ISSUES PAPER
Proposed ISA 505 (Revised and Redrafted), “External Confirmations”

Introduction
1. The following summarizes the significant comments raised at the June 2008 IAASB meeting, and the Task Force’s response and proposed changes to proposed ISA 505 (Revised and Redrafted).

Significant Comments

A. Determining Whether to Use External Confirmation Procedures
2. At the IAASB meeting in June 2008, significant discussion focused on the matter of whether there should be a requirement for the auditor to determine whether the use of external confirmation procedures is necessary to obtain sufficient appropriate audit evidence at the assertion level. The following summarizes the significant points made in the IAASB deliberations:

• Removal of the “determine whether to use” requirement in paragraph 2 of the extant ISA 505, as it weakens the revised standard relative to the extant ISA 505.

• Some IAASB members supported a rebuttable presumption approach for certain topics (e.g., bank accounts and accounts receivable).

• Some IAASB members expressed concern that the requirement “determine whether to use” would be difficult to operationalize and may ultimately result in a perfunctory compliance exercise. However, other IAASB members indicated that the decision to use external confirmations should be driven by risk assessments.

• Some IAASB members expressed concern over the sprinkling of guidance between two or three different ISAs. However, there were differing views on where the “determine whether to use” requirement might be placed – for example, some favored ISA 500 (Redrafted)\(^1\), some ISA 505 (Revised and Redrafted) and some ISA 330 (Redrafted)\(^2\).

3. There was an extensive discussion of two possible approaches to developing a requirement that is:
   1. A rebuttable presumption; or
   2. Based on paragraph 2 of the extant ISA 505 (despite its drawbacks).

4. In surveying the IAASB members’ views, there was overwhelmingly support in favor of approach 2. Approach 1 was rejected because of the need, when the presumption is rebutted, to document why confirmation requests were not sent, and because there are many circumstances where external confirmation procedures may not be effective.

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\(^1\) ISA 500 (Redrafted), “Audit Evidence.”
\(^2\) ISA 330 (Redrafted), “The Auditor’s Response to Assessed Risks.”
5. In responding to the comments from the IAASB, the Task Force considered the following two questions in developing a new requirement:
   - Can a requirement be developed that is consistent with paragraph 2 of extant ISA 505, but which does not contain its drawbacks?
   - Which ISA should establish this requirement?

_Dev eloping the New Requirement_

6. The Task Force considered paragraph 2 of extant ISA 505 in relation to different wording suggested in the comment letters to ED-ISA 505, as well as suggestions raised during IAASB meetings. In doing so, the Task Force wished to ensure that the wording did not mandate the consideration of the need to obtain external confirmations for all assertions. The Task Force also did not want to develop a requirement that sets a high bar that might deter auditors from using external confirmations in response to assessed risks.

7. In reviewing the responses to ED-ISA 505, and comments at IAASB meetings, the Task Force noted that there are different potential “hooks” for a new requirement. For example:
   - During the planning phase of the audit, by basing the requirement on paragraph 8 of ISA 300 (Redrafted). The Task Force felt that such a requirement would be at too high a level.
   - When discussing with the engagement team the susceptibility of the entity’s financial statements to material misstatement, in accordance with paragraph 10 of ISA 315 (Redrafted). The Task Force felt that such a requirement also would be at too high a level.
   - When designing and performing audit procedures that are appropriate in the circumstances, in accordance with paragraph 6 of ISA 500 (Redrafted). The Task Force felt that it is not appropriate to link a specific requirement with respect to performing external confirmation procedures with ISA 500 (Redrafted), which is principally definitional in nature.
   - When responding to assessed risks in accordance with paragraphs 6, 7, 20 or 22 of ISA 330 (Redrafted).

The Task Force concluded that paragraph 7 of ISA 330 (Redrafted) is the most appropriate hook for the new requirement because that paragraph deals with responding to assessed risks of material misstatement at the assertion level, which is when external confirmation procedures are generally performed.

