

**STATEMENT OF AUDITING STANDARDS**  
**402**  
**EXTERNAL CONFIRMATIONS**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)\**

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\* HKSA 505 "External Confirmations" is effective for audits of financial statements for periods beginning on or after 15 December 2004.

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*Statements of Auditing Standards (SAs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SAs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

## **Introduction**

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance on the auditors' use of external confirmations as a means of obtaining audit evidence.
2. *The auditors should determine whether the use of external confirmations is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions. In making this determination, the auditors should consider materiality, the assessed level of inherent and control risk, and how the evidence from other planned audit procedures will reduce audit risk to an acceptably low level for the applicable financial statement assertions. (SAS 402.1)*
3. SAS 400 "Audit evidence" states that the reliability of audit evidence is influenced by its source and nature. It indicates that, in general, audit evidence from external sources is more reliable than audit evidence generated internally, and that written audit evidence is more reliable than audit evidence in oral form. Accordingly, audit evidence in the form of written responses to confirmation requests received directly by the auditors from third parties who are not related to the entity being audited, when considered individually or cumulatively with audit evidence from other procedures, may assist in reducing audit risk for the related assertions to an acceptably low level.
4. External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements. In deciding to what extent to use external confirmations the auditors consider the characteristics of the environment in which the entity being audited operates and the practice of potential respondents in dealing with requests for direct confirmation.
5. External confirmations are frequently used in relation to account balances and their components, but need not be restricted to these items. For example, the auditors may request external confirmation of the terms of agreements or transactions an entity has with third parties. The confirmation request is designed to ask if any modifications have been made to the agreement, and if so what the relevant details are. Other examples of situations where external confirmations may be used include the following:
  - a. Bank balances and other information from bankers.
  - b. Accounts receivable balances.
  - c. Inventories held by third parties at bonded warehouses for processing or on consignment.
  - d. Property title deeds held by lawyers or financiers for safe custody or as security.
  - e. Investments purchased from stockbrokers but not delivered at the balance sheet date.
  - f. Loans from lenders.
  - g. Accounts payable balances.

Further guidance on bank confirmation requests is set out in paragraphs 42 - 52 below.

6. The reliability of audit evidence obtained by external confirmations depends, among other factors, upon the auditors applying appropriate procedures in designing the external confirmation request, performing the external confirmation procedures, and evaluating the results of the external confirmation procedures. Factors affecting the reliability of confirmations include the control the auditors exercise over confirmation requests and responses, the characteristics of the respondents, and any restrictions included in the response or imposed by management.

### **Relationship of external confirmation procedures to the auditors' assessments of inherent risk and control risk**

7. SAS 300 "Audit risk assessments and accounting and internal control systems" discusses audit risk and the relationship between its components: inherent risk, control risk, and detection risk. It outlines the process of assessing inherent and control risk to determine the nature, timing, and extent of substantive procedures to reduce detection risk, and therefore audit risk, to an acceptable level.
8. SAS 300 also indicates that the nature and extent of audit evidence to be obtained from the performance of substantive procedures varies depending on the assessment of inherent and control risks, and that the assessed levels of inherent and control risk cannot be sufficiently low to eliminate the need to perform any substantive procedures. These substantive procedures may include the use of external confirmations for specific financial statement assertions.
9. Paragraph 58 of SAS 300 indicates that the higher the assessment of inherent and control risk, the more audit evidence the auditors need to obtain from the performance of substantive procedures. Consequently as the assessed level of inherent and control risk increases, the auditors design substantive procedures to obtain more audit evidence, or more persuasive evidence, about a financial statement assertion. In these situations, the use of external confirmation procedures may be effective in providing sufficient appropriate audit evidence.
10. The lower the assessed level of inherent and control risk, the less assurance the auditors need from substantive procedures to form a conclusion about a financial statement assertion. For example, an entity may have a loan that it is repaying according to an agreed schedule, the terms of which the auditors have confirmed in previous years. If the other work carried out by the auditors (including such tests of controls as are necessary) indicates that the terms of the loan have not changed and has led to the level of inherent and control risk over the balance of the loan outstanding being assessed as low, the auditors might limit substantive procedures to testing details of the payments made, rather than again confirming the balance directly with the lender.
11. Unusual or complex transactions may be associated with higher levels of inherent or control risk than simple transactions. If the entity has entered into an unusual or complex transaction and the level of inherent and control risk is assessed as high, the auditors consider confirming the terms of the transaction with the other parties in addition to examining documentation held by the entity.

