

2023

Audit Quality Unit (AQU)

**Quality of audit evidence
and audit procedures
performed on the financial
statement disclosures**

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Vision

Public trust and confidence in quality auditing and accounting



Mission

Upholding quality corporate reporting and an accountable profession

Our Values



Excellence

Striving to be the best we can be



Independence

Regulating impartially and objectively



Integrity

Being trustworthy and respectful

1. Introduction

1.1. Background

Auditors play a fundamental role in ensuring the credibility of the financial information published in audited financial statements. A statutory audit results in an audit opinion as to whether or not the financial statements, including related disclosures, are prepared in accordance with the applicable financial reporting framework.

The Conceptual Framework of the International Accounting Standards Board (IASB) defines the faithful representation of an asset, liability, equity, income or expense. It refers to not only recognition and measurement but also presentation and related disclosures. Disclosure requirements of financial reporting frameworks are of equal importance as recognition within the primary statements.

As user needs grow and financial reporting standards evolve, there is a greater focus on qualitative disclosures. Appropriate, relevant, and high-quality disclosures are becoming increasingly important to the users of the financial statements. This includes outlining the risks impacting the entity, the judgements made and any estimation uncertainties that exist.

The International Auditing and Assurance Standards Board (IAASB) revised several International Standards on Auditing (ISAs) in 2017. The revisions addressed the expected effort required from auditors in addressing disclosures in financial statements.

Paragraph 13(f) of ISA 200¹ states that disclosures:

“comprise explanatory or descriptive information, set out as required, expressly permitted, or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement, or in the notes, or incorporated therein by cross-reference.”

Compliance with the ISAs, in connection with disclosures, must be considered at all stages of an audit. The ISAs recognise the significance of disclosures when obtaining an understanding of the entity and its environment, performing risk assessments and evaluating audit evidence when forming the audit opinion.

Furthermore, the ISAs frequently refer to “classes of transactions, account balances and disclosures” when outlining the auditor’s responsibilities in many areas. This supports the view that disclosures are of equal importance as classes of transactions and account balances.

The following table illustrates some of the relevant ISAs when addressing financial statement disclosures, broken into the stages of the audit that they relate to:

¹ ISA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (Ireland)

Planning the audit and risk assessment process	Obtaining sufficient appropriate audit evidence	Completing the audit
ISA 210 Agreeing to the terms of audit engagements	ISA 240 The auditor's responsibility to consider fraud in an audit of financial statements	ISA 240 The auditor's responsibility to consider fraud in an audit of financial statements
ISA 240 The auditor's responsibility to consider fraud in an audit of financial statements	ISA 260 The Auditor's responsibility to communicate with those charged with governance	ISA 260 The Auditor's responsibility to communicate with those charged with governance
ISA 260 The Auditor's responsibility to communicate with those charged with governance	ISA 330 The auditor's procedures in response to assessed risks	ISA 450 Evaluation of misstatements identified during the audit
ISA 300 Planning an audit of financial statements	ISA 500 Audit evidence	ISA 700 Forming an opinion and reporting on financial statements
ISA 315 Obtaining an understanding the entity and its environment and assessing the risks of material misstatement	ISA 501 Audit evidence – specific considerations for selected items	
ISA 320 Audit materiality	ISA 540 Auditing accounting estimates, including fair value accounting estimates, and related disclosures	
	ISA 550 Related parties	
	ISA 560 Subsequent events	
	ISA 570 Going concern	
	ISA 580 Written representations	

External events such as COVID-19, natural disasters, and geopolitical events such as regional conflicts and increasing inflation are some examples of major issues that have driven global economic uncertainty over the last number of years. Therefore, the importance of financial statement disclosures that meet users' needs is ever increasing. In addition, disclosures relating to sustainability and climate change risks are now a key focus for users and it is clear that qualitative disclosures, in this area, are as important to users as quantitative disclosures.

Therefore, financial statement disclosures are now a regular common enforcement priority for both audit and financial reporting regulators. Both the Committee of European Auditing Oversight Bodies (CEAOB) and European Securities and Markets Authority (ESMA) have highlighted financial statements disclosures as a key area in recent years. This has coincided with IAASA including and evaluating the quality of audit evidence and audit procedures performed by PIE auditors in the area of financial statement disclosures as part of our inspections.

