



United States Government Accountability Office
Washington, DC 20548

May 29, 2009

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Subject: PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2009-002,
Concept Release on Possible Revisions to PCAOB's Standard on Audit Confirmations

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) concept release on possible revisions to the auditing standard on audit confirmations.

We appreciate the PCAOB's efforts to establish auditing standards on audit confirmations for registered companies and agree that confirmation procedures can be an important means of obtaining audit evidence.

We have serious concerns about the PCAOB's proposal to retain and even expand the presumptive requirement to request confirmation of accounts receivable. International Standard on Auditing (ISA) 505, *External Confirmations*, does not require confirmation of particular accounts or transactions. Confirmation of accounts receivable has been a presumptively mandatory requirement in the U.S. since 1939 in response to a fraud case, where the auditors failed to detect misstatements due to fictitious accounts receivable. In its release, the PCAOB states; "The Board believes that it is important to retain the presumption to request confirmation of accounts receivable and to consider whether additional, similar presumptions to request confirmation of certain other accounts may be appropriate. In addition, the Board is considering whether and how improvements to the standard on confirmations could enhance the quality of audits." Yet the Board does not present any evidence or reasoning to support its belief that the presumptively mandatory requirement should not only be maintained, but possibly expanded.

As the Board examines the confirmation standard to determine if it continues to be appropriate in the current business climate, we encourage a thorough reconsideration of the benefits and drawbacks of retaining the presumption to request confirmation of accounts receivable and adding similar presumptions to request confirmation of certain other accounts. With 70 years experience implementing this Standard in the U.S., there should exist ample bodies of evidence to facilitate research in this area. The presumptive requirement, in our opinion, is problematic because it supplants auditor judgment, may result in over-reliance on confirmation procedures, and does not take into account

dramatic changes in the conduct of business since the requirement was put in place in 1939.

The presumptive requirement supplants auditor judgment by presuming that confirmation procedures are the most effective audit procedure to address the risk of material misstatement in accounts receivable, and directs the auditor to perform the audit using that assumption. Rather than requiring auditors to use judgment based on audit risk and materiality to determine the most effective procedure to obtain audit evidence supporting management's assertions related to accounts receivable, the presumptive requirement has auditors using the same procedure regardless of risk, materiality, or other relevant facts and circumstances. In addition, the presumption that requesting confirmations is always the most effective audit procedure is not entirely consistent with the PCAOB's proposed auditing standard *The Auditor's Responses to the Risks of Material Misstatement*, which states that the auditor should design and perform audit procedures the nature, timing, and extent of which are based on and address the risks of material misstatement for each relevant assertion of each significant account and disclosure.¹

The unintended consequence of the requirement is that it may encourage auditors to: (1) minimize the importance of risk and materiality assessments of accounts receivable, since the procedures to be performed on accounts receivable are predetermined; (2) spend too much time performing confirmation procedures in situations when there is a low risk of material misstatement for accounts receivable or when relevant and reliable audit evidence, such as subsequent collection, is available; and (3) spend too little time evaluating risk and performing analyses in situations when there is a risk of material misstatement for accounts receivable due to collusion between the audited entity and the customer.

Over-reliance on confirmation procedures may result from the premise that evidence is more reliable when it is obtained from independent sources outside the entity,² which is reinforced by the presumptively mandatory requirement. A key presumption is that the responding party, in addition to being knowledgeable and independent, is willing to spend the time and effort needed to provide accurate and valid information in the confirmations and submit their response to the auditors. It is often difficult for auditors to evaluate the responder's knowledge and independence and determine whether the confirmed information was actually verified by the confirming party.

Furthermore, research suggests that practitioners may place undue reliance on confirmation procedures by assuming that the confirmations are derived from independent sources.³ Studies of Accounting and Auditing Enforcement Releases issued by the Securities and Exchange Commission (SEC) have identified several confirmation pitfalls, including a significant number of cases of collusion between auditees and customers.⁴

¹ PCAOB Release No. 2008-006, October 21, 2008, page A4-4, par. 6.

² PCAOB standard AU Sec 326.21a.

³ P. Caster, R. Elder, and D. Janvrin, "Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory*, vol. 27, no. 2 (2008). Pg. 270.

⁴ *Ibid.* pg 255.

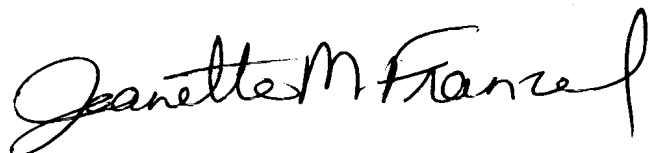
Finally, the presumptive requirement does not take into account dramatic changes that have occurred in the conduct of business since 1939. Auditors are required to direct confirmation requests to third parties whom the auditor believes are knowledgeable about the information being confirmed.⁵ This requirement appears to presume existence of a relationship between the audited entity and the responder, as may have existed 70 years ago when the presumptive requirement was adopted.⁶ Since then, however, the U.S. economy has become much more complex and decentralized, making such relationships less likely. Many vendors and suppliers now outsource their administration functions, such as bill paying and responding to confirmation requests.

