Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By e-mail < Edcomments@ifac.org >

23 June 2011

Our Ref.: C/AASC

Executive Director, Professional Standards
International Auditing and Assurance Standards Board,
International Federation of Accountants,
545 Fifth Avenue, 14th Floor,
New York 10017, USA.

Dear Sir,

IAASB Discussion Paper on *the Evolving Nature of Financial Reporting: Disclosure and its Audit Implications*

The Hong Kong Institute of Certified Public Accountants is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned IAASB Discussion Paper highlighting the recent trends in the range, volume and complexity of financial statement disclosures. Our comments on the Discussion Paper are set out in the attachment. We have provided comments from the perceptive of regulators and auditors.

It is noted that from the comments received from regulators and practitioners, there is a consistent message that the issues raised by the IAASB Discussion Paper should be addressed when developing accounting standards. The issues raised are all relevant. However, answers to the questions on the issues raised may not be straightforward. The issues around disclosures are not isolated to audit implications. They are closely related, and an integral part, of the ongoing debates on corporate reporting and auditor reporting.

It is believed that considerations on the audit implications of financial disclosures and the issue of auditability of disclosures need to be primarily addressed by the IASB, the accounting standard setter, but with the IAASB working closely alongside. It is important for the IAASB to work with IASB to understand the objective of disclosure requirements and what they expect. Accordingly, we would recommended that the IAASB should establish a mechanism for formal and regular interaction with the IASB to ensure its views have been fully considered by the IASB when the IASB revises or develops new accounting standards. We trust that our comments are of assistance to you. If you require any clarifications on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/SH/jn

Encl.

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ATTACHMENT

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE IAASB DISCUSSION PAPER *THE EVOLVING NATURE OF FINANCIAL REPORTING: DISCLOSURE AND ITS AUDIT IMPLICATIONS*

Consultation Questions for Regulators, Including Audit Oversight Bodies

Section II–Financial Reporting Disclosure Trends

R.1 Have you encountered a disclosure which you believe was immaterial, and could have been removed to enhance the understandability of the financial statements? Please provide examples, your reasoning for why you believed they were immaterial in the context and why you believed they were not omitted.

In view of the of the extensive disclosure requirements in the IFRS standards issued in recent years, the regulators note that preparers may be not willing to go through the process of deciding what is "material" and expose themselves to the risk of their judgement being challenged. Preparers may adopt a "full compliance" approach and provide each and every disclosure in the standards regardless of the materiality or the cost to provide the information.

In addition, it is noted that that in practice entities often provide boilerplate and generic disclosures to meet the disclosure requirements under IFRSs without sufficient consideration to ensure the information presented is entity specific, relevant and material, and will be useful to users of financial statements in making economic decisions.

A commonly mentioned example is IFRS 2. This standard requires extensive disclosure of the details, calculation methodology and inputs and financial impact of share-based plans in force. Many claim that this is not useful, especially when the total value of the plan is scarcely significant.

Section III–How Do ISAs Currently Deal with Disclosures?

R.2 Do you believe the ISAs provide sufficient requirements and guidance in respect of disclosures? Please explain your answer.

Though there is guidance in ISA 320 "Materiality in Planning and Performing an Audit", the evaluation of an appropriate materiality for the assessment of misstatements in disclosures could be different from misstatements affecting the primary statements and more guidance on this evaluation would be useful.

Section IV–Audit Issues Regarding Disclosures Required by a Financial Reporting Framework

R.3 What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

In general, we believe that where the disclosures are derived from the accounting system or relate to a line item, there would normally be sufficient appropriate audit evidence be obtained in the course of auditing the assertions for the related line item. We are of the view that there may not be another separate evidence gathering exercise.

Mandatory forward looking information in financial statements which focuses on the timing of future cash flows is typically limited to those transactions which expose the entity to liquidity or other going concern uncertainties. We believe that such forward looking information should be provided in management discussion & analysis commentary, rather than in the financial statements, and should be placed in the context of a discussion of the prospects of the business for the foreseeable future (which would include information about sales plans and trends in general relating to the entity's goods and services, rather than focusing only on existing contracts).

