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21 June 2011

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Our Ref: 2011/JE/TCSC1/IAASB/90

Subject Line: IAASB Discussion Paper, *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications*

Dear Sir:

The International Organization of Securities Commissions Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the IAASB Discussion Paper, *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing and professional standards, other pronouncements and statements.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

Purpose of the Project

We are supportive of the Board's efforts to explore a critical component of financial reporting. We believe the Board's Discussion Paper is a useful initiative which comes at a time when the global



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securities markets are working to emerge from the recent financial crisis and other shocks. Disclosure is an important component of public reporting to investors and we believe users of financial statements need and should have access to full and fair disclosures in order to make better informed investment decisions.

The importance of disclosures in the financial reporting process is even more compelling in the present financial reporting environment as certain disclosure requirements have become more objective-based in nature and may give rise to less correlation between footnote disclosures and specific line items of the financial statements. This may increase the difficulty experienced by preparers, auditors, investors and other stakeholders as they attempt to relate disclosures to specific line items of the financial statements.

Overarching Guidance Regarding Disclosures

Consistent with the examples provided in Appendix 1 of the Paper, we believe the topic of disclosures is relevant and applicable to several auditing standards. The importance of disclosure to the fair presentation of the financial statements is highlighted by the notion that any disclosure could contain a misstatement that, individually or when aggregated with others, could have a material effect on the financial statements taken as a whole. Individual financial statement notes could contain material disclosures that could influence the investment decisions of investors or other financial statement users.

A trend toward an increase of objective-based disclosure requirements in an accounting framework coupled with the difficulties sometimes associated with the timing of the preparation of disclosure information can present considerable challenges for preparers, auditors and accountants. With this in mind, we believe that there is a case for the IAASB to provide some form of overarching auditing guidance regarding disclosures that would supplement the content that is now contained in all the ISAs. Due care should be exercised to ensure that such guidance does not appear to imply that disclosures may be considered as secondary to other auditing issues addressed by the ISAs.

Equality of Disclosures in the Financial Reporting Process

In the Paper the IAASB states, "ISAs often refer to classes of transactions, account balances and disclosures when describing the auditor's responsibilities in many areas, indicating that disclosures are treated in the same way as classes of transactions and account balances in the application of many auditing requirements." We support treatment that accords disclosures the same importance as transactions and account balances in auditing standards. Consistent with this concept, we believe if a



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financial statement line item is considered to be material, careful consideration should be given to all of the related note disclosures in light of the materiality of the financial statement line item. We also believe that disclosures can be qualitatively material even if the amounts involved might be quantitatively immaterial. An example of this is the case in which the disclosure may be the primary and/or exclusive manner in which the financial reporting model conveys information about a matter to financial statement users.

Objective-Based Disclosure Requirements

In the Paper's discussion of "The Prevalence of Objective-Based Disclosure Requirements", the IAASB states that:

"One of the themes of recent accounting standard-setting activities has been the increased use of objective-based disclosure requirements in addition to specific disclosure requirements... These objective-based disclosure requirements create particular challenges for preparers. They must "stand back" from the financial statements and evaluate whether sufficient disclosures have been made. This is a highly judgmental process and it may be difficult for management to substantiate how they complied with these types of disclosure requirements."

We agree that preparers must stand back from the financial statements and evaluate whether sufficient disclosures have been made, and believe it is important to emphasize in relevant guidance that if both preparers and auditors do not perform this "big picture" assessment, then the effectiveness and usefulness of financial reporting may diminish.

Enforceability of Disclosures

In the Paper the IAASB states that "similar to the discussion regarding the auditability, there is also an attention to the enforceability of accounting standards." We agree that there should be an attention to the enforceability of accounting standards. To this point, we have observed that the qualitative nature of objective-based disclosures in which financial statement preparers are required to use their judgment to determine the content of information to be disclosed to meet the objectives presents a greater challenge to both regulators and auditors. We believe that even objective-based disclosure requirements must be written with sufficient specificity to enable preparers to understand their obligations and enable regulators to hold them accountable for making proper disclosures.