We recommend that the PCAOB reconsider the appropriateness of retaining the presumptive requirement for auditors to request confirmation of accounts receivable. An effective approach to obtaining evidence to support the entity's assertions related to accounts receivable is to apply provisions of the audit risk and evidence standards to determine whether audit confirmation procedures would be most effective. These standards and the related guidance provide sufficient principles-based direction for auditors to determine when to use audit confirmation procedures.

The Board has requested comment on the specific questions noted in the Attachment to the Concept Release. We provide the requested comments in Attachment 1 to this letter. Because our responses reference paragraphs from the International Standard on Auditing (ISA) 505, *External Confirmations*, and the Proposed Statement on Auditing Standards (SAS), *External Confirmations (Redrafted)*, we have also attached copies of those documents.

We thank you for considering our comments on this very important issue.

Sincerely yours,



Jeanette M. Franzel
Managing Director
Financial Management and Assurance

Enclosures:

cc: The Honorable Mary L. Shapiro, Chairman
Securities and Exchange Commission

⁵ PCAOB standard AU Sec 330.26.

⁶ PCAOB Release No. 2009-002, April 14, 2009, page 7.

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board

James L. Kroeker, Acting Chief Accountant
Securities and Exchange Commission

Mr. Harold Monk, Jr., Chair
Auditing Standards Board

Mr. Martin F. Baumann, Chief Auditor
Public Company Accounting Oversight Board

GAO's Responses to Specific Questions in the Attachment to PCAOB Concept Release

Question 1:

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

No, we believe the objective stated above would not be appropriate because it has as its basis the presumptively mandatory requirement for auditors to perform procedures to confirm accounts receivable. As noted in our letter, we have serious concerns with the presumption that auditors should always use confirmation procedures to obtain evidence supporting management's assertions related to accounts receivable. Instead, we recommend that the PCAOB adopt the following objective, which is consistent with ISA 505 and presumes that the auditor has conducted a separate evaluation to determine whether confirmations would be an effective audit procedure given the facts, circumstances, and assessed risks: *"The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."*

Questions 2, 3 & 4:

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

The definition of confirmation should allow for non-traditional responses such as facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party. We believe, however, that the PCAOB should not include oral statements in its definition. Oral statements may be testimonial evidence, but they are not confirmations. We recommend adopting the following definition of confirmation, which is consistent with the draft ASB standard: *"Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form, or by electronic or other medium, or through direct access by the auditor to information held by a third party."*

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

All confirmation responses carry some risk of interception, alteration or fraud. As noted in ISA 505, paragraph A11, such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Accordingly, the auditor should be required to develop procedures to address this risk.

Adopting provisions consistent with paragraphs A11–A17 of the draft ASB standard would provide appropriate direction applicable to the use of electronic confirmations and third-party

**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release**

service providers, as well as guidance on addressing the risk that the information is not from a proper source and that the integrity of the data has been compromised.

Questions 5, 6, 7 & 8:

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

The requirements and guidance proposed in questions 5-8 would be overly prescriptive and unnecessary if the auditor adopts a risk-based approach, as discussed in our letter. Furthermore, academic research indicates that there are several key barriers to confirmation effectiveness.¹ For these reasons and the reasons detailed in our letter, it would not be logical to expand the presumptive requirement or establish new requirements that auditors request confirmation of accounts receivable or other items.

Questions 9 & 10:

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

These questions address procedures that would be better suited to guidance documents.

Questions 11 & 12:

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

¹ P. Caster, R. Elder, and D. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory*, vol. 27, no. 2 (2008). Pg. 253.

**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release**

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

We agree that PCAOB standard AU 330 needs updating to address technology advances and other economic changes. For instance, the standard should discuss the importance of auditors controlling (1) the information to be confirmed, (2) the selection of the confirming parties, and (3) the design and sending of the confirmation requests. These issues would be properly addressed by adopting provisions similar to paragraphs 7 and A6 of the draft ASB standard.

Questions 13, 14 & 15:

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third party database or provided by the third-party service provider is reliable?

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

The above issues would be appropriately addressed by adopting provisions consistent with ISA 505, paragraphs 10, 11, A13 and A14, which deal with auditor responsibilities in these situations.

Questions 16, 17 & 18:

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

We agree that auditors should be required to (1) perform alternative procedures for non-responses to positive confirmation requests, (2) investigate all but trivial exceptions identified in confirmations responses, and (3) consider the implications of non-responses and exceptions. These issues would be appropriately addressed by adopting provisions consistent with ISA 505 paragraphs 12, 14, A18, A19, A21 and A22.

Question 19:

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

GAO's Responses to Specific Questions in the Attachment to PCAOB Concept Release

It is not necessary for the standard to indicate the specific procedures to be used in such circumstances. The standard requires auditors to perform alternative procedures for each non-response. The appropriate procedures would depend on risks, facts, and circumstances. Specifying procedures for the auditors to perform in such situations would be overly prescriptive. Instead, these issues would be better suited to a guidance document.

