

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

13 September 2010

Proposed Auditing Standard Related to Confirmation and Related Amendments to Certain PCAOB Auditing Standards, PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

Ernst & Young LLP (Ernst & Young) is pleased to submit comments on the Public Company Accounting Oversight Board's (PCAOB or the Board) request for comment regarding the proposed standard related to confirmations (the proposed standard). PCAOB interim auditing standard AU section 330, *The Confirmation Process*, was adopted based on the US Auditing Standard that was written and adopted for fiscal periods ending after June 15, 1992. Since that time, advances in technology have expanded and transformed the ways in which businesses communicate and have provided auditors with additional techniques when using audit confirmations to gather audit evidence. These additional techniques have engendered improvements in both the efficiency and effectiveness of obtaining audit evidence, and have the potential for significant additional benefits as the use of technology evolves. However, its use also presents circumstances and risks not previously contemplated by the interim auditing standard. In addition, the prevalence by which confirming parties are utilizing restrictive language in confirmations has increased the risk that auditors may not adequately consider the effect of such language on the evidence provided by a confirmation response.

While we are supportive of the Board's efforts to update its interim standards for changes in the use of technology and for the auditor's consideration of restrictive language included in confirmation responses, we are not aware of significant other practice issues involving the use of confirmations generally. The proposed standard significantly departs from previous PCAOB standards in terms of its level of prescriptiveness, extends beyond the areas of technology and restrictive language and will result in substantial changes in the manner in which auditors utilize confirmations. We agree that confirmations, when properly designed and used in the appropriate circumstances, may provide more reliable audit evidence than audit evidence generated internally by the company or provided directly from the company. However, we believe that auditors should utilize their professional judgment when determining whether and to what extent confirmations should be used based on their risk assessment and the particular facts and circumstances of the engagement. Expanding the areas where confirmations are presumed to be effective will potentially result in auditors utilizing confirmations when they are not the most effective or efficient means of obtaining audit evidence based on the auditor's assessment of risk, as well as result in additional documentation burdens, particularly when they are not used, due to the proposed standard's expansion of areas where the use of confirmation procedures is presumptively mandatory.

In our view, such outcomes will not have a corresponding increase in audit quality. In addition, the proposal includes a number of requirements that we believe will pose significant operational challenges for auditors that may result in significant increases in effort without a corresponding increase in the level of evidence obtained. As a result of such concerns, we are not supportive of the issuance of the proposed standard without substantial modifications. In the remainder of this letter we more fully explain our concerns and suggested modifications, which we have organized in the following areas:

- ▶ Relationship of confirmation to the auditor's assessment of audit risk
- ▶ Importance of principles-based standards
- ▶ Operational concerns of certain aspects of the proposal
- ▶ Inclusion of requirements within illustrative examples
- ▶ PCAOB standards setting process

In addition, we have other specific comments which we have included as an attachment to the letter.

Relationship of confirmation to the auditor's assessment of audit risk

We agree with the Board's assertion in paragraph 4 of the proposed standard that "in designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk." We believe that risk assessment, appropriately applied by the auditor, should underlie the entire audit process, and result in audit procedures that limit audit risk to an appropriately low level. The Board's recently approved Auditing Standard No. 15, *Audit Evidence* (AS 15), describes the auditor's responsibility to obtain sufficient appropriate audit evidence in the performance of his or her audit procedures and emphasizes that the nature and extent of such evidence needed should be based on the auditor's consideration of the risk of material misstatement. AS 15 discusses several types of audit procedures that the auditor may consider performing in order to achieve his or her objective to obtain "appropriate audit evidence that is sufficient to support the opinion expressed in the auditor's report," including inspection, observation, inquiry, confirmation, recalculation, reperformance and analytical procedures.

However, we are concerned that the Board appears to presume that certain relevant assertions that "can" be adequately addressed by confirmation procedures reflect a higher assessment of risk and, thus, require more persuasive audit evidence. Such a presumption would appear to minimize the fact that the auditor has a responsibility to plan and perform the audit to design audit procedures that are responsive to the auditor's assessed level of risk in order to obtain sufficient and appropriate evidence. In most situations, an auditor has a choice in the type of procedures that can be performed to provide the evidence needed to support the opinion. As such, we do not believe an approach where audit procedures are prescribed, irrespective of the auditor's risk assessment, is conducive to audit quality. In fact, such a situation could lead auditors to perform procedures that are not necessarily responsive to the assessed risks or, more importantly, to draw inappropriate conclusions from such procedures. For example, while we acknowledge that material misstatements due to fraudulent financial reporting

often result from improper revenue recognition, we do not believe that the fraud risk related to improper revenue recognition necessitates that the auditor's risk assessment for the existence assertion of accounts receivable be higher. Specifically, for example, a properly designed confirmation request for accounts receivable would not address the risk of improper revenue recognition due to channel stuffing. A similar situation exists in situations involving multiple element arrangements, where the recognition of accounts receivable may not mirror the recognition of revenue, and thus a positive response received on a properly designed accounts receivable confirmation would provide little or no evidence as to whether revenue is properly recognized.