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Observations Regarding Disclosure Preparation

In the Paper's discussion of "Observations Regarding Disclosure Preparation", the IAASB states that "...even where the process for preparing the financial statements themselves is well-organized and structured, the process for preparing disclosures is usually less formal and less structured. In order to meet the filing deadline within the short period of time, entities are usually rushing to finish the process, and so there is a disincentive for both preparers and auditors to make any changes to disclosures, including deletions of disclosures that might now be considered to be immaterial." We agree with the perception that the preparation of disclosures may, at times, be rushed and less structured; however, we observe that there are useful ways to address such a less structured process. One way would be to provide guidance that helps auditors to be more proactive in engagement and audit planning and communicating with management early in the audit process regarding disclosures that will be needed. Sometimes it is possible to plan for and carry out some of the disclosure audit work earlier in the financial reporting and audit processes. We believe it might be useful for the IAASB to consider providing auditors with alerts or other guidance regarding how the auditor can be proactive concerning disclosures. Such considerations could draw on some of the points raised in this Discussion Paper and might inform the auditor about proactive steps such as:

1. Initiate discussions with and inquiries of management earlier in the audit process regarding disclosure information that will be needed, walking through last year's annual report to understand things such as:
 - a. What has changed that will drive additions to or removal of disclosures?
 - b. Whether there are any unexpected variances from estimates made in the prior year?
 - c. What appropriate supporting evidence is available to substantiate amounts disclosed?
 - d. Who within the organization will be tasked with supplying the relevant information?
 - e. Are there foreseeable challenges in gathering the relevant information?
2. Consider changes to accounting policies impacting the company as compared to prior years, anticipating such things as implementation alternatives available under the requirements and sources of sufficient appropriate audit evidence.
3. During planning and fieldwork, seek preliminary views from management and/or those charged with governance on what aspects of new transactions should be considered material with respect to disclosure requirements.
4. If the company has a disclosure committee or similar group within the organization, consider opportunities to access the work performed by these groups which may inform the auditor's work. This may involve reviewing minutes of the committee and/or discussing with members of the committee significant points raised in meetings.



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We believe these examples may be useful considerations as the IAASB explores issues surrounding the concern that entities may be rushing “to finish the [financial statement disclosure] process” to meet the filing deadline. We believe that providing guidance to auditors may help them to be proactive with respect to disclosures so that the work effort and extent of audit procedures are not compromised, particularly in those instances in which management may tend to be late in giving attention to providing required disclosures.

We also agree with the observation that the accumulation of unnecessary detail, duplicative or uninformative disclosures can decrease the effectiveness of financial reporting. However, it is also true that potentially valuable information relating to the financial statements should not be eliminated simply because a note is considered too voluminous. While identifying appropriate deletions of current disclosure information may be a valid interest for preparers and auditors, an even greater concern is to ensure that no disclosures are inappropriately omitted from the financial statements.

Risk Assessment Procedures Should Continue Throughout the Audit

Paragraph 58 states “one challenge is that disclosures may be prepared late in the financial reporting process and may be produced using less formal procedures. This may make it difficult for auditors to perform at least some of the risk assessment procedures until closer to the end of the financial reporting process and the risk assessment process may also be less formalized.” We agree that the late preparation of disclosures together with less formal disclosure preparation processes can be challenging for auditors. We believe there should be more emphasis on disclosure considerations, including its related controls and processes, during the planning phase of an audit and throughout the audit. As mentioned earlier, we believe the IAASB could provide useful guidance to address this issue.

Similarly, we believe the auditor’s assessment of the risks of material misstatement, including those related to disclosure, should begin at an early point and continue throughout the audit. We believe there is a heightened level of audit risk relating to disclosures when the preparation of the disclosures falls closer to the opinion date especially if the auditor has not developed an expectation of what the disclosure content should entail. In certain instances, the greatest audit risk with respect to disclosures may lie within the process or timing of its preparation as opposed to the content of the disclosure.