R.4 Some disclosures include the fair value of a financial statement line item measured on another basis, such as historical cost. In this circumstance, what level of effort do you expect an auditor to apply on the fair value disclosure? Should the auditor's effort be the same as if the fair value was on the face of the financial statements?

We are of the view that auditors should obtain sufficient audit evidence on the fair value disclosure. The auditor's effort for such disclosure should not be less than if the fair value was on the face of the financial statements.

R.5 Does the shift in the IASB Conceptual Framework away from reliability and towards faithful representation change what you expect of preparers and auditors? Please explain your answer.

We believe that considerations on the audit implications of financial disclosure cannot be divorced from first considering whether the requirements on recognition and re-measurement of assets and liabilities are appropriate in the first place.

We also believe that the issue raises another fundamental question on accounting standard setting, namely, there is a need to reconsider what information and where the information should reside in annual reports. We believe that once the what information questions has been identified, the question of where the information should reside should be based on the key criteria of the "reliability" of the information. We note that a substantial number of new mandatory disclosures under IFRSs, especially those relating to re-measurement of financial instruments after their initial recognition, are directed at indicating that the stated amounts are based on assumptions which are very subjective and could be incorrect. We believe that a guiding principle that may be used is that if the re-measurement is highly subjective because it is based on assumptions that are not verifiable or auditable, such re-measurement information should be placed outside the primary financial statements.

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In this connection, we believe that there is an urgent need for the IASB to complete its Conceptual Framework project and consider the fundamental issue of the conceptual reasons for re-measurement of assets or liabilities to fair value after their initial recognition. If re-measurement is determined to be conceptually sound, the IASB should determine whether re-measurement should be applied to all assets and liabilities and how the re-measurement should be reflected in financial reports. Adjustments required for re-measurement of assets and liabilities to their fair value in substance represent recognizing "hypothetical" transactions between "hypothetical" parties and at "hypothetical" exit prices. Their recognition has the same accounting effect as a sale and immediate buy back from a non-existent by hypothetical party which normally is not permitted to be recognized. Moreover, the current requirement for re-measurement to fair value is mandated for some but not all assets and liabilities. We believe that there is the need to revisit the basic question of the purpose of accounting, what should be accounted for and what should be recognized in financial statements. Is its purpose to value how much an entity is worth? If this is the purpose, should not all assets and liabilities be stated at their exit values?

We believe that reliability of information and the recognition of "actual transactions" should take precedence over the recognition of hypothetical "as if" or pro forma transactions, which is the result of adoption of fair value re-measurement of assets and liabilities. Fair value re-measurement "assumes" that a transaction has happened but it has not. Moreover, in most cases we believe that an entity does not have the intention nor is able to undertake the hypothetical transaction at the reporting date. We nevertheless appreciate that fair value information is sometimes relevant and the key questions are where such information should be presented and should or can the information be properly audited.

R.6 What is your expectation regarding the need for disclosures not specifically required by the financial reporting framework, but which some users may believe are relevant to the fair presentation of the financial statements? Examples may include noncompliance with a critical law, even though there is no quantitatively material effect, or the fact that the entity does not have a material holding of a particular asset class, such as sovereign debt, which may be of particular interest in the current economic environment.

We believe that it is necessary to provide more disclosures than required by the financial reporting framework if, by doing so, would give a true and fair view. We acknowledge the fact that due to the high levels of judgement about what disclosures would be necessary to achieve fair presentation (in the absence of a specific GAAP requirement), in practice this is a very difficult decision to make for both preparers and auditors as is illustrated in the examples provided where for instance it may be debatable whether information about legal compliance is necessary to tell the complete financial story of the entity, or whether it is more governance related.

