

February 1, 2010

Mr. James Gunn
Technical Director, International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Dear Mr. Gunn:

We appreciate this opportunity to comment on the Consultation Paper, *Auditing Complex Financial Instruments*, as developed by the International Auditing and Assurance Standards Board (IAASB). Below you will find our responses to the specific questions posed in the Consultation Paper.

RESPONSES TO SPECIFIC QUESTIONS:

1. Do you agree with the IAASB's overall approach for revising IAPS 1012, in particular the usefulness of the APB's work as a starting point for the revision of an international auditing practice statement?

The current global financial crisis has highlighted a lack of understanding of many of the complex financial arrangements in place and the serious accounting and auditing consequences that such agreements create. Because of this, it is important to highlight the audit issues surrounding this topic.

We are strongly supportive of using the work of the UK's Auditing Practice Board (APB) as a starting point for revising International Auditing Practice Statement (IAPS) 1012, *Auditing Derivative Financial Instruments*, as it efficient to leverage the hard work of the APB, and it will result in the timelier development of a revised IAPS 1012. We hope the IAASB continues to work with other national standard setters in such a collaborative fashion, while at the same time, seeking wider views and input through the issuance of Consultation Papers.

2. What are respondents' views as to the overall structure and content of the Practice Note? In considering this question, respondents are asked for views about the level of

detail of the APB's Practice Note, including the length and flow of the document, and its suitability in an international context.

While it is true that the Practice Note is long with 152 paragraphs, we believe that this level of detail is necessary to provide guidance in such a complex area. We also believe that it will be very useful in an international context.

However, we also believe it will be necessary for the IAASB to clearly communicate the level of authority any resulting IAPS will have. As currently written, we believe the Practice Note may be too detailed to be considered equivalent to application material in the ISAs, but is nonetheless effective background and guidance.

3. If respondents think the Practice Note is insufficient, in what areas should the IAASB consider including additional guidance in revising IAPS 1012? Specific examples as well as the rationale for a particular suggestion would be helpful.

Given the subjective nature of assumptions used in valuations for complex financial instruments, and the likelihood that management and the auditor may arrive at different valuation amounts, it would be helpful to reference ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimate, and Related Disclosures*, to explain how the auditor evaluates the reasonableness of valuations and determines misstatements, if any. Specifically, that:

- where the audit evidence supports a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement; and
- where the auditor has concluded that using the auditor's range provides sufficient appropriate audit evidence and management's point estimate lies outside of the range, the misstatement is no less than the difference between management's point estimate and the nearest point of the auditor's range.

4. Are there currently any national standards or guidance in your particular jurisdiction that should also be considered by the IAASB in revising IAPS 1012?

The PCAOB has issued a series of Staff Audit Practice Alerts related to this area, which should be considered during the revision of IAPS 1012. Dates and titles of the practice alerts are as follows:

- PCAOB Staff Audit Practice Alert No. 2 (Dec 10, 2007) – Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists

- PCAOB Staff Audit Practice Alert No. 3 (Dec 5, 2008) – Audit Considerations in the Current Economic Environment
- PCAOB Staff Audit Practice Alert No. 4 (April 21, 2009) – Auditor Considerations Regarding Fair Value Measurements, Disclosures, and Other-Than-Temporary Impairments

5. Is the Practice Note clear on what is meant by the term “complex financial instruments”? If it is not, how could the definition and illustrative examples be improved, bearing in mind the evolving nature of these instruments?

The Practice Note is clear on what is meant by the term “complex financial instruments.” We believe that the explanation is clear and complete.

6. Is the guidance included in paragraphs 9-12 of the Practice Note helpful in explaining its applicability to audits of entities of all sizes? If not, should such guidance be deleted or expanded in revising IAPS 1012; if so, how?

Yes, the guidance in paragraphs 9-12 is helpful in explaining the Practice Note’s applicability to audits of entities of all sizes. When developing the revised IAPS, the IAASB may wish to consult the SMP task force to solicit additional items to include in this section, to highlight the fact that the guidance is widely applicable. It will be important to ensure that auditors of smaller entities not ignore this valuable guidance simply because they assume it would not be relevant to them.

7. Throughout the Practice Note, examples of how the guidance can be applied in a range of entities – from smaller entities to larger financial institutions – have been included. Do respondents believe the guidance is adequately balanced, or would a revised IAPS 1012 be more helpful if focused at a different level?

We believe that the guidance is adequately balanced because the principles are the same in both cases.

8. Many of the considerations described in the Practice Note can also be applied to simpler financial instruments. Would it be more appropriate in revising IAPS 1012 for the guidance to be developed to apply to *all* financial instruments rather than limiting it to complex financial instruments?

While many of the considerations described in the Practice Notes can also be applied to *all* financial instruments, there may be “scope creep” if the scope was expanded beyond complex financial instruments. We believe it is better to focus only on complex financial instruments, because this is where the risks generally lie, but also ensure that auditors understand that some of the basic concepts are applicable to all financial instruments.

9. Are the types of risks described in paragraph 59 of the Practice Note understood across a number of industries and applicable in an international context?

The types of risks described in paragraph 59 (operational risk, valuation risk, credit risk, and legal risk) are widely understood and would be applicable in an international context.

10. Is the guidance in paragraphs 64-84 (particularly related to information systems, control activities, and monitoring of controls) helpful for auditors in obtaining an understanding of controls for a financial statement audit? Is the guidance helpful for audits of entities that have smaller portfolios of complex financial instruments?