Liaising with the IASB on Its Conceptual Framework

When auditing full and fair disclosures, we believe there may be benefits to be gained by the development of a sound financial reporting framework that addresses objectives, qualitative



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characteristics, recognition, measurement and disclosure in the context of reporting to investors and other financial statement users. As a result of the interplay of auditing with the relevant accounting framework, we encourage the IAASB to liaise with the IASB when the IASB deliberates its *Conceptual Framework - Phase E: Presentation and Disclosure, including Financial Reporting Boundaries* project. Further, the responses of investors and other stakeholders commenting on an IASB project may provide helpful input on investors' perceptions of disclosures required by financial reporting frameworks.

Integral to the topic of disclosures is the concept of materiality. We believe a sound financial reporting framework may be helpful to preparers, auditors and accountants to better define and apply materiality with respect to disclosures. We believe that such a framework should provide authoritative guidance regarding disclosures to assist preparers, auditors and accountants in the financial reporting process in judging when disclosures are sufficient. To this end, we believe it would be very beneficial for the IAASB to consult with the IASB concerning the IASB's experience and thoughts regarding materiality in matters related to disclosures.

We are copying the IASB on the submission of our letter to make them aware of the comments under this subheading for their consideration.

Boilerplate Language

Paragraph 31 states that "an entity in a particular industry may also make judgments about the disclosures that are particularly relevant in the circumstances of that entity. However, this may result in entities in the same industry not including the same disclosures. While that fact in and of itself might yield useful information to users, it is at a cost of less comparability and consistency which other users - and regulators - might value more."

We agree that industry-related disclosures can be very relevant to users. We also believe the use of boilerplate language should be limited in its use and enhanced, where necessary, to reflect unique and meaningful information relevant to the company, whether it is in financial reporting or auditor reporting (where modifications to the standard auditor's report are required). We believe users of financial statements, including investors and regulators expect differences in language used by various companies that reflect differences in both business models and transaction details, and give a good picture of the facts and circumstances surrounding specific activities. While the Paper touches on certain issues surrounding the use of "boilerplate language", we believe the IAASB should be more explicit and comprehensive in its coverage of this subject.



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In addition to the above, we have provided answers to selected questions in Appendix A to this letter.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss the matters noted in this letter, please contact either Nigel James or me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
Standing Committee No. 1
International Organization of Securities Commissions

cc: Li Li Lian, IASB Project Manager



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Appendix A

Consultation Questions for Regulators, Including Audit Oversight Bodies

The following questions are designed to solicit perspectives from regulators on the challenges faced when considering disclosures. Regulators are asked to comment on the following questions, and are invited to raise any other issues relating to disclosures that should be brought to the IAASB's attention.

Section II–Financial Reporting Disclosure Trends

Section II of the discussion paper explores the recent trends in financial reporting disclosures, and the practical experiences of preparers and auditors.

R1) 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.

We believe that the inclusion of unnecessary or immaterial disclosures in the financial statements could obscure the presentation of material information and/or reduce the ability of users to understand the facts and circumstances associated with these matters.

We believe the use of boilerplate language, disclosure checklists (as a compliance exercise), as well as a desire to avoid potential questions from regulators, can lead to excessively long and unnecessary disclosures. This is exacerbated by both the time pressures of preparing financial statements and the practice of using a roll forward of prior year disclosures as the starting point for the current year financial statements.

Two examples of a potentially immaterial disclosure are as follows:

1. Certain IFRS 2 (share-based payment) disclosures (excluding directors' schemes, which may be material by nature of the subject matter), which can extend over several pages for relatively immaterial amounts that do not enhance the users' understanding of the basic facts. Preparers and auditors should consider whether it may be appropriate to present the information that is required to be conveyed by such disclosures in a way (e.g., narrative, other format, etc...) that is more concise.



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2. Certain accounting policy disclosures particularly when the disclosure is not relevant or specific to the company.

Please see additional comments under the headings “*Observations Regarding Disclosure Preparation*” and “*Boilerplate Language*” in the body of our letter.

Section III—How Do ISAs Currently Deal with Disclosures?

Section III describes the key requirements and guidance for auditors in dealing with disclosures.