R.7 What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosure:

- **Judgments and reasons;**
- **Assumptions/models/inputs;**
- **Sources of estimation uncertainty/sensitivity analysis disclosures;**
- **Descriptions of internal processes;**
- **Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and**
- **Objective-based disclosure requirements.**

The Discussion Paper deals with the issue of the need to consider "materiality" with respect to disclosures in financial statements in arriving at a conclusion as to whether a true and fair view is given. It is believed that further guidance should be provided by the IASB to preparers of financial statements. This guidance should be in substance the same as any additional guidance developed by the IAASB for auditors. It is therefore paramount that the two standard setting bodies have the same views on the matter as both preparers and auditors have a common goal of ensuring that the financial statements show a true and fair view.

In our view, we believe the following would constitute a material misstatement:

- Judgments and reasons – the reasons do not support the judgments
- Assumptions/models/inputs – using assumptions/models that are not widely used in a specific industry
- Sources of estimation uncertainty/sensitivity analysis disclosures – not disclosing the complete analysis, especially those with negative implications
- Descriptions of internal processes – not a complete description
- Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis – fair value not determined on an appropriate basis
- Objective-based disclosure requirements – objective of disclosure not met with the limited information provided

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R.8 Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute sufficient appropriate audit evidence for such a disclosure? What do you believe would constitute a misstatement of such a disclosure?

It is key to identify what qualitative characteristics the disclosure should meet in order to satisfy users' needs and how to apply them in the context of financial disclosures.

We may consider a misstatement to exist if for instance we believe the disclosure does not fully reflect the controls that are in place or accurately describe the controls.

(b) **The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect an auditor to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?**

It is expected that the auditor ascertains whether the disclosure reflects the facts and results of the stress test by checking to the stress test performed.

Section V–Questions about Auditability

R.9 Are there disclosures which, in your view, are not capable of being audited? Please explain your reasoning.

In general, if the preparers of the financial statements are able to support the disclosures with evidence, they should be capable of being audited. However, an audit means more than just reporting the preparation process as auditors must also consider the relevance, evidence supporting and reasonableness of assumptions used. This is the most difficult part of the audit especially where there is little solid evidence to support future projections and assumptions that are not under the control of the preparer or management.

R.10 What criteria do you believe should be used to assess an auditor's judgment in respect of the fair presentation of the financial statements as a whole?

As the ISAs are principles based standards, the auditors in conducting the audits of financial statements should obtain sufficient appropriate audit evidence to support the fair presentation opinion as a whole and able to justify the opinion when called upon to do so, with reference to the financial reporting framework. In the case of financial statements prepared under IFRS, the criteria should include:

- Relevance – Relevant financial information should be capable of making a difference to the decisions made by users.
- Representational faithfulness – Financial reports represent economic phenomena in words and numbers. Accordingly, it is our view that financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. It should be complete, neutral and free from error. The objective is to maximize those qualities as much as possible such that it includes all information that is necessary for a user to understand the economics of the transaction, including all necessary descriptions and explanations. Including fair value re-measurements do not represent faithfully transactions but in fact represent recognizing "hypothetical" transactions that the company does not intend to make or cannot make.

R.11 Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach the audit of financial statements, including disclosures. What is your view?

In general, we agree with the observation. Auditors would need to be mindful of the issues that are important to their local regulators.

The Quality Assurance Department (QAD) of the HKICPA publishes annual reports and regular publications communicating common deficiencies noted from reviews or common or topical accounting issues which the QAD considers worth highlighting to members.

In addition, the Hong Kong Exchanges and Clearing Limited (HKEx) continuously conducts a Financial Statements Review Programme which review, on a sample basis, issuers' published periodic financial reports, including quarterly, interim and annual reports. The HKEx publishes an annual report of key observations and findings.

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Consultation Questions for Auditors

Section II–Financial Reporting Disclosure Trends

A.1 Have you had discussions with entities about whether some of their required disclosures might be considered immaterial? What factors did you take into account? Please explain what difficulties (if any) you have experienced.

