

## SA 505 – “External Confirmations”

### DEFINITIONS

- **External confirmation** - Evidence obtained as a direct written response to auditor from a 3<sup>rd</sup> party in paper form, or by electronic or other medium.
- **Exception** - A response that indicates a **difference b/w info.** requested to be confirmed & **info. provided by confirming party** (needs to be assessed for entire population after analyzing reason).
- **Non-Response** - A **failure** of confirming party **to respond**, or fully respond, to a positive confirmation request, or a confirmation **request returned undelivered**
- **Negative confirmations request** - A request that confirming party **respond directly to auditor only** if confirming party **disagrees** with information provided in request.

### TYPES OF REQUESTS

Positive confirmation request	Negative confirmations
<ul style="list-style-type: none"> <li>▪ A positive external confirmation request asks confirming party to <b>reply in all cases</b>, either by indicating agreement or asking to provide info.</li> <li>▪ A response to a positive confirmation request is expected to provide <b>reliable audit evidence</b>.</li> <li>▪ There is a <b>risk</b>, that a <b>confirming party may reply, without verifying</b> that info. is correct.</li> <li>▪ Auditor may <b>reduce this risk</b> by using positive confirmation <b>requests that do not state amount &amp; ask</b> confirming party to fill amount.</li> <li>▪ Use of this type of <b>“blank” confirmation request may result in lower response rates</b>.</li> </ul>	<p>Negative confirmations <b>provide less persuasive audit evidence</b> than positive confirmations.</p> <p><b><u>Auditor shall NOT use negative confirmation requests as sole substantive audit procedure unless All of following are present:</u></b></p> <ol style="list-style-type: none"> <li>1. Auditor has <b>assessed ROMM</b> as <b>low</b> &amp; has obtained <b>SAAE regarding operating effectiveness of controls</b></li> <li>2. Population of items comprises a <b>large number of small, homogeneous</b>, a/c bal. or trxn.</li> <li>3. <b>Very low exception rate</b> is expected</li> <li>4. Auditor is <b>not aware of conditions that would cause recipients</b> to disregard such requests.</li> </ol>

### EXTERNAL CONFIRMATION PROCEDURES ADOPTED BY THE AUDITOR TO OBTAIN AUDIT EVIDENCE

- When using external confirmation, auditor shall maintain control over external confirmation requests :
1. **Determining Information to be confirmed or Requested** - To confirm any a/c balances / To confirm **terms of agreements** OR To confirm absence of certain conditions (side agreement)
  2. **Selecting the appropriate confirming Party** - Confirming party, auditor believes is **knowledgeable about information** to be confirmed
  3. **Designing confirmation requests including determining that requests are properly addressed and contain return information for responses to be sent directly to auditor** -
    - Design of a confirmation request may **directly affect** confirmation **response rate**, and **reliability of evidence obtained**.
    - **Determining that requests are properly addressed** includes **testing validity** of **some** or all of the **addresses** on confirmation requests before they are sent out.
  4. **Sending the Requests including Follow-Up requests when applicable, to confirming party** - Auditor may send an **additional confirmation request when** a **reply** to a previous request has **not** been **received** within a reasonable time.

Factors to consider when designing confirmation requests include:

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| <ul style="list-style-type: none"> <li>▪ <b>Assertions being addressed.</b></li> <li>▪ <b>Specific ROMM, including fraud risks.</b></li> </ul> | <ul style="list-style-type: none"> <li>▪ <b>Method of communication</b> (paper /electronic)</li> <li>▪ <b>Mgt.'s encouragement to confirming parties</b></li> </ul> |
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<ul style="list-style-type: none"> <li>▪ <b>Layout &amp; presentation</b> of confirmation request.</li> <li>▪ <b>Prior experience</b> on similar engagements.</li> </ul>	<p>to respond to auditor.</p> <ul style="list-style-type: none"> <li>▪ <b>Ability of intended confirming party</b> to confirm or provide requested info.</li> </ul>
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Mgt.'s refusal to allow auditor to send a confirmation request - Steps taken by auditor	Reasonableness of Mgt.'s refusal
<ol style="list-style-type: none"> <li>1. <b>Inquire</b> as to mgt.'s <b>reasons for refusal</b>, &amp; seek evidence of their <b>reasonableness</b></li> <li>2. <b>Evaluate implications</b> of mgt.'s refusal on auditor's assessment of ROMM, including risk of fraud, &amp; on NTE of other procedures.</li> <li>3. Perform <b>alternative procedures</b> designed to obtain relevant and reliable audit evidence.</li> <li>4. If <b>auditor concludes</b> that <b>mgt.'s refusal</b> to allow auditor to send a confirmation request is <b>unreasonable</b>, <b>OR</b> he is <b>unable to obtain relevant &amp; reliable audit evidence</b> from alternative audit procedures, <b>Communicate with TCWG</b> (SA 260)</li> <li>5. Auditor also shall <b>determine implications</b> for audit &amp; auditor's <b>opinion</b>. (SA 705)</li> </ol>	<p>A <b>refusal by mgt.</b> to allow auditor to send a confirmation request is a limitation on auditor.</p> <p>Auditor should <b>inquire reasons</b> for limitation.</p> <ul style="list-style-type: none"> <li>▪ A common reason is <b>existence of a legal dispute</b> or <b>ongoing negotiation</b> with intended confirming party, resolution of which may be affected by an untimely confirmation request.</li> <li>▪ <b>Seek evidence</b> as to <b>validity &amp; reasonableness of reasons because of risk that</b>, mgt. may be attempting to deny auditor access to audit evidence that <b>may reveal fraud or error</b>.</li> </ul>

No Response in case of Negative Confirmation:
<ul style="list-style-type: none"> <li>• The failure to receive a response to a negative confirmation request <b>does not explicitly indicate</b> verification of <b>accuracy of info</b>.</li> <li>• Accordingly, a failure of a confirming party to respond to a negative confirmation request <b>provides significantly less persuasive audit evidence</b>.</li> <li>• Confirming parties are <b>more likely to respond</b> indicating their disagreement with a confirmation request <b>when info. in request is NOT in their favor</b>, and less likely to respond otherwise. E.g. Holders of bank deposit a/c may be more likely to respond if they believe that the balance in their a/c is understated in confirmation request, but less likely to respond when bal. is overstated.</li> </ul>

Alternative audit procedures
<ul style="list-style-type: none"> <li>▪ <b>For A/c receivable balances</b> - examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.</li> <li>▪ <b>For A/c payable balances</b> - examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.</li> </ul>

## EVALUATING THE EVIDENCE OBTAINED

- Auditor shall **evaluate whether Results** of external confirmation procedures **provide relevant & reliable evidence**, or whether **performing further audit procedures is necessary**.
- When evaluating results of confirmation requests, auditor may categorise such results as follows:
 

<ul style="list-style-type: none"> <li>▪ A response indicating <b>agreement</b> with information provided in confirmation request, or providing <b>requested information without exception</b></li> <li>▪ A response <b>deemed unreliable</b></li> <li>▪ A <b>non-response</b></li> <li>▪ A response indicating an <b>exception</b>.</li> </ul>
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