R2) Do you believe the ISAs provide sufficient requirements and guidance in respect of disclosures? Please explain your answer.

ISAs, as currently drafted, consider the audit of disclosures “hand in hand” with the audit of classes of transactions and balances. In most circumstances, as described in Appendix 1 of the Paper, the audit of disclosure is “on equal footing” with the audit of financial statement line items, based on which the auditor may assume that the audit of disclosures can occur at the same time and in the same way (or on the same basis) as the audit of the related items in the financial statements. This assumption might no longer be justified. The approach followed in the ISAs, in line with a traditional type of disclosure, as defined in the Paper, could no longer be adequate vis a vis the contemporary type of disclosure that is, very often, more complex, broad and of a narrative nature than in the past and one that includes a variety of information which may not be derived from the general ledger accounting system.

This shift may warrant the development of more specialized auditing guidance relating to disclosure. In addition, guidance may be increasingly important given the move to more objective-based disclosure requirements in more recent IFRSs potentially giving rise to more qualitative disclosures and narrative explanations.

It is also important to note the issues in paragraphs 37-38 of the Paper, which indicates that disclosure notes are often prepared late in the financial reporting process and which follow a process for preparing disclosure notes that is often less formal and structured than the process for preparing the financial statements themselves. This may have a subsequent impact on the approach to the audit procedures that are applied to the disclosure notes and could also be addressed by providing guidance, as discussed earlier in this letter.

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



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Section IV discusses the implications of disclosures required by accounting standards. In particular, it explores the challenges in providing evidence to support some disclosures (paragraphs 59–78) and discusses the assessment of materiality and misstatements (paragraphs 79–101).

R3) What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

Regarding paragraph 63 which addresses “*a disclosure related to a line item that is reflected in the financial statements at fair value*”, we believe the auditor should evaluate the main judgments and assumptions and processes that the preparer has utilized in determining key judgements and assumptions that feed into the underlying fair value models, and should consider whether management has provided appropriate, meaningful disclosures that can be understood by users, avoiding boilerplate wording.

Regarding paragraph 64 which addresses “*a disclosure of the fair value of a line item recorded on another basis, such as amortized cost*”, we believe the audit effort to obtain evidence of the fair value should be the same as for other line items recorded at fair value in the balance sheet. The audit work/effort should be the same regardless of whether the fair value is recorded or disclosed in the notes to the financial statements. We believe this is important for comparability purposes where a choice is being made to disclose fair value information as opposed to financial statement measurement (for example, measurement choices for investment properties under IAS 40). The audit work/effort should depend on the materiality of the amounts or information involved.

R4) 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?

See answer to Q R3 regarding paragraph 64 of the Paper.

R5) 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 reliability and faithful representation are both important, and any perceived matter of emphasis on one or the other does not change the work expected of preparers and auditors. We



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consider this more as a change in terminology to clarify the requirements and reflect the potential increase in the amount of judgment that is required in preparing and auditing financial statements.

Disclosures still need to be complete and neutral; i.e., not always over or under stated as paragraph 27 states “two other aspects of the revised IASB Conceptual Framework may be particularly relevant when thinking about disclosures. The sub-characteristic of neutrality requires management to ensure that the financial statements are free from bias. This helps to ensure that the financial statements are a neutral depiction of the economic phenomena and are not - slanted, weighted, de-emphasized or otherwise manipulated to increase the probability that financial information will be received favorably or unfavorably.” This may be particularly relevant when considering how qualitative disclosures are written.

R6) 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 non-compliance 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.

When the relevance of a disclosure is being evaluated for a set of financial statements prepared under IFRS, we believe IAS 1, Presentation of Financial Statements (paragraph 17 and particularly 17(c)) is applicable which states that “an entity achieves a fair presentation by compliance with applicable IFRSs. A fair presentation also requires an entity...to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.” In our view, even if a company is compliant with the specific IFRS requirements, paragraph 17(c) requires preparers and auditors to step back and look at the big picture to ensure the omission of certain information, which may otherwise not be required, does not cause the financial statements to be misleading.