### **Assertions addressed by external confirmations**

12. SAS 400 categorizes the management assertions embodied in financial statements as existence, rights and obligations, occurrence, completeness, valuation, measurement, and presentation and disclosure. While external confirmations may provide audit evidence regarding these assertions, the ability of an external confirmation to provide audit evidence relevant to a particular financial statement assertion varies.
13. External confirmation of an account receivable provides strong audit evidence regarding the existence of the account as at a certain date. It also provides audit evidence regarding the operation of cut-off procedures. However, such confirmation does not ordinarily provide all the necessary audit evidence relating to the valuation assertion, since it is not practicable to ask the debtor to confirm detailed information relating to its ability to pay the account.
14. Similarly, in the case of goods held on consignment, external confirmation is likely to provide strong audit evidence to support the existence and the rights and obligations assertions, but might not provide audit evidence that supports the valuation assertion.

15. The relevance of external confirmations to auditing a particular financial statement assertion is also affected by the objective of the auditors in selecting information for confirmation. For example, when auditing the completeness assertion for accounts payable, the auditors need to obtain audit evidence that there is no material unrecorded liability. Accordingly, sending confirmation requests to an entity's principal suppliers asking them to provide copies of their statements of account directly to the auditors, even if the records show no amount currently owing to them, will usually be more effective in detecting unrecorded liabilities than selecting accounts for confirmation based on the larger amounts recorded in the accounts payable subsidiary ledger.
16. When obtaining evidence for assertions not adequately addressed by external confirmations, the auditors consider other audit procedures to complement external confirmation procedures or to be used instead of external confirmation procedures.

### **Design of the external confirmation request**

17. *The auditors should tailor external confirmation requests to the specific audit objective. (SAS 402.2)*
18. When designing the external confirmation request, the auditors consider the assertions being addressed and the factors that are likely to affect the reliability of the confirmations. Factors such as the form of the external confirmation request, prior experience on the audit or similar engagements, the nature of the information being confirmed, and the intended respondent, affect the design of the external confirmation requests because these factors have a direct effect on the reliability of the audit evidence obtained through external confirmation procedures.
19. Also, in designing the request, the auditors consider the type of information respondents will be able to confirm readily since this may affect the response rate and the nature of the audit evidence obtained. For example, certain respondents' accounting systems may facilitate the external confirmation of single transactions rather than of entire account balances. In addition, respondents may not always be able to confirm certain types of information, such as the overall accounts receivable balance, but may be able to confirm individual invoice amounts within the total balance.
20. External confirmation requests ordinarily include management's authorization to the respondent to disclose the information to the auditors. Respondents may be more willing to respond to an external confirmation request containing management's authorization, and in some cases may be unable to respond unless the request contains management's authorization.

### **Use of positive and negative confirmations**

21. The auditors may use positive or negative external confirmation requests or a combination of both.
22. A positive external confirmation request asks the respondent to reply to the auditors in all cases either by indicating the respondent's agreement with the given information, or by asking the respondent to fill in information. A response to a positive confirmation request is ordinarily expected to provide reliable audit evidence. There is a risk, however, that a respondent may reply to the confirmation request without verifying that the information is correct. The auditors are not ordinarily able to detect whether this has occurred. The auditors may reduce this risk, however, by using positive external confirmation requests that do not state the amount (or other information) on the confirmation request, but ask the respondent to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the respondents.
23. A negative external confirmation request asks the respondent to reply only in the event of disagreement with the information provided in the request. However, when no response has been received to a negative external confirmation request, the auditors remain aware that there will be no explicit evidence that intended third parties have received the confirmation requests and verified that the information contained therein is correct. Accordingly, the use of negative external confirmation requests ordinarily provides less reliable audit evidence than the use of positive external confirmation requests, and the auditors consider performing other substantive procedures to supplement the use of negative external confirmations.

24. Negative external confirmation requests may be used to reduce audit risk to an acceptable level when:
  - a. the assessed level of inherent and control risk is low;
  - b. a large number of small balances is involved;
  - c. a substantial number of errors is not expected; and
  - d. the auditors have no reason to believe that respondents will disregard these requests.
25. A combination of positive and negative external confirmations may be used. For example, where the total accounts receivable balance comprises a small number of large balances and a large number of small balances, the auditors may decide that it is appropriate to confirm all or a sample of the large balances with positive external confirmation requests and a sample of the small balances using negative external confirmation requests.