Question 20:

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Existing PCAOB standards include procedures for the auditor to perform in cases when management requests that the auditor not confirm certain accounts, transactions, agreements, or other items. In such situations, the auditor should communicate with those charged with governance in accordance with PCAOB standard AU Section 380.16. The auditor also should determine the implications for the audit and for the auditor's opinion in accordance with PCAOB standard AU Section 508. However, if the PCAOB believes these issues should be addressed within the confirmation standard, it should adopt provisions consistent with those of ISA 505 paragraphs 8, 9, and A8-A10.

Question 21:

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

When a confirmation response contains disclaimers and restrictive language, auditors should evaluate the impact on the reliability of the response. If the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor would treat such a response as a non-response and perform alternative audit procedures to obtain relevant and reliable audit evidence.

Adopting provisions consistent with those of paragraph A16 of the draft ASB standard would properly address this issue.

Questions 22 & 23:

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release**

The auditor should understand the limitations of the audit evidence obtained from negative confirmation procedures and should not use negative confirmation requests as the sole substantive procedure to address an assessed risk of material misstatement at the assertion level.

Circumstances in which negative confirmations may be appropriate include when:

- (a) the auditor has assessed the risk of material misstatement as low and has obtained audit evidence to support 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.

Adopting provisions consistent with those of paragraph 15 of ISA 505 would properly address this issue.

INTERNATIONAL STANDARD ON AUDITING 505
EXTERNAL CONFIRMATIONS

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

CONTENTS

	Paragraph
Introduction	
Scope of this ISA	1
External Confirmation Procedures to Obtain Audit Evidence	2-3
Effective Date	4
Objective	5
Definitions	6
Requirements	
External Confirmation Procedures	7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request	8-9
Results of the External Confirmation Procedures	10-14
Negative Confirmations	15
Evaluating the Evidence Obtained	16
Application and Other Explanatory Material	
External Confirmation Procedures	A1-A7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request	A8-A10
Results of the External Confirmation Procedures	A11-A22
Negative Confirmations	A23
Evaluating the Evidence Obtained	A24-A25

International Standard on Auditing (ISA) 505, “External Confirmations” should be read in conjunction with ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s use of external confirmation procedures to obtain audit evidence in accordance with the requirements of ISA 330¹ and ISA 500.² It does not address inquiries regarding litigation and claims, which are dealt with in ISA 501³.

External Confirmation Procedures to Obtain Audit Evidence

2. ISA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.⁴ That ISA also includes the following generalizations applicable to audit evidence:⁵
 - 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.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This ISA is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

3. Other ISAs recognize the importance of external confirmations as audit evidence, for example:
 - ISA 330 discusses the auditor’s responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and to design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level.⁶ In addition, ISA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation

¹ ISA 330, “The Auditor’s Responses to Assessed Risks.”

² ISA 500, “Audit Evidence.”

³ ISA 501, “Audit Evidence—Specific Considerations for Selected Items.”

⁴ ISA 500, paragraph A5.

⁵ ISA 500, paragraph A31.

⁶ ISA 330, paragraphs 5-6.

procedures are to be performed as substantive audit procedures.⁷

- ISA 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁸ To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. ISA 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.⁹
- ISA 240 indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.¹⁰
- ISA 500 indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.¹¹

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (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 or other medium.
 - (b) 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.

⁷ ISA 330, paragraphs 18-19.

⁸ ISA 330, paragraph 7(b).

⁹ ISA 330, paragraph A53.

¹⁰ ISA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph A37.

¹¹ ISA 500, paragraph A8.

- (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.
- (e) 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.

Requirements

External Confirmation Procedures

- 7. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:
 - (a) Determining the information to be confirmed or requested; (Ref: Para. A1)
 - (b) Selecting the appropriate confirming party; (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; and (Ref: Para. A3-A6)
 - (d) Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)

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 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 260.¹² The auditor also shall determine the implications for the audit and the auditor’s opinion in accordance with ISA 705.¹³

¹² ISA 260, “Communication with Those Charged with Governance,” paragraph 16.

¹³ ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report.”

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

10. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. (Ref: Para. A11-A16)
11. If 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 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 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 and Redrafted). (Ref: Para A20)

Exceptions

14. The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A21-A22)

Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: (Ref: Para. A23)
 - (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.

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 Confirmation Procedures

Determining the Information to Be Confirmed or Requested (Ref: Para. 7(a))

- A1. External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement.”

Selecting the Appropriate Confirming Party (Ref: Para. 7(b))

- A2. 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.

Designing Confirmation Requests (Ref: Para. 7(c))

- A3. 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 responses.
- A4. 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 authorization 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 authorization.
 - The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

- A5. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party’s agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party 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 confirming parties.
- A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

Follow-Up on Confirmation Requests (Ref: Para. 7(d))

- A7. 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

Reasonableness of Management’s Refusal (Ref: Para. 8(a))

- A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: Para. 8(b))

- A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with ISA 315.¹⁴ For example, if management’s request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with ISA 240.¹⁵

Alternative Audit Procedures (Ref: Para. 8(c))

¹⁴ ISA 315, “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment,” paragraph 31.

¹⁵ ISA 240, paragraph 24.

A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A19 of this ISA. Such procedures also would take account of the results of the auditor's evaluation in paragraph 8(b) of this ISA.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests (Ref: Para. 10)

A11. ISA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹⁶ All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

A12. Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify web site authenticity.

