

May 2023

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# Proposed ISA (UK) 505 (Revised) Invitation to Comment and Impact Assessment

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## Objective

- The Financial Reporting Council (FRC) proposes, subject to consultation, to revise International Standard on Auditing (UK) 505 *External Confirmations* to reflect recent enforcement findings and to ensure that the standard is reflective of modern approaches to obtaining confirmations.
- Revised ISA (UK) 505, with its additional material on the use of digital platforms to obtain confirmations, greater focus on investigating exceptions and a prohibition on negative confirmations will improve the quality of audit engagements by addressing key public interest issues.

## Invitation to comment

- The FRC is requesting comments on this consultation by 1 September 2023. Comments are invited in writing on all aspects of the consultation, particularly in relation to questions 1-3 as detailed below. Comments on the Consultation Paper should be sent to:

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## Introduction

1. The Financial Reporting Council (FRC) is committed to acting as a proportionate and principles-based regulator and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality audit and assurance work, to maintain investor and wider stakeholder confidence in audit and assurance.
2. The ISAs (UK) are based on corresponding international standards issued by the IAASB. Where necessary, the international standards have been augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural, and business context.
3. ISA (UK) 505 *External Confirmations* includes the requirements and application material relevant to auditors when seeking to use external confirmations as a source of audit evidence. Though it was updated for conforming amendments in May 2022, the core standard and its requirements have not been revised since 2016.
4. Recent enforcement findings demonstrated that the work undertaken by some auditors in relation to investigating exceptions, for example when confirmations do not contain the information expected, was insufficient and that some auditors over-relied on negative confirmations when they were unlikely to provide sufficient evidence to support a conclusion.
5. Additionally, since the previous revision of ISA (UK) 505, new digital means of obtaining confirmations have become prevalent. Stakeholders indicated that whilst the core requirement in ISA (UK) 505 were still relevant, it would be beneficial to understand the regulatory position on the use of these digital means to obtain confirmations.
6. With both these factors in mind we convened a working group to consider the revision of ISA (UK) 505, comprising FRC staff from the Audit and Assurance Policy, Audit Quality Review and Enforcement teams, along with representatives from audit firms within the UK. This working group developed the proposed ISA (UK) 505, with a summary of the revisions highlighted below.

## Summary of Key Revisions

7. Included below is a summary of the proposed new UK material included within revised ISA (UK) 505:

Key UK Addition	Revised ISA (UK) 505 Paragraph Reference	Explanation
Additional clarification on what constitutes an electronic external confirmation	6(a)	<p>The requirements in ISA (UK) 505, though they make reference to an electronic medium, are structured in a way which most closely aligns with the sending and receiving of a physical letter. As such auditors have made repeated enquires of the FRC as to the acceptability of other forms of confirmation, such as direct access to third party information through software interfaces.</p> <p>In response to this, we have added in wording to paragraph 6 (a) which reflects the fact that confirmations may be obtained through directly accessing information held by third parties through web portals or software interfaces.</p>

		<p>For example, auditors might make use of the provisions within Open Banking legislation to access client bank accounts for the purposes of confirming the accuracy of amounts held, though we have not referred to any specific solution or means of access in order to ensure the ISA remains up to date.</p> <p>In order to ensure that auditors consider all relevant assertions when using such means of confirmation, we have strengthened the requirements within paragraph 7 (c) as discussed below.</p>
Prohibition on the use of negative confirmations	6 (c)	<p>Negative confirmations, where the confirming party responds directly only if the confirming party disagrees with the information provided in the request, have been prohibited in proposed ISA (UK) 505, to aid in improving the quality of audit evidence obtained when auditors make use of external confirmations.</p> <p>This is primarily due to enforcement findings where auditors have inappropriately relied on negative confirmations, for example where a response was unlikely ever to be received even if there were relevant matters, thus calling into question the suitability of a negative confirmation. They are also generally considered a less persuasive form of audit evidence than positive confirmations.</p> <p>Discussion within the working party indicated agreement that negative confirmations were not as effective as positive ones, and that better alternatives existed to obtain audit evidence when a positive confirmation request was not obtainable.</p>
Designing confirmations to provide evidence for relevant assertions	7 (c)	<p>In order to support the additions to paragraph 6(a) we have included additional material in paragraph 7(c) to ensure that auditors design confirmations in order to obtain sufficient appropriate audit evidence in relation to all assertions identified in respect of ISA (UK) 330.<sup>1</sup></p> <p>This is applicable to all means of confirmation but can be particularly relevant to certain forms of digital confirmation where the software interface or application may provide the auditor with evidence over some assertions, such as accuracy or valuation, but not completeness. In these instances, the auditor would have to ensure they have alternative evidence over other relevant assertions.</p>
Enhanced requirements in relation to investigating exceptions	14-1	<p>We have included enhanced requirements in relation to auditor responsibilities when investigating exceptions in response to enforcement findings that in some cases auditors are not appropriately considering risk when confirmations are not as expected.</p> <p>As such, the enhanced requirements direct auditors to consider if exceptions are indicative of fraud or a deficiency in the entity's system to internal control and how follow-up procedures will allow the auditor to obtain sufficient appropriate audit evidence.</p>

<sup>1</sup> ISA (UK) 330 (Revised July 2017) The Auditor's Responses to Assessed Risks

## Effective Date

8. The proposed effective date of revised ISA (UK) 505 for it to be effective for audits of financial statements for periods beginning on or after December 15, 2024.

## Questions

**Q1: Do you agree with the additional material included in respect of digital means of confirmation? If not, please provide your reasons.**

**Q2: Do you support the prohibition on negative confirmations? If not, please provide your reasons.**

**Q3: Do you support the enhanced requirements in relation to auditors investigating exceptions? If no, please provide your reasons.**

**Q4: Is the proposed effective date appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.**

## Impact Assessment

9. As a matter of policy, the FRC's auditing standards are based on the corresponding international standards issued by the IAASB. Where necessary the international standards are augmented with additional requirements to address specific UK legal and regulatory requirements; and additional guidance that is appropriate in the UK national legislative, cultural, and business context. We believe that the revisions to ISA (UK) 505 are appropriate and proportionate to address issues that have been identified since the current standard was issued. We propose to maintain the FRC's supplementary material, where appropriate, from the current standards.
10. We believe that benefits in the public interest of enhancements to the quality of audit, although not quantifiable, will outweigh the costs of changes that may be necessary to audit firms' approaches to group audit.

**Financial Reporting Council**

**May 2023**



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