Guidance on information systems, control activities, and monitoring of controls is helpful to entities with all sizes of portfolios of complex financial instruments.

11. Is the guidance on substantive procedures in paragraphs 105-108 of the Practice Note helpful to auditors? Are there other procedures that should be considered in revising IAPS 1012?

The guidance provided in paragraphs 105-108 are fairly generic to any audit area, with the exception of the guidance in paragraph 107 that interim audit procedures related to the value of complex financial instruments may be less valuable due the possible fluctuations in fair values between interim and year-end dates.

However, some may feel that this information does provide a useful flow in the document to describe the balance of control procedures and substantive procedures to perform.

12. Are there additional issues or best practices relating to the auditor's application of the audit risk standards that have been noted that should be included in revising IAPS 1012?

Nothing specific to note related to the application of the audit risk standards.

13. Is the additional guidance included in the Practice Note helpful for auditors in obtaining sufficient appropriate audit evidence in relation to complex financial instruments?

Yes, the additional guidance on obtaining sufficient appropriate audit evidence for each assertion is some of the most useful material in the Practice Note, and will be very helpful to auditors.

14. Is the additional guidance relating to the valuation assertion applicable to most complex financial instruments? Are the concepts in this section easily understood and relevant in an international context?

The guidance relating to the valuation assertion will be applicable to most complex financial instruments. The only concept which may not be applicable in all jurisdictions is “reserving for residual uncertainties.”

15. Would it be helpful to include more generic guidance describing concepts such as broker quotes, the different types of pricing services that may be used, and other forms of evidence and cite examples of how this information is typically gathered and in what particular circumstances?

Yes, it would be helpful to include more generic guidance describing concepts such as broker quotes, different types of pricing services that may be used, and other forms of evidence.

It would be useful to explain that even though management may use an outside third party to value their complex financial instruments, management remains responsible for supporting such valuations. This includes understanding the methodology and process behind any third party- valuation.

16. Is the guidance on the use of models, from both a preparer and auditor perspective, sufficient? If not, what further guidance could be added and why?

Yes.

17. Is the Practice Note sufficiently clear that the issues relating to valuation and the types of risks involved in financial instruments apply equally to financial assets and financial liabilities or should more guidance be added about financial liabilities?

The guidance provided is sufficiently clear.

18. Are there additional issues or best practices relating to the auditor’s need to obtain sufficient appropriate audit evidence that have been noted that should be included in revising IAPS 1012?

It would be helpful to clarify that simply obtaining an external confirmation is not considered “obtaining sufficient appropriate audit evidence” for a valuation.

19. Is the guidance included in the Practice Note on disclosures helpful?

Yes, the guidance included in the Practice Note on disclosures is helpful. If there is any way to include more guidance and remain framework neutral, the IAASB should consider doing so.

20. Is more guidance needed on the audit of disclosures? For example, is more guidance needed to address how the auditor would obtain sufficient appropriate audit evidence when the disclosures about risks and uncertainties are qualitative in nature or the information is derived from information systems that are not otherwise used to generate information for inclusion in the financial statements? How should the IAASB deal with these areas in revising IAPS 1012, while ensuring the framework neutrality?

Yes, additional guidance on the audit of disclosures would be helpful, but this may be difficult to achieve while also being framework neutral.

21. Is the guidance included on communication with those charged with governance helpful? Is there scope for adding additional guidance on the auditor's communications with those charged with governance with respect to valuation and control issues that come to the auditor's attention?

The guidance on communication with those charged with governance is helpful. It would be better to include additional matters, for example, making those charged with governance aware of the implications on the auditor's report if there are issues related to significant estimation uncertainty or inadequate disclosure.

22. Are their best practices relating to auditor's communications with regulators, prudential supervisors and others, for example, where such communication or reporting is required by law or regulation, that should be acknowledged in revising IAPS 1012?

Nothing specific to note.

23. Would further guidance on the possible implications for the auditor's report when auditing complex financial instruments be helpful? For example, this could include guidance on the use of Emphasis of Matter paragraphs, Other Matter paragraphs and limitations on the scope of the audit.

Yes, it would be very helpful to include further guidance on the possible implications for the auditor's report when auditing complex financial instruments. Specifically, it would be helpful to understand under what circumstances the auditor may consider including an Emphasis of Matter paragraph, and at what point a scope limitation would be required.

24. Is the use of an Overview section helpful or is such a section duplicative?

Although duplicative, the overview section is helpful.

25. For the areas noted above (professional skepticism, professional judgment, use of experts, and use of management's experts), is the level of guidance included in the Practice Note helpful?

Paragraphs 28 and 29 on professional skepticism and professional judgement are very generic. It would be useful if these paragraphs could be tailored to issues to be considered for complex financial instruments. The material on use of management's expert is very helpful, but could also be expanded.

26. Are there any issues that may arise with the Practice Note from a translation perspective?

No translation issues noted.

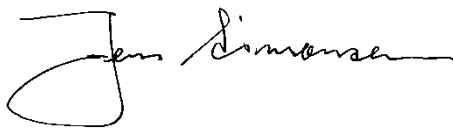
COMMENTS ON THE APPENDIX:

- **Throughout the document**

Use of the phrase "needs to" should be eliminated.

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact Jens Simonsen, Director of Global Audit Services at + 1 212 492 3689.

Very truly yours,

A handwritten signature in black ink, appearing to read "Jens Simonsen". The signature is written in a cursive style with a large, looped initial "J".

Jens Simonsen