



Ms. Kathleen Healy
Technical Director, IAASB

Posted as a comment on:
www.ifac.org

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Ref.: AUD/AKI/HBL/NRO/HBU/EBL

Dear Ms. Healy,

Re: FEE comments on the IAASB Exposure Draft (ED): “Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements”

- (1) FEE (the Federation of European Accountants) is pleased to provide you with its comments on the IAASB Exposure Draft (ED): “Proposed Changes to the International Standards on Auditing (ISAs) – Addressing Disclosures in the Audit of Financial Statements” (“the ED”). Our main comments are summarised here below.

General comments

- (2) FEE welcomes the manner in which the ED recognises the need for alignment with current developments in financial reporting. It is important that all disclosed information is relevant, reliable and presented in a comparable and understandable manner.
- (3) In our response to the Discussion Paper (DP) “The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications” of June 2011, we welcomed the initiation of a thorough debate with all stakeholders on the fundamental issues concerning financial statement disclosures in recognition that developments in this area impact the readability, the understandability and the auditability of the financial statements as a whole. We agreed that it was time for the IAASB to carefully consider whether the ISAs provide the auditor with the necessary framework for the audit of disclosures and FEE commends the IAASB for tackling this issue.

- (4) However, in our opinion, the matter dealt with in this ED cannot be solved by the IAASB alone and it is essential for the IAASB to adopt a holistic collaborative approach to this matter, with other critical stakeholders such as the IASB, and address the matter in a more co-ordinated fashion. Simply observing each other's efforts and dealing with the issue in parallel is unlikely to result in a satisfactory outcome.
- (5) FEE agrees with the IAASB's decision not to address disclosures by way of a separate ISA. Although such an approach might emphasise its importance, we believe that the audit of disclosures is best addressed throughout the suite of ISAs. FEE also supports the IAASB's view that, in general, most of these amendments are best served through changes to application guidance. The "Preliminary Staff Publication" is also a useful accompaniment to highlight the particular difficulties surrounding disclosures and provides helpful and focussed guidance. FEE would, therefore, support the issuance of this publication along with the revised standards.

Applicability in an SME¹ environment

- (6) It is important to consider the SME impact following amendments to the ISAs and we commend the IAASB for addressing a specific question on this matter in the ED.
- (7) In our view, the proposed changes to the audit of disclosures appear to be far more relevant to the public interest entity or the listed entity environment, than to the SME environment. With regard to the disclosures in the audited financial statements, FEE agrees that a proportionate approach must be possible, but strongly believes that this can only be achieved if a robust and comprehensive cost versus benefit analysis is undertaken.

Conclusion

- (8) Having said that, the cost versus benefit issue is not only an SME one: in finalising this project, factors such as auditor performance and audit quality improvements with regard to disclosures in general need to be balanced against the costs of making changes to so many ISAs. We refer to paragraphs 9, 11 and 22 of this letter and to the specific comments made about costs and translations in paragraphs 32 and 34 respectively.
- (9) Although we recognise the valuable work carried out by the IAASB to date, we are concerned as to the likely limited extent of the project's success due to fundamental matters – namely materiality, the use of judgement in estimations and the evidence gathering in regard to certain disclosures – not being adequately addressed in this ED, as conceded by the IAASB itself. These key issues still need to be covered, and most likely in conjunction with other stakeholders such as the IASB.

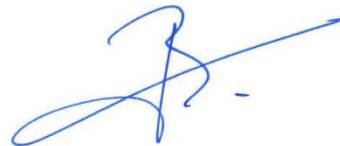
¹ SME stands for Small- and Medium-sized Enterprises

- (10) Our detailed responses to the questions stated in the ED are set out in the appendix. For further information on this FEE² letter, please contact Hilde Blomme on +32 2 285 40 77 or via email at hilde.blomme@fee.be or Noémi Robert on +32 2 285 40 80 or via email at noemi.robert@fee.be from the FEE team.

Yours sincerely,



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FEE President



Olivier Boutellis-Taft
FEE Chief Executive

² FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 47 professional institutes of accountants and auditors from 36 European countries, including all of the 28 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 800,000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

Appendix – Comments on specific matters

1. Whether, in your view, the proposed changes to the ISAs are appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and, thereby, will further support the proper application of current requirements in the ISAs?

- (11) FEE acknowledges that the ED provides greater clarity and useful guidance in a number of areas to assist the auditor in the audit of disclosures. However, some of the suggested guidance is rather self-evident in nature and it is unlikely that it will make much difference to auditor performance and the quality of auditing disclosures.
- (12) FEE welcomes the increased emphasis placed upon disclosures, although the sheer weight of guidance could now be perceived as disproportionate, e.g.:
- In ISA 300, two out of three paragraphs under the subheading “the audit plan”; and
 - In ISA 315 under the subsection on the “process of identifying risks of material misstatements” three out of five paragraphs address disclosures.

