

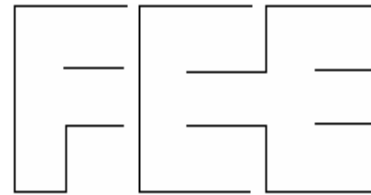
Date
15 February 2007

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Mr. Jim Sylph
Executive Director Professional Standards
International Auditing and Assurance Standards Board (IAASB)
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Edcomments@ifac.org

Dear Mr. Sylph,

Re: Exposure Draft – Proposed Revised and Redrafted ISA 505 on External Confirmations

As the representative organisation of the European accountancy profession, FEE is pleased to comment on the Exposure Draft – Proposed International Standard on Auditing (ISA) 505 (Revised and Redrafted) on External Confirmations (Proposed ISA 505).

FEE considers the proposed ISA 505 is an improvement on the existing standard. However, we believe that our comments which follow would further enhance the standard, especially in relation to the suggested clarification of the objective.

1. Main Comments

1.1 Objective

The “Significant Matters” portion of the Explanatory Memorandum to Proposed ISA 505 states that the IAASB decided to move away from the explicit reference in extant ISA 505 to a determination whether the use of external confirmations is necessary because “...the auditor’s consideration of whether, and to what extent, to use external confirmation procedures is inherent in the requirements of ISAs 315 (Redrafted) and 330 (Redrafted)...”. We consider that the Clarity Project should lead to guidance which, amongst other qualities, is explicit, rather than implicit, and we are not convinced that (implicit) reliance on inherent guidance in other ISAs is wholly satisfactory in this respect.

Accordingly, FEE proposes the following amended Objectives:

“The objectives of the auditor are:

- (a) In response to the assessed risk of material misstatement, to determine whether to use external confirmations; and*
- (b) If using external confirmations, to design and perform such procedures to obtain relevant and reliable audit evidence.”*

This alternative text clarifies the two step approach in this area and, as with extant ISA 505, explicitly acknowledges circumstances will arise where external confirmations are not relevant, or may not be appropriate. It is also consistent with the model in the proposed revised and redrafted ISA 620.

1.2 Additional requirement

As reflected in our response below to Question 1, FEE supports the risk-based approach derived from ISA 315 (Redrafted) and ISA 330 (Redrafted) and is not proposing any changes thereto.

However, as a consequence of our suggested clarification of the objective of Proposed ISA 505, an initial requirement should be added to oblige the auditor to determine whether to use external confirmation procedures or not.

FEE suggests the following initial requirement:

"The auditor shall determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level."

To assist auditors to properly and consistently comply with this additional requirement to determine whether to use external confirmations or not, we suggest the content of paragraphs 2 and 3 in the Introduction section be moved to the Application and Other Explanatory Material relating to this additional requirement. This change may necessitate placing the current paragraph A5 ahead of the discussion in paragraphs A2 to A4 on the relevance of external confirmations.

2. Other Comments

2.1 Comments on Requirements

Reliability of the external confirmation procedures - Paragraphs 10 and 11

Although the principles assumed to be included in paragraphs 10 and 11 are broadly acceptable, the auditor is expected to adopt an over-sceptical approach in these paragraphs. The requirements in paragraphs 10 and 11 supplemented by application paragraphs A16 through A20 refer to the auditor having doubts about the reliability of the response to a confirmation request. If it is concluded that a confirmation request is not reliable the auditor has to consider the risk of fraud.

Clarification is required of what is meant by reliability in this context. It would be unrealistic to expect the auditor to conclude that the confirmation evidence is unreliable if the only reason for this is that there is a difference between what has been confirmed by the third party and the company's records.

One can infer from the second sentence of paragraph A16 "no response is without some risks of interception, alteration or fraud" that the risk that the IAASB has in mind is fraud risk rather than error risk. Paragraph A22 also includes in its last sentence "a non-response to a confirmation request may indicate a previously unidentified fraud risk factor that requires further evaluation".

