

February 15, 2008

Mr. James Sylph
Technical Director, IAASB
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Re: Exposure Draft: *Proposed Redrafted International Standard on Auditing (ISA) 505 (Redrafted), External Confirmations.*

Dear Mr. Sylph:

The American Institute of Certified Public Accountants (AICPA) is pleased to comment on the above referenced exposure draft. We commend the International Auditing and Assurance Standards Board (IAASB) on its proposed revisions to International Standard on Auditing (ISA) 505. We believe that the objective for the Proposed ISA is appropriate, and that the proposed requirements are appropriate responses to that objective.

Request for Specific Comments

1. *The proposal that proposed ISA 505 (Revised and Redrafted) should not mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement.*

We agree with the proposal that proposed ISA 505 (Revised and Redrafted) should not mandate the use of external confirmation requests in any particular circumstance or in response to any particular risk of material misstatement.

We believe however, that external confirmation procedures are presumptively the most appropriate audit procedure to obtain sufficient appropriate audit evidence regarding existence and other of the assertions relating to accounts receivable. As noted in [Proposed redrafted] ISA 500, *Considering the Relevance and Reliability of Audit Evidence*, the reliability of audit evidence is increased when it is obtained from independent sources outside the entity¹. Consequently, we believe that the ISA should include a rebuttable presumption that the auditor will use external confirmations to audit accounts receivable unless:

- Accounts receivable are immaterial to the financial statements.

¹ Proposed Redrafted ISA 500, Paragraph A23.

- The use of confirmations would be ineffective. (For example, if, based on prior years' audit experience or experience on engagements with similar circumstances, 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 confirmations would be ineffective.)
- The auditor's combined assessed level of inherent and control risk is low, and the assessed level, in conjunction with the evidence expected to be provided by analytical procedures or other substantive tests of details, is sufficient to reduce audit risk to an acceptably low level for the applicable financial statement assertions. In many situations, both confirmation of accounts receivable and other substantive tests of details are necessary to reduce audit risk to an acceptably low level for the applicable financial statement assertions.

An auditor who has not requested confirmations in the examination of accounts receivable should be required to document how this presumption was overcome and how other substantive procedures that were performed address the relevant assertions satisfactorily.

2. The proposal that the scope of proposed ISA 505 (Revised and Redrafted) be directed at the effective performance of external confirmation procedures when the auditor determines that such procedures are an appropriate response to an assessed risk of material misstatement, and that accordingly the ISA should not require that the auditor consider when, or under what circumstances, it may be appropriate to use external confirmation procedures when performing an audit of financial statements.

We agree in principle with the proposal that the scope of proposed ISA 505 (Revised and Redrafted) be directed at the effective performance of external confirmation procedures when the auditor determines that such procedures are an appropriate response to an assessed risk of material misstatement, and that accordingly the ISA should not require that the auditor consider when, or under what circumstances, it may be appropriate to use external confirmation procedures when performing an audit of financial statements. However, we believe the ISA also should recognize, in the application material, that for certain assertions external confirmation procedures combined with other procedures may be the only way to obtain sufficient appropriate evidence.

3. Whether proposed ISA 505 (Revised and Redrafted) appropriately limits the extent to which auditors may use negative confirmation requests.

We agree that proposed ISA 505 (Revised and Redrafted) appropriately limits the extent to which auditors may use negative confirmation requests. We believe however that to assist auditors in properly using negative confirmations, it would be helpful to include additional application material relating to the use of negative confirmations, and in particular specific examples of when they might be used. For example, negative confirmations are useful in confirming deposit liabilities of financial institutions, as depositors typically will respond if their balances are understated.

Electronic Confirmation:

We note an increasing trend in practice towards use of an electronic process that facilitates confirmation between the auditor and the confirmation respondent. We therefore recommend that the IAASB include application material on the use of electronic confirmations. Attached as an Appendix to this letter is guidance issued by the ASB that relates to the auditor's consideration of electronic confirmations. While this guidance is not comprehensive, it may provide a useful starting point for the IAASB's consideration of application material specific to the use of electronic confirmations.

Paragraph Comments:

Paragraphs 7(d) and A11: Paragraph 7(d) requires the auditor to maintain control over the external confirmation requests and responses, including: "communicating with the confirming party, including determining that requests are appropriately addressed and include return information for responses to be sent directly to the auditor, and sending the requests to the confirming party." We agree with this requirement, as determining that requests are appropriately addressed is an important part of the auditor's external confirmation procedures.

