

February 11, 2011

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

Submitted electronically at: [www.iasb.org](http://www.iasb.org)

**Re: Proposals Relating to International Auditing Practice Statements (IAPSs) and  
the Proposed International Auditing Practice Statement, IAPS 1000, *Special  
Considerations in Auditing Complex Financial Instruments***

The New York State Society of Certified Public Accountants, representing more than 27,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned exposure drafts.

The NYSSCPA's Auditing Standards Committee deliberated the exposure drafts and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Herringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



Margaret A. Wood  
President

Attachment

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**PROPOSALS RELATING TO INTERNATIONAL AUDITING PRACTICE  
STATEMENTS (IAPSs)**

**WITHDRAWAL OF EXISTING IAPSs**

**CLARIFICATION OF THE STATUS AND AUTHORITY OF NEW IAPSs**

**PROPOSED AMENDMENTS TO THE *PREFACE TO THE INTERNATIONAL  
QUALITY CONTROL, AUDITING, REVIEW, OTHER ASSURANCE, AND  
RELATED SERVICES PRONOUNCEMENTS***

**PROPOSED INTERNATIONAL AUDITING PRACTICE STATEMENT  
IAPS 1000, *SPECIAL CONSIDERATIONS IN AUDITING COMPLEX FINANCIAL  
INSTRUMENTS***

**February 11, 2011**

**Principal Drafters**

**Jan C. Herringer  
Elliot A. Lesser  
Mark Springer**

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Ernest J. Markezin  
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**New York State Society of Certified Public Accountants**  
**Auditing Standards Committee**

**Comments on**

**Proposals Relating to International Auditing Practice Statements (IAPSs)**

**Withdrawal of Existing IAPSs**

**Clarification of the Status and Authority of New IAPSs**

**Proposed Amendments to the *Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements***

**Proposed International Auditing Practice Statement  
IAPSs 1000, *Special Considerations in Auditing Complex Financial Instruments***

The New York State Society of Certified Public Accountants is pleased to submit the following comments in response to the request by the International Auditing and Assurance Standard Board (IAASB) for comments on the proposals relating to IAPSs and the proposed International Auditing Practice Statement 1000, *Special Considerations in Auditing Complex Financial Instruments* (proposed IAPS). Overall, we support both the proposals relating to the IAPSs and the proposed IAPS.

We agree with the IAASB that the existing IAPSs are largely outdated and are generally inconsistent with the formulation of the clarified International Standards on Auditing (ISAs), and for this reason we believe that withdrawal is appropriate. Additionally, any necessary guidance (not already set out in the ISAs) should be reviewed for inclusion in either a newly developed IAPS or integrated into the application guidance of a relevant ISA. Further, we believe that the IAPSs should not introduce additional requirements beyond those already set out in the ISAs. Instead, they should provide more in-depth clarifying guidance with respect to specific topics for which the implementation of the requirements of the ISAs might be more complex.

Our remaining comments relate to the proposed IAPS 1000.

**General Comments**

*Assessing and Responding to the Risks of Material Misstatement*

Market conditions, interest rates, and credit quality have a profound impact on the valuation of complex financial instruments. Management and those charged with accounting for and valuing these instruments must have a clear understanding of all relevant elements of the instrument and the transactions that give rise to the instruments. In order to gain this understanding, the aforementioned individuals should have access to and direct communication with those executing the transactions. Further, auditors need to

(1) understand the process by which management obtains its understanding of complex financial instruments to ensure the transactions are properly reflected in the financial statements and (2) evaluate the risk of material misstatement. Accordingly, we recommend adding such guidance to the section entitled, *Assessing and Responding to the Risks of Material Misstatement*, as we believe this understanding is essential and might be overlooked by practitioners.

#### *Consideration of the Risk of Fraud*

We note that Table 1, *Types of Risks to which Entities May Be Exposed through the Use of Complex Financial Instruments*, provides a comprehensive list of the risks involved relating to complex financial instruments. However, we believe that the related “fraud risk,” which is inherent in the risks set out in Table 1, should be separately specified in the table to remind auditors of the susceptibility of complex financial instruments to the risk of fraud. In addition, consistent with our comment above, we recommend including guidance that explains that fraud risk increases if someone at the company in a position to perpetrate a financial fraud understands a financial instrument’s complexities, but others in management and those charged with governance do not have that same level of understanding.

