



International Federation of Accountants

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Agenda Item

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Committee: IAASB
Meeting Location: Seoul
Meeting Date: September 21-25, 2009

Auditing Complex Financial Instruments

Objective of Agenda Item

1. To review and approve the draft Consultation Paper on auditing complex financial instruments.

Task Force Composition

2. The Task Force comprises:
 - John Fogarty, Chair, IAASB Member
 - Jon Grant, IAASB Member and Member of UK Auditing Practices Board (APB) Working Party on Complex Financial Instruments
 - Tomokazu Sekiguichi, IAASB Member
 - Gregory Fletcher, US Public Company Accounting Oversight Board
 - John Hughes, KPMG and Chair of UK APB Working Party on Complex Financial Instruments
 - Tom Omberg, Deloitte
 - Marc Pickeur, Basel Committee on Banking Supervision
3. The International Valuation Standards Council has also been invited to join the Task Force but has not yet nominated a representative.
4. The members of the Task Force met via teleconference in July and August 2009 to discuss the form and content of the draft Consultation Paper.

Background

5. At its June 2009 meeting, the IAASB unanimously approved a project to develop guidance for auditors dealing with complex financial instruments. This project includes:
 - (a) The development of a “briefing paper” (or equivalent) to raise awareness and highlight a number of practical considerations that are currently posing challenges in audits of complex financial instruments; as well as

- (b) The revision of IAPS 1012¹ to bring it in line with the clarified ISAs and, as appropriate, to further expand it for additional guidance for auditors when applying ISAs in the context of complex financial instruments.

The IAASB agreed that the UK Auditing Practices Board's (APB) work to revise its Practice Note (PN) 23² should be leveraged in achieving these objectives.

Status of the UK APB's Work

6. The APB discussed a revised draft of the PN at its July 29, 2009 meeting. Subsequent to that meeting, the APB's Working Party met to further revise the PN and intends to present a final PN for the APB's approval at the September 17, 2009 meeting.
7. The APB's website explains that "Practice Notes are intended to assist auditors in applying Auditing Standards of general application to particular circumstances and industries. Practice Notes and Bulletins are persuasive rather than prescriptive. However, they are indicative of good practice, even though they may be developed without the full process of consultation and exposure used for APB Standards." The timing of the APB's approval has been planned for issuance of the PN in time for auditors to use it on audits of December 2009 period ends.
8. The APB intends to issue the approved version of the PN as interim guidance, primarily for two reasons:
 - (i) It is based on the current ISAs (UK and Ireland), which will still be extant for the next main reporting season. It is anticipated that conforming changes will be needed to the APB's Practice Note when the clarified ISAs become effective in the UK (i.e., for audits of entities with accounting periods ending on or after December 15, 2010).
 - (ii) There may be changes in relevant regulations and guidance from regulators over the next year that will need to be reflected in the PN, in particular as relevant accounting standards are under review and future changes may have implications for auditors.

Development of the Paper

Objectives

9. The project proposal explained that the principle objective of the Consultation Paper would be to highlight a number of practical considerations that are currently posing challenges in audits of complex financial instruments in advance of the 2010 audit season. Its secondary objective would be to obtain feedback on the IAASB's planned revision of IAPS 1012 using the APB's work as a possible starting point.
10. The Task Force considered how best to accomplish the principle objective in the necessary timeframe, recognizing that any materials issued much later than October 15, 2009 would be of limited use to auditors already involved in interim audit work for year-end audits. Some Task Force members were initially of the view that, given the dual objectives, it might be preferable

¹ International Auditing Practice Statement (IAPS) 1012, "Auditing Derivative Financial Instruments."

² Practice Note 23, "Auditing Derivative Financial Instruments," issued in April 2002 and based on IAPS 1012.

to issue two documents rather than one “briefing paper:” one could take the form of a Staff Audit Practice Alert or similar non-authoritative Staff-issued publication, while the other would be more of a request for comment based on the APB’s Practice Note.

11. However, two challenges arise with this approach:
 - (i) There would be a limited amount of meaningful new guidance that could be offered in a Staff document; and
 - (ii) It would not necessarily be appropriate for the IAASB to be seen to be “endorsing” guidance from a national standard setter, in particular since the IAASB would not have had the opportunity to review such guidance in significant detail.
12. Instead, the Task Force believes the most appropriate approach to achieve the objectives would be to indicate to potential respondents that there are key issues that the IAASB will likely need to consider in revising IAPS 1012 (issues that were in fact most likely to be noted in the upcoming audit season), and that, in the IAASB’s view, the guidance issued by the APB represents a positive way forward as a starting point to address the issues in an international context.
13. Accordingly, the Introduction of Agenda Item 4-A seeks to clarify the following:
 - The purpose of the Consultation Paper: to seek views on a number of matters that require consideration in relation to the IAASB’s plans to develop guidance relating to auditing complex financial instruments by revising its extant IAPS 1012.
 - The plan to leverage the APB’s work on its Practice Note: includes an explicit statement that the IAASB intends to use the APB’s guidance in its entirety as a starting point in revising IAPS 1012 (appropriate caveats have also been included to highlight that due process will apply to revised IAPS 1012).
 - How the Consultation Paper aims to not only solicit views but also raise awareness: by highlighting a number of practical considerations that are currently posing challenges in audits of complex financial instruments, illustrating how the APB’s Practice Note provides guidance in these circumstances, and asking for views as to whether that guidance is helpful and should be incorporated into IAPS 1012 or whether it could be further expanded.
 - The acknowledgement that the APB’s Practice Note is useful guidance: by highlighting the APB’s work as a national standard setter and soliciting views on the applicability of such work in an international context.

