



30 October 2007

To: **Members of the Hong Kong Institute of CPAs**  
**All other interested parties**

## **INVITATION TO COMMENT ON IAASB EXPOSURE DRAFTS OF INTERNATIONAL STANDARDS ON AUDITING**

### **Proposed ISA 505 (Revised and Redrafted), *External Confirmations* and ISA 620 (Revised and Redrafted), *Using the Work of an Auditor's Expert***

***Comments to be received by 25 January 2008***

The Hong Kong Institute of Certified Public Accountants' (Institute) Auditing and Assurance Standards Committee is seeking comments on the IAASB Exposure Drafts which have been posted on the Institute's website at:  
[www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/](http://www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/).

The Explanatory Memorandum to the Exposure Drafts provides background information and explanation of the proposed ISAs.

In summary, the IAASB's intentions in developing the revisions to the ISAs are set out below:

#### **ISA 505**

The proposed ISA 505 addresses concerns about the use and reliability of external confirmations as audit evidence. Recent experience has indicated that external confirmations may not always be as reliable as expected as audit evidence, giving rise to requests for more rigorous requirements governing the auditor's use of external confirmations.

The key changes are:

- The proposed ISA does not mandate the use of external confirmation requests in any particular circumstances or in response to any particular risk of material misstatement. The IAASB concluded that making external confirmations requests mandatory would conflict with the audit risk model, may not improve audit quality, and would suffer from significant operational disadvantages having regard to the international context in which the ISAs are applied.
- It is no longer a requirement in the proposed ISA for auditors to determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level. The IAASB concluded that the auditor's consideration of whether, and to what extent, to use external confirmation procedures when performing an audit of financial statements is inherent in the requirements of ISAs 315 (Redrafted) *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its*



*Environment* and 330 (Redrafted) *The Auditor's Responses to Assessed Risks*, and that those ISAs provide adequate guidance to assist auditors to decide in that regard.

- The proposed ISA does not prohibit the use of negative confirmation requests in an audit of financial statements. However, it includes requirements and application and other explanatory material limiting the extent to which an auditor may use them.

Therefore, the IAASB is seeking views on the following:

- The proposed ISA should not mandate the use of external confirmation requests in any particular circumstances or in response to any particular risk of material misstatement.
- The scope of the proposed ISA is directed at the effective performance of external confirmations 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.
- Whether the proposed ISA appropriately limits the extent to which auditors may use negative confirmation requests.
- Whether the objectives for the proposed ISA are appropriate, and whether the proposed requirements are appropriate responses to those objectives under the clarity drafting conventions.

### **ISA 620**

The proposed ISA deals with the auditor's use of the work of a person or organization possessing expertise in a field other than accounting or auditing, employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence. It places particular emphasis on the need for the auditor to evaluate the expert's objectivity, and to establish a proper understanding with the expert of the expert's responsibilities for the purposes of the audit.

The key change is that the proposed ISA deals only exclusively with considerations relevant to using the work of an auditor's expert. The extant ISA deals with both an auditor's expert and a management's expert. Material dealing with the work of a management's expert is presented in the conforming amendments to the proposed ISA 500 (Redrafted) *Considering the Relevance and Reliability of Audit Evidence*.

In addition, there is no change to the definition of "expert" from the extant ISA which excludes persons or organizations possessing expertise in accounting or auditing. The IAASB is of the view that such expertise is normally expected of an auditor accepting an engagement would possess any required specialized accounting and auditing expertise. Similarly, the definition of "management's expert" in the conforming amendments to proposed ISA 500 (Redrafted) excludes persons or organizations possessing expertise in accounting.

The IAASB is seeking views on the following:

- The proposed ISA deals exclusively with considerations relevant to using the work of an auditor's expert, and accordingly material dealing with the work of management's expert be expanded and moved to proposed ISA 500 (Redrafted)
- The definition of "expert" in proposed ISA excludes person or organizations possessing expertise in accounting or auditing.

In accordance with the Institute's ISA Convergence Due Process, comments are invited from any interested party and the Institute would like to hear from both those who do agree and those who do not agree with the proposals contained in the IAASB Exposure Drafts.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IAASB Exposure Drafts to be considered, comments on the exposure draft of proposed revised and redrafted ISA 505 and ISA 620 are requested to be received by the Institute on or before **25 January 2008**. Comments may be sent by mail, fax or e-mail to:

Patricia McBride  
Executive Director  
Hong Kong Institute of Certified Public Accountants  
37/F., Wu Chung House  
213 Queen's Road East  
Hong Kong

Fax number (+852) 2865 6776  
E-mail: [commentletters@hkcipa.org.hk](mailto:commentletters@hkcipa.org.hk)

Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

October 2007  
Exposure Draft

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Response Due Date  
25 January 2008

*ED of Proposed ISA 505 (Revised and Redrafted)*

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## **External Confirmations**

*ED of Proposed ISA 620 (Revised and Redrafted)*

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## **Using the Work of an Auditor's Expert**



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

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ED of Proposed ISA 505 (Revised and Redrafted) “External Confirmations”

ED of Proposed ISA 620 (Revised and Redrafted) “Using the Work of an Auditor’s Expert”

IAASB Press release

This Exposure Draft may be filed in the “Exposure Drafts, Invitations to Comment” section of Volume III of the Institute Members’ Handbook.

The Exposure Draft can also be found on the Institute’s website at:  
[www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/](http://www.hkicpa.org.hk/professionaltechnical/assurance/exposedraft/).

*Proposed Revised and Redrafted International  
Standard on Auditing*

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**ISA 505, External Confirmations**

*Conforming Amendments*

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**Proposed ISA 500, Considering the  
Relevance and Reliability of Audit  
Evidence**



## REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 505 (Revised and Redrafted), “External Confirmations” in September 2007 for publication. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **February 15, 2008**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

Comments should be emailed to [Edcomments@ifac.org](mailto:Edcomments@ifac.org). They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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## **EXPLANATORY MEMORANDUM**

### **Introduction**

This memorandum provides background to, and an explanation of, proposed International Standard on Auditing (ISA) 505 (Revised and Redrafted), “External Confirmations.” The International Auditing and Assurance Standards Board (IAASB) approved the proposed ISA in September 2007 for exposure.

### **Background**

Recent experience has indicated that external confirmations may not always be as reliable as expected as audit evidence. As a result, some stakeholders believe that more rigorous requirements governing the use of external confirmations by the auditor are required. At the same time, others have questioned whether external confirmations are in fact an effective audit technique in obtaining relevance and reliable audit evidence.

In December 2005, the IAASB commenced a project to revise the standards and guidance in extant ISA 505 addressing the auditor’s use of external confirmations, within the context of the audit risk model.

### **Significant Matters**

#### **Mandating External Confirmation Requests**

The IAASB considered whether external confirmation requests should be mandated in particular circumstances in order to improve audit quality and enhance the persuasiveness of audit evidence obtained by the auditor.

The IAASB concluded that making external confirmation requests mandatory would conflict with the audit risk model, may not improve audit quality, and would suffer from significant operational disadvantages having regard to the international context in which the ISAs are applied. In particular, the IAASB noted that to mandate the use of external confirmation requests in particular circumstances would:

- Require the presumption that external confirmations requests would always provide relevant and reliable audit evidence, and that such evidence would always be used. Research and experience have shown, however, that there is no basis for such a presumption. As stated in proposed ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence,” the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- Introduce inconsistency with ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks.” That ISA requires that the auditor design and perform audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level, and explains that the auditor’s assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing audit procedures

- Disregard the fact that an effective confirmation request is dependent on the confirming party being engaged in the process. Whether the confirming party is so engaged is beyond the auditor's control.
- Result in the use of external confirmation requests even in circumstances where the auditor has reason to believe that responses would not be obtained or would be unreliable.
- Require exceptions to be provided for, in light of jurisdictional differences and practical considerations.

Accordingly, the proposed ISA does not mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement.