Accordingly, we recommend that the Board modify the proposed standard to indicate that the auditor should exercise professional judgment in determining whether to design confirmation procedures for a relevant assertion based, in part, on the results of the auditor's risk assessment. We believe that such changes would appropriately emphasize that, while confirmations generally may provide more reliable audit evidence, their use represents but one way in which the auditor can obtain evidence to support his or her conclusion regarding a financial statement assertion, and the auditor should consider whether their use is appropriate in the circumstances based on the requirements of AS 15.

Importance of principles-based standards

We believe that the proposed standard is overly prescriptive and does not adequately allow for the auditor to use professional judgment and tailor his or her audit procedures to be responsive to the assessed risks. Specifically, we are concerned with the expansion of the requirement to use confirmations in the areas of receivables, cash and significant risks, without also including a provision whereby auditors may exercise professional judgment in determining not to perform confirmation procedures when the use of confirmations in such areas would be ineffective or the associated risk of material misstatement is sufficiently low. Additionally, page 13 of the Release states that "if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures." However, the Board fails to acknowledge that there are instances in which the auditor does not have the ability to improve the effectiveness of confirmation procedures, such as in the healthcare industry, where years of historical experience has shown that such confirmation requests generate very low response rates. Furthermore, several large recognizable companies' stated policy is not to respond to any confirmation requests. As a result, we believe that auditors may expend significant efforts to perform confirmation procedures when such procedures are known not to be effective.

We also believe that the requirement to confirm certain account balances, without a corresponding exception based on the auditor's judgment, will result in an increased documentation burden in situations in which an auditor concludes that confirmation procedures would either not be effective or, based on the assessed level of risk, other audit procedures would be equally effective. In addition, we are concerned that the proposed standard may result in an increase in the performance of confirmation procedures when such procedures may not be the most effective procedure, thereby inadvertently shifting the auditor's focus away from areas of higher risk that should require increased auditor attention. Any of these outcomes would not enhance audit quality. Therefore, we encourage the PCAOB to reconsider these provisions and allow the auditor to use his or her judgment in determining whether confirmation procedures are appropriate in the circumstances to address the identified risks.

Operational concerns of certain aspects of the proposal

Concerns related to certain procedures or information required to be obtained

We believe that the proposal includes requirements for auditors to perform additional procedures that are outside an auditor's control and to consider or assess certain risk factors based upon information we believe an auditor should not be reasonably expected to know. For example:

- ▶ Paragraphs 16 and 31 require the auditor to consider the “[l]ocal customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information” when designing and assessing the reliability of confirmations. We question whether and how an auditor would reasonably be expected to have this knowledge. In addition, we note that to the extent the PCAOB is aware of such situations, it would be helpful for the PCAOB to make that information known to all registered accountants in order to enhance the effectiveness of the confirmation procedures.
- ▶ Paragraph 32 requires the auditor to assess any indication that the confirming party is not competent or objective, has questionable motives, or is not free from bias with respect to the company, when evaluating the reliability of the response received. We question whether an auditor would be able to sufficiently assess these qualities given the limited interaction between the auditor and the confirming party. We believe the Board should clarify its expectations for what an auditor should be looking for that could indicate that a confirming party “had questionable motives.” In addition, in situations where an auditor determines that there is a higher risk that a confirming party's response may not be reliable, we recommend the PCAOB consider whether requiring confirmations in such circumstances would be appropriate.

Given these concerns we urge the Board to consider the practical implications of certain aspects of the proposal.

Use of internal audit function in the confirmation process

We concur with the proposed standard's requirement for the auditor to maintain control over the confirmation process and for the evaluation of confirmation responses, which is consistent with the extant PCAOB confirmation standard. However, we note that the proposed standard restricts the auditor's ability to utilize the internal audit function to send confirmation requests, receive confirmation responses or evaluate the evidence obtained from performing confirmation procedures. The Board's rationale for restricting the role of the internal audit function, as well as the auditor's ability to use judgment in the confirmation process, is unclear.

