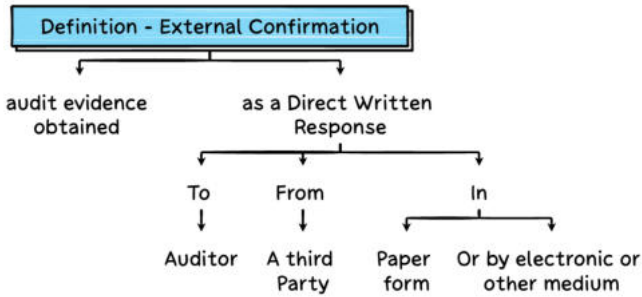


## SA 505 – External Confirmations



### Definitions of other terms

#### 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**.

#### 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.

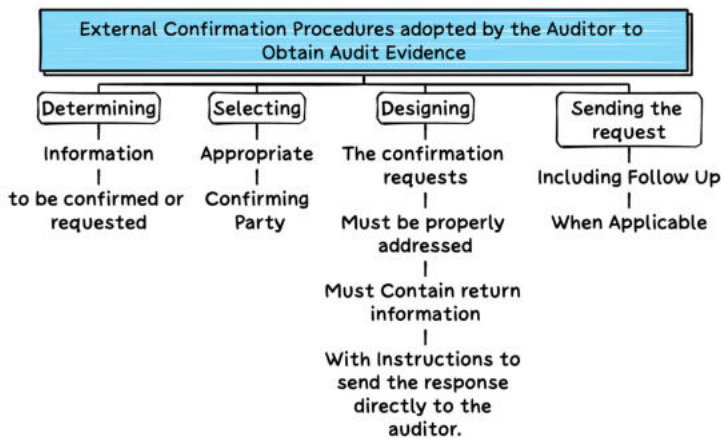
#### Non-response

A **failure** of the confirming party to **respond**, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

#### 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.

The exception needs to be assessed to the entire population after analyzing the reason for the difference.



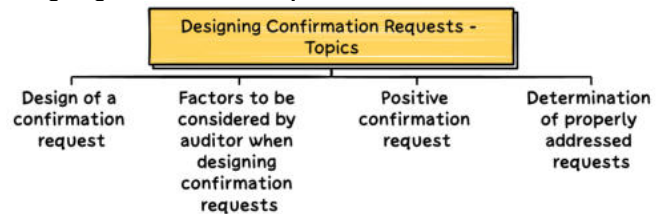
Determining the information to be confirmed or requeste	
frequently performed	to confirm or request information regarding account balances and their elements.
may also be used	to confirm terms of agreements, contracts, or transactions
	or to confirm the absence of certain conditions, such as a "side agreement"

### Selecting the appropriate confirming party;

- 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 financial institution from whom to request confirmation.

The auditor should choose a party that has accurate and direct knowledge of the information being confirmed. Example: A financial institution official familiar with the transactions or arrangements is the best person to confirm.

### Designing Confirmation Requests



#### Design of a confirmation request

- 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 response

#### Factors to be considered by auditor when designing confirmation requests

Factors to consider when designing confirmation requests 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 **authorisation** 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 authorisation.
- The **ability** of the **intended** confirming **party** to **confirm** or provide the requested information (for example, individual invoice amount versus total balance).

#### Positive confirmation request

Positive Confirmation Request

- Ask Confirming Party to Reply the Auditor in all cases:
  - Either Agreement
  - Disagreement

- or Providing the info Requested
- It Provides Reliable Audit Evidence
- Risk → Reply without verification
  - To Reduce this risk send Request without stating Amount or a Request to furnish info
  - But it may lead to decline in Confirmation Response Rate

### Determination of properly addressed requests

- Ensure Requests are Properly Addressed
- Check Validity of Some Addresses before Sending Confirming Requests

### Follow-Up on Confirmation Requests

- The auditor may send an **additional** confirmation request when a reply to a previous request has not been received within a reasonable time.
- For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

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

If management refuses to allow the auditor to send a confirmation request, the auditor shall

- **Inquire** as to management's **reasons** for the refusal, and seek **audit evidence** as to their **validity** and reasonableness
- Evaluate the **implications** of management's refusal **on risks** of material misstatement, **including** the risk of **fraud**, and on the nature, timing and extent of other **audit procedures**; and
- Perform **alternative audit procedures** designed to obtain relevant and reliable audit evidence.

### Common reason

Common reason: Legal dispute or ongoing negotiation with the confirming party which may be affected by an untimely confirmation request.

### Alternative Audit Procedures

Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
- For accounts payable balances – examining subsequent cash disbursements, and other records, such as goods received notes.

### If Refusal is Unreasonable or Alternative Procedures Fail

- Auditor must communicate with TCWG (SA 260).
- Determine audit implications and opinion as per SA 705.

DPQ 🍷👉 CA Rishi is appointed as an auditor of AIR Ltd. for the financial year ending on March 31, 2024. During the audit, he observed that the company's books of accounts reflect a significant number of trade payables and receivables as on the balance sheet date. To verify the accuracy of the

trade receivables, CA Rishi decided to send confirmation requests to some of trade receivables. However, the management refused to permit him to send these confirmation requests to the selected parties. How should the auditor proceed in the given situation? (MTP2, Jan 2025, 5 marks)

### Negative Confirmations (When to use?)

- A request that the confirming party **respond** directly to the auditor **only if** the **confirming party disagrees** with the information provided in the request.
- Negative Confirmations: Provide less persuasive audit evidence than positive confirmations.
- Not used as sole substantive procedure unless all conditions are met.
  - a. The auditor has assessed the **risk** of material misstatement as **low** and has obtained **sufficient appropriate audit evidence** regarding the **operating effectiveness** of **controls** relevant to the assertion;
  - b. The population of items subject to negative confirmation procedures comprises a large number of **small, homogeneous** account balances, transactions or conditions;
  - c. A very **low exception rate** is expected; and
  - d. The auditor is **not aware** of **circumstances** or conditions that would **cause** recipients of negative confirmation requests to **disregard** such requests.

### Negative Confirmations Other points - Limitations

- No response does not confirm receipt or accuracy of information.
- Provides less persuasive evidence than positive confirmations.
- Confirming parties more likely to respond if information is unfavorable to them.
- Example:
  - Bank deposit holders may respond if their balance is understated but not if overstated.
  - In this case, Negative confirmations help detect understatement, but not overstatement.

### Evaluating the Evidence Obtained

Auditor assesses if confirmation results are relevant and reliable or if **further audit procedures** are needed. Individual confirmation results may be categorized as follows

- A **response** by the appropriate confirming party **indicating agreement** with the information provided in the confirmation request, or providing requested information without exception;
- A **response deemed unreliable**;
- A **non-response**; or
- A **response indicating** an exception.