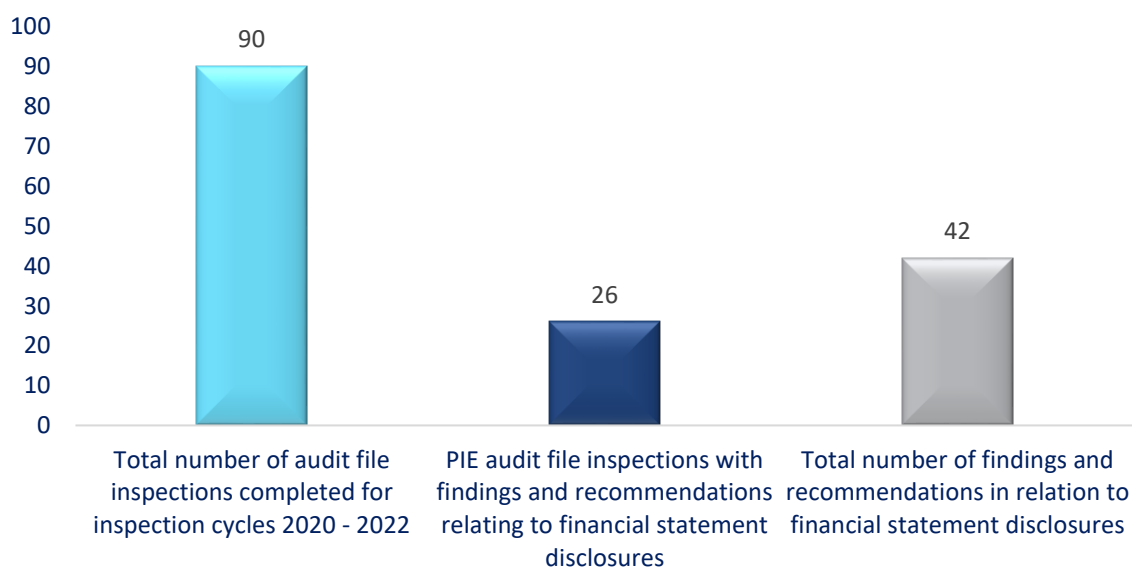
1.2. Objective and scope of this thematic report

IAASA reviews the quality of audit evidence obtained and audit procedures performed by PIE auditors as part of our inspection process. The objective of this thematic report is to highlight our key findings and recommendations raised in the area of financial statement disclosures. The report will highlight key trends arising from our last three inspection cycles (2020 to 2022), in particular:

- the number of PIE audit file inspections resulting in findings and recommendations relating to this topic;
- the number of findings and recommendations relating to this topic; and
- the common auditing standard requirements relating to the respective findings and recommendations raised in this area.

2. Findings and recommendations

2.1. Statistics for the inspection cycles 2020 to 2022



IAASA completed 90 audit file inspections spread across eight PIE audit firms in 2020 and seven PIE audit firms in both 2021 and 2022.

For each audit focus area selected for inspection, IAASA evaluated the quality of audit evidence and audit procedures performed on the financial statement disclosures. For example, if the audit review area was financial assets, IAASA inspected the audit procedures performed on the financial statement disclosures relating to financial assets.