This seems unrealistic as the possibility of non-responses is always present with any confirmation procedure but auditors typically would not assume that just because a confirmation has not been received there is some new fraud risk. The fraud risk should have been identified in the first place and will be a factor that the auditor takes into account when concluding whether or not confirmation evidence is an appropriate response to the risk.

Accordingly, we suggest the Application and Other Explanatory Material be amended to place greater emphasis on the risk of errors in order to achieve a better balance between error and fraud risks.

Alternative procedures - Paragraph 12

The extent of alternative audit procedures very often represents a crucial issue with respect to the audit burden. We believe that this question remains unanswered in paragraph 12 and its application material in paragraphs A21 to A23 in respect to non-responses. Paragraph A22 indicates that the nature and extent of alternative audit procedures is affected by the assessed risk of material misstatement. In practice auditors may conclude that they do not need to obtain 100% evidence in respect of items that have not been confirmed, the objective will be simply to draw a conclusion about the extent to which the account balance being tested could be misstated.

Accordingly, and in order to state early-on in Proposed ISA 505 that the extent of alternative procedures represents a judgmental issue in the hands of the auditor, FEE suggests that the first sentence of paragraph A22: 'The nature and extent of alternative audit procedures are affected by the assessed risk of material misstatement at the assertion level' be included after the first sentence of paragraph 12, supplemented by application material as explained above.

Negative confirmation requests - Paragraph 14

FEE agrees that negative confirmations should only be permitted under specific conditions. In this context, proposed paragraph 14 (c) constitutes an overly stringent threshold. As the response rate to confirmations is rarely 100%, we suggest this wording be amended to refer to the auditor's reasonable expectation that recipients will not disregard confirmation requests as follows:

"The auditor has no reason to believe that recipients of negative confirmation requests will in general disregard such confirmation requests."

Reference is also made to our comments on paragraph A26 below.

2.2 Comments on Application and Other Explanatory Material

General

In circumstances where the auditor requests confirmation of specific matters and/or balances from parties that are involved in managing, directly or indirectly, the entity subject to audit, the distinction between an external confirmation covered by ISA 505 and a written representation covered by ISA 580 may not always be clear cut. Accordingly, we suggest the IAASB provide brief commentary on this issue.

Paragraph A3

Cut-off is another good example where external confirmation procedures generally provide less relevant evidence and, as such, could be added to paragraph A3.

Paragraphs A5 and A6

Adoption of the FEE proposal recommending an initial requirement to oblige the auditor to determine whether to use external confirmations in response to an assessed risk of material misstatement, would enable the Section in the Application and Other Explanatory Material on 'External Confirmation Procedures as a Response to Assessed Risks', and notably paragraphs A5 and A6, dealing with considerations relating to the auditor's consideration as to whether to use external confirmations or not, to be referenced to such requirement rather than to the Introduction Section.

Paragraph A26

FEE recommends to add further guidance to paragraph A26 to explain when negative confirmations may be useful and when not (i.e., highlight their benefits in some circumstances to counter the possible perception that the IAASB generally discourages their use). For example, holders of bank deposit accounts are most likely to respond if they believe the balance on their account is understated in the confirmation request, but are less likely to respond when they believe it is overstated or accurate. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is less likely to be effective if the auditor is seeking evidence that they may be overstated. The reverse would hold true for creditor balances.

2.3 Editorial Comment

Paragraph 8 (a)

The verb 'challenging' has a flavour which appears too confrontational and, therefore, we suggest to replace it by 'questioning'.

2.4 Responses to IAASB's Questions

2.4.1 Views about 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.

FEE agrees that Proposed ISA 505 should not mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement and believes that the risk-based approach followed by Proposed ISA 505 is appropriate, to be further developed as explained in our main comments on the objective.

2.4.2 Views about 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.

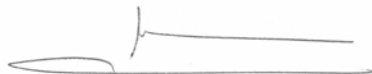
Reference is made to our comments above on the objective.

2.4.3 Views whether proposed ISA 505 (Revised and Redrafted) appropriately limits the extent to which auditors may use negative confirmation requests.

Reference is made to our comments above on negative confirmation (paragraph 14).

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours sincerely,



Jacques Potdevin
President