R7) 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;



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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.

With respect to objective based disclosures requirements, we believe that:

- a. It is important that the disclosures be clear and specific.
- b. A material misstatement of a disclosure would exist if:
 - There are errors or omissions that could mislead a user of the financial statements or
 - Important information is convoluted or obscured by the inclusion of a voluminous amount of information.

More specifically, we believe the following represent potential material misstatements of a disclosure:

Judgments and reasons/assumptions/models/inputs - Factually incorrect information (e.g. the disclosed does not reflect all the actual facts and circumstances).

Sources of estimation uncertainty/sensitivity analysis disclosures: (i) Factually or mathematically incorrect information; (ii) incomplete – e.g. missing ‘sources’, or sensitivity did not include a key variable; (iii) inadequate explanation of identified ‘sources’; and (iv) sensitivity was not a reasonably possible change.

Descriptions of internal processes – factual misrepresentation.

Disclosure of fair value information for a line item recorded on the balance sheet using a different measurement basis: Same principles as misstatement for financial statement line items.

Objective-based disclosure requirements: The information does not fulfill the objective (e.g. effects of a major transaction on accounts are not completely explained). As an example, IFRS 7 requires disclosures sufficient to allow users to evaluate significance of and risks from usage of financial instruments. The specific requirements address this, but it is entirely conceivable for the specific requirements to be met without meeting the overall objective. For example, if liquidity risk is the most significant risk facing the entity, and the IFRS 7 disclosures provide reams of market risk disclosures,



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but a compliant, bare-bones liquidity risk disclosure almost hidden at the end, then such disclosures would not meet the objective (i.e., because of lack of prominence and comparative levels of detail).

R8) 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?

Regarding the disclosures of the policies and procedures for managing the risk arising from financial instruments, and the controls the entity has put in place to mitigate risks, we believe that auditors should verify that the description of those policies and procedures is accurate and complete, and that the policies and procedures are actually being used.

We believe sufficient appropriate audit evidence would include consideration of:

1. The factual correctness and adequacy of the explanation,
2. Whether the audit evidence addresses the objective,
3. Is the audit evidence consistent with cumulative audit knowledge and experience, and
4. The degree to which the processes and controls are appropriate – i.e. if a control is described, does the auditor actually believe it addresses the described risk?

(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?

On the proposed disclosure of stress test information which is currently not required by IFRS, we may be able to provide a more complete response if we comment on the standard when it is finalized. Nonetheless, regarding our initial observations, we believe that while sufficient and appropriate audit evidence could be available in auditing the description of the process that the entity followed and the outcomes of the stress test, it is very likely that evidence on whether the test was appropriately performed and on the appropriateness of the outcome in the entity's circumstances may be less reliable.



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Moreover, from a users perspective there is also a danger that the “audit” of such disclosures creates an expectations gap on the ability of the entity to withstand future shocks. Should this type of disclosure become a requirement in the IFRS framework, at a minimum, we believe the above mentioned issues will need to be properly addressed in the auditing standards and related guidance.

Section V—Questions about Auditability

Section V considers auditability of disclosures, and the implications of the IASB’s concept of “verifiability” on the auditability of disclosures.

R9) Are there disclosures which, in your view, are not capable of being audited? Please explain your reasoning.

We believe that all disclosures can be subjected to some degree of meaningful work effort or audit procedures. The type and scope of these procedures will depend on the nature, subjectivity and uncertainty of the item being audited, in order to obtain sufficient, appropriate audit evidence.

R10) 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 not clear as to what this question is asking as it seems overly broad. As a general statement, we believe that auditors are subject to whatever the oversight regime requires. In addition, in order to assess the fair presentation of the financial statements as a whole, the information should be sufficient in quantity and quality to satisfy the expectations of a reasonable investor.

R11) 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?

We believe that communications from financial reporting regulators to preparers and auditors regarding potential areas of concern and/or of topical interest can be useful as preparers and auditors consider relevant areas. Also, we believe preparers and auditors should take another look at disclosures in those areas where regulators have taken enforcement action in the recent past.