_Which ISA Should Establish This Requirement?

8. The Task Force considered whether the new requirement should be located in either ISA 330 (Redrafted) or proposed ISA 505 (Revised and Redrafted). The Task Force believes

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3 ISA 300 (Redrafted), “Planning an Audit of Financial Statements.”
4 ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment.”
that the new requirement is most appropriately located in ISA 330 (Redrafted). This approach is consistent with the IAASB’s preference that the scope and focus of ISA 505 be on establishing requirements intended to improve auditor performance when using external confirmations, with the starting point being when the auditor has determined that the use of external confirmation procedures is an appropriate response to an assessed risk of misstatement.

**Wording of the New Requirement**

9. The Task Force proposes that a conforming amendment to paragraph 7 of ISA 330 (Redrafted) be made as follows:

“In designing the further audit procedures to be performed, the auditor shall:

(a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including:

(i) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (i.e., the inherent risk); and

(ii) Whether the risk assessment takes account of relevant controls (i.e., the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and (Ref: Para. A9-A18); and

(b) Obtain more persuasive audit evidence the higher the auditor’s assessment of risk; and (Ref. Para. A19)

(c) Identify those assessed risks of material misstatement at the assertion level for which external confirmation procedures are to be performed as further audit procedures. (Ref. Para. A19A)”

10. The Task Force also proposes a new application material paragraph be added to ISA 330 (Redrafted) that is paragraph A5 of proposed ISA 505 (Revised and Redrafted) discussed at the June 2008 IAASB meeting. This paragraph provides factors that may assist the auditor in determining whether external confirmation procedures are to be performed as further audit procedures.

**Matters for IAASB consideration**

(a) Does the IAASB agree with the proposed wording of the new requirement?

(b) Does the IAASB agree with the proposed location of the new requirement in ISA 330 (Redrafted)?
B. Electronic Confirmations

11. Several respondents to ED-ISA 505 requested that more guidance on electronic confirmations be provided in the ISA. The Task Force previously concluded that the proposed ISA 505 (Revised and Redrafted) presented at the June 2008 IAASB meeting accommodates the use of electronic confirmations and that more detailed guidance is beyond the scope of the project. However, at the June meeting, this latter conclusion was challenged and the Task Force was asked to include more guidance specific to electronic confirmations in the revised draft of the ISA. In particular, it was suggested that some examples should be provided addressing issues associated with the use of electronic confirmations, such as whether an email confirmation is coming from the appropriate confirming party.

12. The Task Force sought to develop guidance relating to electronic confirmations that addressed the following matters:
   • When an auditor receives a response electronically, there may be issues around the reliability of that response;
   • However, such issues may be addressed if there is an appropriate process for responding electronically; and
   • There is increasing prevalence of the use of third party service providers to facilitate electronic responses to confirmation requests.

13. The Task Force developed two new application paragraphs (see paragraphs A16 and A17 of Agenda Item 2-B) that it believes are responsive to the IAASB’s request that the proposed ISA contain more guidance on electronic confirmations.

Matter for IAASB Consideration

Does the IAASB agree with the proposed additional application material dealing with electronic confirmations?

C. Consideration of the Need to Re-expose

14. Agenda Item 2-D presents a marked up of the revised draft of proposed ISA 505 (Revised and Redrafted) from ED-ISA 505.

15. It is the Task Force’s view that the proposal to add a new requirement to ISA 330 (Redrafted) is consistent both with extant ISA 505 and ED-ISA 505, and does not introduce new principles or changes of substance. The Task Force further believes that other changes to ED-ISA 505 are principally in response to comments received.

16. Accordingly, the Task Force is of the view that re-exposure is not necessary.5

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5 IAASB Working Procedures regarding re-exposure state: “Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the IAASB before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the IAASB; or substantial change to the substance of an International Standard or Practice Statement.”