PROPOSED REVISION OF PRACTICE NOTE 23 (REVISED)

SPECIAL CONSIDERATIONS IN AUDITING FINANCIAL INSTRUMENTS

RESPONSE FROM ICAS TO THE FRC

3 January 2013
Background

1. ICAS welcomes the opportunity to comment on the FRC's consultation paper “Proposed Revision of Practice Note 23 (Revised): Special Considerations in Auditing Financial Instruments”. Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK’s and the world’s great companies.

2. Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

ICAS is supportive of the key objective to revise the guidance available on the audit of financial instruments following the issue of updated international guidance based on the clarified ISAs. We consider that the proposal to incorporate the supplementary guidance from Practice Note 23, currently omitted from the International Auditing Practice Note (IAPN) 1000, is appropriate and sensible.

Our response to the specific consultation questions

Question 1
Do you agree that it is appropriate to update PN 23 (Revised) by taking the guidance in IAPN 1000 and supplementing it with further relevant guidance which is not covered in the IAPN? If not, please explain how you believe the PN should be updated.

Response 1
We agree that it is appropriate to update PN 23 (Revised) using IAPN 1000 as a starting point and supplementing this with the guidance included in PN 23 (Revised) which is not covered by IAPN 1000.

Question 2
Do you agree that the PN should distinguish between the text of the IAPN and the supplementary FRC guidance by the use of grey shading as in the ISAs (UK and Ireland)? If not, please explain why.

Response 2
We agree that the use of grey shading to demonstrate the differences between the IAPN text and the supplementary FRC guidance is sensible and established practice following its use in the ISAs.

Question 3
Do you agree with all the supplementary FRC guidance that has been included? If not, please give reasons and explain how you believe it should be modified.

Response 3
We agree with what has been included by way of supplementary guidance and consider this to be both appropriate and sensible.

Question 4
Is there any guidance from the IAPN with which you disagree? If so, please give reasons and explain how you believe it should be modified.

Response 4
There is no guidance from the IAPN with which we disagree.
Question 5
Are there any other considerations relating to the audit of financial instruments that you believe should be addressed? If so, please identify and explain them and the reasons why you believe that guidance is needed.

Response 5
We believe that the following considerations relating to the audit of financial statements should also be addressed:

- The use of an expert is key and as such, expert guidance is required in terms of establishing procedures to be performed and evaluating the resulting working papers. It appears that excessive reliance is placed on the entity’s own controls in this area. For example, only an expert could execute the guidance mentioned in paragraph 127. Accordingly, we welcome the additional paragraph at the end of paragraph 79 proposing the use of an expert if there are complex financial instruments involved.
- We welcome the reference to internal audit at paragraphs 82-83 as often internal audit departments, especially in large financial institutions, are very experienced and specialised and can add significant value to the audit of financial instruments. In addition, internal audit departments often have their own quantitative experts or will co-source valuation experts into the team as there is increasing pressure from regulators (particularly the FSA) to do so. More could be made of the possibilities of working with internal audit – in terms of understanding the nature of the trading activity, the control environment and management culture as well as understanding the detailed instruments.
- We would also suggest a reference to internal audit again in the paragraphs 114-137 in particular within paragraph 120-2 as, within many organisations, internal audit generally performs extensive testing of Independent Price Verification function controls.
- The reference in paragraph 113-1 to “confirming the validity of valuation models” is incredibly wide-reaching. Based on first-hand knowledge of the sector, significant numbers of valuation models exist, some of which are highly complex and essentially impossible to validate. The reference is expanded in paragraphs 121-132 but we would propose a greater acknowledgement of the aforementioned complexity and its impact on the audit.
- We suggest that greater reference could be made in paragraphs 121-132 of the use of consensus pricing services referred to in paragraph 54. This is the key measure which is used by the Banking industry in terms of verifying prices for complex financial instruments.

Question 6
Do you agree that the structure established by IAPN 1000 is appropriate and helpful? If not, please give reasons and explain how you believe it should be modified.

Response 6
We agree that the structure established by IAPN is both appropriate and helpful.

Question 7
Do you believe that the application of the proposed guidance will significantly increase audit costs? If yes, please identify the specific aspects of the guidance and, as far as possible, the nature and quantum of the additional costs.

Response 7
We believe that there will be additional audit costs associated with the application of the proposed guidance; however, we do not believe that these will be significant.
**Question 8**

Do you believe that the updated guidance will result in benefits that would outweigh any increased costs? If not, please explain why.

**Response 8**

We believe that the updated and clarified guidance will result in benefits that would outweigh any increase in costs.