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Exposure Draft: Proposed Changes to the International Standards on Auditing (ISAs)–Addressing Disclosures in the Audit of Financial Statements

Dear Ms Healy

The European Banking Authority (EBA) welcomes the opportunity to comment on the IAASB's Exposure Draft: *Proposed Changes to the International Standards on Auditing (ISAs)–Addressing Disclosures in the Audit of Financial Statements* (hereinafter referred to as 'the ED').

Consistent with the EBA's reply to the IAASB's Discussion Paper: *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* on 1 June 2011, we would like to reiterate our strong interest in promoting sound and high quality auditing standards for the banking and financial services industry which, together with high quality financial reporting by financial institutions are key elements of market confidence and discipline.

The EBA welcomes the IAASB's proposals, which seek to provide more clarity on the work which is expected from auditors when auditing the financial statements' disclosures as well as to address the practical challenges due to the evolving nature of disclosures especially in the recent years. The EBA considers that such focus could improve the quality of disclosures in the financial statements. However, the EBA believes that some of the proposals could be developed further and some of the application material could be enhanced to requirements in order that there is a more consistent and robust audit of disclosures.

Our comments in the Appendix are based on our perspective as a prudential banking regulator and are structured according to the topics covered by the ED. However, they do not provide answers to every question raised in the ED.

If you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely

(signed)

Andrea Enria

Appendix

General comments

The EBA welcomes many of the proposed amendments in the ED, which place more emphasis on the audit of disclosures. Disclosures are an integral part of the financial statements of an entity and therefore deserve equal attention by auditors during the course of an audit. The EBA particularly welcomes the following:

- emphasis placed on considering disclosures earlier in the audit cycle (ISA 300 A12b);
- greater prominence to the relevant audit considerations when information is derived from systems or processes not part of the general ledger system (ISA 315 A89a);
- proposal to integrate the assertions for presentation within the definition of other assertions (ISA 315 A124);
- more examples of possible areas of material misstatement in disclosures (ISA 315 A128c);
- more guidance on what constitutes a misstatement such as omission of disclosures beyond what is specifically required by the framework which are necessary for fair presentation (ISA 450 A1).

Overall, we support the inclusion of greater emphasis on the consideration of disclosures throughout the ISAs. However, we believe that some proposals could be developed further or enhanced to requirements in order to ensure consistent and robust application as noted below.

Audit Evidence

As the IAASB acknowledges in the explanatory memorandum of the ED, enhancements to the quality of disclosures in financial statements require collaboration and cooperation between various stakeholders, including among others the IASB, which is currently undertaking the Disclosure Initiative project as well as a review of the Conceptual Framework and which might be relevant to these proposals. However, without ignoring the practical challenges that may arise, we would welcome the amendment of ISA 500, in order to include more detailed requirements and/ or guidance on what constitutes ‘sufficient and appropriate evidence’ in relation to the audit of disclosures so that the audit of disclosures is given sufficient prominence compared to the other elements of financial statements.

Exercise of Professional Scepticism

The EBA regrets that the proposals do not seem to include enough requirements or guidance on the exercise of professional judgement and therefore professional scepticism in challenging the management’s assumptions during the audit of disclosures. As the IAASB acknowledges, professional scepticism is fundamental to the audit of financial statements including the disclosures. In this regard, we believe that the disclosures are an area which may include significant scope for use of judgement with a potential pervasive impact on the financial statements in their entirety (for example, the selection of material information to be disclosed, the description of the accounting policies, the disclosure of transactions and events such as litigation claims). Therefore, in line with the IAASB proposed work program for 2015 – 2016, the EBA would welcome additional proposals on the requirements and/ or guidance on challenging the management's use of judgement related to the disclosures of financial statements, which could reinforce the concept of professional scepticism in an audit.

In this regard, paragraph 15 of ISA 200 which refers to the application of professional scepticism when planning and performing an audit could be amended to make specific reference to the application of professional scepticism in the audit of disclosures.

In addition, under ISA 700, when the auditor is evaluating whether the financial statements achieve fair presentation, we believe more guidance could be provided to support the auditor's exercise of professional scepticism in respect of the disclosures. For example auditors could use their expertise in order to:

- challenge whether there are disclosures which, given the evolving economic environment, should be included the financial statements, or should be more prominent in them;
- evaluate whether the disclosures do meet the objectives for the disclosures as laid out in the relevant accounting standard e.g. IFRS 7, *Financial Instruments: Disclosures*; and
- challenge whether the disclosures are informative, useful and understandable to the users.

We appreciate that this evaluation is within the context of evaluating whether the financial statements and disclosures achieve fair presentation overall, but would reiterate the point made by the IAASB that, 'appropriate, relevant and high-quality disclosures have become increasingly important to users of financial statements.'[1]

Application Material versus Requirements

The EBA is of the view that some of the proposed amendments to the application material may be interpreted in practice as requirements (rather than application material), in that the auditor would always be expected to undertake such procedures. This is particularly pertinent to matters noted in ISA 330, A59 covering aggregation and disaggregation, and classification of amounts and ISA 450 A13a, where evaluating whether misstatements in non-quantitative disclosures are material should take into account matters such as their effect on the relevant disclosures, as well as their overall effect on the financial statements as a whole. We also note that ISA 700 A3a and b as well as A4a and b include application guidance related to an auditor's evaluation of the understandability and fair presentation of the disclosures of the financial statements, which would be expected of an auditor in all instances. Elevating this application material to requirements would further enhance the quality and robustness of the audit of disclosures.

Use of terms in the proposals

The ED includes references to both the terms 'notes' and 'disclosures', without a sufficient articulation of the conditions for the use of each one in each case. This might introduce

[1] *IAASB [Preliminary] Staff Publication: Addressing Disclosures in the Audit of Financial Statements,* 2014, page 1

unnecessary complexity and inconsistency in the application of the requirements. Similarly, the proposals include in some instances the addition of ‘disclosures’ alongside the existing reference to ‘financial statements’ (for example ISA 240, paragraph A11), while in others only a reference to ‘financial statements’ is included (for example ISA 240, paragraph A10). This type of selective emphasis in ISAs might undermine the overall effectiveness of the proposals, because it might be interpreted that when only financial statements are mentioned (and disclosures not explicitly mentioned), then auditors need not apply the respective requirements to the audit of disclosures.

Therefore, the EBA would support the amendment of the proposals by consistent use of the terms ‘disclosures’ and ‘notes’ and appropriate definition of each one. In this context, the EBA would suggest that any specific reference to disclosures besides the existing general references to financial statements needs to be justified in order to ensure robustness and consistency in the application of the requirements. Additionally, the EBA would recommend the addition of ‘or to omit disclosure altogether’ to the end of the newly proposed sentence in ISA 240 paragraph A11 to ensure consistency with other proposed amendments (for example to ISA 315, Appendix 2).