### **Management requests**

26. *When the auditors seek to confirm certain balances or other information externally, and management requests the auditors not to do so, the auditors should consider whether there are valid grounds for such a request and obtain evidence to support the validity of management's requests. If the auditors agree to management's request not to seek external confirmation regarding a particular matter, the auditors should apply alternative procedures to obtain sufficient appropriate audit evidence regarding that matter. (SAS 402.3)*
27. *If the auditors do not accept the validity of management's request and are prevented from carrying out the external confirmations, there has been a limitation on the scope of the auditors' work and the auditors should consider the possible impact on the auditors' report in accordance with SAS 600 "Auditors' reports on financial statements". (SAS 402.4)*
28. When considering the reasons provided by management, the auditors apply an attitude of professional skepticism and consider whether the request has any implications regarding management's integrity. The auditors consider whether management's request may indicate the possible existence of fraud or error. If the auditors believe that fraud or error exists, the auditors apply the guidance in [SAS 110 "Fraud and error"]. The auditors also consider whether the alternative procedures will provide sufficient appropriate audit evidence regarding that matter.

### **Characteristics of respondents**

29. The reliability of evidence provided by an external confirmation is affected by the respondent's competence, independence, authority to respond, knowledge of the matter being confirmed, and objectivity. For this reason, the auditors attempt to ensure, where practicable, that the external confirmation request is directed to an appropriate individual. For example, when confirming that a covenant related to an entity's long-term debt has been waived, the auditors direct the request to an official of the creditor who has knowledge about the waiver and has the authority to provide the information.
30. The auditors also assess whether certain parties may not provide an objective or unbiased response to an external confirmation request. Information about the respondent's competence, knowledge, motivation, ability or willingness to respond may come to the auditors' attention. The auditors consider the effect of such information on designing the external confirmation request and evaluating the results, including determining whether additional procedures are necessary. The auditors also consider whether there is sufficient basis for concluding that the external confirmation request is being sent to a respondent from whom the auditors can expect a response that will provide sufficient appropriate audit evidence. For example, the auditors may encounter significant unusual year-end transactions that have a material effect on the financial statements, the transactions being with a third party that is economically dependent upon the entity. In such circumstances, the auditors consider whether the third party may be motivated to provide an inaccurate response.

### **The external confirmation process**

31. *When performing external confirmation procedures, the auditors should maintain control over the process of selecting those to whom a request will be sent, the preparation and sending of external confirmation requests, and the responses to those requests. (SAS 402.5)*

32. Control is maintained over communications between the intended recipients and the auditors to minimize the possibility that the results of the external confirmation process will be biased because of the interception and alteration of external confirmation requests or responses. The auditors ensure that it is the auditors who send out the external confirmation requests, that the requests are properly addressed, and that it is requested that all replies are sent directly to the auditors. The auditors consider whether replies have come from the purported senders.

#### **No response to a positive confirmation request**

33. *The auditors should perform alternative procedures where no response is received to a positive external confirmation request. The alternative audit procedures should be such as to provide the evidence about the financial statement assertions that the external confirmation request was intended to provide. (SAS 402.6)*
34. Where no response is received, the auditors ordinarily send a reminder. Where there is still no response to the request, the auditors consider contacting the recipient of the request to elicit a response. Where the auditors are unable to obtain a response, the auditors use alternative audit procedures. The nature of alternative procedures varies according to the account and assertion in question. In the examination of accounts receivable, alternative procedures may include examination of subsequent cash receipts, examination of shipping documentation or other client documentation to provide evidence for the existence assertion, and sales cut off tests to provide evidence for the completeness assertion. In the examination of accounts payable, alternative procedures may include examination of subsequent cash disbursements or correspondence from third parties to provide evidence of the existence assertion, and examination of other records, such as goods received notes, to provide evidence of the completeness assertion.

#### **Reliability of responses received**

35. The auditors consider whether there is any indication that external confirmations received may not be reliable. The auditors consider the response's authenticity and performs procedures to dispel any concern. The auditors may choose to verify the source and contents of a response in a telephone call to the purported sender. In addition, the auditors request the purported sender to mail the original external confirmation directly to the auditors. With ever-increasing use of technology, the auditors consider validating the source of replies received in electronic format (for example, fax). Oral confirmations are documented in the working papers. If the information in the oral confirmations is significant, the auditors request the parties involved to submit written confirmation of the specific information directly to the auditors.