PCAOB Interim Standard AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AU 322), currently provides a framework to guide the auditor in determining whether to use the work of the internal audit function. The framework, which is enhanced by guidance included in PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 5), outlines that the extent to which an auditor can utilize the work of the internal audit function depends on the auditor's assessment of the risk of material misstatement of the particular assertion(s) as well as the competence and objectivity of the internal audit function. We believe this framework provides an

auditor with the appropriate perspective when determining whether, and to what extent an auditor can rely on the work of the internal audit function in the context of confirmation procedures. It is our experience that auditors have applied the extant guidance in a number of ways related to the performance of confirmation procedures – particularly at financial institutions. Accordingly, we are concerned that the proposed standard, as currently written, will have far-reaching practical implications on specific industries.

For example, many financial institutions have robust internal audit functions. Given the expectations of audit committees and regulators, such internal audit functions often consist of highly competent and objective personnel and as such, are often utilized by audit teams consistent with PCAOB standards. In some situations, internal audit functions at financial institutions perform confirmation procedures for their own purposes, and as such, have developed tools to assist in selecting samples for confirmation and / or to gather information to populate the confirmations. These internal audit functions also often have extensive experience following up with non-responses, performing alternative procedures and evaluating exceptions. It is our experience that, in situations involving sufficiently competent and objective internal audit personnel and where the risks of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, independent auditors have appropriately utilized internal audit functions to support many aspects of the confirmation process, including efforts to assist the external auditor’s selection of items to confirm, mailing of confirmation requests, follow-up with non-responses, performance of alternative procedures and investigation of exceptions. We believe that such assistance, subject to appropriate oversight and review by the external auditor, is appropriate and has a positive impact on both the effectiveness and efficiency of the audit by allowing the independent auditor to focus appropriate attention on the audit areas of higher risk, which is consistent with extant PCAOB guidance (e.g., AS 5 and the risk assessment standards recently approved by the Board). Therefore, we encourage the PCAOB to consider allowing the auditor to utilize his or her judgment, consistent with AU 322, in utilizing a company’s internal audit function in the context of confirmations.

Inclusion of requirements within illustrative examples

We appreciate the Board’s inclusion of illustrative examples to help provide clarification to the guidance within the proposed standard. However, we do not believe the PCAOB should embed auditor requirements within the illustrative examples as they should not be determinative of required audit procedures. We recommend that the Board replace the term “should” with “may” in each of the illustrative examples in the proposed standard (e.g., paragraphs 10, 14, 19, 28 and 35). In instances in which the Board intends certain illustrative examples to be interpreted as requirements, we recommend that the Board consider “elevating” the requirements included in such illustrative examples as additional paragraphs within the proposed standard as it may be difficult for auditors to apply broadly a requirement contained within a narrow example.

Additionally, pages 18, 22 and 31 of the release accompanying the proposed standard (Release), as well as the Note accompanying paragraph 28 of the proposed standard include several illustrative examples involving the confirmation of accounts payable balances. We believe that the inclusion of such illustrative examples with respect to accounts payable may lead to auditor confusion due to the fact that the proposed standard does not require the confirmation of accounts payable balances. As such, we request that the Board consider removing the references to confirmation of accounts payable from the illustrative examples in both the Release and the proposed standard.

PCAOB standards setting process

We acknowledge the Board's efforts to consider the requirements of the relevant standards of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB). The comparison in Appendix 3, which outlines the significant differences in requirements between the board's proposed standard and those of the corresponding standards of the IAASB (ISAs) and ASB (SASs), is helpful in understanding and articulating the differences in requirements among the (existing or proposed) standards. However, as previously stated in other comments to the Board, although the differences between the proposed standard and those of the ISAs and the SASs included in Appendix 3 are intended to be helpful to auditors in understanding the intent of the Board, we believe that providing such a high level view of the differences may result in confusion for the auditor and ultimately reduce audit quality. Specifically, for example, the comparison in Appendix 3 indicates that several areas of the comparative ISAs and the SASs "do not include similar requirements" to those being proposed by the Board. However, although the proposed requirements may not be included as prescriptive requirements in the ISAs and SASs, we note the other standard setters often require the auditor to exercise judgment in determining the appropriate audit procedures to be performed, supplemented by additional application guidance similar to the PCAOB's requirements. We believe the PCAOB should consider the existence of such guidance in its comparisons given the fact that auditors have a responsibility to understand such guidance (to the extent they are applying the requirements) as it is integral to understanding and achieving the overall objectives of the standard. We also note that Appendix 3 does not identify the Board's position on the inability to use internal audit in the confirmation process as a difference with the SASs and the ISAs, although such position is clearly a difference between the proposal and the other standards. In addition, we recommend that Board consider providing additional insight into how auditor performance is expected to change as a result of the proposed standard. This might be accomplished with tabular comparisons and analyses to allow auditors the additional visibility into the Board's thought process in developing the PCAOB standards, and enhancing auditors' understanding, implementation, and consistent execution of the standards on all audits they perform.