The following are comments received from practitioners:

- Judgements are made in practice by engagement teams based on the facts and circumstances of the client engagement. It is difficult to articulate the factors that drive those judgements. There is however, consensus that judgements are not limited to quantitative measures.
- In practice, there may be a greater focus on omissions in disclosure than in determining whether disclosures made by management may be immaterial.
- Generally, it is accepted that if a line item is not material the related disclosures are also, ordinarily, considered not to be material. However, it is necessary to consider the break-down of the line item and whether there is any netting of balances.
- Given some disclosures are not related to financial statement line items, line item materiality cannot be the only factor driving decisions about materiality of disclosures. Other criteria need to be applied in judging importance to users.

Difficulties:

- Agree with the Discussion Paper's assessment of the practical difficulties in judging materiality of disclosures.
- Group reporting situations can also present difficulties if reporting systems and/or management's information collation processes are such that information is compiled only for those disclosures deemed in advance to be necessary. There may, therefore, be incomplete information to enable the auditor to determine the relative materiality of certain disclosures.
- Difficulties can also arise in situations where senior management or those charged with governance do not give sufficient consideration of the disclosures.

Section III–How Do ISAs Currently Deal with Disclosures?

A.2 How do you approach the identification and assessment of the risks of material misstatement in disclosures?

Generally, practitioners consider presentation and disclosure an assertion in determining risks associated with a financial statement line item. However, it is generally acknowledged that the level of "formality" given to assessment of risk at the assertion level for disclosure may be, in practice, given less attention than for financial statement line items.

Some audit methodologies also include consideration of non-financial statement line item disclosing risks.

It is generally acknowledged that the level of "formality" given to assessment of risk at the assertion level for disclosures may be, in practice, given less attention than for financial statement line items. There is likely an element of truth that, in practice, more attention may be being paid to the completeness assertion.

A.3 Are there ISA requirements that, in your experience, pose practical challenges in respect of disclosures? Please explain your answer.

In general, we believe that engagement teams are able to make appropriate judgements about whether all disclosures required to properly convey significant transactions have been made.

Practical difficulties can arise in large group audits in determining the impact of component information on the relevant materiality of group disclosures. Given reporting practices in some entities and/or jurisdictions, disclosures may be considered late and/or given limited attention in the financial reporting process, impacting the group audit teams' ability to fully scope significant components and determine risks related to disclosures at the planning stage of the audit.

It is our understanding that some practitioners are concerned about the ISA 705 requirement for the auditor to include omitted disclosures, which are considered material to users understanding of the overall financial statements, in the audit report.

Section IV– Audit Issues Regarding Disclosures Required by a Financial Reporting Framework

A.4 Have you encountered situations where you experienced difficulty in obtaining sufficient appropriate audit evidence for a disclosure, even though management believed it had appropriate supporting evidence for the disclosure? If management's consideration of a disclosure can be appropriately supported by evidence and documentation, are there factors that could nevertheless make a disclosure unauditable? If management has not provided evidence and documentation in support of a disclosure, do you believe you are able nevertheless to obtain SAAE on the disclosure? Please explain your answer.

Generally, it is believed that if a financial reporting framework includes a requirement for a disclosure, and management are capable of preparing it, then that disclosure is auditable.
That is, however, in the context of the fair presentation of the financial statements as a whole and not whether it would be appropriate to give an audit opinion on that disclosure alone.

A key obstacle to obtaining sufficient appropriate audit evidence arises in situations where management has determined a disclosure as not material and has, as a result, not prepared the disclosure or compiled the information necessary for that disclosure. It can, therefore, be difficult for the auditor to obtain sufficient appropriate evidence to support management's judgement on disclosures that have not been included because management consider them not to be material.

Management's assessment of what constitutes "evidence" for a disclosure may not always correspond to the expectations of the auditor. For example, management may perform an analysis for the purposes of obtaining the information for disclosures and consider that analysis, e.g. a spreadsheet, to be the "evidence" i.e. focusing more on the process rather than the underlying supporting evidence. It is therefore important for clear communication between the auditor and appropriate levels of management at the audit planning stage to convey the expectations of "evidence".

