Montreal, June 1st, 2011

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

Dear Madam/Sir:

Please find enclosed the comments of the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec on the Discussion Paper entitled "*The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications.*"

Please note that neither the Ordre des comptables agréés du Québec nor any of the persons involved in preparing the comments, shall have any liability in relation to their use and no guarantee whatsoever shall be provided regarding these comments, as specified in the following disclaimer.

Yours truly,

Annie Smargiassi, CA
Secretary to the Exposure Draft Review Committee

Encl.: Disclaimer and comments

c. c. The Canadian Auditing and Assurance Standards Board (AASB)

DISCLAIMER

Subject to the conditions described herein, the documents prepared by the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec (the Ordre), hereinafter referred to as the "comments," provide the opinion of members on statements of principles, documents for comment, associates' drafts and final exposure drafts published by the CICA, Accounting Standards Board, Auditing and Assurance Standards Board, Public Sector Accounting Board, Risk Management and Governance Board and by other organizations.

The comments submitted by the Committee should not be relied upon as a substitute for engagements entrusted to professionals with specialized knowledge in their field. It is important to note that the legislation, standards and rules on which the comments are based may change at any time and that, in some cases, the comments may be controversial.

Neither the Ordre nor any person involved in preparing the comments shall have any liability in relation to their use and no guarantee whatsoever shall be provided regarding these comments. The comments provided are not binding on the members of the Exposure Draft Review Committee, the Ordre or the Office of the Syndic in particular.

Users of the comments shall take full responsibility for, and assume all risks relating to, the use of the comments. They agree to release the Ordre from any claim for damages that could result from a decision they made based on these comments. They also agree not to mention the comments in the opinions they express or the positions they take.

COMMENTS OF THE EXPOSURE DRAFT REVIEW COMMITTEE OF THE ORDRE DES COMPTABLES AGRÉÉS DU QUÉBEC ON THE DISCUSSION PAPER ENTITLED “THE EVOLVING NATURE OF FINANCIAL REPORTING: DISCLOSURE AND ITS AUDIT IMPLICATIONS”

TERMS OF REFERENCE OF THE COMMITTEE

The terms of reference of the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec are to collect and channel the views of practitioners in public practice and members in business, industry, government and education, as well as those of other persons working in related areas of expertise.

For each exposure draft or other document reviewed, the Committee members share the results of their analysis. The comments below reflect the views expressed, and unless otherwise specified, all of the Committee members agree on these comments.

The Ordre has not acted upon and is not responsible for the comments expressed by the Committee.

GENERAL COMMENTS

The Committee members welcome the publication of the discussion paper. They are pleased that the IAASB addresses issues that they experienced in their current practice.

They find interesting that the questions’ section is segregated into distinct categories and think that it is appropriate.

The Committee members represent many types of financial statements users and as such, have responded to many questions in all the different categories.

CONSULTATION QUESTIONS FOR PREPARERS

SECTION II–FINANCIAL REPORTING DISCLOSURE TRENDS

P1) What have been the most significant challenges you have experienced in preparing disclosures?

The most significant challenges we faced result from disclosures that are not derived from the accounting such as forward-looking information, disclosures relating to accounting of estimates, fair values, risk reduction measures and controls, etc.

Those disclosures are also prepared late in the process of the financial statements finalisation, reducing the period of time allocated to their preparation.

Another important challenge is to include sufficient disclosures to respect requirements without overloading financial statements. The objective is to keep the financial statements understandable by the users.

For small or medium sized entities (SMEs), auditors are often taking an active part of the financial statements disclosures but at the same time trying not to interfere with their objectivity and independence. SMEs don't always have knowledge and budget to prepare disclosures that meet the requirements.

P2) Have you included a disclosure in your financial statements to comply with a specific disclosure requirement, even though you believed the disclosure was immaterial? What factors led you to this decision? What practical difficulties exist when deciding to omit a disclosure that you consider to be immaterial?

Yes some immaterial disclosures have been included in the financial statements (F/S), even though we believed the disclosures were immaterial. For the disclosure process to be more effective, less time consuming and less expensive, models of disclosures are often used. Trend to maintain comparability in disclosures is also viewed has a mean to reduce confusion for users of financial statements and to avoid too many questions from stakeholders.