The application material to paragraph 7 (paragraphs A7 to A11) does not however contain any additional guidance relating to this requirement. In fact paragraph A11 includes verification of the accuracy of the original address as an example of a procedure that might be performed as a *follow-up procedure*. We believe that to be consistent with the requirement in paragraph 7(d), such verification is required as part of the design and control of the initial confirmation request. We also believe that this is a very important part of managing the risks related to the reliability of audit evidence obtained from using external confirmations. It would therefore be helpful to clarify in the application material that confirmation respondent's addresses need to be verified prior to initial confirmation requests

being sent to the confirming party. We recommend that the phrase “may verify the accuracy of the original address, and then”, in the last sentence of paragraph A11 be deleted.

Further, we believe that the guidance in paragraph A11 is not appropriately located. As non-responses are dealt with in paragraph 12, the application material in paragraph A11 should be placed as application material to paragraph 12.

In addition we believe that paragraph 7(d) would be clearer if it were redrafted as follows:

- (d) ~~Communicating~~ ***Controlling communications*** with the confirming party, including:
- determining that requests are appropriately addressed ~~and~~
 - ~~include return information for~~ requesting that responses to be sent directly to the auditor, and
 - sending the requests to the confirming party; and

Paragraph A23: This application material does not appear to be providing guidance that is incremental to the requirement in paragraph 12, and consequently we recommend that it be deleted.

Thank you for the opportunity to comment on this exposure draft. If you have any questions regarding the comments in this letter, please contact Ahava Goldman at +1-212-596-6056, agoldman@aicpa.org or Sharon Walker at +1-212-596-6026, swalker@aicpa.org.

Respectfully submitted,

/s/ Harold Monk, Jr.
Chair, Auditing Standards Board

APPENDIX

AU Section 9330

The Confirmation Process: Auditing Interpretations of Section 330, The Confirmation Process

1. Use of Electronic Confirmations

.01

Question—Section 330, The Confirmation Process, paragraph .29 states (italicized portions are for emphasis):

There may be situations in which the respondent, because of timeliness or other considerations, responds to a confirmation request other than in a written communication mailed to the auditor. When such responses are received, additional evidence may be required to support their validity. For example, facsimile responses involve risks because of the difficulty of ascertaining the sources of the responses. To restrict the risks associated with facsimile responses and treat the confirmations as valid audit evidence, the auditor should consider taking certain precautions, such as verifying the source and contents of a facsimile response in a telephone call to the purported sender. In addition, the auditor should consider requesting the purported sender to mail the original confirmation directly to the auditor...

This paragraph uses phrases such as “written communication” and “mail the original confirmation” when describing the confirmation process. Can an electronic confirmation be considered to be reliable audit evidence?

.02

Interpretation—Yes, properly controlled electronic confirmations may be considered to be reliable audit evidence. The acceptance of electronic confirmations or the use of an electronic confirmation process is not precluded by the examples in section 330.

.03

No confirmation process with a third party is without some risk of interception, alteration, or fraud. Risks associated with paper confirmations and use of the mail

includes the risk that the confirmation respondent will not be a bona fide and authorized respondent. An electronic confirmation process that creates a secure confirmation environment may mitigate the risks of human intervention and misdirection. The key 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, alteration, or fraud with respect to the confirmation.

.04

Pursuant to paragraph .09 of section 326, Audit Evidence, the auditor should consider the reliability of the information to be used as audit evidence. In relation to the electronic confirmation process, the auditor's consideration of the reliability of the information should include consideration of the risk that:

- The confirmation response might not be from the proper source.
- A respondent might not be authorized to respond.
- The integrity of the transmission might have been compromised.

.05

If a system or process that facilitates electronic confirmation between the auditor and the confirmation respondent is in place, and the auditor plans to rely on such a system or process, an assurance trust services report or another auditor's 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 a report would usually address the three risks previously stated. If these risks are not addressed in the report, the auditor may perform additional procedures to address those risks.

.06

If the auditor is satisfied that the electronic confirmation process is secure and properly controlled and the confirmation is directly from a third party who is a bona fide authorized respondent, electronic confirmations may be considered as sufficient, valid confirmation responses. Various means might be used to validate the sender of electronic information and the respondent's authorization to confirm the requested information. For example, the use of encryption, ^{fn.1} electronic digital signatures, ^{fn.2} and procedures to verify Web site authenticity ^{fn.3} may improve the security of the electronic confirmation process.

Footnotes (AU Section 9330 — The Confirmation Process: Auditing Interpretations of Section 330):

[fn 1](#) Encryption is the process of encoding electronic data in such a way that it cannot be read without the second party employing a matching encryption “key.” Use of encryption reduces the risk of unintended intervention in a communication.

fn 2 Digital signatures may use the encryption of codes or text or other means to ensure that only the claimed signer of the document could have affixed the symbol. The signature and its characteristics are uniquely linked to the signer. Digital signature routines allow for the creation of the signature and the checking of the signature at a later date for authenticity.

fn 3 Web site authenticity routines may use various means including mathematical algorithms to monitor data or a Web site to ensure that its content has not been altered without authorization.