### **Determining When to Use External Confirmation Procedures**

Extant ISA 505 requires that the auditor determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence at the assertion level. In revising the extant ISA, the IAASB deliberated whether that requirement is in fact necessary and relevant in the context of the proposed ISA.

In considering this matter, the IAASB noted that ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment" requires that the auditor identify and assess the risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures. A requirement in proposed ISA 505 (Revised and Redrafted) that the auditor consider whether to use external confirmation procedures may therefore lead the auditor to document that consideration for each assertion associated with material account balances, classes of transactions and disclosures. Alternatively, such consideration may be documented at an engagement level, rendering the activity relatively perfunctory. The IAASB also noted that ISAs 315 (Redrafted) and 330 (Redrafted) provide guidance on the auditor's determination of the nature, timing, and extent of audit procedures, and contain references to when external confirmation procedures may be used.

The IAASB therefore concluded that the auditor's consideration of whether, and to what extent, to use external confirmation procedures when performing an audit of financial statements is inherent in the requirements of ISAs 315 (Redrafted) and 330 (Redrafted), and that those ISAs provide adequate guidance to assist auditors to decide in that regard. It is therefore unnecessary for the proposed ISA to establish a requirement that the auditor do so. Rather, the IAASB believes that the scope and focus of proposed ISA 505 (Revised and Redrafted) should be on setting requirements that will improve auditor performance, with the starting point of the proposed ISA being when the auditor has determined that the use of external confirmation procedures is an appropriate response to an assessed risk of material misstatement.

To assist auditors, proposed ISA 505 (Revised and Redrafted) provides references to other ISAs that recognize the importance of external confirmations as audit evidence and provide guidance regarding when the auditor considers using external confirmation procedures as a response to an assessed risk of material misstatement at the assertion level.

## **Negative Confirmation Requests**

Extant ISA 505 provides for the use of negative confirmations under certain limited circumstances and includes guidance explaining the audit evidence limitations inherent in their use. A number of concerns have been expressed that auditors may be placing undue reliance on negative confirmation requests as a source of audit evidence. Accordingly, the IAASB considered whether use of negative confirmation requests should be prohibited, or limited to specific circumstances.

The IAASB concluded that an ISA should not prevent the auditor from performing a particular audit procedure simply because that procedure would provide only limited audit evidence. Rather, the auditor should understand the limitations of the audit evidence obtained from such a procedure when deciding to use that procedure and in evaluating the audit evidence obtained. Further, the IAASB believes that negative confirmation requests may in fact be a useful audit procedure when performed in conjunction with other substantive audit procedures. However, the IAASB decided to place strict limits on the circumstances in which negative confirmation requests may be used as the only substantive audit procedure to address an assessed risk of material misstatement at the assertion level.

Accordingly, proposed ISA 505 (Revised and Redrafted) does not prohibit the use of negative confirmation requests in an audit of financial statements. However, it includes requirements and application and other explanatory material limiting the extent to which an auditor may use them.

## **Effective Date**

The current IAASB project timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008. The IAASB has agreed that the complete set of ISAs will be effective for audits of financial statements for financial periods beginning on or after December 15, 2009. The IAASB believes that it is in the interest of auditors and others who use the ISAs that the standards should be released as soon as they are approved so as to facilitate their implementation.

## **Guide for Respondents**

The IAASB welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this exposure draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

## **Request for Specific Comments**

The IAASB would welcome views on the following:

1. 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.
2. 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, 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 indicate at what level (e.g., financial statement assertion) such consideration should be made, and whether and how the auditor should document such consideration.

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

### **Request for Comments on the Application of the Clarity Drafting Conventions**

In addition to the matters referred to above, the IAASB is seeking comments on the application of the clarity drafting conventions. Respondents are asked to consider whether the objective for the proposed ISA is appropriate, and whether the proposed requirements are appropriate responses to that objective.

### **Comments on Other Matters**

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed ISA.

<p>To be considered, responses should be emailed to <a href="mailto:Edcomments@ifac.org">Edcomments@ifac.org</a>. They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by <b>February 15, 2008</b>.</p>
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**PROPOSED INTERNATIONAL STANDARD ON AUDITING 505**  
**(REVISED AND REDRAFTED)**  
**EXTERNAL CONFIRMATIONS**

(Effective for audits of financial statements for periods beginning on or after [December 15, 2009])

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[Proposed] International Standard on Auditing (ISA) 505 (Revised and Redrafted), “External Confirmations” should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), “The Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) establishes requirements and provides guidance for performing external confirmation procedures. It does not address inquiries regarding litigation and claims. Part C: Procedures Regarding Litigation and Claims of ISA 501, “Audit Evidence—Additional Considerations for Specific Items” establishes requirements and provides guidance on such inquiries.

### External Confirmation Procedures as a Response to Assessed Risks

2. [Proposed] ISA 500 (Redrafted) indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.<sup>1</sup> That ISA also includes the following generalizations applicable to audit evidence that may be relevant to external confirmations:<sup>2</sup> (Ref: Para. A1-A6)

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium.

Accordingly, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than internally generated evidence.

3. Other ISAs recognize the importance of external confirmations as audit evidence, for example:
  - ISA 330 (Redrafted) requires the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk.<sup>3</sup> Consequently, as the assessed risk of material misstatement increases, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.
  - ISA 240 (Redrafted) indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.<sup>4</sup>
  - [Proposed] ISA 500 (Redrafted) indicates that corroborating information obtained from

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<sup>1</sup> [Proposed] ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence,” paragraph 6.

<sup>2</sup> [Proposed] ISA 500 (Redrafted), paragraph A23.

<sup>3</sup> ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks,” paragraph 7(b).

<sup>4</sup> ISA 240 (Redrafted), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements,” paragraph A37.

a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.<sup>5</sup>

### **Effective Date**

4. This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].

### **Objective**

5. The objective of the auditor when using external confirmation procedures in response to an assessed risk of material misstatement is to design and perform such procedures to obtain relevant and reliable audit evidence.

### **Definitions**

6. For the purpose of the ISAs, the following terms have the meanings attributed below:
  - (a) External confirmation – Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
  - (b) Positive confirmation request – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
  - (c) Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
  - (d) Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
  - (e) Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity’s records, and information provided by the confirming party.

### **Requirements**

#### **External Confirmation Procedures**

7. When the auditor decides to use external confirmation procedures in response to an assessed risk of material misstatement, the auditor shall maintain control over the external confirmation requests and responses, including:
  - (a) Determining the information to be confirmed or requested;

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<sup>5</sup> [Proposed] ISA 500 (Redrafted), paragraph A2.

- (b) Selecting the appropriate confirming party;
- (c) Designing the confirmation requests;
- (d) Communicating with the confirming party, including determining that requests are appropriately addressed and include return information for responses to be sent directly to the auditor, and sending the requests to the confirming party; and
- (e) Evaluating the evidence obtained (responses, non-responses and exceptions) from the external confirmation procedures. (Ref: Para. A7-A11)

### **Management’s Refusal to Allow the Auditor to Send a Confirmation Request**

8. If management refuses to allow the auditor to send a confirmation request, then the auditor shall:
  - (a) Evaluate the reasonableness of management’s refusal by challenging the reasons provided by management and seeking evidence about the validity of such reasons; (Ref: Para. A12)
  - (b) Evaluate the implications of management’s refusal on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A13)
  - (c) Where possible, perform alternative procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A14)
9. If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain appropriate audit evidence from alternative procedures performed in accordance with paragraph 8(c), the auditor shall communicate with those charged with governance, and consider the possible effect on the auditor’s opinion in accordance with [proposed] ISA 705 (Revised and Redrafted).<sup>6</sup>

### **Results of the External Confirmation Procedures** (Ref: Para. A15)

#### *Reliability of Responses to Confirmation Requests*

10. If the auditor has doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. (Ref: Para. A16-A19)
11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures. (Ref: Para. A20)

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<sup>6</sup> [Proposed] ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”



### *Non-Responses*

12. In the case of non-responses, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. If the auditor determines that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence to respond to assessed risks of material misstatement, and the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with [proposed] ISA 705 (Revised and Redrafted). (Ref: Para A21-A23)

### *Exceptions*

13. The auditor shall investigate exceptions to determine whether or not they represent misstatements. (Ref: Para. A24-A25)

### **Negative Confirmations**

14. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall only use negative confirmation requests as the sole substantive procedure to address an assessed risk of material misstatement at the assertion level when the auditor has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion and concluded that the risk of material misstatement is low, and:
  - (a) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances;
  - (b) Very few or no exceptions are expected; and
  - (c) The auditor has no reason to believe that recipients of negative confirmation requests will disregard such confirmation requests. (Ref: Para. A26)

### **Evaluating the Evidence Obtained**

15. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether performing further audit procedures is necessary.

