

## The challenges of the evolving nature of disclosures



### Introduction

In January 2011, the IAASB<sup>1</sup> published Discussion Paper *The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications* (the discussion paper).

Recent trends in the nature, extent and complexity of financial statement disclosure requirements create issues and practical challenges for all stakeholders in financial reporting and not only auditors. Many of the matters auditors need to consider in auditing disclosures are encountered first by preparers. The IAASB is seeking insight on the issues relevant to auditing disclosures in a financial statement audit. It is soliciting input from all stakeholders and has provided separate questions for preparers, users, regulators and auditors.

Comments on the discussion paper are due by 1 June 2011. The discussion paper is available on the IAASB's [website](#).

### Background and executive summary

#### Financial Reporting Disclosure Trends

Over the past decade, the nature of financial reporting has evolved to meet the changing needs of users of financial statements and to respond to the increased complexity of business models, management of risks and uncertainty. Disclosures have shifted from providing disaggregated information of line items presented on the face of the financial statements to include a broad variety of more comprehensive, complex and subjective disclosures. These include disclosure of the fair value of items measured on a cost basis, risk management policies and practices, assumptions, inputs and models, sensitivity analysis, the effect of alternative measurement bases and sources of estimation uncertainty. Some of these disclosures may not be derived from the traditional financial reporting systems and may include forward-looking, subjective information.

#### Key issues raised:

- How to balance the 'understandability' assertion for disclosure with the compliance focused assertion of 'completeness'.
- How is materiality determined for disclosures.
- How is sufficient appropriate audit evidence obtained for different categories of disclosures.

In light of these trends and challenges, the IAASB invites all stakeholders who have an interest in financial reporting, i.e. preparers, investors, lenders, creditors, regulators and auditors, to consider their approaches to disclosures.

The discussion paper identifies the categories of disclosures that pose the most significant challenges for both preparers and auditors. These include:

- judgements, policy decisions and reasons for their selection;
- assumptions, inputs and models;
- sources of estimation uncertainty and sensitivity analyses;
- descriptions of internal processes;
- fair value disclosures for amounts recognised in the statement of financial position using a different measurement basis; and
- objective-based disclosures, which include requirements to provide additional disclosures when compliance with the specific disclosure requirements in a standard will be insufficient for users to understand the impact of particular transactions, other events and conditions relating to the entity's financial position and performance.

The discussion paper also considers the impact of recent changes to the IASB's<sup>2</sup> *Conceptual Framework for Financial Reporting* on financial statement disclosures, such as, the replacement of 'reliability' with 'faithful representation', the increase in the focus of relevance over reliability and the inclusion of 'understandability' as an enhancing qualitative characteristic. Refer *Briefing Sheet – Issue 213* for further information on the changes to the IASB's conceptual framework.

## Issues raised by the evolving nature of disclosures

The discussion paper raises issues faced by preparers and auditors as a result of the evolving nature of disclosures. Implications for the preparers and auditors:

- How are disclosures supported and audited when disclosure information is derived from risk management or other systems, other than from 'traditional' accounting systems?
- How to balance the 'understandability' assertion for disclosures with the compliance-focused assertion of 'completeness'? How does a preparer or an auditor determine that a required disclosure is not material?
- How the objective of 'neutrality' applies to disclosures. How does the preparer or an auditor evaluate qualitative disclosures and whether they are free from bias?

The discussion paper focuses on audit issues relating to current disclosure requirements. It also is linked indirectly to some financial reporting initiatives that focus on enhancing disclosures both within and outside financial statements. For example, some of the consideration of materiality, completeness and understandability may be relevant to projects such as the FASB's<sup>3</sup> disclosure framework project, the detail of which are available on the FASB's [website](#). Some of these issues raised by the IAASB also may be relevant for efforts to supplement financial statements with other types of reporting such as sustainability reporting.

## Audit issues regarding disclosures

Recognising that International Standards on Auditing are directed to an audit of financial statements as a whole, rather than each disclosure, the IAASB is seeking input on:

- what constitutes sufficient appropriate audit evidence in relation to different categories of financial statement disclosures;
- how to apply the concept and measures of materiality to disclosures; and
- how to evaluate misstatements in disclosures.

The discussion paper is based on the premise that all disclosures are capable of being audited, but solicits input from stakeholders on the challenges to this premise.

The IAASB acknowledges that there may be an advantage in developing further guidance on the type of factors to be considered when evaluating qualitative disclosures.

Another issue considered in the discussion paper is the concept of fair presentation and whether the phrase 'presents fairly' means compliance with the financial reporting framework or whether it is an overarching concept that goes beyond compliance with the explicit requirements of a financial reporting framework to encompass the broader issues of understandability, prominence and presentation of key disclosures in the context of the financial statements as a whole.

### Abbreviations

- 1 IAASB: International Auditing and Assurance Standards Board
- 2 IASB: International Accounting Standards Board
- 3 FASB: US Financial Accounting Standards Board

© 2011 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

KPMG International Standards Group is part of KPMG IFRG Limited.

Publication name: *In the Headlines*

Publication number: Issue 2011/06

Publication date: February 2011

The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

The *In the Headlines* contains links to third party websites not controlled by KPMG IFRG Limited. KPMG IFRG Limited accepts no responsibility for the content of such sites or that these links will continue to function. The use of third party content is to be governed by the terms of the site on which it is hosted and KPMG IFRG Limited accepts no responsibility for this.

[kpmg.com/ifrs](http://kpmg.com/ifrs)

***In the Headlines* is KPMG's update on International Financial Reporting Standards (IFRSs) and financial reporting related regulatory developments.**

If you would like further information on any of the matters discussed in this issue of *In the Headlines*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.