

Practical Guidance No. 7 (Issued – August 2010)

Topic: Existence and completeness of accounts receivables and accounts payables through confirmations

Introduction

1. Accounts receivables and accounts payables are usually material balances on the face of the balance sheet of most entities. It is therefore important for auditors to identify the specific risks pertaining to the existence and/or completeness of accounts receivables and accounts payables balances so that appropriate audit procedures can be designed to address such risks.
2. The most common procedure applied to obtain appropriate audit evidence to address the existence and/or completeness assertions of accounts receivables and accounts payables is by requesting external confirmation from the relevant debtors and creditors respectively.
3. With reference to the “Audit Practice Bulletin No 1 of 2010” issued by ACRA on 3 May 2010 on external confirmations, it is stated that “ACRA expects auditors to continue to use confirmations as a means of obtaining audit evidence to ascertain the existence and/or completeness of assets and liabilities”.

For a more detailed discussion on the issue of external confirmations, please refer to ACRA’s Audit Practice Bulletin No 1 of 2010.

4. This Practical Guidance discusses some of the common practical issues in addressing the assertions of existence and completeness of both accounts receivables and accounts payables through the use of external confirmations in the course of the audit.

Guiding Principles

5. Clarified SSA 500.A31 “Audit Evidence” indicates that the reliability of audit evidence is influenced by its source and nature, and is dependent on the individual circumstances under which it is obtained. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:
 - The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
 - Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
 - Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
 - Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.
6. Clarified SSA 505.7 “External Confirmations” states that when using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:
- Determining the information to be confirmed or requested;
 - Selecting the appropriate confirming party;
 - Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
 - Sending the requests, including follow-up requests when applicable, to the confirming party.
7. The Audit Guidance Statement (“AGS”) 2 “Verification of Debtors Balances – Confirmation by Direct Communication” also provides detailed guidance on confirming receivable balances. Notwithstanding that AGS 2 addresses specifically on circularization of accounts receivables balances, the same principle therein should apply to the circularization of accounts payable balances.

Practical Application

8. Whilst seeking external confirmation is one effective and common way of obtaining reliable audit evidence pertaining to the existence and/or completeness of accounts receivables and payables, auditors need to bear in mind some of the common practical issues to keep the confirmation process effective.

Control over the confirmation process

9. For the confirmation process to be effective in gathering reliable audit evidence, it is paramount that auditors exercise control over the confirmation requests and responses. This includes the auditors sending out the confirmations themselves and requesting that the confirmations be returned to their offices directly.

Objectives of the confirmations request

10. In designing the confirmation request, auditors need to take into consideration the objective to meet. For example, to ascertain the completeness of accounts payables, the auditor would consider sending a “blank” confirmation to the respondents, to fill in the balances due to them.

Non-replies to external confirmation requests

11. In the event where there are no replies to the confirmation requests circularized, Clarified SSA 505.12 requires the auditor to perform alternative procedures to obtain relevant and reliable audit evidence. These alternative audit procedures should provide audit evidence on the assertions that the confirmation request was intended to provide and should cover 100% of the circularized balances where replies are not received.
12. This means that the auditor is required to verify other supporting documents as an alternative procedure to ascertain the existence and completeness assertions of the accounts receivables and accounts payables balances.
13. For accounts receivables, alternative procedures would include the examination of subsequent cash receipts, shipping documentation or any other documentation that supports the existence assertion of accounts receivables. Sales invoices are considered internally generated documents and therefore not a reliable source of information to address the existence of accounts receivables.
14. For accounts payables, the auditor should perform alternative procedure through the examination of supplier invoices with accompanying delivery documents including shipping documents to provide audit evidence of the existence assertion. The search for unrecorded liabilities after year end is also a mitigating procedure in addressing the completeness of liabilities.

Circularization of confirmations before year end

15. In cases where the auditor is required to issue an audit opinion shortly after the balance sheet date to meet the tight reporting deadlines of the audit client, the auditor may

consider performing an audit on certain account balances prior to the balance sheet date at an interim date. In such instances, the auditor needs to perform roll forward procedures such as by verifying to evidence of customer acknowledgement and/or suppliers' delivery orders and suppliers' invoices for purchases respectively to validate the movements during the intervening period between the interim date and the balance sheet date.

Returned confirmations with discrepancies/exceptions

16. When the returned confirmations show discrepancies or exceptions, auditors are expected to investigate such matters by reviewing and testing the reconciling items by vouching to the relevant supporting documents and evaluating whether balances with exceptions require any adjustments.
17. Should the auditor evaluate that the discrepancies noted is not an isolated case, the auditor would need to consider extending the samples or scope of audit procedures to ascertain that the accounts receivables and accounts payables balances recorded in the books are not misstated.

Conclusion

18. In conclusion, the auditor needs to exercise professional skepticism in forming the conclusion on whether the audit evidence gathered through the confirmation process and alternative audit procedures are sufficient and appropriate to address the existence and completeness of accounts receivable and accounts payable balances as at the reporting date.

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