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## **Application and Other Explanatory Material**

### **External Confirmation Procedures as a Response to Assessed Risks** (Ref: Para. 2)

- A1. ISA 330 (Redrafted) deals with the auditor's responsibility to design and implement responses to the risks of material misstatement that the auditor has identified and assessed in accordance with ISA 315 (Redrafted).<sup>7</sup>

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<sup>7</sup> ISA 315 (Redrafted), "Identifying and Assessing Risks of Material Misstatement Through Understanding the Entity and Its Environment."

*Relevance of External Confirmations*

- A2. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their constituent parts, but need not be restricted to these items. For example, the auditor may request confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a confirmation request may specifically address the absence of a “side agreement” that may be relevant to an entity’s cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:
- Bank balances and other information relevant to banking relationships.
  - Accounts receivable balances and terms.
  - Inventories held by third parties at bonded warehouses for processing or on consignment.
  - Property title deeds held by lawyers or financiers for safe custody or as security.
  - Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
  - Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
  - Accounts payable balances and terms.
- A3. Although external confirmations may provide relevant evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant evidence. For example, external confirmations provide less relevant evidence relating to the recoverability of accounts receivable balances, than they do of their existence.
- A4. The auditor may determine that external confirmation procedures prepared for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for other information relevant to other assertions in the financial statements. Such considerations may influence the auditor’s decision about whether to use external confirmation procedures.

*Considerations in Determining the Appropriateness of External Confirmations*

- A5. Factors that may assist the auditor in determining whether external confirmation procedures are an appropriate response to an assessed risk of material misstatement include:
- The confirming party’s knowledge of the subject matter – if the subject matter of external confirmation procedures is complex or highly subjective, responses may be more reliable if provided by a person at the confirming party who is more knowledgeable about the information being confirmed.

- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
  - May not accept responsibility for responding to a confirmation request.
  - May consider responding too costly or time consuming.
  - May have concerns about the potential legal liability resulting from responding.
  - May account for transactions in different currencies.
  - May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.

- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

*When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence*

- A6. In certain circumstances the auditor may determine that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence to address an assessed risk of material misstatement. Examples of such circumstances include where:
- The information available to corroborate management’s assertion(s) is only available outside the entity.
  - The entity’s information systems and internal controls are unreliable or ineffective.
  - Specific fraud risk factors, such as the risk of management override of internal controls, prevent the auditor from relying on evidence from the entity.

**External Confirmation Procedures** (Ref: Para. 7)

*Control Over External Confirmation Requests and Responses*

- A7. Controlling communications between the intended confirming parties and the auditor reduces the risk of unreliable results of the external confirmation procedures.

*Designing Confirmation Requests*

- A8. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
- A9. Factors to consider when designing confirmation requests may include:
- The assertions being addressed.
  - Specific identified risks of material misstatement, including fraud risks.
  - The layout and presentation of the confirmation request.
  - Prior experience on the audit or similar engagements.

- The method of communication (for example, in paper form, or by electronic or other medium).
- Management’s authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management’s authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

*Identifying the Appropriate Confirming Party*

A10. Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the intended confirming party from which to request confirmation.

*Follow-Up on Confirmation Requests*

A11. The auditor may perform procedures to obtain external confirmations for non-responses. For example, the auditor may verify the accuracy of the original address, and then send additional or follow-up requests.

**Management’s Refusal to Allow the Auditor to Send a Confirmation Request**

*Reasonableness of Management’s Refusal* (Ref: Para 8(a))

A12. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to challenge the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to evaluate such reasons and to seek audit evidence about their validity because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

*Implications on the Assessment of Relevant Risks of Material Misstatement* (Ref: Para 8(b))

A13. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the relevant risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA 315 (Redrafted). For example, if management’s request to not confirm is unreasonable, this may indicate a fraud risk factor that requires further evaluation in accordance with ISA 240 (Redrafted).

*Alternative Procedures* (Ref: Para 8(c))

- A14. The alternative procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A21-A23 of this ISA. Such procedures also would take account of the results of the auditor’s evaluation as discussed in paragraph 8(b) of this ISA.

**Results of the External Confirmation Procedures** (Ref: Para. 10-13)

- A15. When considering responses to confirmation requests and whether they provide audit evidence that addresses an assessed risk of material misstatement, the auditor may categorize responses as follows:
- (a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information;
  - (b) A response deemed unreliable;
  - (c) A non-response; or
  - (d) A response indicating an exception.

*Reliability of Responses to Confirmation Requests* (Ref: Para. 10)

- A16. Even when audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.<sup>8</sup> No response is without some risks of interception, alteration or fraud. Such risks exist regardless of whether the response is in paper form, or by electronic or other medium. Accordingly, the auditor may assess the reliability of a response by evaluating whether it:
- Was received directly by the auditor;
  - Appeared to come from the originally intended confirming party; and
  - Was received by a means that provides sufficient evidence as to the identity of the originating party.
- A17. The auditor is required to determine what modifications to, or additional, procedures are necessary to resolve doubts over the reliability of information to be used as audit evidence.<sup>9</sup> The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the purported confirming party. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the purported confirming party to respond in writing directly to the auditor.
- A18. An oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. However, upon obtaining an oral response to a confirmation request, the auditor may, depending on the

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<sup>8</sup> [Proposed] ISA 500 (Redrafted), paragraph A23.

<sup>9</sup> [Proposed] ISA 500 (Redrafted), paragraph 14.

circumstances, request the confirming party to respond in writing directly to the auditor, or seek audit evidence to support the information in the oral response.

- A19. A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not, in themselves, invalidate the reliability of the response as audit evidence.

*Unreliable Responses* (Ref: Para. 11)

- A20. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the relevant risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA 315 (Redrafted). For example, an unreliable response may indicate a fraud risk factor that requires further evaluation in accordance with ISA 240 (Redrafted).

*Non-Responses* (Ref: Para. 12)

- A21. Examples of alternative audit procedures the auditor may perform when a response to a positive confirmation request is not considered necessary to obtain sufficient appropriate audit evidence include:
- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end, to provide audit evidence for the cut-off assertion.
  - For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.
  - For bank balances – directly accessing information held by a third party concerning a client’s account.
- A22. The nature and extent of alternative audit procedures are affected by the assessed risk of material misstatement at the assertion level. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such a situation, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with ISA 315 (Redrafted). For example, a non-response to a confirmation request may indicate a previously unidentified fraud risk factor that requires further evaluation in accordance with ISA 240 (Redrafted).
- A23. If a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence to address an assessed risk of material misstatement, and the auditor does not receive an external confirmation, an inability to obtain sufficient appropriate audit evidence results. [Proposed] ISA 705 (Revised and Redrafted) establishes requirements and provides guidance when there is an inability to obtain sufficient appropriate audit evidence.

*Exceptions* (Ref: Para. 13)

- A24. Exceptions noted in responses to confirmation requests may assist the auditor in determining the extent of misstatements and potential misstatements. When the auditor identifies a misstatement, the auditor is required to evaluate whether such misstatement is

indicative of fraud.<sup>10</sup> Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a weakness in the entity's internal control over financial reporting.

- A25. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

**Negative Confirmations** (Ref: Para. 14)

- A26. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request and verification of the accuracy of the information contained in the request. Accordingly, a non-response to a negative confirmation request provides less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also are more likely to respond indicating their disagreement with a negative confirmation request when the information in the request is not in their favor and less likely to respond otherwise, unless the information is material to them.

