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Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
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Organização Internacional das Comissões de Valore

May 12, 2008

Mr. James M. Sylph  
Executive Director, Professional Standards  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Email [Edcomments@ifac.org](mailto:Edcomments@ifac.org)

**Re: Proposed Revised and Redrafted International Standard on Auditing ISA 505, External Confirmations (ISA 505).**

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed ISA 505. As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

#### **Scope of this ISA**

The title of this ISA is "External Confirmations", implying that this is an ISA fully covering the subject of External Confirmations in the audit process, and we note that paragraph 1 states that this ISA "establishes requirements and provides guidance for performing external confirmation procedures". The ISA does not, however, address the important precursor to performing external confirmation procedures, which is the auditor's determination of whether to use them. Extant ISA 505 requires that the auditor "determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level." In our view, omitting this determination from the

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scope of this ISA, and thus from its objective and related requirements, results in a weakening of this ED as compared to the extant ISA, especially since this requirement has not been appropriately addressed by other ISAs (more specifically ISAs 315 and 330).

We acknowledge and understand the Board's view that ISAs 315 (Redrafted) and 330 (Redrafted) provide overall guidance on the auditor's determination of the nature, timing, and extent of audit procedures; however, we note that neither of these standards explicitly requires the auditor to "determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level" (as required in paragraph 2 of extant ISA 505)<sup>1</sup>. Furthermore, the approved and issued ISA 315 lists as risk assessment procedures only three types of auditor actions: inquiries of management and others within the audited entity, analytical procedures, and observation and inspection. Therefore we do not agree with the Board's view that ISAs 315 and 330 provide adequate guidance to assist auditors in deciding whether to use confirmations because neither of these standards (nor proposed ISA 505) describes the relationship of confirmation procedures to the auditor's assessment of audit risk, as currently described in paragraphs 9-11 of extant ISA 505.

In our view, the determination of whether and how to use external confirmations is an essential part of an audit. We recommend that the Board evaluate ISA 315, ISA 330, ISA 500, and ISA 505 as a whole and develop a clear, positive and more comprehensive approach regarding determining the use of external confirmations. We believe that the ISAs should:

- Require the auditor to determine whether he should or should not perform external confirmation procedures, in particular for assertions associated with account balances in which there should be a presumption that external confirmations provide relevant and reliable audit evidence, such as the examples listed in paragraph A2.
- Contain additional application guidance assisting the auditor in this determination.

We believe that paragraphs A2 to A6 of ED ISA 505 and paragraphs 4, and A4 to A19 of ED ISA 500, as well as paragraphs A9 and A19 of the redrafted and reissued ISA 330, represent a good starting point for developing both appropriate requirements and additional useful guidance.

### **Objective**

As proposed, the objective in paragraph 5 of this ISA states "The objective of the auditor when using external confirmation procedures in response to an assessed risk of material misstatement is to design and perform such procedures to obtain relevant and reliable audit evidence." We believe the objective would be improved if it were modified in two ways. First, it should be expanded to address the determination of whether to use confirmations as discussed above under "Scope", perhaps with words such as "The objective of the auditor is to determine whether to use external confirmations and where used, to design and perform confirmation procedures in such a way as to obtain relevant and reliable audit evidence." Second, the objective should be revised to delete the clause, "in response to an assessed risk of material misstatement", as one would want the auditor to design and perform confirmation procedures in such a way as to obtain relevant and reliable audit evidence regardless of the point in time and purpose of the confirmations.

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<sup>1</sup> Paragraphs A5, A9 and A49 of ISA 330 (Redrafted) are the only paragraphs of either ISA 315 (Redrafted) or ISA 330 (Redrafted) that refer to external confirmation procedures. These paragraphs do not require the auditor to determine whether the use of external confirmation procedures is necessary to obtain sufficient appropriate audit evidence at the assertion level.

## **Requirements – External Confirmation Procedures**

We agree that the ISAs, as a set of standards for both listed and non-listed companies, should not mandate the use of external confirmations in any particular circumstance. We further agree that it is appropriate for an auditor to use judgment in deciding whether and how to use confirmations in obtaining audit evidence. We would also note, however, that procedures to confirm bank balances and other information relevant in banking relationships are required or are common practice in many jurisdictions, and that the daily recordkeeping of banks would ordinarily produce the information to support such confirmations. We consider bank balances to be critical to an audit given that many transactions involve cash. Information on other banking relationships appearing on bank confirmations may also be important in identifying unrecorded liabilities, contingent liabilities, etc. Therefore we would expect that bank confirmations would be done unless there are persuasive reasons why this is not an appropriate procedure in the audit underway.

We also believe that external confirmations should be used in circumstances where there is an increased risk of misstatement of an item and it would be practicable to obtain an external confirmation to obtain sufficient and appropriate audit evidence. If the auditor judges that confirmations are not needed in this circumstance, we believe that the auditor's working papers should make it evident how the other procedures used were effective in obtaining sufficient and appropriate audit evidence.

Therefore, while we support the use of auditor judgment, we believe the ISA should be more positive as to the value and appropriate use of confirmations. We recommend that some mention be made of the fact that regulatory requirements may mandate confirmations in some jurisdictions in paragraph 7. We would also suggest a change in the wording of the requirement from “When the auditor *decides to use* confirmation procedures...etc” to “When the auditor *determines that confirmation procedures are appropriate...*” etc. (Italics ours). Our thinking here is that the judgment involved should not be simply an elective decision based on preference, but rather one that takes into account considerations of when confirmations are appropriate. Conforming changes would also need to be made in Application Material paragraph A2.

