audit. They also have the view that the proposed approach would avoid inserting the emphasis into some but not all of the elements of the information system relevant to financial reporting referred to in paragraph 18, sub-paragraphs (a)–(f), without a particular rationale for being selective in doing so, which could be seen as narrowing the scope of the emphasis in a manner that could in itself potentially be seen to interpret the boundaries.

#### **Matters for IAASB Consideration**

4. The IAASB is asked for its views on the matters set out in paragraphs 15–20 above, including whether it agrees that this should not be explored further at this stage, but should rather be considered further as part of a future work effort (e.g., either as part of a project to consider ISA 315 (Revised) or the development of guidance on obtaining sufficient appropriate audit evidence for certain types of disclosures.)
5. The IAASB is asked for its views on the proposed changes to the ISAs in ISA 315 (Revised), paragraphs 18, A89a, A99(a), and ISA 330, paragraphs 20, 30 and A13. **(See Agenda Item 2-B)**

### **C. Other Revisions to the ISAs**

21. Except as discussed in Sections A and B above, other substantive changes that are being proposed in **Agenda Item 2-B** have been detailed below. Other editorial changes have also been made to some other ISAs as a result of Board feedback and the Task Force’s deliberations.

#### *Proposed Changes that May Affect More than One Standard*

##### **Emphasizing Disclosures when Referring to the Financial Statements**

22. In various places within the ED, the IAASB agreed that it would be beneficial to emphasize disclosures when referring to the financial statements. Various respondents had noted that doing so through the use of extensions to the phrase “financial statements” such as “financial statements including disclosures”, and “financial statements including related disclosures,” was confusing, and may lead to insufficient attention being given to disclosures, and insufficient work effort, in places where the extension ‘including disclosures’ was not present.

23. The Task Force undertook an exercise to review the use of the extension, and:

- Where the Task Force was of the view that the emphasis was not needed, deleted the extension (for example ISA 315 (Revised), paragraph A119, ISA 330, paragraph 24 and ISA 700 (Revised), paragraph 8)); and
- Where the Task Force was of the view that it was important to keep the emphasis, deleted the extension and emphasized disclosures in other ways within the same paragraph (for example ISA 315 (Revised), paragraph A80).

In performing this exercise, the Task Force observed that there were a few other paragraphs in the ISAs, which had not previously been considered by the Task Force (e.g., ISA 700 (Revised), paragraphs 48 and A62–A64), in which similar extensions were used and to which conforming amendments were therefore considered necessary by the Task Force (these have been clearly marked in **Agenda Item 2-B**). Other instances of these conforming changes have also been made to ISAs not discussed in this Agenda Paper and can be found in **Agenda Item 2-C** (see paragraph 6(a)).

#### Using the Term ‘Qualitative’ in Place of ‘Non-Quantitative’ in Relation to Disclosures

24. There was concern expressed by a Board member about the use of the term ‘qualitative’ disclosures. The Task Force reconsidered whether a term such as “narrative” would be more appropriate. However, as the term ‘qualitative’ encompassed everything that is not quantitative (i.e., purely numerical), it was agreed that it would be most appropriate to continue to use this term.

#### Using the Terms ‘Qualitative’ and ‘Quantitative’ in Relation to Misstatements

25. The Task Force also reflected on the appropriateness of the terms ‘qualitative’ and ‘quantitative’ misstatements. They agreed that this distinction, when applied to ‘misstatements’, could be confusing as some quantitative misstatements could also have qualitative aspects. The Task Force therefore concluded that the term ‘qualitative’ would only be used to distinguish disclosures i.e., quantitative from qualitative disclosures. Instead, when seeking to distinguish misstatements that have a qualitative aspect, the Task Force has referred, for example, to ‘misstatements in qualitative disclosures’ or ‘misstatements of a size or nature that could result in a material misstatement’, depending on the circumstances.

#### ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

##### Use of the Terms ‘Obligations’ and ‘Equity Interests’ and ‘Cross-Reference’ in the Definition of Financial Statements

26. A few Board members questioned the use of the terms ‘obligations’ and ‘equity interests’ together in the definition of financial statements (ISA 200, paragraph 13(f)). In particular, they questioned whether the distinction between obligations and equity interests was necessary or, if used, could cause confusion. The Task Force reflected on the phrase and concluded that it would be more appropriate to use the terms “assets, liabilities and equity” to be consistent with the way these concepts have been used to describe the assertions in ISA 315 (Revised), paragraph A124. In addition, these have been conformed to the terms used by the accounting standard setters, and corresponding changes made to the way these are reflected in the assertions in paragraph A124(b).

