

## EXTERNAL CONFIRMATIONS (LECTURE A639 – 7.33 MINUTES)

External confirms are dealt with in ISA (UK) 505 *External Confirmations*. ISA (UK) 505 cross-refers to ISA (UK) 500 *Audit Evidence* by noting that the following generalisations apply to audit evidence:

- 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.

*ISA (UK) 505 para 2*

Depending on the circumstances, external confirmations may prove to be more reliable than evidence generated internally by the entity.

The objective of ISA (UK) 505 is for the auditor to design and perform such procedures to obtain relevant and reliable audit evidence when using external confirmations.

### **1.1 Requirements**

The auditor is required to maintain control over all external confirmation requests. This includes:

- Determining the information to be confirmed or requested.
- Selecting the appropriate party to make the confirmation.
- Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor.
- Sending the requests, including follow-up requests when applicable, to the confirming party.

The most common types of external confirmations requested by audit firms include bank audit letters (although the mandatory requirement to obtain a bank audit letter has been relaxed and such letters are determined on a risk basis by the auditor) and debtors circularisation letters.

### **1.2 Management refuses to allow a confirmation request**

Although quite rare in practice, in situations when management refuses to allow the auditor to send a confirmation request, the auditor must:

- Determine why management has refused the request and obtain audit evidence to support their validity and reasonableness.
- Consider the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including fraud risk as well as on the nature, timing and extent of other audit procedures.

- Perform alternative audit procedures which are designed to obtain relevant and reliable audit evidence.

Where the auditor concludes that management's refusal is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from other procedures, the auditor must enter into communication with those charged with governance in accordance with ISA (UK) 260 *Communication with Those Charged with Governance*. In addition, the auditor must also determine the implications for the auditor's opinion in accordance with ISA (UK) 705 *Modifications to the Opinion in the Independent Auditor's Report*.

### **1.3 Evaluating the results**

Where an external confirmation is received by the auditor, but the auditor has doubts concerning the reliability of the response to a confirmation request, the auditor must obtain further audit evidence to resolve those doubts. This could arise, for example, where the auditor does not believe the response is authentic or the auditor does not believe the response is portraying accurate information.

Where the auditor concludes that a response is unreliable, the auditor must evaluate the implications on the assessment of the relevant risks of material misstatement (including fraud risks) as well as on the related nature, timing and extent of other audit procedures.

In all cases, the auditor must evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. In cases such as trade debtors circularisations, further audit procedures will always be necessary to address the valuation assertion (e.g. after-date cash receipts testing).

#### ***Non-responses***

Response rates for certain types of external confirmations can be quite low; particularly for debtors circularisations. Where non-responses are concerned, the auditor must carry out alternative audit procedures to obtain relevant and reliable audit evidence. For example, with the client's permission, contacting the client's customer and asking for confirmation of their purchase ledger balance by telephone or confirmation by other forms, such as in an email.

In rare situations, the auditor may conclude that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence where alternative audit procedures will not provide such evidence. In these situations, where the auditor does not obtain such confirmation, they determine the implications for the audit and the auditor's opinion (which may be qualified due to a limitation in scope/insufficient evidence).

#### ***Exceptions***

In some cases, a response may be received that indicates exceptions – for example a debtor's circularisation may request positive confirmation of a £2,000

balance at the year-end, but the customer states the amount on their purchase ledger is only £1,700. In such situations, the auditor must investigate such exceptions to establish whether, or not, they are indicative of misstatements.

## **1.4 Negative confirmations**

Circularisations to customers and suppliers can be both positive and negative. However, ISA (UK) 505 recognises that negative confirmations provide less persuasive audit evidence than positive ones. To that end, the standard does not allow the auditor to use negative confirmation requests as sole substantive procedures to address an assessed risk of material misstatement at the assertion level, unless **all** of the following are present:

- (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.'*

*ISA (UK) 505 para 15(a) to (d)*