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Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
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15 January 2010

Dear Sir/Madam

Consultation Paper – *Auditing Complex Financial Instruments*

On behalf of RSM International Limited, a global network of independent accounting and consulting firms, we are pleased to have the opportunity to respond to your request for specific comments on the aforementioned Consultation Paper issued by the IAASB in October 2009.

Our responses to the specific matters on which the IAASB is seeking feedback are set out below.

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?

Although we agree that the APB's PN 23 is a good starting point and basis to work from, we would also encourage the IAASB to investigate and utilise similar material developed by other audit standard-setting bodies around the world (e.g. US PCAOB and AICPA) so that the best guidance from around the world is used in revising 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.

The structure of PN 23 appears to be robust and comprehensive and we believe it to be suitable in an international context.

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.

Whilst we understand the range of what constitutes a complex financial instrument is very wide and all instances could not be considered in the guidance, we believe specific guidance on how to apply the principles of the PN to the audit of common types of financial instruments should be considered.

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 that although the description of what constitutes a complex instrument is clear, it may be helpful to give greater prominence to paragraph 8 of the PN which emphasises that many of the principles in the PN apply to simple instruments.

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 it is helpful to outline the various ways in which entities might utilise financial instruments but believe greater emphasis should be placed on the fact that simple entities are also likely to make use of financial instruments that fall within the scope of this guidance.

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 greater emphasis should be placed on the fact that the guidance applies equally to smaller entities with complex financial instruments. That is, the guidance applies to the complexity of the instrument and not the assumed complexity of the entity being audited.

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 we agree that the guidance should be developed to apply to all financial instruments, auditors should be able to audit less complex financial instruments utilizing ISA 540 (Revised and Redrafted). Thus while addressing the fact that the guidance applies to all financial instruments, the majority of the guidance within IAPS 1012 should continue to focus on auditing complex 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?

We believe that the utilisation of financial instruments will give rise to an operational risk in most situations and that the definition of operational risk tends to lead the reader to think that this type of risk would only arise in complex, more sophisticated situations. Without duplicating ISA 540, we believe that more prominence needs to be given to operational risks arising in less complex situations.

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?

Please see our responses to points 7 and 9 above.

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 concur with the warning about solely placing reliance on analytical procedures. We believe that the inclusion of examples of substantive procedures designed to test common audit objectives for complex financial instruments should be considered.

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?

We are unaware of any additional issues or best practices that have not been included.

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 that the additional guidance as 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 the additional guidance is applicable to most complex financial instruments, but would suggest adding a section that clarifies/summarises the circumstances in which the approach to auditing valuations (i.e. external pricing, modelling, etc) would be applicable.

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 it would be helpful to include more detailed guidance but would recommend including them as appendices as to not overwhelm the main guidance.

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?

We believe additional guidance would also be useful on the type of models that are used, which would be acceptable and how they operate.

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 use of the term instrument should lead the reader to realise that it applies to both assets and liabilities. However, at present it is not until paragraph 38, which relates to materiality, that it is made clear that instruments may be assets or liabilities. Indeed, it is possible for the same instrument to be an asset or a liability at different times and subject to different circumstances and can move from asset to liability in short order. It would be helpful to have a clear statement to this effect in the introductory paragraphs of the document. It would also be helpful if the differences in risks associated with assets and liabilities were compared.

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?

We believe it would be useful for the guidance to give a clear warning that auditors need to be very robust in challenging the various models and approaches to valuing instruments that an entity might adopt, especially when there is no liquid market for the instruments. There is a danger that an entity will try various models until it finds one that gives the answer they are looking for. We also believe it would be useful to include common issues in obtaining sufficient appropriate audit evidence in the areas that involve the need for auditors to actually audit the reasonableness of management's assumptions used in modelling (i.e., situations where there is not a quoted market price).

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

We believe that the guidance included in the Practice Note on disclosures is generally helpful. However, we believe that references to UK standards, guidance or bodies should be removed because they may not be relevant or understood in an international context.

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?

We believe that more guidance on these areas of disclosure would be helpful.

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 area of financial instruments is one where those charged with governance, especially non executive directors and audit committees, may not be sufficiently involved on a day-to-day basis to fully appreciate the risks associated with using these instruments. This is believed to be a key issue underlying the present global economic environment. Therefore inclusion of guidance with respect to communication between auditors and those charged with governance is helpful and very welcome.

We believe that the guidance might suggest that where a financial instrument is truly complex the auditor should specifically discuss with those charged with governance the business objective for using the financial instrument and the risks to which they understand the entity is exposed as a result.

22. Are there 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?

We believe best practices should be written such that they would be universally applicable. However, as each country is likely to have its own local regulatory and legislative requirements in these areas, it may be helpful if each country which adopts the guidance inserts a section on its own local requirements.

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.

We believe further guidance would be helpful, in particular guidance when the auditor should use an emphasis of matter and when a qualification is more appropriate. Similarly, potential limitations of scope arising from lack of evidence would need to be very carefully considered in terms of the potential of the instruments to undermine the entire financial statements. However, this guidance may be more appropriately, or alternatively, included in the current IAASB audit reporting projects.

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

We believe the Overview section is helpful, despite the resulting duplication, because it helps to highlight and identify the key matters.

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

While we believe the level of guidance included in the Practice Note is helpful, again we recommend that more emphasis of the fact that there are aspects of this guidance that apply to financial instruments

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that are not especially complex would be helpful. Some of the guidance seems to be linked to complex operating environments which won't always be the case.

We would be pleased to discuss our comments further with members of the IAASB or its staff. If you wish to do so, please contact Robert Dohrer (tel: +1 919 645 6819; email: robert.dohrer@rsmi.com).

Yours sincerely



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