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Dear Mr Sylph

**Proposed International Standard on Auditing 505, External
Confirmations (ISA 505)**

The Committee of European Banking Supervisors welcomes the opportunity to comment on the Proposed International Standard on Auditing 505, External Confirmations (ISA 505).

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to the financial stability of the market. As banking supervisors we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

We appreciate the efforts of the International Auditing and Assurance Standards Board (IAASB) to revise and clarify the auditing standard.

We have some concerns about the coverage of the auditor's assessment of when to use external confirmations and some aspects of the assessment and follow up actions to review the reliability of such confirmations.

We provide more detail on these points, and other comments in response to the questions posed by the IAASB, in the attached appendix.

Our comments were coordinated by our Expert Group on Financial Information (EGFI), and especially by its Subgroup on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGFI, Arnoud Vossen (+44.20.7382.1792) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely



Kerstin af Jochnick

Chair

Comments on ISA 505, External Confirmations (ISA 505)

1. Is it appropriate 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?

In principle we do not believe it is necessary to mandate the use of external confirmation requests in any particular circumstances, either in ISA 505, ISA 500 or other ISAs directed to specific assertions (e.g. related parties).

2. Is it appropriate 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 such consideration should be made, and whether and how the auditor should document such consideration.

The board has now revised ISA 505 to focus on the 'how' to conduct external confirmations rather than the 'when' and the 'how'. In principle, we have no issue with this approach, but we do believe there needs to be a proper coverage of when external confirmations may be an appropriate approach to obtaining audit evidence somewhere in the ISAs. Though such a consideration could be included in ISA 500, Audit Evidence, we believe it would be preferable to include it in ISA 505, as is the case in the extant ISA 505. Our reasons are laid out below.

As stated in ISA 505 para 2, 'audit evidence is more reliable when it is obtained from independent sources outside the entity.' Therefore it is important that obtaining external confirmations continues to be a reasonable part of the auditor's armoury for obtaining audit evidence and the auditor properly evaluates when and where it is an appropriate method for obtaining audit evidence.

This evaluation of whether to use external confirmation requests for particular items has to be made in the light of:

- (i) The degree of risk of material misstatement;
- (ii) The degree of risk of fraud; and
- (iii) The likely effectiveness of such a request for obtaining appropriate audit evidence.

ISAs 240 & 330 provide some coverage of when it may be appropriate to use external confirmations in a particular situation where there may be more likelihood of fraud at the assertion level, in particular management may be inflating sales (ISA 240:A37, ISA 330:A49). ISA 330 also makes a general

reference to third party evidence, as an example of increasing the quantity or quality of audit evidence, in its application material (ISA 330:A19). We are not convinced that this is sufficient coverage of when it could be most appropriate to use external confirmations.

In respect of whether there should be a requirement for an auditor to assess whether external confirmations would be appropriate, we believe that, in some circumstances, such an assessment would be appropriate. Otherwise, we are concerned that the overall emphasis of the evidential ISAs would shift too far away from the obtaining of external confirmations as an appropriate audit procedure for gathering evidence in a way that may not improve audit quality. Paragraphs A2, A5 and A6 of ISA 505, seem to provide appropriate guidance about those situations, and factors, where such an assessment may be appropriate. These should be linked to an appropriate requirement in ISA 505.

We would envisage that there would be a presumptive assumption that auditors would use external confirmations for bank confirmations, accounts receivable and third party balances. We believe it would also be reasonable that, in those situations where it is specified that external confirmations should be considered in order to obtain relevant and reliable audit evidence, and it is significant, the auditor should document his decision to use/not use external confirmations.

3. Does proposed ISA 505 (Revised and Redrafted) appropriately limit the extent to which auditors may use negative confirmations?

Though some of our members have doubts over whether negative confirmations can ever provide appropriate audit evidence, ISA 505 does seem to restrict appropriately when negative confirmations can be used. However, we would suggest that the introductory sentence to paragraph 14 should more accurately reflect the limited evidential value of negative confirmations. Rather than stating that negative confirmations provide less persuasive audit evidence than positive confirmations, a comment that negative confirmations provide very limited audit evidence, but may be appropriate in some limited circumstances would better reflect their evidential value.

4. Other comments

Paragraphs 28 and 29 of the extant ISA 505, provides guidance on the reliability of responses and the auditor's assessment and subsequent consideration when certain parties may 'not provide an objective or unbiased response to a confirmation request.'

The revised ISA 505 covers the reliability of responses through guidance about identifying an appropriate confirming party who is *knowledgeable* (A 10) and considerations about the reliability of the responses in relation to the *receipt* by the auditor from the intended confirming party in an *appropriate manner* (A16). However, the revised ISA 505 does not seem to cover other aspects of whether responses are reliable. In particular it does not cover the need to assess the independence and likely objectivity of the respondent (except in a minor reference in A 5) or other evidence about the respondents that subsequently comes to the attention of the auditor which may affect the perceived reliability of the responses. These aspects were covered in the extant ISA 505.

In paragraph A10, we are not sure that the example provided about a financial institution is particularly helpful. It would seem reasonably evident that a request for confirmation about particular transactions needs to be sent to an

individual who is knowledgeable about such transactions, but there are other criteria which should be applied e.g. whether the individual will provide an objective or unbiased response. We suggest this example is omitted.

We would encourage the IAASB to revisit this area covering the assessment and subsequent evaluation of the reliability of the response to ensure that it does address all aspects that the auditor should reasonably review when identifying the likely bias and then evaluating the possible bias of any response.

Where management does not permit the auditor to send a confirmation request, Paragraph 8 (c) requires the auditor, where possible, to perform alternative audit procedures. However, paragraph 9, which deals with what the auditor should do if they cannot obtain audit evidence from the alternative audit procedures, does not also cover the situation where the auditor was not able to perform alternative audit procedures. We suggest that this possibility should also be included in paragraph 9.

Paragraph 10 covers what the auditor should do if s/he has doubts about the reliability of the response to a confirmation request. We are not sure it is clear whether this is covering the reliability of an individual or all responses to a particular request.

We also note that paragraph 37 of the extant ISA 505, which covers external confirmations prior to the year end, has not been carried over into the ED. We would suggest that this might be a useful paragraph to include in the revised ISA 505.