



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

**VIA ELECTRONIC MAIL:
edcomments@ifac.org**

Mr Jim Sylph
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IAASB exposure draft ISA 505 (revised and redrafted), external confirmations

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure draft. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the proposal captioned above.

We appreciate the efforts of the International Auditing and Assurance Standards Board (IAASB) to revise and redraft this ISA. However, we have concerns about the ISA's coverage of:

- when to use external confirmations; and
- the assessment of the reliability of external confirmations.

We have provided more detailed comments in the attached appendix. These comments have been prepared by the Committee's Accounting Task Force, chaired by Ms Sylvie Math erat, Director of the Bank of France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Sylvie Math erat (+33 1 4292 6579), Marc Pickeur, who chairs the Audit Subgroup of the Accounting Task Force (+32 2 220 5253), or Linda Ditchkus at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

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Appendix

Basel Committee comments on IAASB exposure draft ISA 505 (revised and redrafted), external confirmations

Introduction

The Basel Committee on Banking Supervision¹ (the Committee) has a strong interest in high quality and independent audits of banks and has carefully analysed the proposed revised and redrafted International Standard on Auditing (ISA) pertaining to external confirmations. The remainder of this appendix highlights certain issues, questions and suggestions for the Board's consideration.

Comments on ISA 505, External confirmations

- 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?**

We do not believe it is necessary to mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement. This may undermine the ability of an auditor to exercise professional judgement over when it would be most appropriate to use external confirmation requests to obtain audit evidence.

- 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

¹ The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.

indicate at what level such consideration should be made, and whether and how the auditor should document such consideration.

We believe it is necessary that the ISAs provide sufficient guidance as to when external confirmations may be an appropriate approach to obtaining audit evidence. As stated in paragraph 2 of ISA 505, "external confirmations received directly by the auditor from confirming parties may be more reliable than internally generated evidence." For example, any consideration of whether to use external confirmation requests for particular items has to be evaluated by the auditor in 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.

Separately, there is the issue of whether an auditor should be required to consider whether external confirmations are appropriate in certain circumstances. We believe that, in some circumstances, the auditor should make an assessment of whether external confirmations 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-A6 of ISA 505 provide some guidance about those situations and the relevant factors where such an assessment may be appropriate. These could either be linked to an appropriate requirement in ISA 500 or, if the scope of ISA 505 is changed back to the "when" as well as the 'how' of external confirmations, to a requirement in ISA 505. It would be appropriate to expect the auditor to have an external confirmations policy, which would include considering using external confirmations for bank balances and other information relevant to banking relationships, 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 the account balance is significant, the auditor should be required to document the rationale and decision regarding whether the use of external confirmations was appropriate.

3. Does proposed ISA 505 (revised and redrafted) appropriately limit the extent to which auditors may use negative confirmation requests?

ISA 505 appropriately restricts when negative confirmations should be used. However, we would suggest that the limited evidential status of such confirmations should be more clearly emphasised in the introductory sentence in paragraph 14.

4. Other comments

When 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 he or she 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 be included in paragraph 9.

Paragraphs 10 and 11 provide guidance on the reliability of responses to confirmation requests and should be enhanced to require the auditor to consider the implications for the auditor's opinion when a response is not reliable (ie consistent with the guidance in paragraph 12 regarding non-responses).

Paragraphs 28 and 29 of the extant ISA 505 provide 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* (paragraph A10) 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* (paragraph A16). However, except in a limited reference in the last bullet point of paragraph A5, the revised ISA 505 does not seem to provide sufficient coverage of the need to consider the independence and likely objectivity of the respondent and other evidence about the respondent that subsequently comes to the attention of the auditor. Both these matters were covered in paragraphs 28 and 29 of the extant ISA 505 and should be retained in revised ISA 505.

The guidance within paragraph A10 is not complete, because it includes the attribute of a *knowledgeable* confirming party without consideration of other important factors, for example the *reliability* or possible biases of the confirming party. We would encourage the IAASB to revisit this concept covering the evaluation of the reliability of the response, which would include paragraphs 10-11 and related application materials in A15-A19, to ensure that it addresses other aspects that the auditor should reasonably review when evaluating the reliability of any response. Additionally, the example provided in paragraph A10 should be removed or revised, because as currently written it may encourage auditors to send confirmations to knowledgeable parties without consideration of potential bias.

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 revised ISA. We believe that it would be useful to include this paragraph in revised ISA 505.