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<sup>10</sup> Refer to ISA 240 (Redrafted), paragraph 35.

## CONFORMING AMENDMENTS TO OTHER ISAS

### [Proposed] ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence”

A16. ~~Confirmation is a specific type of inquiry that is the process of obtaining a representation of information or of an existing condition directly from a third party. Confirmations are frequently used in relation to account balances and their components. An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are used in relation to account balances and their constituent parts. For example, the auditor may seek direct confirmation of receivables by communication with debtors. However, external confirmations need not be restricted to these items. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request is designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmations procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a “side agreement” that may influence revenue recognition. See [proposed] ISA 505 (Revised and Redrafted), “External Confirmations” for further guidance.~~





**International Federation of Accountants**

545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1(212) 286-9570 [www.ifac.org](http://www.ifac.org)

*Proposed Revised and Redrafted International  
Standard on Auditing*

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ISA 620, Using the Work of an  
Auditor's Expert

*Conforming Amendments*

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Proposed ISA 500 (Redrafted),  
Considering the Relevance and  
Reliability of Audit Evidence



## REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved the exposure draft of proposed International Standard on Auditing (ISA) 620 (Revised and Redrafted), "Using the Work of an Auditor's Expert" in September 2007 for publication. The proposed ISA may be modified in light of comments received before being issued in final form.

Please submit your comments, preferably by e-mail, so that they will be received by **February 15, 2008**. All comments will be considered a matter of public record. Comments should be addressed to:

International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

Comments should be emailed to [Edcomments@ifac.org](mailto:Edcomments@ifac.org). They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the exposure draft may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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## EXPLANATORY MEMORANDUM

### Introduction

This memorandum provides background to, and an explanation of, the proposed International Standard on Auditing (ISA) 620 (Revised and Redrafted), “Using the Work of an Auditor’s Expert.” The International Auditing and Assurance Standards Board (IAASB) approved the proposed ISA in September 2007 for exposure.

### Background

The IAASB commenced this project in December 2004 in response to developments that indicated a need to revise extant ISA 620, “Using the Work of an Expert,” including:

- (a) The recent updating of corresponding national auditing standards in a number of jurisdictions;
- (b) A concern that the extant ISA 620 mainly focuses on the use of experts with respect to substantive procedures regarding the measurement of account balances, whereas experts may be used for other purposes during the audit, for example, to assist in identifying and assessing the risks of material misstatement; and
- (c) The possibility that the wider use of fair value accounting may require more frequent use of experts by the auditor.

During the project, the IAASB considered matters, including whether the auditor’s report should refer to the expert, and how the nature, timing and extent of audit procedures varies depending on such matters as: the nature of, and risks of material misstatement in, the matter to which the expert’s work relates; the significance of the expert’s work in the context of the audit; the auditor’s knowledge of and experience with previous work performed by the expert; and whether the expert is subject to the auditor’s firm’s quality control policies and procedures.

The IAASB believes that the proposed ISA will enhance the consistency of auditor performance in an audit of financial statements through more specific requirements and expanded guidance.

### Significant Matters

#### Definition of Engagement Team

As noted in the explanatory memorandum accompanying the exposure draft of [proposed] ISA 220 (Redrafted) and [proposed] ISQC 1 (Redrafted),<sup>1</sup> the IESBA<sup>2</sup> issued two exposure drafts<sup>3</sup> in

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<sup>1</sup> [Proposed] ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements” and [proposed] International Standard on Quality Control (ISQC) 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements,” July 2007.

<sup>2</sup> The International Ethics Standards Board for Accountants of IFAC.

<sup>3</sup> Exposure drafts of Section 290, “Independence—Audit and Review Engagements” and Section 291, “Independence—Other Assurance Engagements” of the *Code of Ethics for Professional Accountants*, December 2006.

December 2006 that included a proposed definition of “engagement team.” The IESBA is currently in the process of considering comments received on its exposure drafts, and the IAASB has consulted the IESBA on the direction that it may take in finalizing the definition of “engagement team.” The definition in [proposed] ISA 220 (Redrafted) and [proposed] ISQC 1 (Redrafted) differs from that in the December IESBA exposure drafts, but reflects what the IAASB believes is currently being considered by the IESBA.

The primary difference between the two definitions is that the definition in [proposed] ISA 220 (Redrafted) and [proposed] ISQC 1 (Redrafted) specifically excludes “an auditor’s external expert” from the engagement team. “An auditor’s external expert” is defined in [proposed] ISA 620 (Revised and Redrafted) as “an auditor’s expert who is engaged, not employed, by the auditor. An auditor’s external expert is not a member of the engagement team.”<sup>4</sup>

The IAASB believes it is appropriate to exclude an auditor’s external expert from the definition of “engagement team” in [proposed] ISA 220 (Redrafted) and [proposed] ISQC 1 (Redrafted) because it would be impractical to expect auditor’s external experts to be subject to all the quality control policies and procedures the firm applies with respect to its partners and staff. Similarly, the IAASB believes it would be impractical to expect auditor’s external experts to be subject to all the independence requirements of the [proposed] Code, which is written for application to accountants and accounting firms. If auditor’s external experts were included in the definition, the IAASB considers that this would create a significant barrier to the necessary use of experts in appropriate cases.

In drafting [proposed] ISA 620 (Revised and Redrafted) the IAASB has allowed for this important difference between the auditor’s internal experts (who are members of the engagement team) and external experts. Consequently, it is proposed to require the auditor to take particular steps to evaluate whether an auditor’s expert has the necessary objectivity for the purposes of the audit,<sup>5</sup> Additionally, in the case of an auditor’s external expert further emphasis is placed on the instructions given to the expert and other aspects of the relationship, since the external expert falls outside the audit firm’s quality controls.

### **Management’s Experts**

Extant ISA 620 deals with both an auditor’s expert (i.e., an expert employed or engaged by the auditor) and a management’s expert (i.e., an expert employed or engaged by the entity). However, the auditor’s use of work performed by these two types of expert fundamentally differs and, although some of the related audit considerations are similar, the IAASB considers that it is necessary to draw a clearer distinction between the two. [Proposed] ISA 620 (Revised and Redrafted) now deals exclusively with considerations relevant to using the work of an auditor’s expert. Material dealing with the work of a management’s expert is presented in the conforming amendments to [proposed] ISA 500 (Redrafted).<sup>6</sup>

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<sup>4</sup> [Proposed] ISA 620 (Revised and Redrafted), paragraph 6(d); see also paragraph A8.

<sup>5</sup> [[Proposed] ISA 620 (Revised and Redrafted), paragraphs 9 and A16-A17.

<sup>6</sup> [Proposed] ISA 500 (Redrafted) “Considering the Relevance and Reliability of Audit Evidence.”

## **Specialists in Areas of Accounting and Auditing**

Consistent with extant ISA 620, the definition of “expert” in [proposed] ISA 620 (Revised and Redrafted) excludes persons or organizations possessing expertise in accounting or auditing. The IAASB is conscious of the fact that the work of specialists in particular areas of accounting (e.g., accounting for complex financial instruments) or auditing (e.g., auditing sophisticated IT systems) is used in many audits, and that considerations relevant to using the work of such specialists may often be similar to those relevant to using the work of an auditor’s expert. However, expertise in accounting and auditing is a fundamental requirement for all auditors. Such expertise has therefore been excluded from the definition of “expert” since it would normally be expected that an auditor accepting an engagement would possess any required specialist accounting and auditing expertise.

Similarly, with respect to the conforming amendments to [proposed] ISA 500 (Redrafted), the definition of “management’s expert” excludes persons or organizations possessing expertise in accounting.

The IAASB debated whether a person with expertise in taxation should be included in the definition and decided that when the expertise is in relation to tax compliance issues, the person should be considered an expert. When, however, the expertise is in relation to the accounting implications of taxation, the person would not be considered an expert for the purposes of the ISA as this constitutes a specialist area of accounting expertise. Similar distinctions might be made between expertise in complex modeling for valuation purposes and expertise in accounting for financial instruments.

