

Selected Preliminary Drafting for Proposed ISA 505 (Revised), *External Confirmations*

This Agenda Item includes selected preliminary drafting for Proposed ISA 505 (Revised).

Introduction

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Objective

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Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

(aA) Confirming party – A third party, whether an individual or an organization, to which the auditor sends an external confirmation request. An intermediary is not a confirming party.

(eaB) 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

(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-digital~~ or other medium.

(aC) Intermediary – A party, other than the auditor or the confirming party, who facilitates external confirmation requests and responses between the auditor and the confirming party.

(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.

(bdA) 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.

Requirements

External Confirmations for Cash and Cash Equivalents and Accounts Receivable

6A. In applying Proposed ISA 330 (Revised),¹ if the auditor's assessment of risks of material misstatement at the assertion level for cash and cash equivalents held by third parties or accounts receivable balances and disclosures is such that the inherent risk is not on the lower end of the spectrum of inherent risk, the audit shall determine whether external confirmation procedures are to be performed for these balances and disclosures. (Ref: Para. A0A–A0C)

External Confirmation Procedures

7. When using external confirmation procedures, the auditor shall maintain control over the external

¹ Proposed ISA 330 (Revised), paragraph 19

confirmation ~~requests~~process, ~~including~~by:

- (a) Determining the information to be confirmed or requested; (Ref: Para. A1)
- (aa) Selecting the items to be confirmed or requested:
- (b) Selecting the appropriate confirming ~~party~~parties; (Ref: Para. A2)
- (c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor or through an intermediary; and (Ref: Para. A3–A6)
- (d) Sending the requests, including follow-up requests when applicable, directly to the confirming ~~party~~parties or through an intermediary. (Ref: Para. A7)
- (e) Obtaining the confirmation responses directly from the confirming parties or through an intermediary.

Using an Intermediary

7A. When using an intermediary in the external confirmation process, the auditor shall evaluate the implications of their use on the reliability of confirmation requests and confirmation responses. (Ref: Para. AXX)

Negative ~~Confirmations~~ Confirmation Requests

~~457B.~~ [Moved from paragraph 15] Negative confirmations ~~requests~~ provide less persuasive audit evidence than positive confirmations ~~requests~~. Accordingly, the auditor shall ~~only not~~ use negative confirmation requests ~~as the sole substantive audit procedure~~ to address an assessed risk of material misstatement at the assertion level in combination with other substantive procedures and unless if all of the following preconditions are present: (Ref: Para. ~~A23~~A7A–A7C)

- (a) The auditor's ~~has assessed~~assessment of the risks of material misstatement at the assertion level is such that the inherent risk is on the lower end of the spectrum of inherent risks ~~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.

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, the auditor shall:
- (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)
 - (b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of material misstatement due to fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A9)

- (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A10)
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 relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with ISA 260 (Revised).² The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with ISA 705 (Revised).³

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

- 9A. In applying Proposed ISA 500 (Revised),⁴ the auditor shall evaluate the reliability of confirmation responses. In making this evaluation, the auditor shall consider any information about conditions, events or circumstances that the auditor becomes aware of that: (Ref: Para. AXX–AXX)
- (a) Impairs the credibility of the selected confirming party; or
- (b) Indicates that the confirmation request or confirmation response may have been intercepted or altered.
10. In applying Proposed ISA 500 (Revised),⁵ If the auditor identifies factors that give rise to has doubts about the reliability of the response to a confirmation request, the auditor shall determine what modifications to external confirmation procedures, or what other audit procedures, are necessary obtain further audit evidence to resolve those doubts. (Ref: Para. A11–A16)
11. In applying Proposed ISA 500 (Revised),⁶ If doubts about the reliability of confirmation responses cannot be resolved 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 material misstatement due to fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para. A17)

Non-Responses

12. In the case of each non-response, the auditor shall perform alternative audit procedures for the selected item to obtain relevant and reliable audit evidence. (Ref: Para A18–A19)

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

13. If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with ISA 705 (Revised). (Ref: Para

² ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 16

³ ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

⁴ Proposed ISA 500 (Revised), paragraph 9

⁵ Proposed ISA 500 (Revised), paragraph 12(b)

⁶ Proposed ISA 500 (Revised), paragraph 12A

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Exceptions

14. The auditor shall investigate exceptions to determine whether or not they are indicative of: misstatements. (Ref: Para. A21–A22A)
- (a) Misstatements and if so, whether such misstatements are indicative of fraud;⁷ or
- (b) Deficiencies in the entity's system of internal control.⁸
15. **[Moved to paragraph 7C]**

Evaluating the Evidence Obtained

16. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (Ref: Para A24–A25)

Application and Other Explanatory Material

External Confirmations for Cash and Cash Equivalents and Accounts Receivable (Ref: Para 6A)

A0A. Proposed ISA 330 (Revised)⁹ provides examples of situations in which external confirmation procedures may provide audit evidence in responding to assessed risks of material misstatement at the assertion level. Proposed ISA 500 (Revised)¹⁰ recognizes external confirmation procedures as a type of audit procedure auditors design and perform to obtain audit evidence and also provides examples of situations where external confirmations may be requested by the auditor.

A0B. The auditor may determine not to use external confirmation procedures to address assessed risks of material misstatement at the assertion level for cash and cash equivalents and accounts receivable balances and disclosures. This may be the case when doing so would be:

- Ineffective, such as when, based on the auditor's prior years' audit experience with the entity or experience with similar entities, external confirmation response rates to properly designed confirmation requests are expected to be inadequate.
- Impracticable, such as when the auditor is unable to identify a confirming party who could provide reliable responses to confirmation requests.

In such circumstances, the auditor may need to modify planned further audit procedures in accordance with Proposed ISA 330 (Revised)¹¹ and may, for example, perform audit procedures by directly accessing information maintained by a knowledgeable external source.

A0C. Depending on the auditor's assessed risks of material misstatement at the assertion level, the auditor

⁷ ISA 450, paragraph 5A

⁸ ISA 315 (Revised 2019), paragraph 27

⁹ Proposed ISA 330 (Revised), paragraph A50

¹⁰ Proposed ISA 500 (Revised), Appendix 1, paragraph 6

¹¹ Proposed ISA 330 (Revised), paragraph 6

may perform other substantive procedures or tests of controls in addition to external confirmation procedures for cash and cash equivalents held by third parties and accounts receivable balances and disclosures to reduce audit risk to an acceptably low level.

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Negative Confirmations Requests (Ref: Para. 457B)

A23A7A. 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 or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request, but may be less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding overstatement. **[Moved from paragraph A23]**

A7B. The following example illustrates a situation where the use of negative confirmation requests, in combination with other substantive procedures, may provide sufficient appropriate audit evidence to address an assessed risk of material misstatement at the assertion level.

Example:

An entity has many suppliers (e.g., office supplies vendors) with low-value balances. There are effective controls over purchase orders, goods receipt, and invoice matching. The population of items to be confirmed comprises homogeneous accounts payable balances arising from routine, low-value purchases with similar terms. There are few historical disputes or unmatched invoices. The auditor considers that suppliers would be likely to respond if the stated payable balances are incorrect (especially if understated) because, for example, they rely on timely payments. Therefore, the auditor sends negative confirmation requests, in combination with other substantive procedures, asking suppliers to respond only if the stated payable balance is incorrect.

A7C. The following are examples of other substantive procedures that auditors may perform in combination with negative confirmation requests:

- Substantive analytical procedures.
- Tests of details over subsequent cash receipts or payments.
- Cut-off testing over sales or purchase transactions.

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A23. **[Moved to paragraph A7D]**

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