Additionally, in Table 2, we believe the phrase “including the risk of fraud” should be added to the last sentence of the first paragraph under the subsection, *Commitment to Competence*, such that the sentence would read [additions are shown in bold italics]:

Significant use of complex financial instruments, without relevant expertise within the entity, increases the risk of material misstatement, ***including the risk of fraud.***

#### **Responses to Specific Questions**

##### **1. Is the material included in the proposed IAPS appropriate in light of the proposed status and authority of new IAPSs?**

Yes, overall we believe that, given the proposed status and authority of the new IAPSs, the material included is appropriate such that the IAPSs do not impose any additional requirements beyond the ISAs. In particular, we believe the inclusion of background material separate from the practical audit considerations is extremely helpful in the context of an IAPS.

However, while we understand that no new requirements are included within an IAPS, the authority of an IAPS, as explained in paragraph 23 of the *Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* (the “Preface”) is unclear. The *Preface* explains that auditors “should” determine whether any IAPS is relevant to the circumstances of the audit, and, if so, obtain an understanding of its content. The word “should” is not defined in the ISAs or the *Preface* and may be understood in some jurisdictions to denote a requirement. For this reason, we suggest revising the guidance to eliminate the use of the term “should.”

One way this might be accomplished would be to revise the last sentence in paragraph 23 as follows [deletions are shown in strike through text and additions in bold italics]:

Auditors ~~should determine~~ ***exercise professional judgment in determining*** whether any IAPS is relevant to the circumstances of the audit, and if so, obtain an understanding of its content.

**2. Is the balance of material included in the proposed IAPS appropriate in light of its purpose of assisting a wide range of auditors on an international basis?**

Yes, we believe the balance of material included in the proposed IAPS is appropriate in light of its purpose of assisting a wide range of auditors on an international basis.

**3. Does the proposed form of the IAPS, including the use of two separate sections and shaded tables enhance readability?**

We note that the material has been presented in two sections, the first providing background information and the second section providing guidance relating to audit considerations with respect to complex financial instruments. We agree that this format enhances readability, particularly because this formulation provides easy access to the educational material for those auditors who require it, and sets the relevant detailed auditing guidance in a separate section for easy access by the more experienced auditor.

Further, we generally agree that the use of shaded tables within the document enhances the readability of the proposed IAPS. However, we noted that while in some cases the use of such tables improved readability, in other cases, we thought the extent and nature of some of the shaded text was so extensive that it warranted inclusion within the body of the IAPS rather than including it within a shaded box. For example, see Table 2.

*Definitions Section*

As noted above, we support including an educational section within the document to provide a foundation for understanding the guidance set out in section 2. To enhance the educational material, we believe that a “Definitions Section” might be helpful to those practitioners with limited experience in auditing complex financial instruments. Definitions of terms such as own credit risk, hedge accounting, and day 1 profits or losses, among other terms, might be helpful to readers. While we recognize that some of these terms are described within the text of the IAPS, we believe setting these definitions apart in a separate section will enhance the clarity of the document.

**4. Should an effective date be established for the proposed IAPS and, if so, what would be an appropriate date?**

We do not believe that an effective date is appropriate for the proposed IAPS because it does not establish any requirements that would be incremental to the International

Standards on Auditing. Furthermore, because the IAPS is meant to provide practical guidance and educational material to promote good practice, the establishment of an effective date would not be consistent with its level of authority.

### Comments Requested on Other Matters

The content with respect to special considerations in the audit of smaller entities appears to be sufficient and appropriate.

We have no comments on the following matters:

- Special considerations in the audit of public sector entities
- Developing nations
- Translations

### Paragraph Level Comments

We have provided the following paragraph level comments for your consideration which are editorial in nature, but which we believe improve the overall quality of the document.

Paragraph	Comment
39	Identified deficiencies in control procedures <i>in prior years</i>
42	After assessing the risks associated <i>with</i> complex financial instruments...
Table 2, The Entity's Information Systems, point (a), last sentence (see page 41)	This may result in an increased number of manual transactions, <i>which further increases the risk of error.</i>
Table 4, 2 <sup>nd</sup> paragraph, first bullet	...combined with strong supervisory controls over traders to ensure <i>the integrity of the transactions</i> <del>that they take the task of recording transactions seriously;</del>
77	Entities that use pricing services on a contractual basis to provide routine pricing data used <i>in</i> an entity's models...