## **Effective Date**

The current IAASB project timetable envisages that all ISAs will have been revised and redrafted, or redrafted only, by late 2008. The IAASB has agreed that the complete set of ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2009. The IAASB believes that it is in the interest of auditors and others who use the ISAs that the standards should be released as soon as they are approved so as to facilitate their implementation.

## **Guide for Respondents**

The IAASB welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this exposure draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

## **Request for Specific Comments**

The IAASB would welcome views on the following:

1. The proposal that proposed ISA 620 (Revised and Redrafted) deal exclusively with considerations relevant to using the work of an auditor’s expert, and accordingly material dealing with the work of management’s expert be expanded and moved to [proposed] ISA 500 (Redrafted).

2. The proposal that the definition of “expert” in proposed ISA 620 (Revised and Redrafted) excludes persons or organizations possessing expertise in accounting or auditing, for the reasons explained on page 6 above.

### **Request for Comments on the Application of the Clarity Drafting Conventions**

In addition to the matters referred to above, the IAASB is seeking comments on the application of the clarity drafting conventions. Respondents are asked to consider whether the objectives for the proposed ISA are appropriate, and whether the proposed requirements are appropriate responses to those objectives.

### **Comments on Other Matters**

Recognizing that the final ISA will apply to audits of all sizes and in all sectors of the economy, the IAASB is also interested in comments on matters set out below.

- *Special Considerations in the Audit of Small Entities*—Respondents are asked to comment whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed ISA.
- *Special Considerations in the Audit of Public Sector Entities*—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed ISA.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISA in a developing nation environment.
- *Translations*—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed ISA.

To be considered, responses should be emailed to [Edcomments@ifac.org](mailto:Edcomments@ifac.org). They may also be faxed to +1-212-286-9570 or mailed to 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. They should be received by **February 15, 2008**.



**PROPOSED INTERNATIONAL STANDARD ON AUDITING 620**  
**(REVISED AND REDRAFTED)**  
**USING THE WORK OF AN AUDITOR’S EXPERT**

(Effective for audits of financial statements for periods beginning on or after [December 15, 2009])

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[Proposed] International Standard on Auditing (ISA) 620 (Revised and Redrafted), “Using the Work of an Auditor’s Expert” should be read in conjunction with [proposed] ISA 200 (Revised and Redrafted), “The Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing.”

## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s use of the work of a person or organization possessing expertise in a field other than accounting or auditing, employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence.
2. This ISA does not deal with the auditor’s consultation with specialists in a particular area of accounting or auditing,<sup>7</sup> or with the auditor’s consideration of the work of experts employed or engaged by the entity.<sup>8</sup>
3. If the auditor using the work of an auditor’s expert, having followed this ISA, concludes that the work of that expert is adequate for the purposes of the audit, the auditor may accept that expert’s findings and conclusions in the expert’s field. Nonetheless, the auditor is responsible for the audit opinion, and that responsibility is not diminished by the auditor’s use of the work of an auditor’s expert.

### Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].

## Objectives

5. The objectives of the auditor are:
  - (a) To determine whether to use the work of an auditor’s expert; and
  - (b) If using the work of an auditor’s expert, to determine whether that work is adequate for the purposes of the audit.

## Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:
  - (a) Expert – A person or organization, possessing expertise in a field other than accounting or auditing.
  - (b) Expertise – Skills, knowledge and experience in a particular profession or specialized occupation. (Ref: Para. A1)
  - (c) Auditor’s expert – An expert employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence.

<sup>7</sup> [Proposed] ISA 220 (Redrafted), “Quality Control for an Audit of Financial Statements,” in particular paragraphs 18 and 26(d), includes requirements regarding consultation.

<sup>8</sup> [Proposed] ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence”), in particular paragraphs A30a-A30g, includes guidance regarding experts employed or engaged by the entity. (See proposed conforming amendments with this exposure draft.)

- (d) Auditor's external expert – An auditor's expert who is engaged, not employed, by the auditor. An auditor's external expert is not a member of the engagement team.

## **Requirements**

### **Determining the Need for an Auditor's Expert**

- 7. If expertise in a field other than accounting or auditing is required to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert. (Ref: Para. A2-A8)

### **Nature, Timing and Extent of Audit Procedures**

- 8. The nature, timing and extent of the auditor's procedures with respect to the requirements in paragraphs 9-13 of this ISA will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, matters considered by the auditor shall include:
  - (a) The nature of the matter to which that expert's work relates;
  - (b) The risks of material misstatement in the matter to which that expert's work relates;
  - (c) The significance of that expert's work in the context of the audit;
  - (d) The auditor's knowledge of and experience with previous work performed by that expert; and
  - (e) Whether the expert is subject to the auditor's firm's quality control policies and procedures. (Ref: Para. A9)

### **The Capabilities, Competence and Objectivity of the Auditor's Expert**

- 9. The auditor shall evaluate whether the auditor's expert whose work is to be used has the necessary capabilities, competence and objectivity for the purposes of the audit. In the case of an auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity. (Ref: Para. A10-A17)

### **Obtaining an Understanding of the Field of Expertise of the Auditor's Expert**

- 10. The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:
  - (a) Determine the nature, scope and objectives of that expert's work for the purposes of the audit; and
  - (b) Evaluate the adequacy of that work for the purposes of the audit. (Ref: Para. A18-A19)

### **Agreement with the Auditor's Expert**

- 11. The auditor shall agree, in writing when appropriate, the following matters with the auditor's expert: (Ref: Para. A20-A22)
  - (a) The nature, scope and objectives of that expert's work;

- (b) The respective roles of the auditor and that expert; and (Ref: Para. A23-A24)
- (c) The nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided by that expert. (Ref: Para. A25)

### **Evaluating the Adequacy of the Auditor's Expert's Work**

12. The auditor shall evaluate the adequacy of the auditor's expert's work for the purposes of the audit, including: (Ref: Para. A26)
  - (a) The relevance and reasonableness of that expert's findings, and their consistency with other audit evidence; and (Ref: Para. A27-A28)
  - (b) If significant to the auditor's use of that expert's work:
    - (i) The relevance and reasonableness of the expert's assumptions and methods; and (Ref: Para. A29-A31)
    - (ii) The completeness, relevance and accuracy of source data used by the expert (Ref: Para. A32-A33)
13. If the auditor concludes that the work of the auditor's expert is not adequate for the purposes of the audit, the auditor shall:
  - (a) Agree with that expert on the nature and extent of further work to be performed by that expert; or
  - (b) Perform further audit procedures appropriate to the circumstances. (Ref: Para. A34)

### **Reference to the Auditor's Expert in the Auditor's Report**

14. The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the report shall indicate that the reference does not diminish the auditor's responsibility for the audit opinion.
15. If reference to the work of an auditor's expert is relevant to an understanding of a modification to the auditor's opinion, the auditor's report shall indicate that such reference does not diminish the auditor's responsibility for that opinion. (Ref: Para. A35-A36)

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### **Application and Other Explanatory Material**

#### **Definitions** (Ref: Para. 6(b))

- A1. Expertise in a field other than accounting or auditing includes expertise in relation to such matters as:
  - The valuation of complex financial instruments, land and buildings, plant and machinery, jewelry, works of art and antiques.
  - The calculation of liabilities associated with insurance contracts or employee benefit

plans.

- The estimation of oil and gas reserves.
- The valuation of environmental liabilities, and site clean-up costs.
- The interpretation of contracts, laws and regulations.
- The analysis of complex or unusual tax compliance issues.