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We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or its staff.

Sincerely,



Attachment

Specific comments***Relationship of confirmation to the auditor's assessment of audit risk***

- ▶ Paragraph 4 reiterates a portion of the guidance provided in the Board's recently adopted risk assessment standards, specifically PCAOB Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, and AS 15, *Audit Evidence*. We recommend that the proposed standard include footnote references to these standards rather than replicating the related requirements and guidance to encourage auditors to consider these standards in their entirety when considering the relationship between the auditor's risk assessment and confirmation procedures.

Confirmation of specific accounts

- ▶ The first sentences of paragraphs 6 and 7 of the proposed standard state that "confirmation requests address..." and "confirmation requests do not address...", respectively. We believe that confirmation *requests* do not address specific assertions; rather, *responses* to the confirmation requests constitute audit evidence in support of specific assertions, except when negative confirmation requests are used. We recommend that the Board consider the following revision to paragraph 6:

Confirmation requests could be designed to address one or more of the assertions of specific accounts and disclosures.

- ▶ Paragraphs 8 and 9 of the proposed standard state that "the auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which [receivables or cash accounts and other relationships, respectively] to confirm." We believe that the Board has appropriately addressed the auditor's requirement to assess the risk of material misstatement due to error or fraud in PCAOB Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* (AS 12). We believe that the proposed standard, as currently written, may inadvertently imply that auditors have a responsibility to perform a secondary risk assessment at a level below that of a significant account or disclosure in order to make appropriate confirmation selections. Therefore, we recommend the PCAOB clarify the intended audit response to the extent it extends beyond the requirements of AS 12.
- ▶ Paragraph 11 of the proposed standard provides that confirmation procedures might be an appropriate response to obtain audit evidence for certain relevant assertions even when a significant risk does not exist for that particular account. We believe that the auditor's responsibility to plan the audit to obtain sufficient appropriate audit evidence, based in part on the auditor's assessed risk of material misstatement, is appropriately discussed in AS 15. We do not believe that paragraph 11 offers incremental audit requirements and, therefore, we recommend that the Board consider deleting paragraph 11 in its entirety.

Confirmation procedures

- ▶ Paragraph 17 of the proposed standard provides guidance regarding the use of negative confirmations. Specifically, the fourth sentence of paragraph 17 states that “the auditor should not use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless all of the following factors are present...” We recommend that the Board clarify whether auditors are required to supplement the use of negative confirmations with positive confirmation requests when all of the factors described in the proposed standard are not present or whether negative confirmation requests combined with evidence provided from other audit (non-confirmation related) procedures would provide sufficient appropriate evidence.
- ▶ The second sentence of paragraph 17 of the proposed standard states that “a positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party.” However, in assessing the reliability of confirmation responses, the first two factors in paragraph 31 of the proposed standard refer to indirectly received responses. We recommend that the Board modify paragraph 17 to indicate that, based on an auditor’s risk assessment, obtaining indirectly received responses provides a form of audit evidence with the acknowledgment that the auditor will need to consider whether, and to what extent, supplemental procedures are required.
- ▶ The fourth bullet of paragraph 17 of the proposed standard provides that one factor that must be present for the auditor to use negative confirmation requests as the only form of confirmation request is that “the auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration.” In contrast, the related consideration in extant AU sec. 330, *The Confirmation Process*, is that “the auditor has no reason to believe that the recipients will not consider the requests.” We recommend that the Board clarify whether it intends this difference in terminology to alter the auditor’s evaluation of the use of negative confirmation requests.
- ▶ Paragraph 19 of the proposed standard requires the auditor to perform validation procedures on the addresses of confirmation requests, including substantive procedures or tests of controls, whose extent is based on the risk and materiality of the items being confirmed. It also includes an example that “the auditor should perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements.” We request the PCAOB clarify its views on the extent of evidence provided by tests of controls and substantive procedures. We note that while the example appears to clarify the Board’s intent that areas of higher risk warrant the performance of substantive procedures to validate addresses on confirmation requests, it does not provide insights into the nature and extent of procedures the Board intends auditors to perform based on the materiality and risks associated with the items being confirmed. Since validation procedures under either method constitute, in essence, verification of an address, additional clarification into the Board’s views as to how risk should impact both the nature and extent of validation procedures would be helpful. In addition, we note that auditors currently utilize a number of methods to verify addresses and believe that the PCAOB should consider enhancing the standard by providing them as examples of validation procedures – particularly related to facsimile or e-mail confirmation