Other examples of immaterial disclosures included:

- Material line items in the F/S, but notes to the F/S including many immaterial items;
- Immaterial line items in the F/S, that have somewhat been material in the past.

Please provide any other relevant comments that you wish to make on Section II.

The members have not provided any other comments.

SECTION IV–AUDIT ISSUES REGARDING DISCLOSURES REQUIRED BY A FINANCIAL REPORTING FRAMEWORK

P3) Have you experienced requests from auditors for evidence to support your disclosures that you find difficult to satisfy? If so, please explain the context.

Yes, members experienced requests for evidence to support disclosure that were difficult to satisfy. Major problems were encountered when information had to be supplemented by external entities, as example by law firms.

P4) 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 evidence or support do you believe you need to have as a basis for the assertions you make in the financial statements on such disclosures?

Members believe that evidence must include the followings:

- written proof of discussions about the related risks (that are the basis for the policies and procedures);
- written proof of the existence of the policies and procedures on risks management;
- written proof of the discussions about the existence of the policies and procedures on risks management;
- written proof of the follow-ups about risks management policies and procedures.

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). In preparing financial statements, what, in your view, would be sufficient evidence for you to support your stress test disclosure? What do you believe would constitute a misstatement of a stress test disclosure?

P5) 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 disclosures:

- ***Judgments and reasons;***
- ***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.***

Members indicate that any significant information must be disclosed to facilitate the understanding of the financial statements. Thus, the omission of one of the above items, having a material impact on the financial statements as a whole, would be a misstatement. Providing information about the above items that does not reflect what is actually done in the entity would also be a misstatement.

Please provide any other relevant comments that you wish to make on Section IV.

The members have not provided any other comments.

CONSULTATION QUESTIONS FOR INVESTORS, LENDERS AND OTHER CREDITORS

SECTION II–FINANCIAL REPORTING DISCLOSURE TRENDS

I1) In general, do you believe that the reliability of disclosures is at the same level as that of the line items on the face of the financial statements? Do you believe that different types of disclosures in audited financial statements can or should have different levels of reliability? Please explain your answer.

Members believe that the reliability of disclosures should be at the same level for any type of disclosures. The audit report doesn't make a difference on each type of information and therefore there should not be different levels of reliability.

I2) In the particular circumstance when a financial statement line item is measured on one basis, such as amortized cost, but the disclosure includes the fair value of the line item, should the auditor's effort on the fair value disclosure be the same as if the fair value was on the face of the financial statements? Please explain your answer.

Members indicate that the auditor's effort should be the same no matter where the information is presented in the financial statements because lenders and other creditors use information from the line items on the face of the financial statements <u>and</u> information other than line items to make decisions.

I3) 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 and your reasoning for why you believed they were immaterial in the context.

Members prefer consistency in disclosure even if items are immaterial. For example, if an element such as related parties' transactions was material in prior periods and disclosed in the notes to financial statements but is immaterial in the current period, members prefer to have this information disclosed again in the current period to be consistent and to make it clear for the users that the information was not omitted.

Even if the impact is immaterial, they prefer to have this information disclosed on such circumstances because in some cases this information may be useful. Another example they submitted is the respect of law and regulations.

I4) Do you believe that consistency in disclosures is important (either over time for the same entity, or between entities in the same industry), even if achieving this aim may result in extensive disclosures that may not, in the context of a particular entity, be material to that entity in the current period?

Yes, members believe that consistency in disclosures is very important, even if achieving this aim may result in extensive disclosure that may or may not be material.

Please provide any other relevant comments that you wish to make on Section II.

SECTION IV–AUDIT ISSUES REGARDING DISCLOSURES REQUIRED BY A FINANCIAL REPORTING FRAMEWORK

I5) 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.

Members that represent lenders and creditors indicated that the shift in the IASB Conceptual Framework has not changed their concerns.

I6) 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 a misstatement of such a disclosure?

(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?

Members that represent lenders and creditors have not made any comments on those questions.

I7) 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 disclosures:

Judgments and reasons;

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.

Members that represent lenders and creditors have not made any comments on those questions.