#### Other Change

27. Application material has also been added to clarify that in the definition of financial statements in ISA 200, paragraph 13(f), the direction of the ‘cross-reference’ referred to, is from the financial statements to another document, and not the other way around. (see ISA 200, paragraph A1a).

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

28. The Board asked the Task Force to clarify the link between ‘complex disclosures’ and a ‘risk of material misstatement’. The Task Force has proposed revised wording to introduce an example of aspects of complex disclosures that might give rise to a ‘risk of material misstatement’. (ISA 315 (Revised), paragraph A21a).
29. In response to a request from a Board member, the Task Force has moved the two ‘presentation’ assertions so they are both at the end of ISA 315 (Revised), paragraph A124(a) and (b) respectively.
30. In response to a request from the Board, the Task Force has linked the proposed reminder to the auditor that ‘in identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism’ in ISA 315 (Revised) paragraph A127, to ISA 200. This illustrates that it is not a new requirement as the auditor is already required to exercise professional skepticism in accordance with ISA 200.<sup>14</sup>

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

31. To respond to comments received on the proposed changes to the requirements on the Board teleconference in January 2015 (as outlined in the Decision Summary at the start of this paper), the Task Force has:
- (a) Clarified in ISA 330, paragraph 20(a), that it is the information ‘in the financial statements’ that is being agreed or reconciled, with a corresponding change in paragraph 30 relating to the documentation thereof. Consequential changes arising from the use of the phrase ‘information in the financial statements obtained from outside the general and subsidiary ledgers’ in ISA 315 (Revised), paragraph A89a, have also been made as appropriate.
  - (b) Clarified in ISA 330, paragraph 24, that the proposed considerations of the auditor when evaluating whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework are part of the evaluation that is already required in the extant standard and not an unrelated new requirement (as these considerations were introduced by elevating application material for this requirement).
  - (c) Considered the consistency of the proposed change to “form, structure and content” of the financial statements in light of Board comments that it is not clear what the difference between ‘form’ and ‘structure’ is (see ISA 330, paragraph 24). The Task Force has analyzed the use of this phrase throughout the ISAs, and has taken into consideration the use of this term in ISA 700 (Revised), in which the term “presentation, structure and content” has been used when referring to the financial statements. Accordingly, it is proposed that this be changed to be consistent with ISA 700 (Revised).<sup>15</sup>

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<sup>14</sup> ISA 200, paragraph 15

<sup>15</sup> In addition, paragraph 8 of ISA 700 (Revised) has also been conformed to reflect the use of this phrase.

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

32. In response to the Board discussion in December 2014, guidance in ISA 450 arising from the proposed changes to ISA 320 to distinguish the terminology qualitative from quantitative has been deleted. As a consequence, ISA 450 paragraph A2 has now been reinstated, and a separate proposed description of the concept of 'clearly trivial', as it relates to qualitative misstatements, has now been proposed in ISA 450 paragraph A2a (which is intended to address misstatements in qualitative disclosures).
33. Application material to support the definition of misstatements in ISA 450 paragraph A1(f), which gives an example of a circumstance in which a misstatement may arise, has been revised to clarify that it is a misstatement arising from the omission of a disclosure necessary for the financial statements to achieve a fair presentation, to distinguish the example from the auditor's 'stand-back' discussed in ISA 700 (Revised) paragraph 14 (i.e. as auditors approach the conclusion of the audit they consider whether, viewed as a whole and in view of the issues that they have addressed in the course of the audit, the financial statements are fairly presented).
34. In response to the suggestion of a Board member at the December 2014 IAASB meeting, the Task Force has introduced new guidance for auditors to consider whether misstatements identified in disclosures are indicative of a significant deficiency or deficiencies in internal control that should be reported to those charged with governance (as required by ISA 265<sup>16</sup>) (see ISA 450, new paragraph A7a). The Task Force recognizes that the auditor's consideration as to whether misstatements identified are indicative of significant deficiencies is not restricted to disclosures alone. The Task Force also recognizes that the auditor's response, where misstatements are indicative of a significant deficiency, is not limited to reporting to those charged with governance. However, the Task Force is of the view that making the link with reporting to those charged with governance deficiencies in internal control identified from misstatements is an important aspect of the audit process, and as the Task Force is in the process of strengthening this standard, believes it is a useful addition.
35. Guidance for the auditor in relation to determining whether misstatements in qualitative disclosures might be material included in ISA 450, paragraph A13b, has been redrafted to further clarify the intent.
36. ISA 450, paragraph A17, which gives examples of misstatements in disclosures that could be indicative of fraud, has also been revised to make the link to fraud clearer.

*ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements*

37. In response to comments received from the Board at the January 2015 teleconference, ISA 700 (Revised), paragraphs 13(a) and (d), have been redrafted to clarify that the proposed considerations of the auditor, when evaluating whether the financial statements are prepared in accordance with the applicable financial reporting framework, are part of the evaluation that is already required in the extant standard, and not an unrelated new requirement (as these considerations were introduced by elevating application material for the existing requirement).
38. Some Board members also had reservations regarding the Task Force introducing the phrase "all relevant information" in ISA 700 (Revised), paragraph 13(d), to address completeness (which was added to address a comment from a Board member at the December 2014 IAASB meeting that this concept was missing). In response, the Task Force has addressed the matter by re-phrasing this in

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<sup>16</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

the same manner as in ISA 315 (Revised), paragraphs A124(a) and (b), in relation to the 'completeness' assertions i.e., that all information that should have been included has been included.

39. On elevating the application material in ISA 700 (Revised), paragraph A3a, which had been exposed in the ED (relating to the auditor's considerations when evaluating whether significant accounting policies have been appropriately disclosed), this paragraph had been deleted. At the December 2014 IAASB meeting, the IAASB encouraged the Task Force to develop application material to support the revised requirement. The Task Force have therefore reinstated paragraph A3a, and redrafted the guidance to clarify further the auditor's considerations when evaluating the disclosure of the entity's significant accounting policies.

#### **Matter for IAASB Consideration**

6. The IAASB is asked for its views on the proposed changes to the ISAs as set out in **Agenda Item 2-B** (recognizing the matters for consideration relating to the proposed changes to the ISAs in Questions 1 and 5 above).<sup>17</sup>

## **D. The Way Forward – Materiality and Evidence**

### *Materiality*

40. As discussed in **Section A** above, limited changes to the ISAs have been proposed relating to materiality. Notwithstanding that significant concerns were raised about materiality and its application to disclosures in both the responses to the DP and the ED, the Task Force continues to agree with respondents who have urged the IAASB to postpone significant changes until the IASB has progressed its work in this area.
41. In its project on materiality, the IASB is considering how materiality is being applied in practice. At this time, the IASB is in the process of developing a Practice Statement, with a draft expected to be publicly exposed in mid-2015. The intention of this is that it will provide guidance on the application of materiality. The IASB will also discuss proposals for changes to materiality to align the definition within their standards (currently slightly different wording is used to explain the concept in various International Accounting Standards). At this stage the IASB has indicated no intention to change the definition, however, as the IASB progresses its work in this area the need may arise for a change, at which time it may drive the IAASB to revise ISA 320 accordingly. It would therefore be prudent to wait until the IASB progresses in this area before undertaking any significant changes in ISA 320.
42. The findings from the ISA Implementation Monitoring project and various stakeholders have also identified a potential need for a more holistic review of ISA 320. In the Basis for Conclusions for the IAASB's Work Plan 2015–2016, materiality has been noted as a topic for consideration in the IAASB's future Work Plans. In its [Work Plan for 2015–2016](#), the IAASB has also acknowledged that it needs to remain flexible and continually monitor the prioritization of its projects to respond to emerging needs as necessary. Accordingly, as the IASB progresses its work and proposes changes in relation to materiality, there may be a need for the IAASB to undertake a more timely review of ISA 320. Any project to revise ISA 320 would include considerations about disclosures, in particular, qualitative disclosures.

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<sup>17</sup> There are also conforming amendments proposing changes to the ISAs in **Agenda Item 2-D**; and proposed changes to ISAs 210 (Revised), 240, 260 (Revised) and 300 in **Agenda Item 2-C**.

### *Sufficient Appropriate Audit Evidence for Disclosures*

43. Both the responses to the DP and ED highlighted the need for more guidance on sufficient appropriate audit evidence for disclosures. As the Task Force has progressed this project, it has been agreed by the IAASB that this aspect would need to be a separate consideration, particularly in light of the commencement of work on disclosures by the IASB.
44. The IASB's work on disclosures is to identify and develop a set of principles for disclosures in International Financial Reporting Standards (IFRSs) that could form the basis of a Standards-level project. The focus is on rewriting the general requirements in International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, IAS 7, *Statement of Cash Flows*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, and considering how they may be revised. The IASB expects to present a Discussion Paper on this in mid-2015.
45. Therefore any work by the IAASB in this area would best be done once the IASB has progressed its efforts in this area. In addition, there may be issues relating to evidence beyond disclosures that may warrant a more thorough consideration of the topic of audit evidence.