A13. If a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor may perform procedures to address the risks that:

- (a) The response may not be from the proper source;
- (b) A respondent may not be authorized to respond; and
- (c) The integrity of the transmission may have been compromised.

A14. The auditor is required by ISA 500 to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.¹⁷ The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party. For example, when a confirming party responds by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor.

¹⁶ ISA 500, paragraph A31.

¹⁷ ISA 500, paragraph 11.

A15. On its own, an oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. However, upon obtaining an oral response to a confirmation request, the auditor may, depending on the circumstances, request the confirming party to respond in writing directly to the auditor. If no such response is received, in accordance with paragraph 12, the auditor seeks other audit evidence to support the information in the oral response.

A16. A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence.

Unreliable Responses (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA 315.¹⁸ For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with ISA 240.¹⁹

Non-Responses (Ref: Para. 12)

A18. 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 or correspondence from third parties, and other records, such as goods received notes.

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with ISA 315.²⁰ For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with ISA 240.²¹

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 13)

A20. In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include where:

¹⁸ ISA 315, paragraph 31.

¹⁹ ISA 240, paragraph 24.

²⁰ ISA 315, paragraph 31.

²¹ ISA 240, paragraph 24.

- The information available to corroborate management’s assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls, or the risk of collusion which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity.

Exceptions (Ref: Para. 14)

- A21. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by ISA 240 to evaluate whether such misstatement is indicative of fraud.²² Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity’s internal control over financial reporting.
- A22. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: Para. 15)

- A23. 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.

Evaluating the Evidence Obtained (Ref: Para. 16)

- A24. When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:
- (a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception;
 - (b) A response deemed unreliable;

²² ISA 240, paragraph 35.

- (c) A non-response; or
- (d) A response indicating an exception.

A25. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by ISA 330.²³

²³ ISA 330, paragraphs 28-29.

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

EXTERNAL CONFIRMATIONS

*(To supersede Statement on Auditing Standards No. 67, The
Confirmation Process [AICPA, Professional Standards, vol. 1,
AU sec. 330])*

June 1, 2009

Comments are requested by August 31, 2009

Prepared by the AICPA Auditing Standards Board for comment from persons
interested in auditing and reporting issues.

Comments should be addressed to Sherry Hazel at shazel@aicpa.org.

*Copyright © 2009 by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775*

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2009 by American Institute of Certified Public Accountants, Inc. Used with permission."

CONTENTS

	Page
Explanatory Memorandum	
Introduction	4
Background.....	4
Effective Date	5
Changes From Existing Standards	5
Vote of the Auditing Standards Board.....	5
Issues for Consideration.....	5
Guide for Respondents.....	6
Supplements to the Exposure Draft	7
Comment Period	7
Auditing Standards Board Members.....	8
 Exposure Draft	
Proposed Statement on Auditing Standards <i>External Confirmations</i>	9

Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *External Confirmations*. This proposed SAS would supersede SAS No. 67, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1, AU sec. 330). The accompanying proposed SAS represents the redrafting of SAS No. 67 to apply the Auditing Standards Board's (ASB's) clarity drafting conventions and to converge with International Standards on Auditing (ISAs), as discussed in the following sections.

Background

Clarity

To address concerns over the clarity, length, and complexity of its standards, the ASB is currently making a significant effort to clarify the SASs.¹ The ASB issued a discussion paper, *Improving the Clarity of ASB Standards*,² in March 2007. In response to the feedback received on the discussion paper and subsequent discussions with interested parties, the ASB has established clarity drafting conventions and has undertaken to revise all of its SASs in accordance with those conventions. The proposed SAS has been drafted in accordance with the ASB's clarity drafting conventions, which include the following:

- Establishing objectives for each of the standards
- Including a definitions section, if relevant, in each standard
- Separating requirements from application and other explanatory material
- Numbering application and other explanatory material paragraphs using an *A*-prefix and presenting them in a section following the requirements section
- Using formatting techniques, such as bulleted lists, to enhance readability
- Including, where appropriate, special considerations relevant to audits of smaller, less complex entities within the text of the standards
- Including, where appropriate, special considerations relevant to audits of governmental entities within the text of the standard

Convergence

Consistent with the ASB's strategy to converge its standards with those of the

¹ The pamphlet *Clarification and Convergence* provides information about the ASB's clarity project and can be viewed at [www.aicpa.org/download/auditstd/ASB_Clarify_%20and_Convergence_\(8.5x11\).pdf](http://www.aicpa.org/download/auditstd/ASB_Clarify_%20and_Convergence_(8.5x11).pdf).

² The discussion paper is available online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards.htm.

International Auditing and Assurance Standards Board (IAASB),³ the proposed SAS has been drafted using ISA No. 505, *External Confirmations*, as a base. There are no differences between this proposed SAS and ISA No. 505 other than those for which the ASB believes compelling reasons exist. Differences in objectives, definitions, or requirements between the proposed SAS and ISA No. 505 are identified in the exposure draft's exhibit.

The ASB has made various changes to the language of the ISA to use terms or phrases that are more common in the United States, and to tailor examples and guidance to the U.S. environment. The ASB believes that such changes will not create differences between the application of ISA No. 505 and the application of the proposed SAS.