I8) If there were certain disclosures that were determined to be incapable of being audited, would you want them to be included in the financial statements and labeled —unaudited or would you prefer that they be placed outside of the audited financial statements?

Members that represent lenders and creditors have not made any comments on this question.

Please provide any other relevant comments that you wish to make on Section IV.

Members that represent lenders and creditors have not made any additional comments.

CONSULTATION QUESTIONS FOR REGULATORS, INCLUDING AUDIT OVERSIGHT BODIES

Members have not made any comments on this section.

CONSULTATION QUESTIONS FOR AUDITORS

SECTION II–FINANCIAL REPORTING DISCLOSURE TRENDS

A1) Have you had discussions with entities about whether some of their required disclosures might be considered immaterial? What factors did you take into account? Please explain what difficulties (if any) you have experienced.

Experience with SME:

The focus of many of the discussions we had with entities around the required disclosures is not on materiality but more on the relevance, complexity in evaluation and documentation of the new requirements. The principal difficulties we encountered are linked with the fact that an important proportion of the information required in contemporary financial statements are not produced by the standard accounting systems. It is therefore documented late in the process of production of financial statements. As a consequence, there is an increase pressure on auditors due to the late timing in the production of the information. Furthermore, the audit of such information requires the development of new audit procedures. Due to these additional pressures, our focus has been more on completeness than on materiality of information provided.

Please provide any other relevant comments that you wish to make on Section II.

Members that represent auditors have not made any additional comments.

SECTION III–HOW DO ISAS CURRENTLY DEAL WITH DISCLOSURES?

A2) How do you approach the identification and assessment of the risks of material misstatement in disclosures?

The members that represent auditors focus on:

- Obtaining, in the planning process, a thorough understanding of the entity (its activities, the nature of the transactions it concludes, the nature of its assets and liabilities, its engagements, …), of the entity's environment (its industry and leaders, the users of the financial statements, the entity's customers, suppliers and creditors) and of the entity's accounting and financial information systems and internal controls;
- Reviewing financial statements of public companies doing business in the same industry;
- Reviewing and documenting the required disclosures applicable for the audited entity;
- Communicating at the planning stage with the responsible officials the nature and extent of the required disclosures as well as the nature of the documentation that will be required to support the information provided;
- Communicating with those charged with governance by the audit plan;
- Developing and documenting specific audit procedures aimed to identify missing disclosures;
- Training and supervising the members of the audit team.

A3) Are there ISA requirements that, in your experience, pose practical challenges in respect of disclosures? Please explain your answer.

In general, the audit of a large and sometime complex proportion of the required disclosures demands a thorough understanding of the entity and the challenges it faces. Therefore, only the more experienced auditors with sufficient knowledge and experience can make an accurate professional assessment of the information provided. Their involvement in the audit process is crucial and it creates more pressure on them as they need to invest more time in the audit process (especially at the planning and finalization stages) and supervise more closely junior members of the audit team.

Specifically the following IAS requirements pose practical challenges:

- **IAS 320: materiality:** the application of the concept of materiality to required disclosures requires the application of the professional judgment as elements of lesser amount than materiality for the financial statements as a whole may be need to be disclosed as it is a sensitive information that may influence the decisions of users;

- **IAS 450: Evaluation of misstaments identified during the audit:** Omission of required disclosures is a misstament. Ensuring that the information disclosed is complete and that no information was omitted constitute an important challenge for the auditors. It requires that the auditors have a thorough understanding of the entity, its environment (including common business processes and challenges of the industry, laws and regulations, related parties, etc);

- **IAS 540: Auditing accounting estimates, including fair value:** In order to be able to evaluate the adequacy of the disclosures relating to accounting estimates, the auditor must have the necessary experience and knowledge of the entity and industry.

Please provide any other relevant comments that you wish to make on Section III.

Members that represent auditors have not made any additional comments.