Form of the Paper

14. The project proposal noted that consideration would be given to whether the title “briefing paper” should be replaced with another more suitable label. The Task Force is generally of the view that this publication would be best labeled a Consultation Paper, in line with IFAC’s internal definition: a paper issued to “promote discussion or debate on issues affecting the accountancy profession and seek comments from interested parties on the issues raised in the paper.”
15. In arriving at this conclusion, the Task Force considered that potential respondents are already

familiar with the concept of a consultation paper, since the IAASB issued a consultation paper on its *Strategy and Work Program, 2009-2011*, and commissioned the paper issued in September 2008, “Matters to Consider in a Revision of International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*” (ISRE 2400 paper). Labeling the publication a briefing paper may imply more authority than IAASB intends, and may also not make it clear enough that detailed responses are being sought.

16. While there may be merits for labeling the paper in another way to more adequately highlight the fact that it does contain guidance (because of the inclusion of the APB’s Practice Note as an Appendix), given the current structure, including the detailed questions on which views are sought to assist in the revision of IAPS 1012, the label “Consultation Paper” is likely the most appropriate.

Content of the Consultation Paper

17. The draft of the Consultation Paper to be discussed closely follows the outline that was set forth in the project proposal, and includes the draft of the PN that will be discussed by the APB at its September meeting as an Appendix. In order to achieve the objectives of, and timeframe envisioned for, the Consultation Paper, its focus is on a limited number of issues and reference is made to the applicable guidance in the APB’s PN to illustrate how these issues could possibly be addressed in a revised IAPS.
18. The paper invites views on a number of general questions about the IAASB’s planned approach to revise IAPS 1012, and the role of the APB’s PN in doing so. It also includes specific questions about the following matters, including whether the APB’s guidance is helpful:
 - The applicability of the PN to audits of entities of all sizes;
 - Application of the audit risk standards;
 - Sufficient appropriate audit evidence, including relevance and reliability of fair value information;
 - Disclosure and reporting considerations; and
 - Other matters.
19. Responses are also solicited as to whether there are areas not covered by the PN that may warrant further guidance in the revised IAPS, and whether there are currently any national standards or guidance that should be considered by the IAASB in the revision project.

Matters for IAASB Consideration

- Q1. Is the label “Consultation Paper” appropriate given the objectives of the publication and the material currently included in it?
- Q2. Does the IAASB agree with the content of the “Matters for Specific Consideration” Section, set forth in paragraphs 18-48 of the Consultation Paper?
- Q3. Are there areas included in the Appendix to the Consultation Paper that warrant highlighting in the body of the Consultation Paper?

Issuance of the Consultation Paper

20. As noted at the June 2009 meeting, the IAASB will need to consider how best to issue the Consultation Paper (i.e., as a Staff document, Task Force document, or IAASB document). IAASB practice in this area has been varied. For example, the Strategy Consultation Paper was issued by the IAASB, while the ISRE 2400 paper was commissioned by the IAASB but was a joint paper prepared by three national standard-setters and labeled as such.
21. The Task Force believes that it would be preferable for the paper to be issued as an IAASB paper. This is not only due to the fact that the IAASB will have the opportunity during its September 2009 meeting to review and comment on the paper, but also because the paper itself focuses on the IAASB's planned approach to the project.³
22. Recognizing the brief development cycle, however, the Task Force is of the view that it is appropriate to highlight the following within the Consultation Paper:
 - The paper, including its Appendix, is not meant to be authoritative.
 - The matters raised in the paper are not intended to prejudice the approach the IAASB may take in developing guidance relating to auditing complex financial instruments, the objectives it should achieve, or what the final outcome might be.
 - The IAASB has not yet discussed the proposed wording of the APB's PN in detail, and such wording will be subject to full deliberation in accordance with the IAASB's stated due process.
 - The revision of IAPS 1012 will also include the issuance of an exposure draft for public comment before the guidance is finalized.
23. The Task Force also considered whether the Consultation Paper should have a definitive comment period or whether the paper should allow for responses to be sent to the IAASB at any time. The Task Force concluded that a defined comment period would be preferable so that responses could be summarized and presented to the IAASB at its March 2010 meeting. They agreed that a 90-day comment period, ending no later than January 15, 2010, would be most appropriate, as it will allow for the Consultation Paper to be translated where necessary.
24. The Task Force also suggested that a separate dialogue with representatives from the audit firms could be held after the conclusion of the 2010 audit season to ensure that there are no other issues to consider in revising the IAPS that had not been raised via the consultation process.

Timing of the Consultation Paper

25. The aim of the Task Force is to release the Consultation Paper by mid-October 2009. As necessary, the Task Force will revise the draft Consultation Paper during the September IAASB meeting prior to its clearance by the IAASB. Should the final version of the APB's PN not be

³ Further, positioning it as an IAASB Consultation Paper would make clear it is a Board document and therefore subject to the provisions in the IAASB's due process that comments received through the issue of a consultation paper are considered in the same manner as comments received on an exposure draft.

available until after the IAASB meeting, the Task Force will inform the IAASB of any substantial conforming changes needed to the Consultation Paper before its issuance.

Matters for IAASB Consideration

- Q4. Does the IAASB agree with presenting the Consultation Paper as an IAASB paper?
Q5. Does the IAASB agree with the proposed comment period for the Consultation Paper?

Material Presented

Agenda Item 4-A Auditing Complex Financial Instruments – Draft IAASB Consultation Paper dated September 2009

Action Requested

26. The IAASB is asked to consider the matters highlighted above and approve the draft Consultation Paper (**Agenda Item 4-A**).