Effective Date

The proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 15, 2010.

Changes From Existing Standards

The proposed SAS does not expand SAS No. 67 in any significant respect; however, there are some changes as discussed below. To reflect a more principles-based approach to standard setting, certain requirements that are duplicative of broader requirements in SAS No. 67 have been moved to application and other explanatory material, consistent with ISA No. 505. In the ASB's view, this has not changed the overall effectiveness of the proposed SAS.

The following summarize what the ASB believes would be the most significant changes to existing standards if the proposed standard was issued. The supplementary materials accompanying this exposure draft illustrate detailed changes made to SAS No. 67.

- Paragraphs 8 and 9 of the proposed SAS address the responsibilities of the auditor when management refuses to allow the auditor to send a confirmation request. These responsibilities include communicating with those charged with governance if the auditor concludes that management's refusal is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures. These procedures are not required by AU section 330.
- The ASB has added application material to the proposed SAS regarding the use of oral responses to confirmation requests as audit evidence. Paragraphs A22 and A23 clarify that the receipt of an oral response to a confirmation request does not meet the definition of an external confirmation. These paragraphs provide guidance on how the response may be considered part of alternative procedures performed to obtain sufficient appropriate audit evidence.

³ The ASB's convergence paper is available online at www.aicpa.org/download/auditstd/ASB_Convergence_Plan.pdf.

- The definition of confirmation has been changed as discussed in the ‘Issues for Consideration’ section.

Issues for Consideration

Presumptive Requirement to Confirm Receivables

The ASB has retained the presumptive requirement in the extant SAS to use external confirmation procedures for accounts receivable from paragraph .34 of the extant SAS. This requirement is an addition to the requirements ISA No. 505. As shown in the Appendix of the proposed SAS, this requirement is included as a conforming amendment to proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* because it is part of the process of determining the appropriate audit procedures to perform, which is not included in the scope of the proposed SAS. The ASB concluded that it was appropriate to retain this requirement in the U.S. environment, notwithstanding that the IAASB did not include a similar requirement in ISA No. 505. The ASB is seeking views on its decision to retain the presumptive requirement to use external confirmation procedures for accounts receivable, and on its decision to include that requirement in proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

Definition of External Confirmations

The ASB has expanded the ISA definition of an external confirmation to include direct access by the auditor to information held by a third party. Third-party involvement is increasingly common, and the ASB believes that the inclusion of direct access clarifies the definition. The ASB believes this clarification is an improvement to the ISA definition and that it is not inconsistent with the intent of the IAASB’s definition. The ASB is seeking view on its decision.

Guide for Respondents

The ASB is seeking comments specifically on changes resulting from applying the clarity drafting conventions and converging with the ISA, and their effect on the content of the proposed SAS. Respondents are asked to respond, in particular, to the following questions:

1. Are the objectives of the auditor appropriate?
2. Are the revisions made to converge the existing standard with ISA No. 505 appropriate?
3. Are the differences between the proposed SAS and ISA No. 505 identified in the exhibit, and other language changes, appropriate?

Comments are most helpful when they refer to specific paragraphs, include the reasons

for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after September 30, 2009, for one year. Responses should be sent to Sherry Hazel at shazel@aicpa.org and received by August 31, 2009.

Supplements to the Exposure Draft

To assist respondents in identifying changes and in responding to this request to comment on the proposed SAS, the Audit and Attest Standards staff has prepared the following supplementary materials:

1. A matrix document, which compares of ISA No. 505, the proposed SAS, and extant AU section 330. The schedule has four columns containing the following:
 - a. ISA No. 505
 - b. The proposed SAS, marked to show differences in language between the ISA and the proposed SAS (new and deleted material are shown in colored track changes)
 - c. The requirements and guidance in extant AU section 330, mapped against the proposed SAS, to demonstrate how the material in AU section 330 has been reflected in the proposed SAS
 - d. Comments and rationale
2. A mapping document, which maps the requirements and guidance contained within SAS No. 67 to the proposed SAS to demonstrate how the material in SAS No. 67 has been reflected in the proposed SAS.

This staff-prepared supplementary material is available on the AICPA Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards/default.htm. It is for informational purposes only and does not form part of the exposure draft; however, it may be useful for respondents in formulating comments.

Comment Period

The comment period for this exposure draft ends on August 31, 2009.