In the absence of support for a disclosure from management, the auditor may be able to obtain sufficient appropriate audit evidence from results of procedures already performed on the related line item. That will not, however, apply in all circumstances and is impacted by the nature, timing and extent of those audit procedures.

A.5 What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

- Paragraph 61 – agree with the IAASB's assessment relating to property, plant and equipment, that evidence is generally obtained from the procedures performed on the underlying line item.
- Paragraph 63 – practitioners are aware that regulators have challenged whether auditors are sufficiently challenging assumptions related to, for example, fair values and that there is ongoing debate about what constitutes sufficient appropriate audit evidence for matters that are disclosed in relation to fair value estimates. Difficulties can also arise if management has performed a sensitivity analysis without giving sufficient consideration to the likelihood of alternative scenarios or the relationship between impacts of changes in difference assumptions.
- Paragraph 64 – There are differences in opinion over the level of rigour needed for disclosures of fair value in relation to a line item measured at amortised cost. There is a perception that the level of rigour for a fair value disclosure is not the same as for an item included at fair value on the balance sheet, as it does not impact the key performance indicators (e.g.profit/loss). This is an important area to resolve, as at present there appears to be no clear consensus as to what users are expecting in this situation.
- Paragraphs 65-66 – The extent of evidence necessary depends on the wording of the disclosure requirement. If the disclosure requirement focuses on simply disclosing the outcome of the entity's testing, there would be more focus on the process applied in performing the stress test. The financial reporting framework does not typically give criteria for judging appropriate performance of a stress test. That being said, we believe that if the approach was seriously flawed and the results misleading, auditors would raise those concerns with management and/or those charged with governance.
- Paragraph 67 – we believe that: (i) with respect to internal control, auditor's responsibility is to the description of the control and not the audit of its operating effectiveness - financial statement audit does not include an audit of internal control (where a control had been tested the assessment of the description would include whether it was considered misleading if inconsistent with our conclusion on effectiveness); and (ii) in relation to forward looking statements, or statements of management's intent, management should be able to demonstrate their ability to achieve the stated goal/intent but that the auditor's responsibility is not capable of being extended beyond that. We agree with the observation that there are expectation gaps as to what is expected of the auditor. The objectives of the

disclosures should be specific so that preparers and auditors are aware of their respective responsibilities on the disclosures made.

- Paragraph 70 – in connection with objective based disclosure requirements, different models are emerging. Some frameworks set the objective and establish minimum requirements to achieve that objective. That provides a useful benchmark but allows judgement to be applied to the facts and circumstances of the engagement. Others provide only the requirement, with illustrations of what may be relevant. This allows for more judgement to tailor the disclosure to the entity but will result in less consistency, which may not be understandable to users. It is also clear that there are differences in opinion between standard setters, preparers, auditors, and regulators about how such objective based requirements are to be applied e.g. regulators seek comparability and consistency and less judgement (with IFRS 7 disclosures being an example). If comparability is considered of key importance, then objective based disclosures requirements are more difficult.

A key question is whether those developing financial reporting frameworks are increasingly requiring information in the financial statements that is included to provide context to the financial statements because they don't have the mandate to set requirements for the "front half" of the report – i.e. is there sufficient clarity about what information belongs in the financial statements versus information that would be better presented along with, but outside, the financial statements. For example, the only remedy that IASB has when investors say certain information is relevant to their understanding of amounts included in the financial statements is to include a disclosure requirement. Is this always the right answer? It is important that accounting standard setters consider what they believe the disclosure is trying to achieve and what support they believe management needs to be able to provide. It is also key to explain to users when the accounting disclosure requirements are not necessarily going to provide consistency between entities (e.g. if the requirements reflect the entity's own business model or risk management policies).