The Meaning of Disclosures (ISA 200, paragraph 13 (f))

- (13) The two following detailed changes to the definition of financial statements are of concern to us:
- Addition of: “*... or information incorporated by cross-reference when permitted by applicable financial reporting framework.*”
 - Deletion of: “*The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.*”

Although we acknowledge that the ISAs fall outside any financial reporting framework, it is important to highlight the fact that the proposed text diverges from IAS 1, inclusive of changes proposed thereto in March 2014, which explicitly requires presentation of information on significant accounting policies used. In our opinion, the matters highlighted above do not contribute to enhancing clarity.

- (14) Finally, the purpose of the proposed changes should be the clarification of the meaning of “disclosures”. However, we do not believe that the result is satisfactory and would therefore question whether defining “disclosures” is necessarily an exercise that should form a part of the definition of financial statements; the IAASB might also not be the right body to define “disclosures”. This issue might need further considerations in consultation with other stakeholders.

Addressing Disclosures early in the Audit (ISA 210, 260 and 300)

- (15) Guidance concerning the importance of disclosures during the audit planning process, and the need to emphasize to management their responsibility to deliver information according to an agreed timetable, is helpful and should reinforce the need to integrate the audit of disclosures with the audit of classes of transactions and events, and account balances throughout the audit process, rather than leaving them to the end of the audit process.
- (16) Nevertheless, it should be acknowledged that it is not always possible for management to provide the information to be disclosed at an early stage. Also, no matter how well-planned, it is important to duly recognise that unanticipated circumstances often impact and change disclosures as the audit progresses.
- (17) The ED emphasises the use of information obtained from systems outside the general ledger. FEE agrees with this statement and notes that this information can even come from systems outside the control of the organisation.
- (18) This raises the question as to whether this matter should be more deeply considered. In particular, access to these systems and assessment of their reliability is often not straightforward and, to the extent that the information concerned is non-financial and/or non-quantitative, the auditor has to assess the sufficiency of the evidence available to support such non-quantitative information, an area where the current ISA suite is not well developed.

Risk of Material Misstatement (ISA 240, 315, 320 and 330)

- (19) FEE welcomes the emphasis placed upon consistency, understandability and auditability of disclosures. As referred to above, IAS 1 is currently being revised and, in our opinion, the matter should be approached in a more holistic fashion. The IAASB approach of tackling the audit of disclosures in isolation will not necessarily lead to a satisfactory solution. Whilst acknowledging that auditors are part of the supply chain and have a responsibility to guard against the opaqueness and clutter of the disclosures, FEE reiterates that the issue of disclosures is first and foremost an issue of financial reporting – which of course impacts upon the audit.

Evaluating Misstatement and Forming an Opinion (ISA 450 and 700)

- (20) This is a critical area and, although the proposed changes introduce further guidance, FEE does not believe that the proposed changes are sufficient and would suggest that further development is needed.
- (21) In practice, it is particularly problematic to determine when the aggregated misstatement in non-quantitative information becomes material, and what the terms material and immaterial mean for this type of information. Whilst we acknowledge that this process needs to include a high level of judgement, and therefore cannot be firmly framed per se, materiality in regard to disclosures is an area where FEE believes accounting standard setters need to act.

- (22) We are concerned that the proposed changes in themselves will not be sufficient to lead to a significant improvement in the quality of disclosures in financial reporting. Indeed, as the IAASB acknowledges, this issue needs to be addressed by all participants: preparers, auditors, accounting and auditing standard setters, and regulators. In light of this, FEE would have preferred a more coordinated approach between participants. As indicated as part of our main comments, there is a need for a more holistic approach to solve these issues, while taking into consideration a cost-benefit analysis.
- (23) The wording, especially the use of the term “misleading” information in the proposed changes included in ISA 700, is not consistent with the amendments to other ISAs and FEE suggests it should be changed to “not fairly presented”.
- (24) FEE also notes that some additions to the Application Material are written in a language which is of a level of sophistication that might make it difficult to understand and might create issues upon translation of the ISAs (an issue which will shortly become very important again in the EU). Reference is made for instance to ISA 700 A4a, A4b and A4c.

2. Are there any specific areas where, in your view, additional enhancement to either the requirements or guidance of the ISAs would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit?

- (25) It is recognised that, recently, disclosures have not just become more voluminous, but the nature of them has also changed. There are now more non-quantitative disclosures in the financial statements than there were a decade ago.
- (26) Two fundamental difficulties that this raises for both preparers and auditors are with regards to materiality and the evaluation of misstatements. FEE believes that the proposed changes will do little to help auditors in these areas. Although the IAASB notes a few examples – in ISA 315 A128c for instance – the changes do not actually provide clear guidance to assist auditors as to how judgement might be applied. In regard to materiality and disclosures, FEE believes that the IAASB alone cannot resolve this issue since accounting standard setters also need to act.
- (27) In addition, and as stated in our response to question 1, more guidance would be welcome for situations where the auditor is unable to obtain sufficient evidence to support the information disclosed by management, which is not directly linked to the financial statements.

