



International Federation of Accountants

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Agenda Item
10-A

Committee: IAASB
Meeting Location: Lisbon
Meeting Date: June 15-18, 2009

External Confirmations Staff Audit Practice Alert

Objective of Agenda Item

1. To commission an IAASB Staff Audit Practice Alert on the topic of external confirmations and to consider an initial outline of the proposed alert.

Background

2. At the March 2009 IAASB meeting, it was noted that concern has arisen regarding practitioners' apparent overreliance on external confirmations to obtain audit evidence, especially in the light of recent developments such as the large fraud cases in which external confirmations appear to have played a role. In addition, there is anecdotal evidence of practitioners inappropriately relying on confirmations to support valuation of investments in investment vehicles such as private equity funds. Other practice issues were also noted in relation to external confirmations, including the use of different types of disclaimer language in confirmation responses, and the increasing use of electronic and web-based processes for confirmations. In view of these developments, the IAASB generally agreed that there was scope for raising practitioners' awareness of the potential challenges that may arise in designing and using external confirmations.
3. Subsequent to this meeting, the Steering Committee met to reflect on these discussions and agreed to recommend that IAASB commission a staff alert to raise auditors' awareness about matters relevant to the consideration of the use of external confirmations to obtain audit evidence.
4. The Steering Committee also noted that at the April 2009 IAASB-National Auditing Standard Setters meeting (NSS), participants expressed broad support for an IAASB staff alert on the topic and indicated that they would use or adapt such a publication for their national purposes.
5. In addition, the topic of external confirmations is also on the U.S. Public Company Accounting Oversight Board's (PCAOB) list of priorities. On April 14, 2009, it issued a concept release on possible revisions to its standard on audit confirmations.
6. Given the above developments and discussions, there appears to be an appropriate basis for the development of a staff alert that would contribute to addressing the practice issues regarding external confirmations.

Matters for Consideration

Working Group and Timing

7. Subject to the IAASB commissioning the alert, a small working group comprising 2-3 IAASB members will be established to advise on the development of the alert.¹
8. With regard to timing, subject to the IAASB's views on the key considerations and messages below, it is anticipated that the draft alert would be distributed to the IAASB for comment around the third week of August 2009. A report-back would then be provided at the September 21-25, 2009 IAASB meeting regarding how staff has dealt with IAASB members' comments, if any, in finalizing the alert. The final alert would be expected to be issued in early October 2009 in time for December 2009 year-end audits.

Key Considerations and Messages

9. Prior to developing the alert, staff will consider any recent work undertaken by NSS and others in the area of external confirmations that could be leveraged for purposes of the alert.
10. Subject to the above, an initial outline of the proposed alert is as follows:
 - Introduction
 - Background
 - Nature, purpose and uses of external confirmations under the ISAs
 - Recent developments that have given rise to the need for this alert, e.g.
 - Recent fraud cases in which external confirmations appear to have played a part
 - Use of disclaimer language in confirmation responses
 - Use of electronic and web-based confirmation processes
 - Highlights of requirements and guidance in the ISAs that are relevant to external confirmations (ISAs 505, 500, 240, 330, 501 and 550), and the direction they provide in relation to the following:
 - The importance of exercising professional judgment in determining whether external confirmations are expected to provide relevant and reliable audit evidence, in the context of:
 - Danger of blind reliance or overreliance on confirmations to obtain audit evidence
 - The external economic environment when determining whether external confirmations will be effective as audit procedures (e.g., reluctance of financial institutions to confirm continued availability of credit facilities)

¹ Others, including interested NSS, may be invited to contribute to the development of the alert as appropriate.

- The importance of making appropriate use of external confirmations to obtain audit evidence, in the context of:
 - The need to effectively design and tailor confirmations requests to the specific audit objectives
 - The need for effective execution of the confirmation requests
 - Confirmations of investments in funds such as private equity funds, highlighting the fact that confirmations alone cannot provide sufficient appropriate audit evidence with regard to valuation
- The importance of evaluating the relevance and reliability of information obtained via external confirmations, in the context of:
 - Respondents' competence, independence, authority to respond, knowledge of the matters being confirmed, and objectivity
 - The form of the confirmation responses, including electronic and web-based responses
 - The nature of the information obtained
 - The inclusion of disclaimers and other limitations in the confirmation responses
- The importance of evaluating when external confirmations may need to be supplemented by further audit procedures, in the context of:
 - Exceptions noted between the entity's records and confirmation responses
 - Low response rates
 - Indications that confirmation responses are not authentic
- Importance of considering any specific national guidance that may exist

Action Requested

The IAASB is asked to commission the Staff Audit Practice Alert and to provide views on the key messages outlined above, including whether there are any other matters that should be considered in the development of the alert.