**Auditing Standards Board
(2008–2009)**

Harold L. Monk, Jr., *Chair*
Ernest F. Baugh, Jr.
Sheila M. Birch
Jacob J. Cohen
Walton T. Conn, Jr.
Anthony J. Costantini
Charles E. Frasier
Nicholas J. Mastracchio, Jr.
Jorge Milo
Andrew M. Mintzer

Thomas A. Ratcliffe
Randy C. Roberts
Darrel R. Schubert
Thomas M. Stemlar
Mark H. Taylor
Phil D. Wedemeyer
Stephanie A. Westington
Arthur M. Winstead, Jr.
Megan F. Zietsman

External Confirmations Task Force

Megan F. Zietsman, *Chair*
Andrew M. Mintzer

Stephanie A. Westington
Mindy K. Montgomery

AICPA Staff

Charles E. Landes
Vice President
Professional Standards and Services

PROPOSED STATEMENT ON AUDITING STANDARDS
EXTERNAL CONFIRMATIONS

CONTENTS

	Paragraph
Introduction	
Scope of This Proposed Statement on Auditing Standards	1
External Confirmation Procedures to Obtain Audit Evidence.....	2-3
Effective Date	4
Objective	5
Definitions	6
Requirements	
External Confirmation Procedures.....	7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request.....	8-9
Results of the External Confirmation Procedures.....	10-14
Negative Confirmations	15
Evaluating the Evidence Obtained.....	16
Application and Other Explanatory Material	
External Confirmation Procedures	A1-A7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request.....	A8-A10
Results of the External Confirmation Procedures.....	A11-A25
Negative Confirmations	A26
Evaluating the Evidence Obtained.....	A27-A28
Appendix: Conforming Amendments to Proposed Statement on Auditing Standards, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i> (Redrafted), as a result of Proposed Statement on Auditing Standards, <i>External Confirmations</i>	A29
Exhibit: Comparison of Requirements of Proposed Statement on Auditing Standards, <i>External Confirmations</i> With Requirements of International Standard on Auditing 505, <i>External Confirmations</i>	A30

Proposed Statement on Auditing Standards *External Confirmations*

Introduction

Scope of This Proposed Statement on Auditing Standards

1. This proposed Statement on Auditing Standards (SAS) addresses the auditor’s use of external confirmation procedures to obtain audit evidence in accordance with the requirements of Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)*,¹ and Proposed SAS, *Audit Evidence (Redrafted)*.² It does not address inquiries regarding litigation, claims and assessments, which are addressed in AU Section 337³.

External Confirmation Procedures to Obtain Audit Evidence

2. Proposed SAS, *Audit Evidence (Redrafted)*, indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.⁴ That proposed SAS also includes the following generalizations applicable to audit evidence:⁵

- 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.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SAS is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

3. Other SASs recognize the importance of external confirmations as audit evidence, for example:

¹ *Exposure Draft Proposed SAS*, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted).”

² *Exposure Draft Proposed SAS*, “Audit Evidence (Redrafted).”

³ *AU Section 337*, “Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments.”

⁴ *Exposure Draft Proposed SAS*, “Audit Evidence (Redrafted),” paragraph A5.

⁵ *Exposure Draft Proposed SAS*, “Audit Evidence (Redrafted),” paragraph A32.

- Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), discusses the auditor’s responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.⁶ In addition, Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation procedures are to be performed as substantive audit procedures.⁷
- Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), requires that the auditor obtain more persuasive audit evidence the higher the auditor’s assessment of risk.⁸ To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.⁹
- Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted), indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.¹⁰
- Proposed SAS, *Audit Evidence* (Redrafted), indicates that corroborating information obtained from a source independent of the entity, such as external

⁶ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted),” paragraphs 5 and 6.*

⁷ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)” paragraph 19 and Appendix paragraph 19A.*

⁸ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted),” paragraph 7(b).*

⁹ *Appendix paragraph A59.*

¹⁰ *Exposure Draft Proposed SAS, “Consideration of Fraud in a Financial Statement Audit (Redrafted),” paragraph A38.*

confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.¹¹

Effective Date

4. This proposed SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010.*

Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

6. For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

External confirmation. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form, or by electronic or other medium, or through direct access by the auditor to information held by a third party.

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.

¹¹ *Exposure Draft Proposed SAS, "Audit Evidence (Redrafted)," paragraph A8.*

* This date is provisional, but will not be earlier than December 15, 2010.

Requirements

External Confirmation Procedures

7. When using external confirmation procedures, the auditor should maintain control over external confirmation requests, including:
- (a) Determining the information to be confirmed or requested (Ref: Para. A1);
 - (b) Selecting the appropriate confirming party; (Ref: Para. A2)
 - (c) Designing the confirmation requests, including determining that requests are properly directed to the appropriate confirming party and provide for being responded to directly to the auditor; and (Ref: Para. A3-A6)
 - (d) Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)

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 should:
- (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 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 should communicate with those charged with governance in accordance with SAS, *The Auditor's Communication With Those Charged With Governance (Redrafted)*.¹² The auditor also should determine the implications for the audit and the auditor's opinion in accordance with AU Section 508.¹³

¹² *Statement on Auditing Standards, The Auditor's Communication with Those Charged with Governance (Redrafted), paragraph 12.*

¹³ *AU Section 508, "Reports on Audited Financial Statements."*

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

10. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor should obtain further audit evidence to resolve those doubts. (Ref: Para. A11-A16)

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor should evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of 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 should perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A20)

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 should determine the implications for the audit and the auditor's opinion in accordance with AU Section 508. (Ref: Para A21-A23)

Exceptions

14. The auditor should investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A24-A25)

Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor should not use negative confirmation requests as the sole substantive audit procedure 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. (Ref: Para. A26)

Evaluating the Evidence Obtained

16. The auditor should evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (Ref: Para A27-A28)

Application and Other Explanatory Material

External Confirmation Procedures

Determining the Information to be Confirmed or Requested (Ref: Para. 7(a))

A1. External confirmation procedures frequently are performed to confirm or request information regarding account balances, elements thereof, and disclosures. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.