## **Requirements - Reliability of Responses to Confirmation Requests**

We acknowledge the importance of requiring the auditor to obtain further audit evidence to resolve doubts about the reliability of a response to a confirmation request, and we agree with the requirement in paragraph 10 that “If the auditor has doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.” However we believe that the ISA should contain a more explicit requirement asking for the auditor to make an assessment or judgment regarding the reliability of the answers received from third parties. This would better address our concerns in this regard, as indeed doubts can arise even when such an assessment has been actually performed. But having an explicit requirement to assess reliability will increase attention to this consideration.

We also agree with the associated application materials in paragraph A16 to A19. However, we are concerned that paragraphs 28 and 29 of the extant ISA 505 have been eliminated in the ED because they contain helpful guidance. Those paragraphs discuss the characteristics of respondents and emphasize that the reliability of audit evidence is affected by the respondent's competence, independence, authority to respond, knowledge of the matter being confirmed and objectivity. These characteristics are essential in assessing the reliability of confirmation responses and the extant paragraphs provide the auditor with guidance on whether there is sufficient basis for concluding whether a response will provide sufficient appropriate audit evidence. We suggest inserting paragraphs 28 and 29 from the extant ISA 505 to the application materials and including them in the cross reference made in paragraph 10, as they are useful guidance for the auditor to determining the reliability of confirmation responses.

We are concerned that ISA 505 does not provide guidance relating to electronic confirmations. For example, neither ISA 505 nor the conforming amendments to Proposed ISA 500 make any mention of the ever-increasing use of technology that is noted in the extant ISA 505, issued in 2004, or of how the reliability of audit evidence might be uniquely compromised when electronic confirmation procedures are used. We believe that the addition of application guidance relating to factors affecting the security and reliability of electronic communications, would be helpful, perhaps borrowing from content that is now provided regarding electronic commerce in IAPC 1013 Electronic Commerce – Effect on the Audit of Financial Statements, issued in 2002.

We are also concerned that ISA 505 does not note any need for the auditor to consider whether to validate confirmation responses received via electronic means, e.g., fax or email, as does the extant ISA 505. We believe that it is inappropriate for a new and improved ISA to contain less information on these matters than the older ISA, especially since the use of electronic means has increased.

We also note that the ED does not require the auditor to request confirming parties to follow an oral confirmation response with written confirmation when the information is significant to the audit, as we believe has been required by paragraph 33 in the extant ISA 505, but instead contains a much softer statement in Application Material paragraph A18.

#### **Application Material**

##### *External Confirmation Procedures in Response to Assessed Risks, and Relevance and Considerations in Determining the Appropriateness of External Confirmations*

We recommend removing the phrase “as a Response to Assessed Risks” from the heading for Application paragraph A1 and providing additional coverage of how confirmations may be useful in various aspects of auditing work, for example, by utilizing more of the language that currently exists in the beginning of paragraph 5 in the extant ISA 505 and by noting that confirmations may be a useful supplement to other compliance or substantive audit procedures.

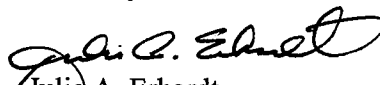
We believe that paragraphs A2 and A5 should contain additional information regarding circumstances under which it may be particularly appropriate to use external confirmations. For example, confirming accounts payable might be particularly appropriate when client controls over payables and cash disbursements are judged to be poor or uncertain, or if industry practices or transactions unique to the audited entity create a higher risk of unrecorded liabilities or inappropriate accounting, or if complex business transactions create an environment where unrecorded accounts might be more likely to exist.

In addition to the comments that we have provided above, Appendix A to this letter outlines our responses to the IAASB’s request for specific comments on ISA 505 and provides additional matters for the Board’s consideration.

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We appreciate the Board’s thoughtful consideration of the points raised in this letter. If you have any questions or need additional information about the comments that we have provided, please do not hesitate to contact me or Susan Koski-Grafer at 202-551-5300 or contact any member of the SC 1 Auditing Subcommittee.

Sincerely,

  
Julie A. Erhardt  
Chair, IOSCO Standing Committee No. 1

## Appendix A

### Response to the IAASB's Specific Requests Related to ISA 505

1. *The proposal that proposed 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 support the Board's proposal not to mandate confirmations, primarily for the reasons articulated in the Explanatory Memorandum, but we believe the ISA should provide a requirement for the auditor to determine whether confirmations are appropriate, and should provide additional guidance pertinent to making such a determination. Please refer to our main letter for a more extensive discussion of our concerns.

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.*

*If a respondent believes that the ISA should require that the auditor consider whether to use external confirmation procedures, please explain why and indicate at what level (e.g., financial statement assertion) such consideration should be made, and whether and how the auditor should document such consideration.*

We believe the scope in this ISA is too narrow. Please see our comments in the main body of our letter.

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

We believe that proposed ISA 505 appropriately limits the extent to which auditors may use negative confirmation requests. However, we believe that the limitations on the ability of auditors to use negative confirmations would be clearer if paragraph 14 were revised as follows:

“Negative confirmations provide less persuasive evidence than positive confirmations. Accordingly, the auditor shall ~~not only~~ use negative confirmation requests as the sole substantive procedure to address an assessed risk of material misstatement at the assertion level ~~unless when~~ the auditor has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion and has also concluded that the risk of material misstatement is low, and:

- (a) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances;
- (b) Very few or no exceptions are expected; and
- (c) The auditor has no reason to believe that recipients of negative confirmation requests will disregard such confirmation requests.”