SECTION IV– AUDIT ISSUES REGARDING DISCLOSURES REQUIRED BY A FINANCIAL REPORTING FRAMEWORK

A4) Have you encountered situations where you experienced difficulty in obtaining sufficient appropriate audit evidence for a disclosure, even though management believed it had appropriate supporting evidence for the disclosure? If management's consideration of a disclosure can be appropriately supported by evidence and documentation, are there factors that could nevertheless make a disclosure unauditable? If management has not provided evidence and documentation in support of a disclosure, do you believe you are able nevertheless to obtain SAAE on the disclosure? Please explain your answer.

The responsibility of the auditor is to gather sufficient appropriate audit evidence to support his opinion. As mentioned, in some situations, management must disclose information which is not derived from the accounting systems but rather results from less formal processes (ex: from the application of management's judgments, assumptions and model). Auditors have trouble in obtaining SAAE, for example, when disclosures concern commercial papers, interest rates, future cash flows, capital disclosure or risk management.

If management has not provided evidence and documentation in support of this type of required disclosure, the auditor may be in a position that he is not able to obtain SAAE from other sources. It is understood that the objective of the auditor is not to form an opinion on each individual disclosure of the financial statements. It is possible, however, that, if the auditor cannot gather SAAE on a material element of disclosure, he will not be able to give an opinion on the financial statements as a whole.

A5) What do you believe are the key issues with gathering audit evidence for the examples given in paragraphs 60–70?

The gathering of audit evidence of a disclosure related to a specific line item from the face of the financial statements and derived from the accounting systems does not generally constitute a particular audit challenge. A note disclosure which includes a description of judgments, assumptions and models applied by management in the evaluation of a line item brings new audit concerns and issues that must be addressed by the auditor. The auditor must gather SAAE to conclude on the appropriateness and completeness of the information presented and on the reasonableness of the assumptions made and methods used. The auditor must determine the nature of the audit evidence he needs to base his opinion. This must be addressed early in the process as the auditor may need to consult sources of information external to the entity to be able to form his opinion.

A6) 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 believe should be applied to the fair value disclosure? Should your effort be the same as if the fair value was on the face of the financial statements?

If material, the same effort should be invested in auditing an element that appears on the face of the financial statements than if the information is disclosed in a note to the financial statements. It is understood that financial statements are composed of the statements and the notes and the auditor's opinion is on the financial statements as a whole.

The auditors evaluate, in planning the extent of their work the risk of misstatement of the financial statements as a whole. In the case of fair values, it is possible that the auditors may not invest the same effort in auditing the information disclosed in the notes than if the financial instrument was presented at fair value on the face of the balance sheet because they may come to the conclusion that the impact of the information disclosed in the notes on the overall risk of misstatements of the financial statements may not be as crucial. Moreover, although relevant, the additional information disclosed in the notes is likely to have a lesser importance to users, as it does not have an impact on the current results.

The audit procedures will cover:

- The reasonableness of the assumptions used.
- The selected measurement basis for the accounting estimates
- The evolution of the measurement basis and of the assumptions used last year.

A7) 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.

As auditors, we believe that all information required to ensure that the financial statements present fairly the financial position of an entity must be disclosed even if not specifically required by the framework. The materiality of the elements presented (whether quantifiable or not) must be assessed, however, as it is important that the financial statements are not loaded with non-relevant information.

A8) In light of the discussion in paragraphs 79–87, what do you believe is the appropriate way of applying materiality to disclosures? Do you believe there is sufficient guidance in the ISAs?

Auditors must use their professional judgment in applying materiality to required disclosures. The basis of their decision must lie on their evaluation as to whether the information could influence the economic decisions that the users are taking on the basis of the financial statements. We agree with the statement that it is important to find a balance between understandability of disclosers, excessively lengthy financial statements, consistency and comparability. ISA gives examples which are useful to the professional in taking his decision.

A9) 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;
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.

A material misstatement is either an omission of sensitive information, the non-disclosure of required material information, a description of judgments, assumptions, models and/or processes which do not reflect what is actually done by management, the disclosure of false results or values measured under a different basis than that described in the financial statements.

A10) 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?

- The answer is a challenge for professional judgment and depends on the appreciation as a whole of the following factors:
    - The understanding and the appreciation of management's process for identifying and responding to the risks of fraud and error in the entity and how the internal controls that management has established mitigate these risks
    - The understanding and the appreciation of how those charged with governance exercise oversight management's process relating to risks' identification and responding
    - The nature and the extent of the performed work (tests of controls or substantive procedures) and the results of audit work.