Selecting the Appropriate Confirming Party (Ref: Para. 7(b))

A2. 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.

Designing Confirmation Requests (Ref: Para. 7(c))

A3. 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 responses.

A4. 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 authorization 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 authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A5. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party’s agreement with the given information, or by asking the confirming party to provide information. A response to a properly designed positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party 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 confirming parties.

A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out. For example, where a confirmation request is sent by electronic mail, the auditor may perform similar procedures to verify the email address supplied by management. If another process is used, the auditor may perform other procedures to determine that the request is directed to the intended recipient. See further guidance in paragraph A12.

Follow-Up on Confirmation Requests (Ref: Para. 7(d))

A7. 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

Reasonableness of Management’s Refusal (Ref: Para 8(a))

A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: Para 8(b))

A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Redrafted).¹⁴ For example, if management’s request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted).¹⁵

Alternative Audit Procedures (Ref: Para 8(c))

A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A20 of this SAS. Such procedures also would take account of the results of the auditor’s evaluation in paragraph 8(b) of this SAS.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests (Ref: Para. 10)

A11. Proposed SAS, *Audit Evidence* (Redrafted), indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹⁶ All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

A12. Responses received electronically, for example by facsimile or electronic mail, involve risks relating to reliability because proof of origin and knowledge of the respondent may be difficult to establish, and alterations may be difficult to detect. An electronic confirmation process that creates a secure confirmation environment may mitigate the risks of interception or alteration. The key to creating a secure confirmation environment lies in the process or mechanism used by the auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation. If the auditor is satisfied that such a process is secure and

¹⁴ *Exposure Draft Proposed SAS, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted),” paragraph 31.*

¹⁵ *Exposure Draft Proposed SAS, “Consideration of Fraud in a Financial Statement Audit (Redrafted),” paragraph 24.*

¹⁶ *Exposure Draft Proposed SAS, “Audit Evidence (Redrafted),” paragraph A32.*

properly controlled, the reliability of the related responses is enhanced. Various means might be used to validate the source of the electronic information and the respondent's knowledge about the requested information. For example, the use of encryption, electronic digital signatures, and procedures to verify Web site authenticity may improve the security of the electronic confirmation process.

A13. The auditor's consideration of the reliability of the information obtained through the confirmation process to be used as audit evidence includes consideration of the risks that:

- (a) The information obtained may not be from an authentic source;
- (b) A respondent may not be knowledgeable about the information to be confirmed; and
- (c) The integrity of the information may have been compromised.

A14. If a system or process that facilitates electronic confirmation between the auditor and the respondent is in place and the auditor plans to rely on such a system or process, an assurance trust services report (for example, Systrust), or another assurance report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that process. Such an assurance report may address the risks described in paragraph A13. If these risks are not adequately addressed in such a report, the auditor may perform additional procedures to address those risks.

A15. The auditor is required by Proposed SAS, *Audit Evidence* (Redrafted), to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.¹⁷ In some cases, the auditor may determine that it is appropriate to address the risks related to the reliability of the information received electronically by directly contacting the purported sender (for example, by telephone) rather than by using alternative means to validate the source of the electronic information. For example, if significant information is provided via an e-mail response, the auditor may perform alternative procedures, including procedures to verify the authenticity of information such as the e-mail address of the purported sender. The auditor may also contact the purported sender directly by telephone to verify that the information received was sent by the confirming party and also that what was received by the auditor corresponds to the information transmitted by the purported sender. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor. Confirmations obtained electronically may be considered reliable audit evidence if the auditor is satisfied that (a) the electronic confirmation process is secure and properly controlled, (b) the information

¹⁷ *Exposure Draft Proposed SAS, "Audit Evidence (Redrafted)," paragraph 9.*

obtained is a direct communication in response to a request, and (c) the information is obtained from a third party who is the intended respondent.

A16. A response to a confirmation request may contain restrictive language regarding its use (for example, language disclaiming the responsibility for the accuracy or completeness of the information included in a response). Such restrictions do not necessarily invalidate the reliability of the response as audit evidence to the extent that the restrictive language does not relate to the assertions being tested by the confirmation. However, when the auditor has doubts as to the reliability of the response that occurs as a result of restrictive language, then in accordance with paragraph 10, the auditor is required to obtain further audit evidence to resolve those doubts. If the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor may conclude that it is necessary to treat such a response as a non-response and in accordance with paragraph 12, be required to perform alternative audit procedures to obtain relevant and reliable audit evidence.

Unreliable Responses (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)*.¹⁸ For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit (Redrafted)*.¹⁹

Non-Responses (Ref: Para. 12)

A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documentation, and other client documentation providing evidence for the existence assertion.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as receiving reports and statements the client receives from vendors.