requests – that may be appropriate depending on the circumstances. Examples of such validation procedures include the following:

- ▶ A conversation with the intended recipient to validate the recipient's facsimile number or e-mail address,
 - ▶ Agreement of the individual's facsimile number or e-mail address to the recipient's letterhead or business card, or as posted to the company website¹ or trade directory,
 - ▶ Agreement of the individual's facsimile number to the physical address belonging to the recipient or the recipient's organization through a reverse contact search or related tool, or
 - ▶ Agreement of the domain of the e-mail address to the company's domain (e.g., @ey.com is a domain for Ernst & Young) based on a company's letterhead, business card, website¹, website certificate¹, domain registration information¹ or other reliable identifying source,
- ▶ Paragraph 19 of the proposed standard also provides certain factors to consider in determining the nature and extent of validation procedures to perform on the addresses, including that "an address is a post office box." We request that the Board clarify its views on the level of risk associated with a post office box. We are concerned that, given the prevalence of their use (particularly in areas such as trade receivables), a post office box may be the only address on file with a company. Without further guidance from the Board, we believe that auditors may perform significant verification procedures related to addresses to post office boxes without a significant increase in the quality of audit evidence obtained.
- ▶ Paragraph 24 of the proposed standard addresses circumstances in which the auditor *agrees* to management's requests not to confirm certain accounts, balances or other items. The accompanying Note to paragraph 24b would require the auditor to "perform procedures to obtain more persuasive audit evidence than he or she would have obtained had there been no response to a confirmation request or had the auditor made a decision not to perform confirmation procedures." We do not support a mandatory requirement to obtain more persuasive audit evidence than that required when performing alternative procedures for non-responses to confirmation requests or when initially deciding to obtain audit evidence through substantive procedures other than confirmation requests. Rather, we believe the Board has appropriately recognized in paragraph 24a of the proposed standard that when the auditor *agrees* to management's requests not to confirm, the auditor should "evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the *nature, timing, and extent of other audit procedures.*" In addition, we are unclear what an auditor should do if an auditor cannot obtain "more persuasive" evidence, such as in situations where alternative procedures normally performed had there been no response to a confirmation request may be the only other means of obtaining evidence. Therefore, we recommend that the Board remove the accompanying Note to paragraph 24b and, instead, allow auditors to exercise professional judgment in determining the implications of management's request on the nature, timing and extent of other audit procedures as described in paragraph 24a.

¹ Validation of the website or reliability of the certificate or domain registry information also should be considered, as applicable.

- ▶ In situations where the auditor agrees to management's requests not to confirm certain accounts, paragraph 24c requires the auditor to communicate management's request to the audit committee. The purpose of this communication requirement is unclear. In cases where the auditor has agreed with management's request, based on his or her evaluation in accordance with paragraph 23, we question whether specifically communicating such information to the audit committee will significantly enhance its oversight responsibilities and could potentially have the unintended effect of shifting focus away from more meaningful issues. In addition, if the Board's intent is for the audit committee to weigh in on the judgments made by both management and the auditor, we question whether these represent areas where an audit committee should commit significant time or effort given the number of issues currently communicated, as well as those items contemplated to be communicated pursuant to the PCAOB's recent proposed standard. Alternatively, we believe the requirement included in paragraph 25 of the proposed standard, which requires communication to the audit committee in situations where the auditor *does not agree* to management's requests not to confirm certain accounts, balances or other items, represents an appropriate threshold and more appropriately aligns with an auditor's existing responsibility to communicate disagreements with management to the audit committee.