### *Moving Forward*

46. On completion of the project (i.e., the proposed changes to the ISAs have been approved), the Task Force recommends that a Working Group and Staff should continue to monitor the IASB's progress on both materiality and disclosures, and keep the Board updated on a periodic basis about the progress being made. The Working Group will also liaise with the IAASB's IASB Liaison Working Group on relevant matters. At the appropriate time, and subject to agreement by the Steering Committee and IAASB based on other competing priorities at the time, work will commence, as relevant, to scope the IAASB's work effort in these areas.

#### **Matter for IAASB Consideration**

7. Does the IAASB agree with the recommendation that a Working Group should continue to actively monitor developments in the IASB's materiality and disclosures projects to inform any future IAASB work?

## **E. Other Matters**

### *Effective Date and Other Matters*

47. Recognizing that the proposed changes to the ISAs affect some of the same ISAs as other IAASB projects recently finalized (Auditor Reporting and ISA 720 (Revised)),<sup>18</sup> it was noted in the ED that the IAASB believed, to the extent possible, the effective date for these proposed changes should be aligned with these other projects. Accordingly, the Task Force believes an appropriate effective date for the standard would be 12–15 months after issuance of the final standards to align with the effective date of the revisions from the auditor reporting and ISA 720 (Revised) projects.
48. The majority of respondents supported the IAASB's proposed effective date.<sup>19</sup> Accordingly, the Task Force recommends that the proposed revisions to the ISAs for Disclosures be effective for audits of

<sup>18</sup> ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

<sup>19</sup> Only a few respondents did not have the view that the effective dates needed to be the same – this was across stakeholder groups.

financial statements for periods ending on or after December 15, 2016 to align with the auditor reporting and ISA 720 (Revised) projects. The nature of the changes, the majority which is to application material, does not, in the Task Force's view, necessitate a longer period than this. Early adoption of the revisions to the ISAs would be permitted, as is the case with all the IAASB's standards unless specifically prohibited.

49. The ED also asked for respondents views on the proposed changes to the ISAs to the public sector, Small- and Medium-Sized Practices (SMPs) and Small- and Medium-Sized Entities (SMEs), developing nations, and whether there are any translation issues noted. With the exception of the comments from the SMP sector, (explained below) there were no other significant concerns expressed with regard to these matters that have not been addressed elsewhere in the agenda material for the December 2014 and January 2015 IAASB meeting and teleconference.
50. Concern has been expressed about the impact of the changes on SMPs. In the view of the Task Force, there has been sufficient support from a broad range of other stakeholders who have strongly supported changes to the ISAs to assist auditors when auditing disclosures as part of the financial statement audit, including providing for more robust audit procedures. The Task Force also believes that the proposed changes, in particular in light of the fact that many are to application material vs. establishing new requirements, are capable of being proportionately applied depending on the size and complexity of the entity. The Task Force therefore proposes moving ahead with the changes. However, the publication of the final changes to the ISAs will be supported by the Staff Publication, which when released in preliminary form with the ED received strong support, including from the SMP sector. This publication has been updated for the changes to the ISAs as discussed in this paper (and December 2014 IAASB papers) to respond to comments from respondents to the ED. The publication has also been expanded in some areas, where practicable, based on suggestions from respondents to the ED (see **Agenda Item 2-E** for the updated draft of the Staff Publication).

#### **Matter for IAASB Consideration**

8. Does the IAASB support the proposed effective date?

#### **F. Due Process Matters**

##### *Significant Matters Identified by the IAASB Task Force*

51. In the Task Force's view, the significant matters it has identified as a result of its deliberations since the beginning of this project, and its considerations therein, have all been reflected in the issues papers presented to the IAASB at its meetings. In the IAASB Task Force's view, there are no significant matters it has discussed in this project that have not been brought to the IAASB's attention.

##### *Consideration of the Need for Further Consultation*

52. The Task Force does not believe that field testing of the proposals, or a roundtable, are warranted, given the nature of the changes and the input from stakeholders, including the Discussion Paper, and liaison with various stakeholders, including regulators and investors.

##### *Consideration of the Need for Re-Exposure*

53. To facilitate the IAASB's consideration of the need for re-exposure, Agenda Item 2-F shows the marked changes from the ED.

54. The Task Force does not believe that re-exposure is needed as the major changes (as shown in Agenda Item 2-F) are in response to comments received on exposure, and do not fundamentally change the principles of any of the affected ISAs because changes to the requirements are either elevations of application material for procedures that would ordinarily be performed on an audit, or added to an existing requirement as an emphasis in respect of disclosures.
55. On the basis of the above, the Task Force believes that re-exposure is not necessary.

**Matter for IAASB Consideration**

9. Does the IAASB agree that re-exposure of the changes to the ISAs for Disclosures is not necessary?