¹⁸ *Exposure Draft Proposed SAS, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)," paragraph 31.*

¹⁹ *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)," paragraph 24.*

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. The auditor may take the receipt of an oral response to a confirmation request into consideration when determining the nature and extent of alternative audit procedures. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)*.²⁰ For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit (Redrafted)*.²¹

A20. The omission of alternative procedures may be acceptable when testing for overstatement of amounts when: (a) the non-responses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to the non-responses, such as that all non-responses pertain to year-end transactions.

When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref. Para. 13)

A21. In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include where:

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls, or the risk of collusion which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity.

A22. An oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. Where the auditor has determined that a written response is necessary to obtain sufficient appropriate audit evidence and the auditor has obtained only an oral response to a confirmation request, the auditor may request the confirming party to respond in writing

²⁰ *Exposure Draft Proposed SAS, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)," paragraph 31.*

²¹ *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)," paragraph 24.*

directly to the auditor. If no such response is received, in accordance with paragraph 13, alternative audit procedures will not provide the audit evidence the auditor requires and the auditor is required to determine the implications for the audit and the auditor's opinion in accordance with AU Section 508.

A23. In a situation where the auditor has concluded that a response to a positive confirmation is not necessary to obtain sufficient appropriate audit evidence and the auditor has obtained an oral response to a confirmation request, alternative audit procedures may include consideration of the oral response as audit evidence. In such a situation, the auditor may, depending on the circumstances, including for example whether the external confirmation has been requested to address a significant risk or not, determine that an appropriately documented oral response to a confirmation request (including details of the identity of the person from whom the response was received, his or her position, the date and time of the conversation) together with the evidence upon which the original confirmation request is based (e.g., statement or other correspondence received by the entity) is sufficient appropriate audit evidence. In connection with such oral response, the auditor may also consider additional precautionary measures to address the reliability of the evidence provided by such response, such as initiating the call to the respondent using a telephone number that the auditor has independently verified as being associated with the entity (e.g., the auditor might call the main telephone number obtained from the entity's website and ask to be directed to the named respondent instead of calling a direct extension provided by the client or included in the statement or other correspondence received by the entity.)

Exceptions (Ref: Para. 14)

A24. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted) to evaluate whether such misstatement is indicative of fraud.²² Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

A25. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: Para. 15)

A26. 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

²² *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)", paragraph 35.*

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.

Evaluating the Evidence Obtained (Ref: Para 16)

A27. When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:

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

A28. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted).²³

²³ *Exposure Draft Proposed SAS, "Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)," paragraph 26 and 27.*

A29.

Appendix: Conforming Amendments to Proposed Statement on Auditing Standards, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), as a result of Proposed Statement on Auditing Standards, *External Confirmations*

19a. The auditor should consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A57a-A57d)

19b. The auditor should use external confirmation procedures for material accounts receivable except when one or more of the following is applicable: (A57e)

- (a) External confirmation procedures for accounts receivable would be ineffective. (Ref: Para.A57f)
- (b) The auditor's assessed level of risk of material misstatement is low, and the auditor plans to obtain sufficient appropriate audit evidence by performing substantive procedures. In many situations, use of external confirmation procedures for accounts receivable and the performance of other substantive tests are necessary to reduce audit risk to an acceptably low level for the relevant assertions.

The auditor should document the basis for any determination not to use external confirmation procedures for accounts receivable.

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para 19a-19b)

A57a. External confirmation procedures frequently may be relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no “side agreement” exists that may be relevant to an entity’s revenue cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.

- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

A57b. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

A57c. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

A57d. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
 - May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests

is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response

- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.
- Information from prior years' audits or audits of similar entities. This information includes response rates, knowledge of misstatements identified during prior years' audits, and any knowledge of inaccurate information on returned confirmations. For example, if the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may instead consider obtaining audit evidence from other sources.

A57e. For the purpose of this SAS, *accounts receivable* means—

- The entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and
- A financial institution's loans.

A57f. Confirmations may be considered ineffective if, based on prior years' audit experience or on experience with similar engagements, the auditor concludes that response rates to properly designed confirmation requests will be inadequate, or if responses are known or expected to be unreliable, the auditor may determine that the use of external confirmation procedures for accounts receivable would be ineffective.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

A59. Paragraph 21 of this SAS requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmations procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms. ~~Substantive procedures related to significant risks are most often designed to obtain audit evidence with high reliability.~~

A30.

Exhibit: Comparison of Requirements of Proposed Statement on Auditing Standards *External Confirmations* With Requirements of International Standard on Auditing 505, *External Confirmations*

This analysis was prepared by the Audit and Attest Standards staff to highlight substantive differences between the proposed Statement on Auditing Standards *External Confirmations* with International Standard on Auditing No. 505, *External Confirmations*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board.

Presumptive Requirement to Confirm Accounts Receivable

Paragraph .34 of SAS 67 contains a presumptive requirement to perform external confirmation procedures for accounts receivable. ISA No. 505 does not include a similar requirement. The ASB concluded that this requirement is appropriate in the U.S. environment. As shown in the Appendix of the proposed SAS, this requirement is included as a conforming amendment to Proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, because it is part of the process of determining the appropriate audit procedures to perform, which is not included in the scope of the proposed SAS (that is, ISA No. 505 and the proposed SAS presume that the auditor has already determined an external confirmation is the appropriate audit procedure.)