#### **Causes and frequency of exceptions**

36. *When the auditors form a conclusion that the external confirmation process and alternative procedures have not provided sufficient appropriate audit evidence regarding an assertion, the auditors should undertake additional procedures to obtain sufficient appropriate audit evidence. (SAS 402.7)*
37. In forming the conclusion, the auditors consider:
- the reliability of the external confirmations and alternative procedures;
  - the nature of any exceptions, including the implications, both quantitative and qualitative of those exceptions; and
  - the evidence provided by other procedures.

Based on this evaluation, the auditors determine whether additional audit procedures are needed to obtain sufficient appropriate audit evidence.

38. The auditors also consider the causes and frequency of exceptions reported by respondents. An exception may indicate a misstatement in the entity's records, in which case, the auditors determine the reasons for the misstatement and assesses whether it has a material effect on the financial statements. If an exception indicates a misstatement, the auditors reconsider the nature, timing and extent of audit procedures necessary to provide the audit evidence required.

## Evaluating the results of the external confirmation process

39. *The auditors should evaluate whether the results of the external confirmation process together with the results from any other procedures performed, provide sufficient appropriate audit evidence regarding the financial statement assertion being audited. (SAS 402.8)*
40. In conducting this evaluation the auditors consider the guidance provided by SAS 430 "Audit sampling".

## External confirmations prior to the year-end

41. When the auditors use external confirmation as at a date prior to the balance sheet date to obtain evidence to support a financial statement assertion, the auditors obtain sufficient appropriate audit evidence that transactions relevant to the assertion in the intervening period have not been materially misstated. For practical reasons when the level of inherent and control risk is assessed at less than high, the auditors may decide to confirm balances at a date other than the period end, for example, when the audit is to be completed within a short time after the balance sheet date. As with all types of pre-year-end work, the auditors consider the need to obtain further audit evidence relating to the remainder of the period.

## Bank confirmation requests

42. While this section deals specifically with communications with members of The Hong Kong Association of Banks (HKAB), the guidance is to be applied to confirmations requested of other financial institutions, for example, deposit-taking companies.
43. "Bank confirmation request" means a request of a bank to provide independent confirmation for audit purposes of such information as the entity's account balances, securities, treasury management instruments, documents and other related information held by the bank on behalf of the entity.
44. Information obtained from bank confirmation requests assists auditors in discharging their responsibilities to obtain sufficient appropriate audit evidence by providing external evidence in relation to such matters as the existence, completeness and valuation of assets and liabilities.
45. Through knowledge of the entity's business and audit planning, the auditors gain an understanding of the nature and extent of the entity's banking and treasury operations. Based on this understanding, the auditors would determine the significance of banking activities to the audit by reference to materiality and audit risk.
46. *The auditors should send bank confirmation requests when the entity's banking activities, including treasury operations, are significant to the audit. (SAS 402.9)*
47. Standard bank confirmation request form provides for the confirmation or provision of information which is customarily held by banks. The use of standard form is considered to be of benefit to both the banks and the auditors. Accordingly, a standard bank confirmation request form has been developed in conjunction with the HKAB, which is reproduced in the Appendix to this SAS.
48. When the auditors require information of matters not covered by the standard request form, a separate letter would be sent to cover the particular matter. The letter to the bank would clearly identify the details of the matter for which confirmation is required and would carry the entity's authorization for the bank to provide the confirmation to the auditors.
49. The auditors will review the bank's reply. The auditors may need to carry out additional tests on matters relating to the entity's banking relationship, for example when other audit procedures indicate doubt as to completeness of the information provided, a separate letter would be sent to the bank enquiring specifically about potential matters of concern.
50. The entity is to complete and sign the authorization on the bank confirmation request requesting its completion by the bank.
51. ~~The auditors are reminded to obtain from the client a list of authorised signatures, together with the specimen signatures and details of signing arrangements, and attach it with the standard request form to facilitate the confirmation of its accuracy and completeness by the banks.~~

52. The HKAB has agreed the following with the Hong Kong Institute of Certified Public Accountants:

a. Standard form

All requests for confirmation of balances/outstandings sent to banks by auditors will be in the standard request form as reproduced in the Appendix to this SAS. The only deviation which will be permitted is that the form may be reduced to A4 size (but no smaller); banks will be entitled to reject forms which deviate from the standard in any other way.

