

Communication to AICPA Members Regarding Electronic Confirmations

In a letter dated July 21, 2008, sent to their clients and certain auditors, Bank of America (BOA) announced that effective October 1, 2008, it will no longer respond to paper confirmation requests and will only respond to confirmation requests submitted electronically via a designated third party service provider. As a result of this announcement, the AICPA's Audit and Attest and Hotline staffs have been receiving inquiries from AICPA members as to how this announcement may affect their audits. The following are some typical inquiries and responses:

Q. It has been announced by BOA that effective October 1, 2008, the bank will no longer respond to paper confirmation requests and will only respond to confirmation requests submitted via a designated third party service provider. We understand that more banks will do the same. May such electronic confirmations be considered reliable audit evidence?

A. Yes. As further described in Auditing Interpretation No. 1, "Use of Electronic Confirmations," of AU section 330, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1, AU sec. 9330 pars. .01-.06) (http://www.aicpa.org/download/members/div/auditstd/AU-00330_9.PDF), electronic confirmations can be considered to be reliable audit evidence if the auditor is satisfied that (1) the electronic confirmation process is secure and properly controlled, (2) the information obtained is a direct communication in response to a request, and (3) the information is obtained from a third party who is a bona fide authorized respondent.

Q. How does an electronic confirmation process that uses a third party service provider typically work?

A. An electronic confirmation process that uses a third party service provider typically involves such third party as an intermediary, whose role it is to provide a secure link between an auditor and a validated financial institution. This secure or controlled link is intended to provide assurance that when a confirmation request is sent it goes directly to the financial institution without interference. Further, because the process is automated, the requested information may be transmitted to the auditor in a secure fashion. For example, the proper use of encryption and digital signatures can provide the auditor confidence in the integrity and authenticity of the confirmation information. Some have used the analogy that an intermediary is acting as an electronic "postal service."

Q. Is there guidance on the risks that the auditor needs to consider related to the reliability of the information received through an electronic process to be used as audit evidence and the auditing procedures that an auditor may perform to test whether electronic confirmations are secure and properly controlled?

A. Yes. Risks to be considered and procedures that an auditor might perform in relation to those risks are described in Auditing Interpretation No. 1 of AU section 330 (http://www.aicpa.org/download/members/div/auditstd/AU-00330_9.PDF). Additionally, an auditor may find the nonauthoritative Professional Issues Task Force (PITF) Alert 03-1, *Audit Confirmations* (http://www.aicpa.org/download/secps/pralert_03_01.pdf), helpful. Additionally, auditors should be aware that the Audit Issues Task Force (AITF) of the Auditing Standards Board is in the process of amending the existing interpretation to further clarify the interpretation and respond to evolving practices relating to the use of electronic confirmations, including situations where third party intermediaries are not involved. An announcement will be made to AICPA members when the revised interpretation is issued.

Q. Will an electronic confirmation contain the same information as a paper confirmation?

A. Maybe. In 1990, the American Bankers Association, the AICPA and the Bank Administration Institute agreed to a standard form to confirm account balance information with financial institutions. The AICPA's Audit and Attest Staff has not performed any review of any specific electronic confirmations. Therefore, an auditor will want to determine through the bank or the intermediary, if any, that the electronic confirmation contains appropriate language and information that is consistent with that which would be received through the use of a paper confirmation in order to provide sufficient appropriate audit evidence. Additionally, an auditor will want to be alert to any types of disclaimers that may appear on the electronic confirmation and how such disclaimers may affect the reliability of the confirmation.

Q. What if the auditor (or his or her firm) is unable to put into place those procedures necessary to make use of electronic confirmations before the deadline established by a bank? Will financial institutions continue to reply to traditional paper confirmations?

A. Because of the trend of financial institutions to move to electronic confirmations, an auditor is encouraged to meet with his or her clients and their financial institutions to determine whether traditional paper confirmations will be permitted. Hopefully, any financial institution that announces an effective date will provide a grace period for those auditors who have not yet registered with an intermediary or who may not yet have completed their due diligence. Nevertheless, AU section 326, *Audit Evidence* (AICPA, *Professional Standards*, vol. 1), requires the auditor to "obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit." If the auditor is unable to obtain sufficient appropriate audit evidence, a scope restriction may require the auditor to qualify his or her opinion or to disclaim an opinion depending on his or her assessment of the importance of the omitted procedure(s) to his or her ability to form an opinion on the financial statements being audited.