- It is an issue to conclude whether there is a misstatement or not. In order to reach that conclusion, a discussion with the management team and/or with those charged with governance would likely be necessary, as it would provide a better understanding of the global picture. The auditor could also gather SAAE through observation, enquiry, review of minutes of meetings and correspondence (memorandums summarizing results of meetings and discussions, e-mails and other form of correspondence), compare actual position reflected in the financial statements with established policies and obtain confirmation, if applicable, with outside parties involved the process applied.

- A misstatement would arise if the information disclosed does not reflect truly the systems and processes in place or if some sensitive information is omitted, or if the amount showed in a note is not based on reliable data and reasonable assumptions

(b) The IASB has proposed disclosures regarding stress tests (see paragraphs 65–66). What work would you expect to do in relation to the proposed stress test disclosures? What do you believe would constitute a misstatement of a stress test disclosure?

- The auditor should request a complete description of the processes followed by management in performing the stress tests and the outcome of these tests. He should gather information from other sources to validate the tests performed and the processes followed are appropriate and test the processes to ensure that the outcome described by management correspond to the outcomes of the tests.

- A misstatement would arise if the information disclosed does not reflect truly the processes followed, if the outcome reported are not indicative of the actual results obtained or if some sensitive information is omitted.

A11) How do you evaluate both qualitative and quantitative misstatements in forming an opinion on the financial statements as a whole? Is it possible to accumulate misstatements of disclosures, particularly when they relate to qualitative or judgmental disclosures? How do prior year's disclosure misstatements affect the evaluation of the current year's financial statements?

Challenges exist in evaluating misstatements on disclosures, to determine whether the auditor can or cannot conclude on the SAAE obtained in order to support his opinion, particularly when qualitative or judgmental disclosures are concerned. It's difficult to evaluate the materiality of the impact. See the answer to question A10.

The auditor sets up materiality levels at the planning stage and adjusts them through the audit process, if required. The quantitative misstatements are compiled and compared to the set levels. It is more difficult to integrate qualitative misstatements to this process. The auditor must document the foresee impacts of qualitative misstatements and describe them. He ultimately must use his professional judgment to determine whether the combination of the impacts of quantitative and qualitative misstatements may influence the decisions of users. The impact of prior year's misstatements on the current year results must be integrated to the evaluation of the impacts of misstatement identified. Prior year results may need to be adjusted.

Please provide any other relevant comments that you wish to make on Section IV.

Members that represent auditors have not made any additional comments.

SECTION V–QUESTIONS ABOUT AUDITABILITY

A12) What are the characteristics of disclosures that, in your view, would not be auditable?

Our understanding is that, if the information disclosed is supported by a process based on judgments, assumptions and models properly described, it is auditable. Only if such process are not properly documented and supported that it may become not auditable.

We, however believe that it could be difficult to determine the neutrality of the information disclose as it would be a challenge to find out indicators of a possible management bias, especially in matters where judgment is involved.

A13) 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?

The materiality levels are used by auditors in evaluating the impact of misstatements identified and determining whether the financial statements present fairly the audited entity's financial situation. Furthermore, auditors must question whether the combination of the impacts of quantitative and qualitative misstatements may influence the decisions of users.

A14) Some believe that the manner in which a financial reporting regulator enforces financial reporting requirements may influence how auditors approach their audits, including how they may approach disclosures. What is your view?

- The auditor's approach is mainly focused on the requirements of the applicable financial reporting framework. In this aspect, the intention of the financial standards will influence the audit approach since it provides guides as to what is required to disclose, how, and why.

- The manner in which financial reporting regulators enforce financial reporting requirements may give additional guidelines to auditors on how to interpret those requirements, how to evaluate the materiality of qualitative disclosures and the impact of disclosures on the decision process of users.

- Notwithstanding how the accounting standards are enforced, the auditors have to obtain SAAE supporting the absence of the management's bias when applying the standards, for example when it comes to accounting estimates or some additional disclosures in notes.

Please provide any other relevant comments that you wish to make on Section V.

Members that represent auditors have not made any additional comments.