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Agenda Item

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Committee: IAASB

Meeting Location: Warsaw, Poland

Meeting Date: July 9-13, 2007

External Confirmations

Objective of Agenda Item

1. To approve as an exposure draft proposed ISA 505 (Revised and Redrafted), "External Confirmations".

Task Force Members

2. The members of the Task Force are:

Craig Crawford (Chair)	IAASB member
David Swanney	IAASB public member
Roberto Tizzano	IAASB member
Simon Hancox	External member
John O'Brien	External member

Activities Since Last IAASB Meeting

3. At its February meeting, the IAASB undertook a first read of proposed ISA 505 (Revised and Redrafted). The Task Force has revised the proposed ISA in response to comments received, and has undertaken additional drafting as necessary, as discussed below.

4. At the April IAASB CAG meeting, the Chair of the Task Force reviewed the comments received from the IAASB in February and the revisions the Task Force was proposing to make in response. CAG representatives generally were in favor of the proposed revisions.

5. At both the IAASB and CAG meetings, the respective members reaffirmed their agreement with the general premise that external confirmations should not be mandated in any particular circumstances.

Significant Matters for IAASB Consideration

Overall Tone of the Proposed ISA

6. In February, the IAASB discussed the need to revise the tone of the proposed ISA from one that does not discourage the use of external confirmations to one that encourages their use.

7. The Task Force has made the following revisions relative to the tone of the document:

   - The requirements in paragraphs 8 and 9, and the related application material in paragraph A9, have been deleted.
   - The material at the beginning of the proposed ISA that serves as transition material to the procedural aspects of proposed ISA 505 has been enhanced by including the application material previously located in paragraphs A1 and A2, dealing with the uses of external confirmations. The transition material also includes links to other ISAs where confirmations are specifically referenced as an appropriate audit procedure.
   - Various wording has been revised to remedy the negative tone of the original draft. For example, paragraph A12 has been deleted.
   - Changes have been made to the level of detail in the application material where the IAASB felt that such guidance served as a disincentive to the use of external confirmations. For example, paragraph A22 has been deleted.

The Objective of the Proposed ISA

8. In discussing the transition from ISA 330 to proposed ISA 505, and the need to revise the tone of the document, the IAASB questioned the appropriateness of the objective as originally drafted in paragraph 6(a). The Task Force notes that the objective of ISA 330 is for the auditor to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks. As proposed ISA 505 addresses what the auditor does when the auditor decides it is appropriate to perform confirmation procedures to address assessed risks, the objective has been revised accordingly. The objective for proposed ISA 505 as currently proposed is:

   "When the auditor decides to perform confirmation procedures in response to an assessed risk of material misstatement, the objective of the auditor is to design and perform such procedures to provide relevant and reliable audit evidence."

9. For information, the following is the draft objective contained in the Supplement to Proposed ISA 200 (Revised and Redrafted):

   "The objectives of the auditor are:

   (a) To determine whether and to what extent, in the circumstances of the audit, to request external confirmation of information as a means of obtaining sufficient appropriate audit evidence in response to an assessed risk of financial statement misstatement; and, if so

   (b) To design and perform effective external confirmation procedures."

Links Between ISA 240 and Proposed ISA 505

10. In February, the IAASB asked the Task Force to consider whether there could be more extensive linkages to ISA 240 (Redrafted) to emphasize that confirmations may be an appropriate procedure to address fraud risk factors, and that exceptions and non-responses to

external confirmation requests may be indicative of fraud. The Task Force has added more guidance in this respect as follows:

- An item has been added to paragraph 5 to indicate that confirmation requests may be designed to provide corroborative information as a response to address an assessed risk of fraud.
- An item has been added to paragraph A8 to indicate that external confirmation requests may be made to address specific fraud risks.
- A reference has been made to ISA 240 in paragraph A20 to indicate that, when the auditor determines that an exception is a misstatement, the auditor is required by ISA 240 (Redrafted) to evaluate whether such a misstatement is indicative of fraud (see paragraph 35 of ISA 240 (Redrafted)).

Negative Confirmations

11. At the February meeting, the IAASB asked the Task Force to downplay the discussion of negative external confirmations in the proposed ISA. The IAASB suggested that this might be achieved by positioning the guidance on negative external confirmations in one section at the end of the document. The Task Force considered this suggestion carefully. It noted that other Requirements within the proposed ISA not only apply to positive external confirmations, but also to negative external confirmations - for example, the requirement to perform suitable procedures with respect to the external confirmation process, and the requirements with respect to management requests to not confirm. Accordingly, while the proposed ISA does contain guidance on negative external confirmations in one section at the end of the document, the definitions and the requirements have been crafted to ensure that they apply to both positive and negative external confirmations, as appropriate.

The Need for Documentation Requirements in the Proposed ISA

12. At the February meeting, the IAASB asked the Task Force to consider whether there is a need for specific documentation requirements in the proposed ISA. The Task Force considered, for example, whether a specific documentation requirement is necessary with respect to:
    - Documenting the external confirmation process;
    - When negative external confirmations are used without performing other substantive audit procedures, how the auditor has met the requirements in paragraph 17; or
    - The auditor's investigation of exceptions in accordance with paragraph 15.

    The Task Force considered these possible requirements in light of proposed ISA 230 (Redrafted) and concluded that the requirements 7-11 of that proposed ISA provide sufficient guidance to auditors. Accordingly, additional requirements or application material with respect to documentation was not considered necessary by the Task Force.

The Appendix to the Proposed ISA

13. The first draft proposed ISA contained an Appendix illustrating the assertions addressed by accounts receivables and bank confirmations. Some IAASB members were concerned that readers may find this Appendix unclear and that it might conflict with text in the application material. The Task Force concluded that the Appendix could be deleted.

Actions Requested

The IAASB is asked to comment with regard to:

1. Whether the proposed objective is appropriate;
2. Whether the proposed links between ISA 240 and ISA 505 sufficiently elevate the profile of fraud considerations associated with external confirmation procedures;
3. The acceptability of the placement of negative external confirmations material within the proposed ISA;
4. The need for specific documentation requirements within the proposed ISA;
5. Whether the proposed changes to the document are responsive to the IAASB's direction to move from "not discouraging" to "encouraging" use of external confirmations

Material Presented (Note: Agenda Item 9-A will be used for purposes of the discussion at the meeting.)

Agenda Item 9-A (Pages 2289 - 2298)	Proposed ISA 505 (Revised and Redrafted) (Clean)
Agenda Item 9-B (Pages 2299 - 2318)	Proposed ISA 505 (Revised and Redrafted) (Mark-up from Feb 07 IAASB meeting)
Agenda Item 9-C (Pages 2319 - 2320)	Proposed ISA 505 (Revised and Redrafted): Proposed Conforming Amendments
Agenda Item 9-D (Pages 2321 - 2324)	Proposed ISA 505 (Revised and Redrafted): Comparison of Requirements in Extant ISA 505 with Proposed ISA 505

Action Requested

14. The IAASB is asked to consider the matters highlighted above and to approve the proposed ISA 505 (Revised and Redrafted) for issue as an Exposure Draft.