



CANADIAN PUBLIC ACCOUNTABILITY BOARD
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

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

Dear Sir:

Re: Consultation Paper, Auditing Complex Financial Instruments

The Canadian Public Accountability Board (CPAB) is pleased to comment on the International Auditing and Assurance Standards Board's (Board's or IAASB's) Consultation Paper, Auditing Complex Financial Instruments.

Complex Financial Instruments pose a significant risk to auditors, and the potential consequences of audit failure are heightened. Accordingly, CPAB strongly supports the need for additional guidance on auditing complex financial instruments and we believe the UK's Auditing Practices Board (APB) revised Practice Note 23, "Auditing Complex Financial Instruments" (the Practice Note) provides an appropriate starting point at an appropriate degree of detail.

We understand that the IAASB will need to determine the level of authority it wishes to establish for the content of the Practice Note. Whatever the outcome of this determination, we would strongly discourage any significant reduction in the guidance contained in the Practice Note when converting it into an IAASB document. Indeed, as set out below, we believe some further examples and additional guidance would be desirable in a few areas. Paragraph 15 of the Consultation Paper raises a concern that the IAASB must ensure that "any guidance in IAPS 1012 does not, and is not seen to, override the principles-based nature of the ISAs by prescribing audit procedures". We do not believe that any of the guidance in the Practice Note would be perceived as prescribing specific auditing procedures. Rather we view the guidance as drawing attention to the key considerations in understanding and applying the audit risk model to the audit of complex financial instruments. The level of guidance provided in the Practice Note will help practitioners in performing audits and promote greater understanding and consistency in the performance of audits in this complex area.

Our remaining comments are incorporated into our answers to the 26 questions posed in the Consultation Paper.

- 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?**

We believe that the UK’s Auditing Practices Board (APB) revised Practice Note 23, “Auditing Complex Financial Instruments” represents a useful starting point for the revision of IAPS 1012.

- 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.**

We believe the level of detail, the length and the flow of the Practice Note are appropriate and suitable in an international context. The level of guidance provided in the Practice Note will help practitioners in performing audits and promote greater understanding and consistency in the performance of audits in this complex area. Therefore, as noted above we would strongly discourage any significant reduction to the content of the APB’s 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.**

Overall we believe the Practice Note provides sufficient guidance. Suggestions for additional guidance have been provided in the responses to questions 14, 15, 16, 17, 20 and 21 below.

- 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 primary supplemental guidance in Canada is Assurance and Related Services Guideline (AuG-39), “Auditing derivative financial instruments”. The Auditing and Assurance Staff of The Canadian Institute of Chartered Accountants also issued a non-authoritative Risk Alert in November 2008 entitled “Auditing considerations regarding fair value of financial assets in a credit crisis”.

- 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?**

We believe the Practice Note is clear on what is meant by the term “complex financial instruments”, recognizing the difficulty in defining these instruments due to their constantly evolving nature.

- 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?**

We believe this guidance is helpful in this respect.

- 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 the balance in the Practice Note is appropriate and we believe the examples are useful.

- 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?**

We believe that the revised IAPS should focus on complex financial instruments as these present auditors with more significant audit challenges and where guidance is most needed.

- 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 risks are appropriately described to be understood across industries and 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?**

We believe the guidance in paragraphs 64-84 of the Practice Note is helpful. For the audits of entities that have smaller portfolios of complex financial instruments we believe the guidance in paragraphs 9-12 is sufficient to put the guidance in paragraphs 64-84 into an appropriate context.

- 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?**

We believe the guidance on substantive procedures is helpful.

- 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?**

No comment.

- 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?**

We believe the additional guidance included in the Practice Note is helpful.

- 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?**

We believe that the guidance related to the valuation assertion is appropriate, applicable to most complex financial instruments and is relevant in an international context. The third bullet in paragraph 110 of the Practice Note states it is important to “...consider whether there are residual uncertainties not taken into account by the valuation process that require further adjustment”. We believe it would be helpful if the guidance provided examples of “residual uncertainties” that might require further adjustment to the fair values and how the auditor might respond.

- 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?**

We believe additional guidance, particularly with respect to pricing services, would be helpful. We also believe it would be helpful if examples were provided of audit procedures that might be performed on such information.

- 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?**

An additional consideration that could be added to paragraph 120 is whether the inputs and assumptions are internally consistent, including whether they are consistent with management’s intent and ability to carry out specific courses of action.

- 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?**

We believe the Practice Note is sufficiently clear that the issues related to valuation and the types of risks involved in financial instruments apply equally to financial assets and financial liabilities. We note however that credit risk is only discussed in the context of counterparty risk and not in the context of the impact of the entity's own credit risk in determining fair values of financial liabilities.

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?

No comment.

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

We believe the guidance on disclosures is helpful (see response to Question 20).

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?

Disclosure is critical to communicate the significance of the risks and exposures to an entity arising from complex financial instruments. Therefore, we believe additional guidance on how the auditor should assess the transparency of the disclosures would be helpful. This additional guidance could be provided through the use of examples to ensure the guidance remains 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?

We believe the guidance on communication with those charged with governance is helpful, however, the scope could be expanded to include additional quantitative disclosure. Specifically we believe that the auditor should provide more transparency in their communications with respect to the actual monetary values of range estimates and sensitivity analysis and where potential errors have been identified the absolute value of the errors in addition to the net impact on the financial statements.

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?

No comment.

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.

No comment.

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

We found the Overview section to be helpful.

25. For the areas noted above, is the level of guidance included in the Practice Note helpful?

The level of guidance included in the Practice Note is appropriate and helpful and, as stated previously, we would strongly discourage any significant reduction in the level of guidance in the revision of the IAPS. As noted in our response to question 3, we have provided some suggestions for additional guidance.

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

No comment.

CPAB appreciates the opportunity to provide input to the Board on the Consultation Paper and believes the use of the UK APB Practice Note, in its entirety, as a starting point for the revision of the IAPS will result in high quality global guidance on the audit of complex financial instruments.

We would be pleased to discuss further any of the above comments.

Yours very truly,



Brian Hunt, FCA
Chief Executive Officer

cc. Greg Shields, CA
Director, Auditing and Assurance Standards
The Canadian Institute of Chartered Accountants