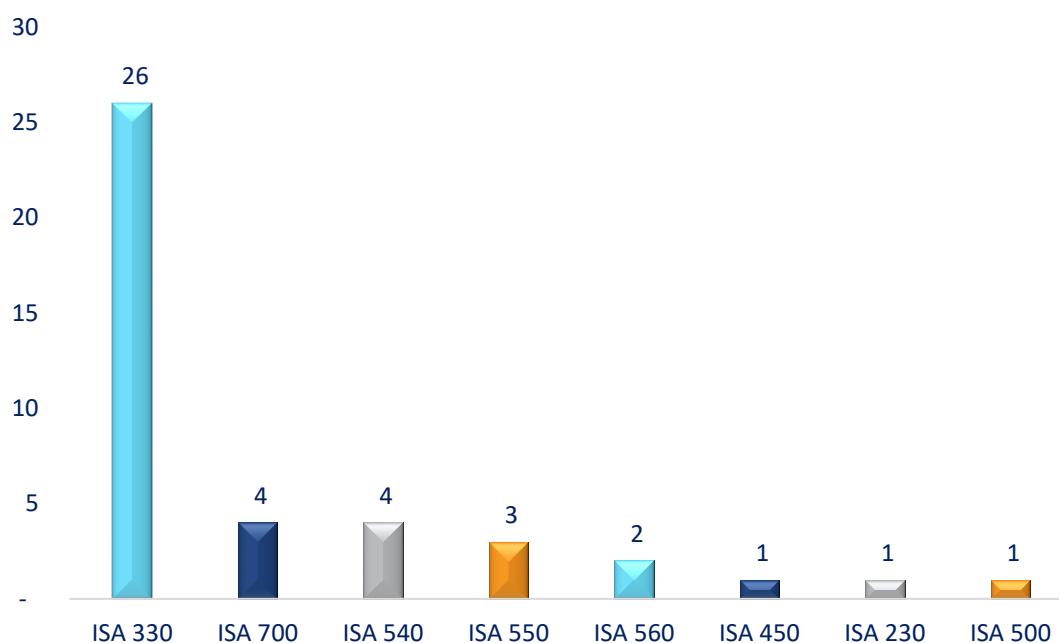
As part of the 2022 inspection cycle, IAASA continued the above approach, along with inspecting the audit procedures performed on the financial statements as a whole.

The majority of the audit file inspections completed (71%) resulted in no findings or recommendations in this area. A high level of compliance with the requirements of the ISAs in relation to the auditing of financial statement disclosures was evident.

However, for 26 of the audit file inspections completed (29%), findings and recommendations were raised in this area. Given the increased focus on this topic in the 2022 inspection cycle, 14 of the 26 relate to the 2022 inspection cycle.

Of those 26 inspections, 42 individual findings and recommendations were raised on the quality of audit evidence and audit procedures performed on the financial statement disclosures. This demonstrates that, in some cases, an individual inspection resulted in multiple findings and recommendations on this topic.

2.2. Number of findings and recommendations per ISA for the inspection cycles 2020 to 2022



The table breaks out the findings and recommendations, relating to the quality of audit evidence and audit procedures performed on the financial statement disclosures into the relevant auditing standard. IAASA's main observations are detailed below.

2.2.1. ISA 330 - The Auditor's Response to Assessed Risks

ISA 330² is the main ISA standard driving the number of findings and recommendations raised in this area. 62% of the findings and recommendations related to this standard, specifically, paragraph 18 of ISA 330.

ISA 330, paragraph 18

"Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure."

The key takeaway from this requirement is that **irrespective** of the assessed risk of material misstatements, auditors are required to design and perform substantive procedures for all **material** classes of transactions, account balances, and disclosure.

When considering whether a financial statement disclosure is material, auditors must consider both quantitative and qualitative disclosures that may have a material impact on the needs of the users of the financial statements. In certain circumstances, the disclosures may be as important, if not more useful and relevant, to users than the financial statement line item itself.

26 of the 42 findings and recommendations raised related to paragraph 18 of ISA 330. The ISA 330 findings and recommendations arose in a variety of areas within the financial statement disclosures, notably:

- **Credit risk rating disclosures** – nine (21%) were raised where IAASA concluded that the audit files had insufficient evidence of the engagement team's design and performance of substantive procedures in this area. IAASA concluded that the disclosure of the credit ratings was material to the users of these financial statements and was significant in understanding the entity's exposure to credit risk.

Examples of good practice observed in this area included engagement teams clearly evidencing that (i) they obtained independent third-party support for the credit ratings disclosed and (ii) they verified that the ratings were reasonable.

- **Fair value hierarchy tables** – six were raised where IAASA concluded that the audit files had insufficient evidence of the engagement team's design and performance of specific substantive procedures to test the appropriateness of the fair value levelling applied to financial asset positions.

Where these financial asset positions were material to the entity, IAASA concluded that the disclosure of the fair value levelling information was material to the users in understanding how the fair values for these financial asset positions were derived.