**Determining the Need for an Auditor’s Expert** (Ref: Para. 7)

- A2. The risks of material misstatement may increase when expertise in a field other than accounting is needed for management to prepare the financial statements, for example, because this may indicate some complexity, or because management may not possess knowledge of the field of expertise. If in preparing the financial statements management does not possess the necessary expertise, management may employ or engage an expert to address those risks. Relevant controls, including controls that relate to the work of an expert employed or engaged by management, if any, may also reduce the risks of material misstatement.
- A3. If the preparation of the financial statements involves the use of expertise in a field other than accounting, it is possible that the auditor who is skilled in accounting and auditing may not possess the necessary expertise to audit those financial statements. The engagement partner is required to be satisfied that the engagement team and any auditor’s external experts, collectively have the appropriate capabilities and competence to perform the audit engagement.<sup>9</sup> Further, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the engagement.<sup>10</sup> The auditor’s determination whether to involve an auditor’s expert, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may need to revise earlier decisions about involvement of an auditor’s expert.
- A4. An auditor who is not an expert in a relevant field may nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor’s expert. This understanding may be obtained through, for example:
- Experience in auditing entities that require such expertise in the preparation of their financial statements.
  - Education, experience or professional development in the particular field of expertise.
  - Discussion with experts.
  - Discussion with auditors who have performed similar engagements.
- A5. In some cases, however, the auditor may determine that it is necessary, or may choose, to use an auditor’s expert to assist in obtaining sufficient appropriate audit evidence. Considerations when deciding whether to use an auditor’s expert may include:

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<sup>9</sup> [Proposed] ISA 220 (Redrafted), paragraph 13.

<sup>10</sup> ISA 300 (Redrafted), “Planning an Audit of Financial Statements,” paragraph 7(e).

- Whether management has used an expert in preparing the financial statements (see paragraph A6).
  - The nature and complexity of the matter.
  - The materiality of the matter, and the risks of misstatement.
  - The expected nature of procedures to respond to identified risks.
  - The availability of alternative sources of audit evidence.
- A6. When management has used an expert in preparing the financial statements, the auditor's decision on whether to use an auditor's expert may be influenced by such factors as:
- The nature, scope and objectives of the management's expert's work
  - Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
  - The extent to which management can exercise control or influence over the work of the management's expert.
  - The management's expert's capabilities and competence.
  - Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
  - Any controls within the entity over the management's expert's work.
- [Proposed] ISA 500 (Redrafted) includes requirements and guidance regarding the effect of the capabilities, competence and objectivity of experts employed or engaged by the entity on the reliability of audit evidence.<sup>11</sup>
- A7. An auditor's expert may be needed to assist the auditor in one or more of the following:
- Obtaining an understanding of the entity and its environment, including its internal control.
  - Identifying and assessing the risks of material misstatement.
  - Determining and implementing overall responses to assessed risks at the financial statement level.
  - Designing and performing further audit procedures to respond to assessed risks at the assertion level.
  - Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements.
- A8. An auditor's expert may be employed by the auditor or may be engaged by the auditor for the purposes of the audit. Experts employed by the auditor include partners and staff, including temporary staff. Such experts are subject to the firm's quality control policies and

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<sup>11</sup> [Proposed] ISA 500 (Redrafted), paragraphs 12(c), and A30a-A30g. (See proposed conforming amendments with this exposure draft.)

procedures, and when performing audit procedures are part of the engagement team. Experts engaged by the auditor are defined as “auditor’s external experts” and are not part of the engagement team.

### **Nature, Timing and Extent of Audit Procedures** (Ref: Para. 8)

A9. The nature, timing and extent of audit procedures with respect to the requirements in paragraphs 9-13 of this ISA will vary depending on the circumstances. For example, the following factors may suggest the need for more extensive procedures or procedures of a different nature:

- The work of the auditor’s expert relates to a significant matter that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor’s expert, and has no prior experience of that expert’s capabilities, competence and objectivity.
- The expert is an auditor’s external expert and is not, therefore, subject to the auditor’s firm’s quality control policies and procedures.

### **The Capabilities, Competence and Objectivity of the Auditor’s Expert** (Ref: Para. 9)

A10. The capabilities, competence and objectivity of an auditor’s expert are factors that significantly affect whether the work of the auditor’s expert will be adequate for the purposes of the audit. Information regarding the capabilities, competence and objectivity of an auditor’s expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert.
- Discussions with other auditors or others who are familiar with that expert’s work.
- Knowledge of that expert’s qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.

A11. When an auditor’s expert is a member of the engagement team, that expert is subject to the auditor’s firm’s quality control policies and procedures.<sup>12</sup> The auditor is responsible for establishing that the engagement team, and any auditor’s external experts, collectively have the appropriate capabilities, competence and time to perform the audit engagement.<sup>13</sup> However, engagement teams are entitled to rely on the firm’s systems unless information provided by the firm or other parties suggests otherwise.<sup>14</sup> This may be relevant to aspects of such matters as:

- Capabilities and competence, through recruitment and training programs.

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<sup>12</sup> That is, those implemented in accordance with [proposed] ISA 220 (Redrafted), and [proposed] ISQC 1 (Redrafted), “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”

<sup>13</sup> [Proposed] ISA 220 (Redrafted) paragraph 13.

<sup>14</sup> [Proposed] ISA 220 (Redrafted) paragraph 3(c).



- Objectivity, through the firm’s policies and procedures to comply with relevant independence requirements.
  - Adherence to regulatory and legal requirements, through monitoring processes.
- A12. When considering the capabilities, competence and objectivity of the auditor’s expert, it may be relevant to consider whether that expert’s work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.
- A13. Other matters that may be relevant include:
- The relevance of the auditor’s expert’s capabilities and competence to the matter for which that expert’s work will be used, including any areas of specialty within that expert’s field. For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations.
  - The auditor’s expert’s capabilities and competence with respect to relevant accounting and auditing requirements, including experience in assisting with the preparation or audit of financial statements, and the use and knowledge of assumptions and methods consistent with the applicable financial reporting framework.
- A14. Objectivity relates to the effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the auditor’s expert. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may eliminate or reduce such threats, and may be created by external structures (e.g., the auditor’s expert’s profession, legislation or regulation), or by the auditor’s expert’s work environment (e.g., quality control policies and procedures). There may also be safeguards specific to the audit engagement.
- A15. The evaluation of the significance of threats to objectivity and of whether there is a need for safeguards may depend upon the role of the auditor’s expert and the significance of the expert’s work in the context of the audit. There may be some situations in which safeguards cannot reduce threats to an acceptable level, for example, if the auditor’s expert has played a significant role in preparing information that is being audited, the auditor may not be able to use the work of that expert.
- A16. When evaluating the objectivity of an auditor’s external expert, it may be relevant to discuss with that expert any circumstances that may create threats to the expert’s objectivity, and any relevant safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Circumstances that it may be relevant to discuss with the auditor’s expert may include interests or relationships with the entity, such as:
- Financial interests.
  - Business and personal relationships.
  - Provision of other services by the expert, including by the organization in the case of

an external expert that is an organization.

In some cases, it may also be appropriate for the auditor to obtain a written representation from the auditor's external expert about any interests or relationships with the entity of which that expert is aware.

A17. Inquiry by the auditor of the entity about any known interests or relationships with the auditor's external expert may also be of assistance in identifying circumstances that may affect that expert's objectivity.

**Obtaining an Understanding of the Field of Expertise of the Auditor's Expert** (Ref: Para. 10)

A18. The auditor may obtain an understanding of the auditor's expert's field of expertise through the means described in paragraph A4 or through discussion with that expert.

A19. Aspects of the auditor's expert's field relevant to the auditor's understanding may include:

- Whether that expert's field has areas of specialty within it that are relevant to the audit (see paragraph A13).
- Whether any professional or other standards, and regulatory or legal requirements apply.
- What methodologies and assumptions are used, and whether they are generally accepted within the auditor's expert's field and appropriate for financial reporting purposes.
- The nature of internal and external data or information the auditor's expert uses.

**Agreement with the Auditor's Expert** (Ref: Para. 11)

A20. The nature, scope and objectives of the auditor's expert's work will vary considerably with the circumstances, as will the respective roles of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore important that these matters are agreed between the auditor and the auditor's expert, and that this agreement is in writing when appropriate, both when the expert is an auditor's external expert and when the expert is employed by the auditor.