b. Timing

Auditors are required where possible to send the form to banks well in advance of the confirmed balance date, which will enable a much more prompt response to be given. Where auditors submit forms after the confirmed balance date, they would expect banks to charge more for the service. Any charges will be for account of the entity and not the auditors.

c. Submission of blank form

The form is to be submitted to the banks in blank.

d. Authorization

Auditors would need to ensure that entities sign the authorization with chops and signatures corresponding to those required by their account mandate.

e. Computer listings

Where an entity has outstandings in any category, it is acceptable for a bank to attach a computer or type-written listing, providing this is suitably identified and authenticated. Where a bank wishes to have the entire form printed by computer, including the headings, this will also be acceptable providing that the print-out is substantially in the column order of the form.

### **Compliance with International Standards on Auditing**

53. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 505 "External Confirmations".

### **Effective date**

54. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004.

To The Manager  
(Name of bank)

*In set of 4 pages*

\_\_\_\_\_  
Office \_\_\_\_\_

Date \_\_\_\_\_

Dear Sir,

**REQUEST FOR BANK CONFIRMATION OF INFORMATION FOR AUDIT PURPOSES**

A/C

(Customer's Name)

For the purposes of our annual audit please complete the attached form to show the following information relating to our affairs with your bank as at the close of business on ..... For each item, please state any factors which may limit the completeness of your reply; if there is nothing to report, state "none".

Please confirm the position by completing the section headed "Bankers' Confirmation" on the final page of this request.

You are hereby authorised to return this request after completion and together with any remarks you may have to our auditors, Messrs. .... of .....

You are hereby authorised to debit any charge for this service to our account number .....

It is understood that your reply to this request will in no way prejudice your rights in respect of your General Lien as Bankers.

Yours faithfully,

(Authorised Signature/s and Chop)

**Item 1 Deposits, Fixed or at Call held in your books**

	Receipt No.	Date	Amount	Interest Rate	Due Date
Local Currency					
Foreign Currency					

**Item 2 Savings Accounts held in your books**

	Account No.	Balance
Local Currency		
Foreign Currency		

**Item 3 Current Account Balance/s held in your books. Please state whether in credit (Cr) or overdrawn (Dr).**

	Account No.	Balance
Local Currency		
Foreign Currency		

**Item 4 Loan Account Debit Balance/s (excluding Loans in connection with Inward cargoes) in your books**

	Account No.	Balance
Local Currency		
Foreign Currency		

SAMPLE

**Item 5 Accounts closed during the year to confirmation date**

	Account No.	Account Type	Date Closed
Local Currency			
Foreign Currency			

**Item 6 Advances to Manufacturers and/or Packing Credits Account and/or Exports Loans granted**

	Account No.	Balance

**Item 7 Acceptances Outstanding in your books**

	Reference No.	Amount
Bills Receivable by you (Banker)		
of which, goods released against Trust Receipt		
Bills held by you for Collection		

**Item 8 Partial payments held by you**

	Reference No.	Amount
On account of Item 7		

**Item 9 Irrevocable Letters of Credit Outstanding in your books**

	Reference No.	Balance Unutilized	Expiry Date

**Item 10 Bills receivable by us (customer)**

	Reference No.	Amount
Bills purchased by you (and outstanding at this date)		
Bills held by you for Collection		

**Item 11 Marginal deposit held by you**

	Reference No.	Amount
On account of Item 7 and Item 9		
On account of Item 10		

**Item 12 Loans granted in connection with Inward Cargoes**

	Reference No.	Amount	Details of Cargo

**Item 13 Guarantees**

Given by you on our behalf	To whom Issued	Amount
i) Shipping Guarantees		
ii) Others		
Received by you on our behalf		

**Item 14 Foreign Exchange Contract Outstanding**

	Reference No.	Balance Unutilized	Rate	Delivery Date
Our (customer's) Sales to Bank				
Bank's Sales to us (customer)				

<b>Item 15 Other direct or contingent liabilities to you</b>	
<b>Item 16 Securities and other documents of title held by you</b>	
Against Facilities granted	
For Safe Custody	

**BANKERS' CONFIRMATION**

We confirm that the balances and information which we have inserted under items 1 to 16 above are correct and complete.

This information is given in strictest confidence, for the purposes of your audit, without any responsibility for error or omission on the part of this Bank, its employees, agents or informants.

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Manager

\* Please delete as appropriate

(Revised June 2002)