Evaluation

- ▶ Paragraph 27 of the proposed standard provides that when a response to a positive confirmation request has not been received, "the auditor should follow up with a second request and should consider following up with a third request." We are concerned that the mandate of a second request and consideration of a third request for positive confirmation requests may not be appropriate in all situations in which confirmation procedures are being performed and may not result in a commensurate increase in audit quality. We recommend that the Board consider allowing the auditor to exercise professional judgment when determining whether it is appropriate to send follow-up confirmation requests, rather than including a requirement.
- ▶ Paragraph 28 of the proposed standard provides guidance that auditors should follow in performing appropriate alternative procedures for non-responses to positive confirmation requests. The fourth sentence of paragraph 28 states that "in addition to performing alternative procedures, the auditor should, for significant transactions or agreements, include the terms of the transactions or agreements in the management representation letter and communicate the terms of the transactions or agreements to the audit committee, or equivalent." We are concerned that this audit committee communication requirement may result in a significant increase in communications to the audit committee that could have the unintended consequence of diverting the audit committee's attention from other, more significant matters. For example, in situations where auditors assess the existence assertion for trade receivables as a significant risk, auditors may interpret this provision to communicate to the audit committee sale agreements related to material receivables balances for which a confirmation response was not obtained. In many cases, such communications may not significantly enhance the audit committee's oversight. Therefore, we recommend the Board consider allowing the auditor to exercise judgment in determining whether certain situations, based on the risks associated with the matter and the potential impact a non-response may have on the auditor's evaluation of the company's assertions, should be communicated to the audit committee.

- ▶ Paragraph 29 of the proposed standard should be clarified to provide for auditor judgment in determining when a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Accordingly, we recommend that the first sentence of paragraph 29 be revised as follows:

When *the auditor determines 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.

- ▶ Page 33 of the Release to the proposed standard requires an auditor to consider whether an exception to a confirmation indicated a previously unidentified risk of material misstatement due to error or fraud or deficiencies in the company's internal control over financial reporting. The notion of the effect of confirmation procedures on the auditor's consideration of the company's internal control is not included within the proposed standard. Therefore, we recommend that the Board revise the proposed standard to incorporate the guidance on page 33 of the Release into paragraph 30 of the proposed standard.
- ▶ Paragraph 35 of the proposed standard describes the procedures that auditors should perform to address the risks that electronic confirmation responses might not be reliable. The first two bullets appear to indicate a preference for auditors to contact the confirming party by telephone when responses are received both via email and facsimile. We are concerned with the amount of effort this particular method would entail and believe that other verification procedures which have developed recently can provide the auditor with sufficient evidence that the confirmation response is reliable. For example, one method that has been developed involves the auditor affixing a unique code to the confirmation after it has been authorized and obtained from the company. Confirmations received without such a code would indicate that a confirmation is not reliable, among other potential issues. Such an approach can be employed in situations where a confirmation is received via either email or facsimile. While this method does not involve directly contacting the confirming party, we believe it provides sufficient evidence that the confirmation was sent by the confirming party (assuming the confirmation was appropriately addressed). Furthermore, it is not uncommon for e-mail confirmation responses to include a link to an institution's secured website for the auditor to confirm the balance via direct access. In these cases, an auditor wouldn't be expected to perform any additional procedures beyond receiving an e-mail response. Therefore, we recommend the Board revise the guidance in paragraph 35 to simply outline the principle that as part of assessing whether a confirmation response is reliable, an auditor is responsible for addressing the risk that a confirmation response may not be from the intended confirming party. Such a principle would allow the standard to stand the test of time for the continued development of alternative methods that may not necessarily involve direct contact with the confirming party, but nevertheless provide sufficient evidence that the response was received from the intended party.
- ▶ The fourth bullet in Paragraph 35 requires the auditor to "evaluate whether direct access is an appropriate means to confirm information about the particular items that is the subject of the confirmation request." The bullet includes an example that confirmations of revenue agreements, which could include terms and oral modifications, may be an inappropriate mechanism for confirmation via direct access. This example appears to indicate that in such situations, a written

confirmation may be more appropriate. Information provided via direct access (assuming such access is granted directly from the confirming party) is essentially no different than if the same information was provided via a written confirmation. While we recognize that the use of direct access continues to develop, we believe the use of such an example may indicate that information provided via direct access provides less evidence than evidence provided in writing. As the technology continues to develop, the manner and types of information conveyed via direct access will likely expand. As such, we do not believe such an inference would be appropriate and believe that the example to the bullet should be removed.