A.6 Some disclosures include the fair value of a financial statement line item measured on another basis, such as historical cost. In this circumstance, what level of effort do you believe should be applied to the fair value disclosure? Should your effort be the same as if the fair value was on the face of the financial statements?

We believe we should obtain sufficient audit evidence for the fair value disclosure. Hence, the work effort would be the same as if the fair value was on the face of the financial statements.

A.7 What is your expectation regarding the need for disclosures not specifically required by the financial reporting framework, but which some users may believe are relevant to the fair presentation of the financial statements? Examples may include noncompliance with a critical law, even though there is no quantitatively material effect, or the fact that the entity does not have a material holding of a particular asset class, such as sovereign debt, which may be of particular interest in the current economic environment.

Practitioners are generally comfortable in applying judgement when determining whether disclosures are necessary to explain significant transactions.

Difficulties arise in convincing preparers to disclosure information not explicitly required by the financial reporting framework. This is of particular relevance in respect of what is considered to be of "qualitative" relevance to users e.g. non-compliance with laws or regulations.

It can also be difficult in advance to anticipate what may be considered relevant information to users.

A.8 In light of the discussion in paragraphs 79–87, what do you believe is the appropriate way of applying materiality to disclosures? Do you believe there is sufficient guidance in the ISAs?

We believe that more guidance in the ISAs is necessary. As noted in the Discussion Paper, it is not clear how performance materiality is to be applied when quantitative amounts in disclosures may significantly exceed the financial statement balances.

The guidance in ISA 450 on qualitative factors is written primarily in the context of how qualitative considerations may influence a judgement regarding the materiality of an amount that is not quantitatively material. However, there is little on how to judge the materiality of disclosures that are qualitative only.

As noted above, where a belief exists that the key performance indicators relevant to users of financial statements are reflected in the primary statements, there can be a tendency to subjectively apply different thresholds of materiality to disclosures.

It is interesting to reflect on whether the qualitative characteristics in the IASB framework apply to disclosures. Many do not appear to have been drafted with disclosures in mind. There may be a need to consider what such characteristics are for disclosures. For this reason, we are supportive of the various projects underway to develop disclosure frameworks, such as the EFRAG project. In doing so, the respective priority of relevance versus comparability comes to light.

Importantly, however, while we believe more guidance for auditors is necessary, many of the issues are not auditing issue alone. This requires collaboration and is perhaps first and foremost an accounting issue. The IAASB needs to engage the IASB to find a common resolution.

A.9 What do you believe represents a material misstatement of a disclosure? Please give an example of what, in your view, would constitute a material misstatement for the following categories of disclosure:

- **Judgments and reasons;**
- **Assumptions/models/inputs;**
- **Sources of estimation uncertainty/sensitivity analysis disclosures;**
- **Descriptions of internal processes;**
- **Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis; and**
- **Objective-based disclosure requirements.**

We believe each of the following characteristics, either alone or in combination, could lead to a conclusion that a material misstatement exists in each of the above categories:

- Quantitatively material error
- Apparent false or misleading statement, including statements about intent that were know to not be achievable
- Omission of a key element of a disclosure, considered necessary for a proper understanding of that disclosure
- Deliberate bias or misleading presentation e.g. cherry picking aspects of the disclosure/statements by management or attempts to mask or mitigate perceived negative statements by use of wording and/or presentation that negates the true underlying message/position

With respect to disclosures of fair value information under a different measurement basis, the more significant difference may be in the precision with which the entity has calculated the different perspective on its relative materiality. This depends on whether there is a belief that a misstatement of the same magnitude in the disclosure, as opposed to the financial statement, would influence decisions of users.

For objective based disclosure requirements, we believe this issue is one of omission of information deemed necessary. A misstatement is unlikely to apply to having too much information.

A.10 Some disclosures are relevant to an understanding of the entity but are not related to any specific line item in the financial statements. Below are two examples of these types of disclosures:

(a) Financial statements may include disclosures of the policies and procedures for managing the risk arising from financial instruments. Such disclosures may, for example, discuss the controls the entity has put in place to mitigate risks. What do you believe would constitute sufficient appropriate audit evidence for such a disclosure? What do you believe would constitute a misstatement of such a disclosure?

