



International Federation of Accountants

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Agenda Item

7

Committee: IAASB
Meeting Location: Madrid, Spain
Meeting Date: September 24-28, 2007

External Confirmations

Objective of Agenda Item

1. To approve as an exposure draft proposed ISA 505 (Revised and Redrafted), “External Confirmations.”

Task Force Composition

2. The members of the Task Force are:
Craig Crawford (Chair) IAASB member
David Swanney IAASB public member
Roberto Tizzano IAASB member
Simon Hancox External member
John O’Brien External member
Michele Caso Technical advisor to Roberto Tizzano

Activities since Last IAASB Discussions

3. At its July meeting, the IAASB undertook a second read of proposed ISA 505 (Revised and Redrafted). The Task Force has revised the proposed ISA in response to comments received, and has undertaken additional drafting as necessary.

Significant Matters for IAASB Consideration

Reliability of Responses to Confirmation Requests

4. At its July meeting, the IAASB discussed paragraph 13 of the draft proposed ISA which stated, “When the auditor determines that a response to a confirmation request is not reliable, the auditor shall treat the response as a non-response.” In discussing this paragraph, the IAASB suggested that the Task Force consider whether there is a need for proposed ISA 505 (Revised and Redrafted) to include a requirement for the auditor to consider whether a response is reliable.
5. In considering this issue, the Task Force referred to the Exposure Draft of proposed ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence,” and the following paragraphs of this Exposure Draft:

11. When designing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.
 14. When audit evidence obtained from one source is inconsistent with that obtained from another, or the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications to or additional audit procedures are necessary to resolve the matter.
6. The Task Force has two different views with respect to these paragraphs:
- (a) Some Task Force members are of the view that paragraph 11 creates a requirement for the auditor to consider the reliability of each response to a confirmation request. Accordingly, in their view, including a similar requirement in proposed ISA 505 (Revised and Redrafted) would not be inconsistent with the Exposure Draft of proposed ISA 500 (Redrafted).
 - (b) Some Task Force members are of the view that paragraphs 11 and 14 of proposed ISA 500 (Redrafted) do not impose a requirement on the auditor to consider the reliability of each response to a confirmation request. They believe that it would be difficult to articulate the actions that the auditor should undertake to meet such a requirement. They also view paragraph 11 as requiring the auditor, when designing appropriate audit procedures, to consider whether these procedures will provide reliable audit evidence (i.e., a planning activity). These members believe that paragraph 14 provides a “stumble across” requirement – if the auditor has doubts about the reliability of a confirmation response, then further action must be taken. Accordingly, in their view, including a requirement in proposed ISA 505 (Revised and Redrafted) for the auditor to consider the reliability of responses to confirmation requests would go beyond proposed ISA 500 (Redrafted).
7. In preparing this revised draft of proposed ISA 505 (Revised and Redrafted), the Task Force has not reached a definitive conclusion on whether or not there should be a requirement for the auditor to consider the reliability of responses to confirmation requests. It has identified two different approaches to dealing with the reliability of responses to confirmation requests. The draft presented includes the following paragraph 11, which is reflective of the views expressed in paragraph 6(a) above:
11. The auditor shall consider the reliability of the response to a confirmation request in accordance with [proposed] ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence.”
8. The other approach, which is reflective of the views in paragraph 6(b) above, would be to replace this paragraph with a requirement as follows:
11. When the auditor receives a response to a confirmation request, the auditor shall evaluate whether the response:
 - (a) Was received directly by the auditor from the confirming party;

- (b) Was sent by the appropriate confirming party; and
 - (c) Indicates whether the confirming party agrees or disagrees with the information provided, or provides the information requested.
9. Inclusion of such a paragraph would provide a basis for identifying doubts about the reliability of a response to a confirmation request, and the related requirement in paragraph 12.

Question for the IAASB:

What is the appropriate form of requirement with respect to the reliability of responses to confirmation requests?

Negative Confirmations

10. Throughout this project, there have been strongly held views among certain members of the IAASB relative to the usefulness of negative confirmations. Some feel that the material in the draft discussed in July suffered from some weaknesses and may not have been sufficiently restrictive relative to the use of negative confirmations.
11. Other comments from IAASB members included:
- There was a concern about banning negative confirmations outright because the auditor should not be precluded by the literature from performing any particular auditing procedure.
 - A suggestion was made that the requirement in paragraph 17 should state that only when the criteria in the paragraph are met does the auditor obtain relevant and reliable audit evidence through use of negative confirmations.
 - Another suggestion was to revise the requirement to state that the auditor needs to conclude on whether sufficient appropriate audit evidence has been obtained without consideration of the results of negative confirmation procedures.
 - Another suggestion was to not have a requirement at all, but rather refer from the definitions to the application material.
12. In considering this issue, the Task Force made the following observations:
- The current draft represents a significant tightening relative to the extant ISA.
 - Removing the requirement altogether and only providing application guidance may leave uncertainty about when negative confirmations may be used.
 - It does not seem appropriate to ban the use of any specific audit procedure.
 - Indicating that negative confirmations never provide audit evidence, or otherwise indicating that sufficient appropriate audit evidence does not include evidence from negative confirmations, is not justified in all circumstances.
13. The Task Force concluded that the requirement in the previous draft is appropriate relative to negative confirmations. However, in recognizing the IAASB's concerns,

the Task Force has revised the introductory wording to make it more precise. Paragraph 17 now reads:

17. Unless the following circumstances are met, the auditor shall only use negative confirmations in conjunction with other substantive procedures that address an assessed risk of material misstatement:
 - (a) The assessed risk of material misstatement associated with the relevant financial statement assertion is low;
 - (b) A large number of small balances is involved;
 - (c) A substantial number of exceptions is not expected; and
 - (d) The auditor has no reason to believe that respondents will disregard the confirmation requests.
14. Alternative wording for this requirement also considered by the Task Force was:
 17. The auditor shall only use negative confirmations in conjunction with other substantive procedures that address an assessed risk of material misstatement.
15. To be consistent with the alternative wording in paragraph 17, as discussed in the previous paragraph, the related application material in paragraph A26 would need to be revised along the following lines:
 - A26. Because the use of negative confirmation requests provides limited audit evidence, there are no circumstances when the use of negative confirmation requests, by themselves, may address an assessed risk of material misstatement. Further, the use of such requests does not reduce the audit evidence otherwise required from other substantive procedures that address the assessed risk of material misstatement. The auditor may, however, find it useful to use negative confirmation requests to provide corroborating evidence that supports audit evidence obtained from such other substantive procedures.

Question for the IAASB:

What is the appropriate form of requirement with respect to the use of negative confirmation requests?

Material Presented

Agenda Item 7-A Proposed ISA 505 (Revised and Redrafted) (Clean)
(Pages 2721 – 2732)

Agenda Item 7-B Proposed ISA 505 (Revised and Redrafted) (Mark-up from July 07
(Pages 2733 – 2746) IAASB meeting)

Agenda Item 7-C
(Pages 2747 – 2748)

Proposed ISA 505 (Revised and Redrafted): Proposed Conforming Amendments

Action Requested

The IAASB is asked to consider the matters in this agenda item and approve the draft exposure draft.

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