Examples of good practice observed in this area included engagement teams clearly documenting their assessment performed and clearly evidencing the conclusions made.

- **Liquidity risk disclosures** – two were raised where IAASA concluded that the audit files had insufficient evidence of the engagement team's design and performance of substantive

² ISA 330 The Auditor's Response to Assessed Risks

procedures to test the appropriateness of the disclosed liquidity of the derivative and non-derivative liabilities.

In these cases, the relevant accounting standards required the entities to disclose a maturity analysis for both derivative and non-derivative financial liabilities. The amounts involved in these disclosures were deemed by IAASA to be material and, as a result, material to the users of the financial statements.

Examples of good practice observed in this area included engagement teams (i) clearly documenting their assessment of the appropriateness of the disclosed liquidity of the derivative and non-derivative liabilities and (ii) agreeing maturity information to appropriate supporting documentation.

- **Intangible assets and goodwill disclosures** – two were raised where IAASA concluded that the audit files had insufficient evidence of the engagement team’s performance of substantive procedures on the required disclosures for intangible assets and goodwill. This was specifically relevant to the required tabular disclosure outlining the movements in intangible assets and the appropriateness of the pre-tax discounts rates applied in the entity’s goodwill assessment.

Given the material amounts relating to the intangible assets and goodwill for the related entities, IAASA deemed these disclosures material to the users of the financial statements.

Examples of good practice observed in this area included engagement teams clearly evidencing their evaluation of the reasonableness of the disclosed movements in the intangible assets. Those movements were supported by (i) audit procedures performed on the closing balances and (ii) the agreement of the pre-tax discount rates to relevant supporting documentation.

2.2.2. ISA 700 - Forming an Opinion and Reporting on Financial Statements

Four findings and recommendations, were linked to ISA 700³, in particular paragraph 10 which states:

“The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.”

Overall, IAASA noted a high level of compliance with this requirement. However, the four findings and recommendations raised related to:

- IAASA concluding, for one finding, that the audit file contained insufficient evidence of how the engagement team assessed the qualitative and quantitative information disclosed in the entity’s disclosed significant accounting policies.
- IAASA concluded, for the remaining three findings, that the engagement teams did not appropriately evidence procedures performed to show they had evaluated whether the disclosures had been properly prepared in accordance with the requirements of the financial

³ ISA 700 Forming an Opinion and Reporting on Financial Statements

reporting framework. In all three cases, IAASA noted that the financial statements of the related entities did not contain all required disclosures of the applicable financial reporting framework.

2.2.3. ISA 540 - Auditing Accounting Estimates and Related Disclosures

The four findings and recommendations stemming from ISA 540⁴ arose during inspection cycles 2020 and 2021. No findings and recommendations were raised during the 2022 inspection cycle, which shows improvements have been made in this area.

However, IAASA highlights that the financial statement disclosures relating to accounting estimates remains a key area of focus for our future inspections. As such, IAASA have outlined further information on the findings and recommendations raised in this area.

Three findings and recommendations were linked to the requirements of paragraph 31 of ISA 540. IAASA concluded that (i) the audit files did not clearly indicate that sufficient appropriate audit evidence was obtained as to whether the disclosures in the financial statements were in accordance with the requirements of the applicable financial reporting framework, nor (ii) how the engagement teams evaluated the disclosure of the estimation uncertainty.

ISA 540, paragraph 31

“The auditor shall design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level for disclosures related to an accounting estimate, other than those related to estimation uncertainty.”

ISA 540, paragraph 22

“When testing how management made the accounting estimate, the auditor’s further audit procedures shall include procedures, designed, and performed to obtain sufficient appropriate audit evidence regarding the risks of material misstatement relating to:

- a) *The selection and application of the methods, significant assumptions and the data used by management in making the accounting estimate.”*

The last finding and recommendation related to the requirements of paragraph 22(a) of ISA 540. IAASA concluded that the engagement team did not evidence, in their evaluation of assumptions deemed highly uncertain by the auditor’s expert, (i) whether these assumptions pose a significant risk of resulting in a material adjustment and (ii) their evaluation of the adequacy of the disclosures relating to such assumptions.