3. Whether, in your view, the proposed changes to the assertions will help appropriately integrate the work on disclosures with the audit work on the underlying amounts, thereby promoting an earlier and more effective audit of disclosures?

- (28) FEE agrees that the incorporation of assertions for presentation and disclosure, within ISA 315, may help the auditor integrate the work on disclosures into the audit work at an earlier stage. It is important that the auditor ensures that sufficient time is devoted to the audit of disclosures. The assignation of greater and more timely attention to the aspect of presentation could positively influence the understandability of disclosures.
- (29) Since FEE believes that the disclosures directly linked to a line item on the face of the financial statements should be given the same attention as the line item itself, we agree with the integration of assertions for “related disclosures” with the assertions relating to classes of transactions and events and account balances in the financial statements.
- (30) FEE also welcomes the IAASB's further guidance on disclosures not directly related to items recorded in the financial statements. However, in itself, we do not believe that this is an adequate response to the expectation gap between auditors and users in this regard; more clarity should be provided, especially on matters such as materiality.

In addition to the request for specific comments above, the IAASB is also seeking comments on the general matters set out below:

- (a) **Preparers (including Small- and Medium-Sized Entities (SMEs)) and Other Users** —The IAASB invites comments on the proposed changes to the ISAs particularly with respect to the practical impacts, if any, of the proposed changes to the ISAs.
- (31) We refer to our comments of the cover letter about the applicability in an SME environment.
- (32) In addition, it should be acknowledged that not only the SME, but also the SMP³ perspective, is important in relation to this subject matter. Proportionately, SMPs are likely to have more SMEs, and those entities with less complex disclosures, within their client portfolios. For those SMPs that customise their audit methodology directly from the auditing standards, the changes may result in additional work and administrative burdens without substantial added value. As indicated in the cover letter, a cost versus benefit analysis should be undertaken.
- (b) **Developing Nations**—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment on the proposed changes to

³ SMP stands for Small and Medium Practice

the ISAs, in particular, on any foreseeable difficulties in applying these in a developing nation environment.

- (33) FEE does not have anything to report on this specific matter.
- (c) **Translations—Recognizing that many respondents may intend to translate the final changes to the ISAs for adoption in their own environments, the IAASB welcomes comments on potential translation issues respondents may note in reviewing the proposed changes to the ISAs.**
- (34) The proposals included in the ED open ten different ISAs, which would all need to be retranslated and even transposed where need be. Some jurisdictions may also have guidance that might need revision. This represents a significant time commitment and cost burden. It is worth considering whether changes in guidance merit such an investment. Therefore, it is imperative that the IAASB performs a cost-benefit analysis of the proposals made, not only from a general, but also from a translation point of view. In this respect, it is noted that a Staff Paper, in which the audit of disclosures is highlighted, involves a smaller administrative and cost commitment.
- (35) In addition, some member bodies of FEE have previously noted that the consequences of using words such as “may” or “could” can, when translated, lead to different interpretations and meanings. Accordingly, the use of consistent terminology throughout the standards is particularly important to avoid inconsistencies that can result in difficulties in the eventual translation of the text.
- (36) Moreover, during the IAASB’s Clarity Project completed in 2009, the IAASB established certain drafting conventions, one of which was to avoid the use of the present tense, unless needed, on the grounds that this introduces ambiguity into the standards as to the authority attached to the particular text. We note a few instances where the proposed wording of application and other explanatory material is ambiguous in the present tense and suggest the IAASB clarifies the intended authority reference (e.g., ISA 315 A21a, A30; ISA 450 A2a, A13a; ISA 700 A3a; A3b, A4, A4a, A4b, A4c).
- (37) Finally, where reference is made to “the general ledger system”, it would be useful to clarify that its sub-ledgers are also meant to be included – therefore this term could be expanded to read “the general and sub-ledger systems”.
- Effective date – The IAASB believes that to the extent possible, the effective date should be aligned with these other projects, namely the IAASB’s Auditor Reporting project and the project to revise ISA 720.**
- (38) Although FEE acknowledges that alignment with other new and revised ISAs can be beneficial, FEE is not convinced that the changes connected to disclosures are fully “reporting driven” and therefore does not support the alignment in this particular case. We believe the effective date of this ED could be later than for those ISAs included in the auditor reporting project. However, from the perspective of not opening up the ISAs too often, it could make sense to coordinate dates with the auditor reporting project.