A21. The more significant the work of an auditor's expert is in the context of the audit, the more likely it is that the agreement between the auditor and that expert will need to be reasonably detailed and set out in writing.

A22. Evidence of the agreement may be included in, for example:

- Planning memoranda and related working papers.
- The policies and procedures of the auditor's firm. When the auditor's expert is a member of the engagement team, the established policies and procedures to which that expert is subject may include particular policies and procedures in relation to that expert's work, including the respective roles of the auditor's expert and other members of the engagement team. The extent of any further documentation depends on the nature of such policies and procedures.

- An engagement letter (in the case of an auditor’s external expert), or other written form of agreement. The Appendix contains a list of matters that the auditor may consider relevant for inclusion in an agreement with an auditor’s external expert. The list may also be of assistance in considering the matters to be included in an agreement with an auditor’s expert who is a member of the engagement team.

*Respective Roles* (Ref: Para. 11(b))

A23. Agreement on the respective roles of the auditor and the auditor’s expert may include:

- Whether the auditor or the auditor’s expert will perform detailed testing of source data.
- The responsibility of the auditor’s expert to respect the confidentiality of information about the entity.
- Consent for the auditor to discuss the auditor’s expert’s findings with the entity and others, and to include details of that expert’s findings in a modified auditor’s report, if necessary.
- Any agreement to inform the auditor’s expert of the auditor’s conclusions concerning that expert’s work.

*Working Papers*

A24. Agreement on the respective roles of the auditor and the auditor’s expert may also include agreement about access to each other’s working papers. When the auditor’s expert is a member of the engagement team, that expert’s working papers form part of the audit documentation. Subject to any agreement to the contrary, auditor’s external experts’ working papers are their own and do not form part of the audit documentation.

*Communication* (Ref: Para. 11(c))

A25. Effective two-way communication helps to ensure that the nature, timing and extent of planned procedures to be performed by the auditor’s expert are properly integrated with other work on the audit, and that the auditor’s expert’s objectives are modified as needed during the course of the audit. For example, when the work of the auditor’s expert relates to the auditor’s conclusions regarding a significant risk, both a formal written report at the conclusion of that expert’s work, and oral reports as the work progresses, may be appropriate. Identification of specific partners or staff who will liaise with the auditor’s expert, and procedures for communication between that expert and the entity, may assist timely and effective communication, particularly on larger engagements.

**Evaluating the Adequacy of the Auditor’s Expert’s Work** (Ref: Para. 12)

A26. The auditor’s consideration of the auditor’s expert’s capabilities, competence and objectivity, the auditor’s familiarity with the auditor’s expert’s field of expertise, and the nature of the work performed by the auditor’s expert may affect the nature, timing and extent of audit procedures to evaluate the adequacy of that expert’s work for the purposes of the audit.

*The Findings of the Auditor's Expert* (Ref: Para. 12(a))

A27. Specific procedures to evaluate the adequacy of the auditor's expert's work for the purposes of the audit may include:

- Inquiries of the auditor's expert, management or others with a particular knowledge of the matter.
- Corroborative procedures, such as:
  - Observing the auditor's expert's work.
  - Examining documentary evidence the auditor's expert provides.
  - Examining published data, such as statistical reports from reputable, authoritative sources.
  - Confirming with third parties, such as regulators, the results of their examinations.
  - Performing detailed analytical procedures.
  - Reperforming calculations.
  - Reviewing how any inconsistencies in evidence were resolved.
- Reviewing the auditor's expert's working papers.
- Discussion with another expert with relevant expertise.
- Discussing the auditor's expert's report with management.

A28. Factors that may be relevant when considering the relevance and reasonableness of the findings of the auditor's expert, whether in a report or other form, may include whether they are:

- Presented in a manner that is consistent with any standards of the auditor's expert's profession or industry.
- Clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed and standards applied.
- Based on an appropriate period and take into account subsequent events, where relevant.
- Subject to any reservation, limitation or restriction on use, and if so, whether this has implications for the auditor.
- Based on appropriate consideration of errors or deviations encountered by the auditor's expert.

*Assumptions, Methods and Source Data*

Assumptions and Methods (Ref: Para. 12(b)(i))

A29. When the auditor's expert's work relates to an accounting estimate developed by management, the auditor's procedures are likely to be directed to considering whether that

expert has properly reviewed the assumptions and methods, including models, used by management. In other circumstances, for example, when the auditor’s expert assists in developing an auditor’s point estimate or an auditor’s range for comparison with management’s point estimate, the assumptions and methods used by the auditor’s expert may be significant to the auditor’s use of that expert’s work.

A30. [Proposed] ISA 540 (Revised and Redrafted)<sup>15</sup> discusses the assumptions and methods used by management in making accounting estimates. Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management’s assumptions and methods, it may also assist the auditor when evaluating the auditor’s expert’s assumptions and methods.

A31. When evaluating the auditor’s expert’s assumptions and methods, relevant factors may include whether they are:

- Generally accepted within the auditor’s expert’s field.
- Consistent with the requirements of the applicable financial reporting framework.
- Consistent with those of management, and if not, what are the reason and effects of the differences.

Source Data Used by the Auditor’s Expert (Ref: Para. 12(b)(ii))

A32. When an auditor’s expert’s work involves the use of source data that is significant to the auditor’s use of that work, procedures such as the following may be used to test that data:

- Verifying the origin of the data.
- Recomputing the inputs.
- Reviewing the data for completeness and internal consistency, including when applicable whether the data is consistent with management’s intent and ability to carry out specific courses of action.

A33. In many cases, testing source data will be done by the auditor. In other cases however, for example, when source data used by an auditor’s expert is highly technical in relation to the auditor’s expert’s field, that expert may test the source data. If the auditor’s expert has tested the source data, it may be appropriate for the auditor to evaluate that data’s completeness, relevance and accuracy by inquiry of that expert, or supervision or review of that expert’s tests.

*Inadequate Work* (Ref: Para. 13)

A34. If the auditor concludes that work of the auditor’s expert is not adequate for the purposes of the audit and the auditor cannot resolve the matter through the additional audit procedures required by paragraph 13, which in rare cases may include employing or engaging another

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<sup>15</sup> [Proposed] ISA 540 (Revised and Redrafted), “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures.”

expert, it may be necessary to express a modified audit opinion in accordance with [proposed] ISA 705 (Revised and Redrafted).<sup>16</sup>

**Reference to the Auditor’s Expert in the Auditor’s Report** (Ref. Para. 14-15)

- A35. In some cases, law or regulation may require a reference to the work of an auditor’s expert, for example, for the purposes of transparency in the public sector.
- A36. It may be appropriate in some circumstances to refer to the auditor’s expert in an auditor’s report containing a modified opinion, to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor’s expert before making such a reference.

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<sup>16</sup> [Proposed] ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report.”

## Appendix

(Ref: Para. A22)

### **Considerations for Agreement Between the Auditor and an Auditor's External Expert**

This appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external expert. The list is illustrative and is not exhaustive; it is intended only to be a guide that may be used in conjunction with the considerations outlined in this ISA. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list may also be of assistance in considering the matters to be included in an agreement with an auditor's expert who is a member of the engagement team.

#### **Nature, Scope and Objectives of the Auditor's External Expert's Work**

- The nature and scope of the procedures to be performed by the auditor's external expert.
- The objectives of the auditor's external expert's work in the context of materiality and risk considerations concerning the matter to which the auditor's external expert's work relates.
- Any relevant technical performance standards or other professional or industry requirements the auditor's external expert will follow.
- The assumptions and methods the auditor's external expert will use, and their authority.
- The effective date of, or when applicable the testing period for, the subject matter of the auditor's external expert's work, and requirements regarding subsequent events.

