



18 February 2008

Our ref: ICAEW Rep 18/08

Mr Jim Sylph  
Executive Director, Professional Standards  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, New York 10017  
USA

By email

Dear Mr Sylph

**PROPOSED REVISED AND REDRAFTED ISA 505 *EXTERNAL CONFIRMATIONS***

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on proposed ISA 505 and conforming amendments to ISA 500 published by IAASB in October 2007.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

**We believe that the clarification reformatting has resulted in a more readable and user-friendly document than previous versions. However, changes to the objective and requirements will help ensure consistency of interpretation and improved audit quality, as explained below.**

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

Katharine E Bagshaw FCA  
Manager, Auditing Standards  
ICAEW Audit and Assurance Faculty  
T + 44 (0)20 7920 8708  
F + 44 (0)20 7920 8708  
E: [kbagshaw@icaew.com](mailto:kbagshaw@icaew.com)

## Objective

*Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?*

**No.** There should be an additional objective to determine whether it is appropriate to use external confirmation procedures. We agree that the auditor's response to risk is addressed by ISA 330 but users of an ISA dealing with external confirmations would expect the ISA to address the determination of whether the use of external confirmation procedures is appropriate. This would be consistent with, for example, the objective in proposed ISA 620 which includes an objective to determine whether to use the work of an auditor's expert.

Paragraph 5 should read as follows:

*5. The objectives of the auditor are:*

- a) to determine whether the use of external confirmation procedures is an appropriate response to an assessed risk of material misstatement; and*
- b) when using external confirmation procedures in response to an assessed risk of material misstatement, to design and perform such procedures to obtain relevant and reliable audit evidence.*

## Requirements

*Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?*

**Not in the following cases:**

### **1. Determining whether to use external confirmations**

Taking account our comment on the objective above, a further requirement should be included:

*The auditor shall determine whether the use of external confirmation procedures is an appropriate response to an assessed risk of material misstatement.*

This requirement should be supported with reference to the risk ISAs such as ISA 330, to emphasise that the auditor's determination will depend on the results of the risk assessment process. It should also cross-refer to the existing application guidance in paragraphs A2 to A6.

### **2. Reasonableness of management's refusal to allow confirmation requests (paragraphs 8 and 9)**

Paragraphs 8, 9 and A13 introduce the concept of reasonableness, referring to 'the reasonableness of management's refusal', the possibility that 'the auditor concludes

that management's refusal .... is unreasonable' and the need to report to those charged with governance in such circumstances. Three issues arise here:

- The need to obtain appropriate audit evidence: the key issue is not management's refusal, but the availability of other audit evidence. Paragraph 8 (c) which deals with this should be brought forward.
- The reasons for management's refusal and their effect on other audit procedures: the requirement to evaluate the reasonableness of management's refusal by challenging the reasons provided by management is unnecessarily confrontational. Paragraph 8 (b) would be better worded as 'Evaluate the appropriateness of the grounds for management's refusal by questioning the reasons provided by management...' The word 'unreasonable' should be replaced by the word 'inappropriate' in paragraph A13.
- The need to report back to those charged with governance: the auditor should only be required to report back to those charged with governance if he considers that the grounds for refusal provided by management are inappropriate and no other alternative audit evidence is available. Paragraphs 9 should be altered accordingly.

### **3. Considering reliability of responses (paragraphs 10 and 11)**

We acknowledge the importance of auditors adopting an attitude of professional scepticism, but certain paragraphs appear to expect the auditor to adopt an excessively sceptical approach.

For example, paragraphs 10, 11 and A16 to A20 refer to the auditor having doubts about the reliability of the response to a confirmation request. It is not clear in this context whether 'reliability' refers to the risk of fraud. Paragraph A16 does not define reliability but the second sentence states that no response is received without some risk of interception, alteration or fraud and thereby implies that fraud risk is to be considered. It would be unrealistic to expect auditors to conclude that confirmation evidence is unreliable, and that there is a fraud risk, simply because there is a difference between what is confirmed and the company's records.

Paragraph A22 states that a non-response to a confirmation request may indicate a previously unidentified fraud risk factor that requires further evaluation. The possibility of non-responses is always present in confirmation procedures and auditors would not generally assume that this represents a fraud risk. The fraud risk should have been identified initially and will be a factor that the auditor takes into account when concluding whether or not confirmation evidence is an appropriate response to assessed risk.

These paragraphs should also make some reference to the possibility of error as well as fraud.

### **4. Alternative procedures for non-responses (paragraph 12)**

Paragraph 12 includes two separate requirements in relation to non-responses. It requires alternative audit procedures to be performed in the case of non-responses, and

the auditor to determine the implications if a response to a positive confirmation is considered necessary but not obtained. It is not clear whether these two issues are linked. If it is intended that there may be situations in which a response is deemed necessary even if satisfactory alternative procedures are performed this should be made clear but we do not believe that this is what is intended. Paragraph 12 should therefore be re-worded as follows:

*In the case of non-responses, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. If alternative procedures are not possible, and consequently the auditor determines that a response to a positive confirmation is necessary to obtain sufficient appropriate audit evidence to respond to assessed risks of material misstatement, the auditor shall determine the implications.....*

The extent of alternative audit procedures required is unclear. Paragraph A22 indicates that the nature and extent of alternative audit procedures is affected by the assessed risk of material misstatement but does not explain whether the alternative audit procedures have to be applied to the full amount of every item for which no response is received. Where, for example, no response is received to a confirmation request for an accounts receivable balance comprising many invoices, auditors may in practice determine that it is possible to draw a conclusion that the risk of material misstatement is sufficiently low without performing alternative procedures for every invoice.

### **Specific matters on which comments were requested**

1. *The proposal that ISA 505 (Revised and Redrafted) should not mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement.*

We agree with the IAASB's decision not to mandate the use of external confirmations, as this is in line with the risk-based approach. It is inappropriate to presume that an external confirmation process will always be an effective audit response as there will be many situations where, for example, the auditor will have reason to believe that responses will not be obtained. Auditors should be able to design and perform audit procedures whose nature, timing and extent are, in the auditor's judgement, the most effective response to the assessed risk of material misstatement.

2. *The proposal that the scope of proposed ISA 505 (Revised and Redrafted) be directed at the effective performance of external confirmation procedures when the auditor determines that such procedures are an appropriate response to an assessed risk of material misstatement, and that accordingly the ISA should not require that the auditor consider when, or under what circumstances, it may be appropriate to use external confirmation procedures when performing an audit of financial statements.*

As noted in our comments in relation to the objective and requirements above, we believe that the ISA should include a requirement to determine whether it is appropriate to use external confirmation procedures.

3. *Whether proposed ISA 505 (Revised and Redrafted) appropriately limits the extent to which auditors may use negative confirmation requests.*

Negative confirmation requests are used very infrequently and it is appropriate to limit their use. The conditions in paragraph 14 are stringent but appropriate. Examples of situations in which negative confirmations might be useful, and when it is less likely they will be useful, should be included in paragraph A26.

### **Application Material**

#### *Paragraph A3*

Cut-off is another example of an assertion for which confirmations provide less relevant evidence and we recommend that this is added to this paragraph.

#### *Paragraph A11*

The guidance in this paragraph states that the auditor may verify the accuracy of the original address where there is a non-response, and then send additional or follow-up requests. However, paragraph 7(d) requires the auditor to determine that requests are appropriately addressed as part of the control over the confirmation process. The example in paragraph A11 is inconsistent with paragraph 7 (d) and should be deleted.