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?

With respect to (a), sufficient appropriate audit evidence relates to whether the controls exist. Consideration is of the factual accuracy of statements and not of the operating effectiveness of the disclosure controls. As noted previously, the auditor would have to respond to known information that led to a conclusion that the statement was false or misleading e.g. if based on reading an internal audit report the auditor was aware of significant deficiencies in those controls. This is comparable to the auditors' responsibility under ISA 720. A misstatement may also arise from "cherry picking" information to be included in the disclosure.

The work effort for stress test disclosures is dependent upon the requirements of the financial reporting framework. We do not believe that the auditor is required to re-perform the stress test or "audit" the inputs and assumptions. The work effort would focus on the accuracy of the description of the test compared to the "test" the entity had actually performed. However, if based on the auditors'

understanding of the entity and its environment the description was considered to be misleading, the auditor would have to take action. As noted previously, it is important for the IAASB to work with accounting standard setters to understand the objective of disclosure requirements and what they expect. Criteria are needed if an auditor is expected to judge the quality of the stress test performed.

A.11 How do you evaluate both qualitative and quantitative misstatements in forming an opinion on the financial statements as a whole? Is it possible to accumulate misstatements of disclosures, particularly when they relate to qualitative or judgmental disclosures? How do prior year's disclosure misstatements affect the evaluation of the current year's financial statements?

If the financial reporting framework mandates a particular presentation (e.g. the proposal in IASB offsetting exposure draft to require certain disclosures in a tabular format) it is difficult to judge whether presenting the same information in a different way renders the disclosure to be misstated.

Qualitative misstatements are difficult to "accumulate", so each potential misstatement needs to be assessed on the facts and circumstances of the engagement.

Where qualitative disclosures contain information that may be deemed to influence judgement on an entity's ability continue as a going concern, this may affect the auditor's evaluation of accumulated misstatements.

In theory, misstatements in disclosures can give rise to both a qualified or adverse opinion. For example, multiple omissions in disclosure or where omission of a disclosure would fundamentally change perception of the financial position and/or results e.g. missing going concern disclosures or significant related party transactions that would change users perception.

With respect to misstatement in prior year disclosures, there are, in theory, treated no differently from errors in the prior year financial statements. However, auditors may, in practice, be more lenient in judging the impact of them because of a perception of the threshold before such misstatements would affect the economic decisions of users.

Section V–Questions about Auditability

A.12 What are the characteristics of disclosures that, in your view, would not be auditable?

As stated in our previous comments, we believe that if a disclosure required by the financial reporting framework and is capable of being prepared by management, then that disclosure should be auditable.

There are circumstances where we might argue that it would not be possible to give an audit opinion on a disclosure separately, but determining what is auditable is different in the context of information relevant to the financial statements taken as a whole. For example, pro forma information, acquire historical information that was audited by someone else or not at all, carve out information which has not been audited separately or to a level of materiality relevant to the carved out information.

In those circumstances a key question is whether users understand the level of "comfort" that is being given on that information.

We believe the IASB needs to work with the IAASB when developing disclosure required in financial statements to ensure that the disclosures can be audited.

A.13 What criteria do you believe should be used to assess an auditor's judgment in respect of the fair presentation of the financial statements as a whole?

We are comfortable that auditors are able to apply judgement in the context of determining whether adequate disclosure has been provided in relation to transactions. It is more difficult to judge emerging needs.

As noted in A7, we support dialogue amongst regulators, preparers and auditors in particular industry sectors to identify emerging information needs that might impact upon fair presentation, before accounting standard setters catch up with solutions under a framework.

A.14 Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach their audits, including how they may approach disclosures. What is your view?

We agree that where a regulator is focusing on a particular area there will inevitably be a focus by both preparers and auditors in those areas in an attempt to avoid criticism.

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~ END ~