#### **The Respective Roles of the Auditor and the Auditor's External Expert**

- Relevant auditing and accounting concepts and standards, and relevant regulatory or legal requirements.
- The auditor's external expert's consent to the auditor's intended use of that expert's report, including any reference to it, or disclosure of it, to others, for example reference to it in a modified auditor's report, if necessary, or disclosure of it to management or an audit committee.
- The nature and extent of the auditor's review of the auditor's external expert's work and findings.
- Whether the auditor or the auditor's external expert will perform detailed testing of source data.
- The auditor's external expert's access to the entity's records, files, personnel and to experts engaged by the entity.
- Procedures for communication between the auditor's external expert and the entity.
- The auditor's and the auditor's external expert's access to each other's working papers.
- Ownership and control of working papers during and after the engagement, including any file

retention requirements.

- The responsibility of the auditor’s external expert to respect the confidentiality of information.
- The auditor’s external expert’s responsibility to perform work with due skill and care.
- The auditor’s external expert’s competence and capacity to perform the work.
- The expectation that the auditor’s external expert will use all knowledge that expert has that is relevant to the audit or, if not, will inform the auditor.
- Any restriction on the auditor’s external expert’s association with the auditor’s report.
- Any agreement to inform the auditor’s external expert of the auditor’s conclusions concerning that expert’s work

### **Communications and Reporting**

- Methods and frequency of communications, including:
  - How the auditor’s external expert’s findings will be reported (written report, oral report, ongoing input to the engagement team, etc.).
  - Identification of specific persons within the engagement team who will liaise with the auditor’s external expert.
- When the auditor’s external expert will complete the work and report findings to the auditor.
- The auditor’s external expert’s responsibility to communicate promptly any potential delay in completing the work, and any potential reservation or limitation on that expert’s findings.
- The auditor’s external expert’s responsibility to communicate promptly instances in which the entity restricts that expert’s access to records, files, personnel or experts engaged by the entity.
- The auditor’s external expert’s responsibility to communicate to the auditor all information that expert believes may be relevant to the audit, including any changes in circumstances previously communicated.
- The auditor’s external expert’s responsibility to communicate circumstances that may create threats to that expert’s objectivity, and any relevant safeguards.



## CONFORMING AMENDMENTS

### [Proposed] ISA 500 (Redrafted), “Considering the Relevance and Reliability of Audit Evidence”

3. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence is necessary to support that opinion and the auditor’s report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from, for example, previous audits and a firm’s quality control procedures for client acceptance and continuance. The entity’s accounting records are an important source of audit evidence along with other sources inside and outside the entity. Also, information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management’s assertions, and any information that contradicts such assertions. (Ref: Para. A1-A3)
10. For purposes of the ISAs, the following terms have the meanings attributed below:  
...
  - (e) Management’s expert – A person or organization employed or engaged by the entity and possessing expertise in a field other than accounting.
12. When information used by the auditor for purposes of the audit was produced by the entity, including any management’s experts, the auditor shall evaluate whether the information is sufficiently reliable for the auditor’s purposes, including as necessary in the circumstances:
  - (a) Obtaining audit evidence about the accuracy and completeness of the information;
  - (b) Evaluating whether the information is sufficiently precise or detailed for the auditor’s purposes; and
  - (c) Evaluating the capabilities, competence and objectivity of a management’s expert, if any. (Ref: Para. A28-A30g)
- A23. ~~Due to the fact that~~ The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant, and whether the information was prepared by a management’s expert. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or an expert engaged by the entity may lack objectivity. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful ...

Information Produced by a Management's Expert and Used for Audit Purposes (Ref: Para. 12(c))

A30a. The preparation of an entity's financial statements may require expertise in a field other than accounting, such as actuarial calculations, valuations, or engineering data. The entity may employ or engage experts in these fields in order to obtain the needed expertise to prepare the financial statements. Failing to do so when such expertise is necessary increases the risks of material misstatement. The capabilities, competence and objectivity of a management's expert, and any controls within the entity over that expert's work, are important factors in considering the reliability of any information produced by a management's expert.

A30b. Information regarding the capabilities, competence and objectivity of a management's expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert.
- Discussions with others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.

A30c. When considering the capabilities, competence and objectivity of a management's expert, it may be relevant to consider whether that expert's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

A30d. Other matters that may be relevant include:

- The relevance of that expert's capabilities and competence to the matter for which that expert's work will be used, including any areas of specialty within that expert's field. For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations.
- The expert's capabilities and competence with respect to relevant accounting requirements, including experience in assisting with the preparation of financial statements, and the use and knowledge of assumptions and methods consistent with the applicable financial reporting framework.

A30e. Objectivity relates to the effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the expert. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats, and may be created either by external structures (e.g., the management's expert's profession, legislation or regulation), or by the management's expert's work environment (e.g., quality control policies and procedures).

A30f. Although safeguards cannot eliminate all threats to a management's expert's objectivity, the significance of threats such as intimidation threats may be less to an expert engaged by the entity than to an expert employed by the entity, and the significance of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

A30g. When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and the expert any circumstances that may create threats to the expert's objectivity, and any relevant safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Circumstances creating threats may include interests or relationships with the entity, such as:

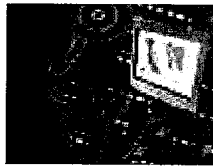
- Financial interests.
- Business and personal relationships.
- Provision of other services.



**International Federation of Accountants**

545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1(212) 286-9570 [www.ifac.org](http://www.ifac.org)



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Helene Kennedy +1-973-394-9256  
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 bryanhall@ifac.org

## **IAASB Issues Exposure Drafts on External Confirmations and the Use of the Work of an Audit Expert**

(New York/October 15, 2007) - At its most recent meeting in Madrid, Spain in September, the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board under the auspices of the International Federation of Accountants (IFAC), approved two sets of new proposals. The first exposure draft addresses concerns about the use and reliability of external confirmations as audit evidence. External confirmations are written responses to the auditor from a third party. The second exposure draft proposes stricter requirements when an auditor uses an expert to obtain audit evidence.

"The proposed standards represent significant steps by the IAASB designed to enhance auditor performance in important areas of the audit of financial statements. Confirmations have sometimes proved to be less reliable than expected and the proposals are intended to assist in making them effective when an auditor decides to use them. In a more complex world, especially where fair values feature in financial reporting, the auditor may have more need of the assistance of experts in other disciplines for the purposes of the audit. The new proposals are therefore timely," explains John Kellas, IAASB Chairman.

These proposed International Standards on Auditing (ISAs) are drafted in accordance with the IAASB's new conventions designed to improve the clarity of its pronouncements. They may be viewed by going to <http://www.ifac.org/eds>.

### **External Confirmations**

Recent experience has indicated that external confirmations may not always be as reliable as expected as audit evidence, giving rise to requests for more rigorous requirements governing the auditor's use of external confirmations. The auditor's decision about

whether to use external confirmation procedures is based upon the identification and assessment of risks of material misstatement in accordance with other ISAs. Proposed ISA 505 (Revised and Redrafted), *External Confirmations*, is 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.

**Use of the Work of an Auditor's Expert**

Proposed ISA 620 (Revised and Redrafted), *Using the Work of an Auditor's Expert*, deals with the auditor's use of the work of a person or organization possessing expertise in a field other than accounting or auditing, employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence. It places particular emphasis on the need for the auditor to evaluate the expert's objectivity, and to establish a proper understanding with the expert of the expert's responsibilities for the purposes of the audit.

**How to Comment**

Comments on the exposure drafts are requested by February 15, 2008. Comments should be submitted by email to [EDComments@ifac.org](mailto:EDComments@ifac.org). They may also be faxed to IAASB ED Comments at +1-212-286-9570 or mailed to IAASB ED Comments at 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website.

**About the IAASB and IFAC**

The objective of the IAASB is to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The Public Interest Oversight Board oversees the activities of the IAASB and, as one element of that oversight, establishes its due process and working procedures.

Founded in 1977, IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 155 members and associates in 118 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce. In addition to setting international auditing and assurance standards through the IAASB, IFAC, through its independent standard-setting boards, sets international ethics,

education, and public sector accounting standards. It also issues guidance to encourage high quality performance by professional accountants in business.

Further information about IAASB may be obtained from its website:  
<http://www.iaasb.org>. The PIOB website address is <http://www.ipiob.org>.

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