2.2.4. ISA 550 – Related Parties

Three findings and recommendations were raised in relation to the quality of audit evidence and audit procedures performed on the related party disclosures, as set out in the requirements of ISA 550⁵.

⁴ ISA 540 Auditing Accounting Estimates and Related Disclosures

⁵ ISA 550 Related Parties

Similar to the audit area of financial statement disclosures, the audit area of related parties has become more in focus in recent years. IAASA included this topic as an area of focus in all our PIE audit file inspections for the 2022 inspection cycle and published a related party factsheet in December 2022.

Related party factsheet

In December 2022, IAASA published our key messages for auditors in the area of related parties, see [here](#) for the related parties fact sheet or www.iaasa.ie.

All three findings and recommendations in this area related to inspections completed during the 2022 inspection cycle.

The findings and recommendations arose in two areas, namely:

- **Assessment of the nature of the related parties** – paragraph 25(a) of ISA 550 states that the auditors shall:

“evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.”

Two findings and recommendations were raised:

- In one case, IAASA concluded that the audit file had insufficient evidence of the engagement team’s assessment of (i) the nature of the disclosed related party relationship and (ii) the transactions made with related parties disclosed in the financial statements.
 - In another case, IAASA concluded that the engagement team’s audit procedures failed to recognise that the related party disclosure was incomplete. For several related parties, the entity’s financial statements did not sufficiently disclose (i) the nature of the related party relationships or (ii) information about the related party transactions and outstanding balances as required by the applicable financial reporting framework. Furthermore, the financial statements did not disclose the name of the entity’s parent and the ultimate controlling party.
- **Related parties at arm’s length** – paragraph 24 of ISA 550 states that:

“if management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion.”

A finding and recommendation were raised where IAASA concluded that the engagement team did not sufficiently evidence their evaluation of the entity’s management’s assertion that the related party transaction was an arm’s length transaction.

It is to be noted that, although the three findings and recommendations noted above were raised in the 2022 inspection cycle, in general IAASA noted high compliance with ISA 550 requirements.

Specifically, examples of good audit practice noted included:

- obtaining sufficient evidence of management's assertion that the related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction and clearly documenting their evaluation of this assumption;
- clearly evidencing the procedures performed in understanding the nature of related party relationships; and
- clearly evidencing the procedures performed to ensure appropriate disclosure of related party relationships, transactions and outstanding balances in accordance with the relevant financial reporting framework.

3. Concluding summary

Overall, there is a high level of compliance with the requirements of the ISAs in relation to the quality of audit evidence and audit procedures performed on the financial statement disclosures.

However, IAASA have noted common trends in relation to a number of ISA requirements concerning the audit of disclosures. Relevant and high-quality disclosures are of significant importance to the users of the financial statements. Auditors play an important role in ensuring that these disclosures are not materially misstated. IAASA reiterate that the auditors are required to consider compliance with the ISAs in relation to financial statement disclosures at all stages of an audit.

In summary, IAASA's key recommendations relating to the quality of audit evidence and audit procedures performed on the financial statement disclosures are:

Irrespective of the assessed risk of material misstatement, auditors should clearly design and perform substantive procedures for all material classes of transactions, account balances, and disclosures. An example of some of the disclosure areas in which findings and recommendations have been raised include:

- Credit risk rating disclosures
- Fair value hierarchy disclosures
- Liquidity risk disclosures
- Intangible assets and goodwill disclosures

Auditors should evidence procedures performed in evaluating whether the disclosures have been properly prepared in accordance with the requirements of the financial reporting framework.

Auditors should ensure that sufficient appropriate audit evidence is obtained as to whether the disclosures in the financial statements, relating to accounting estimates, are in accordance with the requirements of the applicable financial reporting framework. This should include evaluating the disclosures relating to estimation uncertainty.

Furthermore, auditors should evidence, in their evaluation of assumptions deemed highly uncertain by the auditor's expert, (i) whether these assumptions pose a significant risk of resulting in a material adjustment to the related financial statements line item and (ii) their evaluation of the adequacy of the disclosures in relation to such assumptions.

Auditors should ensure that they clearly evidence their evaluation as to whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

Furthermore, if management make an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, auditors should ensure that they obtain sufficient appropriate audit evidence about the assertion.



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